Address to Metro Planning Strategy Joint Industry Symposium

This Sunday Prime Minister Julia Gillard will release the long-awaited 'Australia in the Asian Century' White Paper, authored by former Treasury Secretary Ken Henry

This is especially timely. Among all the 'big picture' trends happening in the global economy, none is more important or profound in its implications for Australia than the gradual shift in the global centre of economic gravity from West to East

I often like to make the point that what is usually described in the Western media as the 'emergence' of Asian economies is actually more usefully and accurately seen as the process whereby nations like China & India are <u>reclaiming</u> the places in the international economic pecking order that they have occupied for most of human history, but which they ceded to Western powers during the last third or so of the last millennium.

As far as we can determine, China and India have always had the world's largest populations. And at least up until around 1500AD, they were also the world's technological leaders. As a result, they were also the world's largest economies.

For almost 1000 years after the fall of the Roman Empire just before 500AD, Western Europeans experience almost no sustained improvements in their material standards of living. It wasn't until Western Europeans began to liberate themselves from the tutelage of the mediaeval Catholic Church – an institution which effectively suppressed any attempt to advance people's understanding of the world around them and how it worked, and stymied some of the essential underpinnings of what we today know as capitalism, such as the borrowing and lending of money at interest – that the phenomenon that we would today refer to as growth in real per capita incomes began to occur in any sort of sustained way.

Paralleling the hitherto unprecedented acceleration in economic growth, Western Europeans also acquired the military capabilities which enabled them to conquer and exploit territories in other parts of the world, including India.

Meanwhile mid-way through the Ming Dynasty China began withdrawing from engagement with the rest of the world: partly as a result, China's per capita income stagnated between 1500 and 1820 – it went from being 50% higher than Western Europe in 1500 to being 50% lower by 1820.

China's per capita income fell by 9% in real terms during the 19th century, and (partly because of ongoing civil war, interrupted only the World War II, by a further 18% during the first half of the 20th century:

or to put it differently, Chinese per capita income was lower in real terms in 1950 than it has been in 1066, when William the Conqueror was invading England.

India's per capita real income was also lower in 1950 than it had been on the eve of World War I, though it was higher than China's.

It wasn't until 1979, three years after the death of Chairman Mao, that China embarked on the series of economic reforms that, as we all know, unleashed the most sustained period of rapid economic growth that the world has ever seen – lifting more people out of poverty than during any other period in history, and raising average per capita incomes in China from 3% of the US level to 20% of the US level in just 35 years (an increase that took Japan almost a century to accomplish).

And it wasn't until 1991, after a serious financial crisis, that India began shedding the legacy of socialism imposed by three generations of the Nehru-Gandhi dynasty, opening up to the rest of the world and dismantling some, though by no means all, of the 'licence Raj' – as a result of which Indian per capita incomes have rise from 4% of the US average to 8% (still a lot lower than China's).

So assuming that China and India continue to maintain economic policies that are conducive to rapid rates of economic growth, it is more or less inevitable that they will once again occupy the positions in the international economic pecking order to which their large populations and the inherent talents of their people entitle them.

Since 1980 China has risen from #12 among countries ranked by GDP measured at purchasing power parities to #2, since 2005 – and according to the IMF's most recent forecasts will overtake the United States as #1 in 2017.

In 1980, India was the world's 9th largest economy (yes, it was still bigger than China back then) to 4th by 2007. This year, according to the IMF, it will move past Japan into 3rd position. And given India's very different population profile from China's it's not inconceivable that some time in the second half of this century, India will move past China into the #1 position.

Of course both China and India are still very poor countries in terms of average incomes. This year, according to the IMF, China ranks #91 in terms of income per head: and even in 2017, when it will pass the US to become the world's largest economy, it will still rank only #80 in terms of income per head. India comes in at #128 (out of 186) in terms of per capita income this year, and according to the IMF will rise by only one place over the next five years.

Even so, the number of people with higher incomes than these averages is going to rise substantially over the next decade. According to a study quoted by the Australian Treasury in last year's budget papers, the number of 'middle class' consumers in Asia will rise from about 500 million in 2009 to 1.2 billion by 2020, and to over 3 billion by 2030. These figures of course include not only Chinese and Indians, but also rapid growth in the number of 'middle class' consumers in other countries with large populations and increasingly favourable economic growth prospects such as Indonesia and the Philippines.

What does all of this mean for Australia, for Victoria, and for Melbourne?

Thus far, the biggest impact of the rapid economic growth in China, and to a lesser extent, India, on the Australia's economy has been via the dramatic increase over the past decade in the prices we get for the mineral and energy commodities with which our continent has been richly endowed, and the no less dramatic increase in investment which the rise in commodity prices has prompted, as mining companies seek to expand their capacity to meet the growing demand for energy and metals of various types.

This 'resources boom' has brought little by way of direct benefit to Victoria, or to Melbourne. Mining accounts for a smaller share of economic activity in Victoria than in any other State except Tasmania: and while historically Melbourne has been the headquarters of a number of large mining companies whose mining activities have been concentrated in other States, over the past two decades we've seen many of those head office functions shift to Brisbane, Perth or overseas.

