CEDA's Top 10 Speeches of 2012

A collection of the most influential and interesting speeches from the CEDA platform in 2012

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committee for economic development of australia

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About this publication
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About CEDA

CEDA – the Committee for Economic Development of Australia – is a national, independent, member-based organisation providing thought leadership and policy perspectives on the economic and social issues affecting Australia.

We achieve this through a rigorous and evidence-based research agenda, and forums and events that deliver lively debate and critical perspectives.

CEDA's expanding membership includes more than 800 of Australia's leading businesses and organisations, and leaders from a wide cross-section of industries and academia. It allows us to reach major decision makers across the private and public sectors.

CEDA is an independent not-for-profit organisation, founded in 1960 by leading Australian economist Sir Douglas Copland. Our funding comes from membership fees, events, research grants and sponsorship.

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committee for economic development of australia

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Introduction

Welcome to CEDA's first annual publication of the Top 10 Speeches for the year.

This new initiative seeks to present what we believe were the most interesting and influential speeches and presentations on the most topical issues that reflect CEDA's charter. They are not ranked, but are simply in chronological order.

The selection aims to represent significant thought leadership issues and research addressed on the CEDA platform. In several cases, these present fresh and bold views and new perspectives on critical issues that are likely to impact on the Australia economy.

Each year CEDA delivers around 300 thought leadership forums across every state and territory in Australia. These provide a platform for economic and social policy discussion and debate, with an impressive line-up of speakers ranging from company CEOs to politicians and notable academics.

Selecting the top 10 has been difficult but these speeches have been selected for a variety of reasons, including who made the speech, what was said, where it was delivered and more importantly the resulting discussion and debate.

I hope you enjoy reflecting on these contributions and CEDA looks forward to continuing to deliver forums with speakers of this calibre in coming years.

Professor the Hon. Stephen Martin
Chief Executive
CEDA

> WOMEN IN LEADERSHIP

> 15 FEBRUARY 2012

> QUEENSLAND

A chairman's perspective

Elizabeth Proust AO

Nestle Australia, Chairman

CEDA's Women in Leadership series has been offered for a number of years across Australia. This speech provides a very candid perspective from someone who has experienced significant change and reform in her working life, on where we've come from in this debate and where we are today, and the biases that continue to hinder progress.

Part of my message is going to be in parts cynical and in some parts negative. So I want to start with something which demonstrates that progress has been made because part of my thesis is that despite notable progress in some areas of women in leadership in this country, we have in fact, in some areas, gone backwards or are in danger of going backwards.

But I want to start with something that shows in about 40 years, progress has indeed been made.

It's a wonderful Department of Trade memo from 1963. And it's real – it's not from *Yes Minister* or *Yes Prime Minister*. I have an actual copy if you want to check. It is available if you Google it and if you have seen it please forgive me but I'm assuming most of you won't have Googled something as obscure as a 1963 Department of Trade memo.

I want to quote from it and read from it extensively, it's only a page and a half, because I want to highlight both the changes and how far we have come, but I also want to question whether the attitudes that lie behind the memo are actually dead or whether they're not somewhat underground.

It's headed, *Women trade commissioners?*

And it's a memo to the Director of the Department.

And it starts:

> *"Even after some deliberation; it is difficult to find reasons to support the appointment of women Trade Commissioners.*
>
> *In countries where media is well developed, such as North America and England where there are no other major drawbacks, such as the Islamic attitude towards women, a relatively young attractive woman could operate with some effectiveness."*

But it's qualified, "in a subordinate capacity."

> *"As she would be the only woman Assistant Trade Commissioner in the whole area, as other countries employ women in this capacity hardly at all, she could attract a measure of interest and publicity.*
>
> *"If we had an important trade in women's clothing and accessories, a woman might promote this more effectively than a man. But even conceding these points, such an appointee could not stay long and could not stay young and attractive forever and later on could well become a problem."*

You will be surprised to learn that he went on to say:

> *"It is much easier to find difficulties, some of which spring to mind."*

And there are about 10:

> *"Women are not employed except to an extremely minor degree, as other career Trade Commissioners in any known service.*

"It is difficult to visualise them as Trade Commissioners. Firstly because they do not mix nearly as freely as businessmen do, most men's clubs for instance do not allow women members."

Not everything has changed.

"Relationships with businessmen would tend to be somewhat formal and guarded on both sides. This would make it more difficult for a woman to obtain information.

"It is extremely doubtful if a woman could, year after year, under a variety conditions, stand the fairly severe strains and stresses, mental and physical, which are part of a life as a Trade Commissioner."

And this is one of the clinchers for him:

"A man normally has his household run efficiently by his wife, who also looks after much of the entertaining. A woman Trade Commissioner would have to do all of this on top of her normal duties.

If we engage single graduates as trainees, most of them would probably marry within five years.

If we recruited from the business world, we would have a much smaller field from which to recruit, as the number of women executives in business is quite small."

Not everything has changed.

And then this is my favourite,

"A spinster lady can, and very often does, turn into something of a battle-axe with the passing years."

You will be surprised to learn that he thinks,

"A man usually mellows".

And his final argument:

"A woman would take the place of a man and preclude us from giving practical experience to one male officer. She could marry at any time and be lost to us. She could not be regarded as a long term investment in the same sense as a man."

And he concludes,

"It would seem that the no's have it."

A couple of days later in a different typewriter, presumably written by a woman or typed by a women in the typing pool, he says he has made some enquiries in the UK and he has been to external affairs in Canberra. (The) UK says that women only handle policy matters, they're not trade commissioners, and the man from external affairs says that they have many more applications from women than men, but they appoint about one woman to every 12 men and that it's a very expensive process going through the assignations but is concerned that they don't have the courage to "slam the door" on this – this being recruiting women – because of the parliamentary opinion pressure groups and so on.

That's 1963 and clearly you would not find such a memo today. But as I said in introducing it, have those attitudes, explicit in that memo, disappeared entirely or just gone underground?

As I'm sure you have all experienced, if they go underground, they are much harder to fight than overt explicit views.

I would argue that good policies and practices have changed both behaviours and attitudes in much of the public sector but in areas of the private sector there are still, if not those overt attitudes, the obvious outcomes of them where you see very few senior women in corporate life.

Now, I want to speak briefly about the Victorian public service and I do that because Janine (Janine Walker, Office of Human Resource Management, Director, and Adjunct Professor of Management, Griffith Business School) has said that is where I work and that is where I live and I have the most experience and only this audience will know how relevant this is to Queensland.

Until 1966, so three years after this memo was written, women had to resign from the Commonwealth public service on marriage. To the younger women in the room that's probably quite bizarre. This change took up to another decade in most of the states of Australia to occur.

In 1982, the Labor Government was elected for the first time in 27 years in Victoria. I was invited by John Cain, the newly elected premier to join his staff. I'd worked for him on a pro bono basis while I was at university.

There was a flurry of social legislation and social reform in 1982-83. Before that time, women could not belong to the Melbourne Cricket Club, or to the Victorian Racing Club, there was even a notorious white line at Flemington over which women could not step.

So in my lifetime, and many of you in the room, silly discriminatory laws and regulations were overturned. When you think of things like the marry bar, the white line at Flemington, and the inability to join sporting clubs, and today still the inability to join men's clubs at least in Victoria, you could say that there has been significant change and that we witnessed much of it, and of course that is true, but I argue that I think it is true for much of the public sector which has led the way on this, but parts of the private sector, and I've spent roughly half my life in the public sector, and half in the private sector, little has changed in some areas of the private sector.

Women constitute about 35 per cent of directors on Commonwealth Government boards, with the Government's stated aim to move that towards 40 per cent. The comparable figure for the top ASX 200 companies for many years was eight per cent of women on private sector boards. But last year reached 12 per cent compared to the 35 per cent after at least two things occurred, one was the ASX announcement of guidelines for women on boards and I'll come to that, and the other was, at least a musing out loud by the Commonwealth Government, that targets might be on the agenda at some stage in the future.

The ASX guidelines, for those of you who are not familiar with them, require companies listed on the ASX to report from the end of this financial year, some are early adopters, but all reporting after 30 June will have to report in their annual reports the number and percentage of women on their boards and the number and percentage of women in senior management.

As an aside, I would say after the reports start coming out around August/September, it will make interesting reading to see the inventive excuses because there are still a large number of ASX companies with no women on their boards despite progress that has been made and they will have to explain to shareholders and to the ASX why they have been unable to find suitably qualified women for their boards.

But whether the figure is eight per cent or 12 per cent, I think we would all agree that it's too low.

When I began my career in 1980 I would not have thought that we would be talking about such a small figure in 2012 nor indeed that we would still be talking about the issue. But your presence here today indicates that it is still a major issue in this country.

And on all of these measures we lag not only the US and Canada, but New Zealand, the United Kingdom and South Africa. Why is this?

I think many of the policies and practices in the private sector mirror this practice in the public sector but change isn't occurring because I think the attitudes have not changed and in some cases, in particular the percentage of women in senior positions in the private sector, the momentum has at best stalled and may indeed be going backwards.

One of the things that I tried to do in my career is to mentor people, especially women. What's become increasingly clear to me in the last six years or so, in particular since I left corporate life, is how dysfunctional so many of our large corporates are.

Why do I say this? The major reoccurring theme in most of my mentoring discussions is the often toxic nature of parts of the corporate world, I'm sure our current sponsors aside, and how uncomfortable many women feel in that world.

I'm speaking from not a scientific example but from hundreds of conversations over those last six years with women and some men who struggled with the culture of their organisation. You can advise people to stay and fight, so that they will eventually win through to the senior positions and be part of the change that's needed in many places. But it's usually rational for individuals to leave and find somewhere else, either their own business, SMEs (small-medium businesses), academia, or the public sector, where they find the culture more conducive.

And I find initially most of the women look to their own behaviours, skills or issues in their own family lives to explain to themselves and to others why they are struggling to fit in. It'll usually take them a while to realise that it's the culture itself that may be the problem.

People who feel they do not fit in opt out, leaving organisations at risk of diversity in all forms, but today we are talking gender at senior levels. This in turn, reinforces the predominate culture; males, often aggressive and often dependant on the old fashioned paradigm that came through in the Department of Trade memo; the wife/female partner at home looking after domestic affairs.