Indeed, in some ways the 'resources boom' has had detrimental effects on the Victorian economy, and on Melbourne, via its effect on the value of the Australian dollar, pushing it to levels that have seriously eroded the competitiveness of some of the Victorian economy's traditional mainstays, notably manufacturing – as well as some of our more recently important sectors such as higher education.

Of course, Victoria has gained some indirect benefits from the mining boom, including as a result of the redistribution of mining-related income initially generated in other parts of the country via the operation of the Federal income tax and social security transfer system – which has resulted in Victorians paying less in personal income tax net of social security benefits in real terms than they did a decade ago, while Western Australians and (to a lesser extent Queenslanders) are paying substantially more – and via the formula under which GST revenues are carved up among State and Territory Governments, which sees Victoria contributing less to other States than it did a decade ago, and WA contributing a lot more (as it should).

And the resources boom has also played a critical role in helping Australia to avoid the recessions to which almost every other 'advanced' economy has succumbed since the onset of the global financial crisis in 2008.

But this 'resources boom' isn't going to last forever. In fact, minerals and energy commodity prices peaked about 15 months ago, and have since fallen by an average of about 20% - although they are still high by historical standards. And the Reserve Bank is now telling us that resources investment will peak some time in 2013 – earlier, and at a lower level, than they had previously anticipated.

This may mean that, at some point, the A$ will start to decline from its present elevated level – although to the surprise of many, the 20% fall in commodity prices since August last year, and the 1½ pc pt fall in official interest rates since November doesn't seem to have had anything like the impact on the A$ that history might have led one to expect.

It may well be that the A$ stays ‘stronger for longer’, in part because of the A$’s new found favour as a ‘safe haven’ in a world where, as Wayne Swan keeps reminding us, we’re one of only eight countries with a stable AAA credit rating from all three major credit rating agencies, and where the five countries whose currencies which have traditionally served as ‘safe havens’ now all have zero interest rates and are engaging in one form of electronic money-printing or another.

A key question for Australia, and for Victoria, therefore is: where will the growth in our economy, and in jobs, come from, after the most employment-intensive phase of the ‘resources boom’ begins to wind down, at some point in the next couple of years? Or, looking longer term, what can we sell to China, and subsequently to India, when their per capita incomes have risen to levels that, if the history of other Asian economies is any guide, they will no longer want as much coal, iron ore, and other resources products from us as they’re likely to in the next few years.

In my view, the answer is unlikely to be manufactured goods, especially if the A$ continues to remain at historically high levels – and even if it doesn’t.

A truth which Australians find very difficult to acknowledge is that, with a few honourable exceptions, Australia has never been particularly good or competitive at manufacturing. That isn’t for the want of trying. Rather, it is the unavoidable consequence of the fact that our domestic market is too small to allow us to reap the ‘economies of scale’ that are required for us to be competitive with much larger economies: and we are too far away from big markets to allow us to reap those ‘economies of scale’ through exports.

And the rise of Asia doesn’t really change that very much: Beijing and Shanghai, Mumbai and Kolkata, remain closer to Berlin than they are to Melbourne.

Australians themselves don’t particularly want to buy Australian-made manufactured goods, unless the Government forces them to by imposing high tariffs and/or draconian quotas, or unless the A$ falls to levels that makes imported manufactured goods prohibitively expensive. So there’s no compelling reason to think that newly affluent Chinese or Indians are going to want to either.

Rather, in my view, the answer to the question, what can Australia sell to the burgeoning middle class consumers of China and India over the next two decades, is likely to be, some combination of agricultural commodities and services.

And that has very different implications for Victoria, and for Melbourne, than those arising from the current ‘resources boom’.

Victoria does have the potential to supply some of what is likely to be growing demand for a variety of more protein-intensive foods from Asian consumers as their incomes rise and their tastes change.

Some of this may, and hopefully will, involve ‘value adding’ to raw commodities – but we need to make sure that we tailor our products to Asian tastes, and that we are competitive on price.

To the extent that we can be successful in that regard, it will be of great benefit to regional Victoria, and some of those benefits will spill over into Melbourne.

Victoria also has the potential to cater for what is likely to be continued rapid growth in the demand for a range of personal and commercial services.

Already over the past decade Victoria has achieved enormous growth in the provision of education services to Asian students, and more recently we have also seen substantial growth in tourist arrivals from China and, to a lesser extent, India. And it’s probably significant that tourists from these countries appear to be looking for something different from the ‘product offering’ that Australia has traditionally put before visitors from other countries – a point that seems to have eluded Australia’s tourism marketing authorities who continue to believe that Australia’s prime tourist attractions are entirely located in Sydney or along the Queensland coast.

The most important implication of this prospect of rapid growth in trade in services between Australia and Asia for you as planners is that trade in services requires the movement of people.