And putting aside the equity argument, it's poor business practice.

It leaves the boardroom and executive team looking nothing like its customer base let alone the wider Australian community.

Now, some reasons for optimism, enough of my gloom.

The ASX guidelines, which I have already mentioned, have had an immediate impact during 2011. Twenty-five per cent of people appointed to ASX boards last year were women, compared to only 10 per cent for the whole of the previous year.

The Australian Institute of Company Directors, of which I am a member, have not only supported the initiative but also begun a very important mentoring program encouraging senior men and women, who are company directors, to mentor aspiring female company directors.

I think what's not acknowledged, and I found this at ANZ where if most people in this room are puzzled by what you do when you're the Secretary of the Department of the Premier and Cabinet, ANZ had no idea what I had been doing in those years in the public service, I think there's still in this country a big gap in knowledge and experience of the skills of people from academia and the public sector can bring to the corporate world. But it is worth examining and emulating the many significant gains that have been made by the public sector.

I mentioned the Cain Labor government; I worked for them for three years. From the time they were elected there was a government requirement in the Victorian public service for there to be at least one woman on every interview panel and a woman on every short list.

People like Katie Lahey, who recently stepped down from the Business Council of Australia, and I had by that stage moved from our earlier roles into the public service itself, and we used to joke that we spent half our working lives on interview panels, but the effort was worth it.

I was first head of a government department, the Attorney General Department, in 1987. Today half of the departments in Victoria are run by women. So in the 25 years from my appointment to today, very significant change (has occurred) and not just at the top. You will find at all senior levels of the Victorian public sector at least 50-50 representation.

If you look at that sort of figure, the percentage of women in our major corporates is tiny and embarrassing, and an extraordinary waste of talent.

It's probably a topic of a whole conversation about what do corporates need to do. And I want to run through a few issues. But it's not one thing, it's a whole range of issues from affordable childcare to CEO commitment to diversity in all forms and not just for this year's fad but in a tangible and measured way; commitment to equal pay, and we know from the statistics that there's not equal pay for equal work; we need to deal with unconscious bias, and we all have them; we need to expose recruitment practices to scrutiny, too many people hire in their own image and don't look outside the square for talent; we need to make mentors available in an ongoing way to women; and we need to ensure that in large, and not so large organisations, there are women's networks.

These are just a few of the things that I think need to be dealt with in a tangible way, but all of those things, without the commitment – the real commitment and not lip service – of the CEO, I don't think tangible progress will be made. And it's interesting to note I worked both for John Cain and for Jeff Kennett, opposite sides of the political spectrum, but the one common factor in all of this success in Victoria has been bipartisan support and commitment to the progress of women in the public service.

Just some personal reflections of relevance to my life and to my career. I'm the eldest of nine children, and fortunate that my parents, but especially my mother, valued education of her daughters above almost everything else. My brothers would say above their education, but as she told them fairly regularly, it's a man's world and all she was doing was levelling the playing field.

Having parents who believe in girl's education and the quality of girl's education I think is really important.

Then to my mother's horror I married when I was 21 and had my daughter when I was 22. I was still finishing my first degree.

I've worked in the oil industry, local, state and federal government and in banking. And if I reflect just for a moment on what helped with my success I think part of it has been moving between the public and the private sectors which I think too few people in this country still do. Some of it involves taking risks but mostly I've had terrific experiences.

My main point in mentioning it here is that I think success, for women at least, is more easily achieved by moving organisations or moving sectors than by staying and attempting to succeed in the one organisation.

For a variety of reasons, when women have stayed in one organisation I think they have been more successful in the public sector than in the private sector. Many notable exceptions, but I think generally true.

No one achieves success on their own. I owe my success to my husband, to the work ethic and sacrifice of my parents, to the nuns who taught me – at a time when Catholic schools were run by nuns, and to the many people I worked with and for. In the latter there are too many to mention but as I said include people as diverse as John Cain and Jeff Kennett.

So I think that there's one slightly insipient way I would like to finish this conversation and then have a dialogue with you about what I've said or what I have left unsaid.

Hopefully the days of the so called super women are behind us, if indeed they ever existed. But women continue to do a disproportionate share of domestic tasks. That's not only inequitable but just plain dumb.

Based on 40 years of marriage, which I have just celebrated, I would like to pass on two pieces of advice. And it's not too late to learn either of them, maybe the second one.

Ensure there is a minimum of one domestic skill that you lack, minimum. Get him to do it or outsource it. My husband assumed when he married me that as the eldest of nine I would be able to cook. I can make steamed rice and toss a salad. Beyond that I've never tried and never will. That's what restaurants are for. Fortunately he's a good cook. But he wasn't until he married me.

And the second is somewhat related to the first which is marry well, which is not an injunction to marry a millionaire but to ensure that your husband/partner regards you as an equal and not as a domestic. I'm still astonished younger men in many of the organisations I'm involved in, where despite perhaps different wording, their attitudes seem to me to be very similar to the attitudes in the 1963 memo from the Department of Trade.

I think the figure is something like 75 per cent of domestic tasks around the home, child rearing etcetera, are done by women. I'm not necessarily inciting a revolt but I'd be happy to encourage you to do less in that sphere so you could do more including enjoying yourself elsewhere.

Q and A

Q. **You said in 2010 that corporate Australia still views women as wives and secretaries. It sounds to me from your presentation your view pretty much still holds?**

A. That was a comment made at a time where I was, several years before that, on the ANZ management board – the group beneath the ANZ main board, where I was the only woman and all of my male colleagues had wives/partners at home and I was the only one with a partner who worked. And my comment was specific to that and then broadened a little to say the experience in corporate Australia where people have careers that take them around the world and where the salaries are very high, is that there's a trailing spouse usually the female and so the experience of women is not as your boss or as your peer but as your wife or secretary. I was somewhat stretching the point but believed it.

Q. One of the things that came through in your speech was disappointment at the slowness of progress so we might address that in a couple of different ways. The ASX guidelines for example, in talking to some of the people who are involved in that program, they seem pretty proud of the progress but would you like to see them move towards naming targets and naming dates in terms of women in boards?

A. Well I think the real crunch will come after the year end with the annual reports and when they're published, and will it be a couple of days stories or will there be an ongoing focus. I have one concern though about the focus on boards which is, the government in Norway mandated 40 per cent of all boards must be filled by women and what is happening is women are being drawn out of executive and other roles and they've got to about 33–34 per cent but the percentage of women in executive roles is now two per cent.

My concern is this; I'm now a company director but I'm not a big influence on culture of a company, I'm an influence but not a big one. The culture is set by the CEO, managers and people in the workplace it's not the company directors. So it would be a very perverse outcome if with the setting of these targets we get to a very large percentage of women on boards but find our universities and corporates have none or very few women in executive life because that is not what was intended with this.

Q. So is that a structural flaw with quotas for simply board positions and how do you get around that?

A. It is and I can relate to the idea of quotas or targets because I think we all want to succeed in what we do on our merit. But it's interesting to see the only movement, apart from snail's pace, was with the ASX guidelines and government quotas. So it's clearly a reaction to perhaps dealing with the quota and it's a reaction to what shareholders may say and I saw at a couple of my AGMs last year for the first time, shareholders asking the Chairman what they were doing about more women on their boards. So it's starting to get there, this will make a bigger effort.

Q. So let's talk now about some of the things you mentioned in your speech. You're talking about what the corporates might do, one of the things was the unconscious bias and another one was women self-selecting themselves out of the equation because they are not getting the support they need in the workplace and (due to) domestic pressures. Can you address how you think corporates are doing in that respect now, and what women can do?

A. I said we all have unconscious biases, it's what we grow up with, and I know that in a number of workplaces people are working at reasonably simple programs to get people to acknowledge those biases and to view it, especially in recruitment and selection of people, and I think that's important. But women self-selecting out of organisations because childcare becomes too hard or because of culture or whatever, is the major contributor. Because if you look at the large corporates and their graduate programs, if they're not 50-50 male and female at the start it's pretty close and yet over time it gets to the point where a very disproportionate number of the women leave for childcare, culture or whatever – self-selecting out. So I think what's needed and some of those issues that I addressed are just part of a total program. If we are serious about this as a business issue, as opposed to an equity issue, then we need a package to address it.

Q. Are you talking about things like onsite childcare, flexible hours all of those things that get raised every now and then?

A. It doesn't need to be onsite childcare, it does in some places, but when my daughter was born I was still a university student and onsite childcare at my university was really important to me. Now it's not practical everywhere but I have a two year old grandson and my daughter is having a second child soon and I know the issues around the cost of childcare, the quality of childcare, the availably of childcare and it is a major issue for working women, and she is one of them.

Q. And what about the private sector then, contributing in that space as well?

A. That's happening and I think it's starting to move to people understanding that if they want to attract and retain the best employees then that is the package of measures they need, but it's not universal.

Q. **Do you think that the impetus will come gradually from the private sector or does it need a stronger regulatory framework from government?**

A. As someone who's worked half a life in government this might sound strange, but I'm not a big fan of government regulation because it has so many unintended consequences. Certainly government should regulate the quality of childcare and the people who are able to establish themselves as childcare providers but I'd be anxious about government getting too involved in the field.

Q. **In terms of the pipeline, what else can companies do to keep women through those higher levels so that there are the numbers there that are required at both a senior level and as a pool to draw from when they are looking?**

A. At younger ages it is childcare, it is flexible working arrangements. I did a piece of work a couple of years ago for John Brumby when he was the Victorian Premier, on the need for an anti-corruption body in Victoria, and I had a small team working with me in the public sector, five young women. None of them were full-time and they were able to job share seamlessly. I would come in and out, the work would be done and the appointments would be made and interview notes written up and I had no idea who was working one day a week or who was working three days a week. They managed it between them. So I think it is possible with a little bit of creativity and a bit of trust in your employees to actually establish flexible working arrangements that work, and the loyalty that that engenders down the track is important. But that's a certain age demographic and then it's around role models, networking, mentoring for women in the organisation.