That is, services trade requires either that foreigners come here so that a service, such as education or tourism experiences, can be provided to them: or that Australians go overseas in order to provide a service, such as consulting, or financial advice, to foreigners.

To me, that particularly highlights the importance of having a highly efficient airport, and highly efficient transport to and from the airport to the CBD, and other parts of Melbourne.

That’s something that it is hard to say, in all honesty, that we have at the moment.

For all the progress we’ve made in so many other ways, it’s incredible to think that, 25 years ago when I first started flying regularly for work purposes, airlines used to quote a time of 1hr and 5 minutes for a flight between Sydney and Melbourne. Now – even though we supposedly have faster and better aircraft - they quote 1 hr and 30 or 35 minutes – and more often than not, it seems, that’s an underquote.

Most of that extra time seems to be spent either on the ground waiting for other planes to land or take off; or in the air circling above either Melbourne or Sydney, waiting for air traffic control clearance to land.

Clearly what this says is that capacity at Melbourne airport hasn’t kept up with demand, and if we want to grow our services trade with Asia we’re going to have to do something about that.

And of course the additional time spent in planes doesn't include the additional time wasted complying with pointless and needlessly costly security procedures before getting on to the plane – something we supposedly free-thinking Australians seem to accept without question – nor the additional time absorbed by slow-moving traffic on the approaches to Tullamarine.

I'd argue, therefore, that a major task for urban planners is increasing the capacity of Tullamarine, and greatly improving the access to and from Tullamarine to the centre and other parts of Melbourne, including by providing alternatives to road access.

If the provision of education services is to continue to be a major driver of economic growth in Melbourne over the next two decades, I think we also need to see improved transport access to Melbourne's major education precincts. Carlton and Parkville are, arguably, reasonably well served in that regard, for essentially historical reasons. But the same could not be said of (for example) Clayton or Bundoora.

I accept that this can't be done without additional funding. To that end, I think governments ought to be more willing to sell existing assets in order to finance the construction of new ones, and to give consideration to other efficient and equitable means of revenue-raising, such as metropolitan improvement rates (which funded the construction of the City Rail Loop more than 30 years ago).

Although not directly related to the facilitation of services trade, I would also argue that Melbourne' transport task is not well served by the seemingly remorseless pressure for ever lower speed limits on this city's major arterial roads.

In saying that let me emphasize that I am not arguing against, or calling for the reversal of, the introduction of 40kmh speed limits in densely trafficked inner suburban shopping strips.

But I do think the introduction some years ago of an 80kmh speed limit on large stretches of the newly-widened Monash Freeway from Glen Iris through to the Westgate Bridge was an egregious over-reaction to a handful of accidents – and is widely seen by the public as just another opportunity to further Victoria's status as the 'fines capital of Australia' – a title justified by the fact that Victorians pay almost $100 per head per annum in fines to their State Government, $33 per head above the national average and more than double the amount the NSW Government takes from its citizens.

One other important planning issue, which I want to acknowledge has been much better handled in Melbourne than it has been in Sydney or Brisbane, though perhaps not as well as it has been in Adelaide, is the provision of an adequate supply of housing, especially affordable housing, to cater to what is likely to be a continually growing population.

According to the most recent report of the National Housing Supply Council, of which I am a member, Victoria had a shortage of housing relative to underlying demand of about 20,000 as of 30th June this year. That figure may change a little when the results of the most recent national Census are taken on board, but I suspect not by a great deal. Victoria's housing shortage is a lot less than New South Wales, for which the estimate as at 30 June was around 95,000, or Queensland, where it was estimated at 80,000 – and that's a difference which reflects well on the Victorian planning system compared with those of NSW or Queensland which have created much greater obstacles in the way of responding to housing demand in those states than exist here.

Nonetheless, the task of catering to rising demand for housing is unlikely to get any easier, as Melbourne's population continues to grow. And as it also continues to age, it's unlikely that Melbourne's housing needs will be as readily catered for by pushing out on the suburban fringes as it has been over the past 15 years or so.

In my view, the objectives of promoting home ownership and increasing the supply of housing, especially affordable housing, aren't well served by policies that centre on giving cash, directly through grants or indirectly through stamp duty concessions, to would be buyers, especially when the majority of those who receive cash in these ways buy established dwellings. All that does is increase the price of those dwellings. Interestingly, State Governments elsewhere in Australia – NSW and Queensland – seem to be getting that message, and are have restructured their programs of assistance to home buyers to reduce or even abolish grants to people who buy existing dwellings, and to give more assistance to people who buy new dwellings.

Some of that will, inevitably, end up in the profit margins of builders and developers – but at least it does stand a better chance of increasing the supply of housing. Its something that the Victorian Government should be considering as well.

Finally, part of what will drive Melbourne's economic growth in 'the Asian century' will be maintaining its status as one of the world's "most liveable cities", so that people will want to come and make this their permanent home, and bring their financial and human capital – their money and their talents – with them. Sensible forward looking planning has played a role in attaining that status, and I'd like to think it will also do so in retaining it.