Q. **You touched on this a little but some writers talk about there being a baby tax – the impact on a woman's career and salary for taking time out to have babies. We were wondering if you had any thoughts on how we can address that particularly when a woman takes timeout early on in her career before she has become established, and the impact of coming back being a year or two behind and maybe even coming back part-time and the impact that has on her career progression and her salary.**

A. It's certainly an issue. It wasn't for me I didn't enter the workforce until my daughter was at school simply because I was finishing my degrees and I didn't regard that as something that hampered me, but I know it does to many people especially when women come back part-time and regard themselves and think they might be seen as less career orientated as they otherwise might have been or as their peers are, and I'm still thinking about the solution to this problem. One of my friends very strongly suggests to women that even if they have to take out an extra mortgage on the house, they should have a house keeper that will pay off further down the track in their careers. Now I never did that and I have no idea what it costs but I'm sure it's not cheap, but I think making sure that if you've got a partner, you're not the only one who is responsible for looking after the child. My husband did at least 50 per cent of the bringing up of our daughter with me, balancing his career and that, so it's not just the woman's responsibility and I think getting as much assistance as you can afford, minimises that and pays off in the longer term in terms of salary.

....

Q. **I recently had a friend who was looking for a job, but wouldn't put her CV out with the senior women she knew where as men wouldn't even think twice. How do we get over this reluctance to use our women's networks to improve our role and our job prospects?**

A. For me, networking has been a really important part of what I've done and there may have been on her part a view that some women don't help other women, I think we have to get over that as well. I think that being prepared to put yourself out there by doing what you have just described but also it's been my experience that women will look at a job ad or a job description and decide they only have three quarters of the criteria and they are not yet ready, let me illustrate that. When I was Deputy in the Industry Department, we had a body called the Small Business Development Corporation; this was in the late 80s. This was advertised in the public sector and more broadly. We had 100 applications all from men. To give my Director General his due, he wasn't going to interview a field that was only men, and could I think of some women who we could tap on the shoulder and ask to apply. So I immediately thought of Susan Holmes who had run her own business, was in the public service, and I rang her and said has she seen the ad and why hadn't she applied. She said there are seven criteria and I can only do six of them. I said that hasn't stopped about half the men in the field applying. She subsequently won it on her merit. But she thought she was one or two jobs away from being ready for that and I found over the years when I've had a role in encouraging young women to put themselves forward for something, there's the same reluctance of using networks to put your CV out there. And we just have to overcome all that.

....

Q. **We all use the term now, unconscious bias, and I do too. But I see in a lot of circumstances what is actually sexism, and particularly among young men who see other young men as people to support and to help because they will help each other in their corporate careers, but they see the women as competitors and actually say and do things that are very sexist to deal with them as a competitor.**

A. I think there's something in the Australian culture that's at play here, and I said we lag behind South Africa, NZ etcetera on these measures. For three years when I was at ANZ I was global head of HR and one of the responsibilities was the graduate program. The young women in both Australia and NZ would at some stage during their first year, seek me out and say they've been through school, they've been through university, they hadn't come across bias discrimination anywhere until they hit the workforce. And why weren't they included in the golf days or why was it the networking and the informal job network, not the formal job network, all went to their male peers and they described the sorts of attitudes that you're talking about. So, I think we've got a more sophisticated 2012 version of the 1963 attitudes still at work and I think whether it's sexism, whether it's unconscious biases, I think at all levels of organisations it is there and it is something which needs to be addressed because again put aside equity for a moment, it is dumb business practice to ignore 50 per cent of the population.

....

Q. Ok I might pick up one other thing from the 1963 memo and that was the desire for the young women who may potentially be trade commissioners to be young and attractive, and my question is this, in corporate Australia today, is there is an element of a 'lookist' culture and how strong is that?

A. I don't think it's just in corporate Australia, I think it's general; you know the only thing people comment about any aspect of Tony Abbott's clothes is his speedos. Julia Gillard is regularly criticised for just about everything that she wears or the colour of her hair etcetera. I was in the public service when Joan Kirner was Premier of Victoria, I'm not sure what it's like for Anna Bligh, but there is I think a different standard at work. I remember some tales by ANZ colleagues when somebody said you have to get more women in this organisation, one of the males said "let's make them better looking ones". You know, so there's that sort of thing at play.

....

Q. So what you've addressed is a broader societal issue, which is much, much harder to address.

A. Yes it's much more than corporate Australia.

....

Q. There were two things that I noticed, there are a limited number of things that women themselves can do because they have to for better or worse fit in to the environment in which they find themselves, whether its public or private, but I have been known to say to young women particularly those getting towards the later 20s or early 30s, that if they are going to continue in their profession, mine is the legal profession, but I have experience in the scientific profession, that they need to take control of their own destiny and that means within their own workforce, within their own domestic life, their family life and their social life. When I say that I'm not quite sure what I mean, so it sounds like a good thing to tell them to take control of their lives and work it out. I wondered if you could put some flesh on those bones.

A. I'll have a go. I certainly agree with your sentiments, and I think what I said about moving between organisations is just what I was doing. I had a number of roles at BP, both BP Australia and BP International in my early career, and all but one of them were terrific. The last one was a job where my colleagues didn't like me and I didn't much like them and I sought out someone who had been my mentor in London, spoke to him and (he) effectively patted me on the head and said, "three more years of this and we've got plans for you in senior management". I was in my early 30s and three years seemed like forever so I left. And I think nobody today, except in rare circumstances, is going to manage your career. You have to regard yourself as managing you career. If you are waiting around for paternalistic organisations to tell you that these are the steps we have in mind, HR people or whatever it's called these days, (it) just doesn't do it and you have to be responsible for your career and if it's not working, I know in the current job market it might not be the best advice to give, but if it's not working, and you don't see too many prospects of it working, polish up your CV and look around.

Q. I just can't help but look around this room and there's some amazing women, many of whom I know and there are some fantastic brave men who are here, but I can't help but think that in Australia, and this is what I've maintained for many years, if the balance of power is in fact with men, how do you get men more engaged in this subject, how do we get women involved in coming to events like this? We have Elizabeth Broderick doing fabulous things like setting up her male champions of change, but that is very slow and I think you've got male CEOs who are having to report on this because of the ASX requirements, but are they really genuine about their feelings to want to make a difference in this space? What's been your experience?

A. The answer is it varies. Some are entirely genuine and some are doing it because their board want to or because there are some targets that have been set for them. I think you're right this will only really get traction when the men who run organisations get this and see it as a business imperative. So that when the top team, whether it's the board or the executives, starts to look like the Australian community and the customer base and so are broadening it out from diversity to gender in all its forms, then we will have made very significant progress. But it won't be a revolution, it will be slow, and as I said some of it will retreat and go backwards and it's on a path where enough women won't take it but it will head in the right direction but don't think it will be fast. I'd love somebody to prove me wrong.

Q. You mentioned before that women have more successfully risen through the ranks in the public sector in terms of staying with that same employer for a longer generation than perhaps in the private sector, and you suggested that individuals may need to move on for that organisation to progress their careers. I guess a double barrel question, what advice would you give to a woman who has a reasonably successful career within a business but hasn't then been able to take that last step or next step and alternatively, for an organisation wanting to retain those women, what could they be doing differently?

A. I think if you're on the verge of a senior role in an organisation, but seeing there are barriers to it or just not progressing, then it needs a serious conversation with the line manager, but more relevantly with somebody else in the organisation. At BP I had a number of people in my area with whom I had career conversations about whether this was going to be the place where I would make my career and they were people who were honest with me, those sorts of honest conversations, and for people in the position to decide who's going to make it to that senior level, if you think about the investment the company has made over many years to somebody who has been there to look at whether it's through an LSI tool or some other kind of 360 and what are the development gaps. The problem is of course somebody outside always looks better than the people inside because they are not known. So what are the gaps, then what might be done in terms of formal programs, mentoring, coaching, whatever to close the gaps. I think the good companies are doing that, are looking at their talent, because you know the person and there won't be too many surprises and it's actually smart practice to do that and I think there's not enough being done, but you know if you're in that position then have an honest conversation with a few people and make the call. It would be scary but there are a lot of great jobs out there today.

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GFC and sovereign risk – mitigating measures and solutions from down under

Professor the Hon. Stephen Martin

CEDA, Chief Executive

This speech was one of a number of international invitations for CEDA's Chief Executive during 2012. It was delivered to an international audience and examined the underlying reasons for the success of Australia's monetary and fiscal policy during and since the Global Financial Crisis.

The success of Australia's economy from a global perspective is often forgotten, and it has not simply been a result of the mining boom. Policies developed in the 80s and 90s and quick action following the onset of the GFC all ensured Australia escaped from the global economic turmoil relatively unscathed and it is important that we are recognised and others learn from these successes.

Introduction

The Global Financial Crisis (GFC) was followed by the deepest recession in the world economy since World War II. However, it could be argued that this was largely a northern hemisphere problem, with its severest effects felt in the United States and Europe. Its consequential effects were not as severe in developing and emerging economies, or in some other developed economies such as Australia.

Governments in developed economies utilised enormous amounts of fiscal and monetary policy stimulus during the height of the GFC to strengthen demand and to restore financial stability in the banking system. Consequently even now interest rates are currently close to zero, while public debt burdens have swelled to the highest levels since the 1940s. Policy makers have had to resort to less orthodox measures to stimulate demand, including quantitative easing and manipulating the yield curve.[1]

Northern hemisphere economies have recovered very slowly and continue to reflect deep malaise in the finance and banking, housing and industrial sectors. Importantly, the seeds of the current European sovereign debt crisis were sown prior to the GFC, were intensified during this time and continue to plague economic recovery in the Eurozone and potentially beyond. They have again focussed the world's attention on issues of globalisation, financial stability, regulatory regimes and political will to take hard decisions.

While various austerity measures and political accommodations devised by European leaders to delay the onset of an "event" have engendered bursts of optimism, financial and equity markets remain nervous and the risk of contagion from an indebted European country default remains elevated.

The Australian economy performed better during the GFC than other advanced economies on nearly all relevant indicators, and continues to do so in the face of current European upheavals. Financial conditions were stressed, but the financial system held up remarkably well; the economy slowed, but did not fall into recession; and while unemployment rose, it did so by far less than in many other advanced economies.

Although Australia was exposed the combined actions of the Government through discretionary fiscal expansion and aggressive monetary policy responses by the independent Reserve Bank of Australia (RBA) achieved remarkable outcomes. While the delivery of several of the Government's fiscal stimulus programs were open to criticism, there is no doubt the underlying strength of the Australian economy and its financial and regulatory system ensured Australia did not go the way of so many other western economies.

A range of factors have been advanced to explain the relatively strong performance of the Australian economy during and since the GFC. These include the strength and stability of the Australian financial system; a strong regulatory environment; prudent fiscal and monetary policies pursued by governments of different political colours over a significant period that have avoided public debt issues while maintaining non-inflationary growth; the flexibility of the exchange rate; and the performance of Australia's major trading partners, particularly China.[2]

As a consequence of this underlying strength and the reasons behind it, lessons learnt from the GFC and its limited exposure to European finances, Australia is better positioned than most advanced economies to withstand the impact of the current European sovereign debt crisis. This paper examines Australia's response to both the GFC and current European sovereign debt crisis, and suggests why it was as resilient as it was and remains so. Lessons for policy makers are advocated.

GFC – a re-cap

The causes of the GFC have been well-documented.[3] The United States sub-prime crisis that began in mid-2007 caused financial institutions to lose confidence in lending to each other. A credit crisis throughout late 2007 and 2008 ensued, with the supply of liquidity and credit to financial institutions, businesses and households gradually drying up, and interbank lending spreads widening.

This situation took a dramatic turn for the worse in mid-September 2008 with the collapse of Lehman Brothers, the fourth-largest investment bank in the US. Confidence plunged – due to concerns over counterparty exposure to Lehman Brothers, further major institutional failures, and fear of a systemic crisis. Banks were considerably less willing to lend to each other and global credit markets effectively froze. Other institutions either sought to become commercial banks (Goldman Sachs, Morgan Stanley), or failed (Washington Mutual). The contagion spread to Europe, resulting in the collapse of several banks.[4]

In response to worsening conditions in the US, Congress provided Treasury with US $700 billion to purchase the troubled assets and take direct equity stakes in financial institutions. The Government subsequently announced a plan to purchase equity from financial institutions and guarantee all senior unsecured debt issued by eligible financial institutions, as well as guaranteeing non-interest bearing transaction deposit accounts.

European nations also agreed to a package of measures to support the European financial system, including the guarantee of interbank loans and the purchase of equity in banks.

Notwithstanding these responses, a sharp deterioration in global financial conditions, with global financial markets highly stressed and financial institutions coming under extreme pressure, ensued. Equity prices fell under the weight of heightened uncertainty and risk aversion, solvency and liquidity was affected, causing share prices of banks to fall sharply.

A sharp deterioration in economic conditions – growth fell from 3.8 per cent in June quarter 2008 to – 2.8 per cent in March quarter 2009 – was accompanied by a collapse of global capital inflows, particularly in advanced economies. The volume of world trade fell sharply, and the pace of global industrial production growth slowed.

GFC and Australia

Australia was not immune from the GFC but its impact could have been far worse. Businesses faced tighter credit conditions and higher funding costs, and falling asset prices raised the cost of capital funding from the share market. Business conditions generally, and investment intentions specifically, became subdued and confidence slumped. Sharp falls occurred on Australian share markets.

Demand for Australia's exports slowed with resulting falls in volumes and prices leading to subsequent falls in terms of trade and the exchange rate. Household financial wealth fell by around 16 per cent through the year to the June quarter 2008. The significant fall in consumer confidence resulted in weaker growth in household consumption and dwelling investment.

These combined to affect the Government's budget position and were reflected in revised GDP growth, the unemployment rate and revenues.[5] Yet while the Australian economy slowed under the weight of global forces, the slowdown was much more moderate and the economy recovered more quickly than in most other advanced countries.

Business confidence recovered following the announcement of the *Nation Building and Jobs Plan* in February 2009 and a further cut in the official cash rate.[6] Consumer confidence rebounded sharply following the announcement of the March quarter 2009 GDP outcome, where the economy recorded solid positive growth, avoiding two consecutive quarters of falling real GDP.

Australia's unemployment rate peaked at 5.8 per cent compared with the OECD average of 8.8 per cent and economic activity rebounded in the March quarter 2009.

Australian Government's response to the GFC

The Government was well prepared to deal with the contingencies flowing from a worsening international economic outlook. Its 2008–09 Budget had been based on striking a balance between tackling inflation and responding to the risks posed by global economic conditions.[7] It had strengthened its financial position by building a $21.7 billion surplus to provide future policy flexibility and supported households by delivering tax cuts and increasing social welfare payments to pensioners and carers.

Additionally the RBA moved to protect growth and financial stability by providing liquidity to financial institutions as international money markets became dysfunctional and reducing the official cash rate rapidly as conditions dictated – an option not available to other economies where interest rates were already low.

However the dramatic shift in the macroeconomic outlook required the Government to implement a raft of proactive policy responses that included:

- Increasing the issue of Commonwealth Government Securities by up to $25 billion to ensure the smooth operation of Australia's financial markets, including enabling the Australian Office of Financial Management (AOFM) to purchase $8 billion in prime, AAA-rated residential mortgage-backed securities (RMBS) that met strict criteria in relation to the quality of the underlying mortgages. The investment was of particular assistance to non-authorised deposit-taking institutions (ADIs) to restore competition in Australia's mortgage market;
- Guaranteeing the deposits of authorised deposit-taking institutions for a period of three years, with a $1 million threshold below which no fees were charged;
- Guaranteeing the wholesale funding of authorised Australian deposit-taking institutions to enable them to raise funds overseas with the same level of support as foreign institutions that received government guarantees, restore confidence in credit markets and ensure that Australia's financial sector continued to lend to Australian corporations, businesses and households;[8]
- Establishing a Financial Claims Scheme[9] to provide depositors and general insurance policyholders with access to their funds in the event of a financial institution failure, and changes to the regulatory framework to allow better management of failing financial institutions;[10]
- Strengthening the protection of consumers of financial services across Australia with the Commonwealth taking over responsibility for the regulation of mortgages, mortgage brokers, margin lending and non-bank lending and endorsed an implementation plan for the regulation of remaining areas of consumer credit; and
- Prohibiting short selling through the combined actions of the Australian Stock Exchange and Australian Securities and Investments Commission (ASIC).

As the outlook for financial markets and the global economy deteriorated further, the Government announced it would guarantee deposits and wholesale funding of authorised deposit-taking institutions; invest a further $4 billion in RMBS, bringing the total investment to $8 billion; and enact a $10.4 billion Economic Security Strategy.[11]

As a consequence of these and other measures, Australia's major banks retained their AA credit ratings. No Australian bank or other authorised deposit taking institution failed, while in the United States, over 100 banks failed between January 2007 and August 2009.[12] Australian banks also remained profitable and were able to access capital markets, enabling them to continue to lend.[13]

Economic security strategy

A second critical element of the Government's response was a $10.4 billion discretionary fiscal stimulus package of around one per cent of GDP, overwhelmingly focused on the first half of 2009 and tightly targeted at those sectors of the economy showing the greatest weakness – household consumption and dwelling investment.[14]

The package consisted of:

- $4.9 billion for an immediate down payment on long term pension reform – a one-off payment of $1400 to eligible single pensioners and $2100 to eligible pensioner couples, including Commonwealth Seniors Health Card holders, as well as a one-off payment of $1000 to Carer Allowance recipients for each person in their care;
- $3.9 billion in support payments for low and middle income families – a payment of $1000 for each child in families eligible for Family Tax Benefit (A);
- $1.5 billion investment to help first home buyers purchase a home – from the date of the announcement to 30 June 2009, the Government introduced the First Home Owners Boost for established homes of $7000 (to take the total grant to $14,000), and for newly-constructed houses of $14,000 (to take the total grant to $21,000); and
- $187 million to create 56,000 new training places under the 2008–09 Productivity Places Program.

This initiative was complemented with a $42 billion *Nation Building and Jobs Plan* that included payments to low and middle income earners and investment in schools (although the Building the Education Revolution (BER) program was heavily criticised), housing, energy efficiency (the pink batts fiasco was a major negative), community infrastructure, roads and support for small businesses.

While nearly all the stimulus was delivered in 2008–09 the package was seen to fit squarely with principles underlying effective discretionary fiscal stimulus – early, temporary and targeted – and complemented the boost to economic activity from interest rate cuts particularly in the first half of 2009.

International financial institutions strongly endorsed Australia's response to the GFC. IMF commended the "quick implementation of targeted and temporary fiscal stimulus" considering that it provided a sizeable boost to domestic demand in 2009 and 2010.[15] OECD concluded that Australia's fiscal stimulus package "was among the most effective in the OECD" and not only "helped to avoid a recession as usually defined" but also that it "had a pivotal role in boosting overall confidence".[16] It attributed the effectiveness of the stimulus to both the size of the measures and the speed with which it was introduced.[17]

The immediate effects of this stimulus dissipated from late 2010 and the transition from public to private demand accelerated accordingly.

European sovereign debt crisis

The current European sovereign debt crisis has been created by a combination of complex factors that include the globalisation of finance; easy credit conditions during the 2002-2008 period that encouraged high-risk lending and borrowing practices; international trade imbalances; real-estate bubbles that have since burst; slow growth economic conditions 2008 and after; fiscal policy choices related to government revenues and expenses; and policy responses used by nations to bail-out troubled banking industries and private bondholders, assuming private debt burdens or socialising losses.

Its beginnings were manifest when several European countries faced the collapse of financial institutions, high government debt and rapidly rising bond yield spreads in government securities. With the collapse of Iceland's banking system in 2008, the crisis spread primarily to Greece, Ireland and Portugal during 2009. In 2010-11 the crisis touched other significant economies such as Spain and Italy, and even threatened the powerhouses of UK, Germany and France in different ways.[18]

Before the GFC, several governments, most notably those of Portugal, Italy, Ireland, Greece, and Spain had been able to finance their deficits at artificially low interest rates. Some had accumulated unsustainable levels of public debts. Markets assumed that if the national situations got worse, these governments would be bailed out by other Eurozone countries in order to forestall a break-up of the Euro.

Equipped with this implicit guarantee, many governments did not address structural problems such as uncompetitive labor markets or unsustainable welfare systems but papered over these problems with government deficits. As the financial crisis hit, government deficits soared due to increasing public spending and falling revenues. Since Eurozone countries are not able to conduct their own monetary policy, they have a higher default risk than countries that can.

Various rescue funds were devised, but with expectations from contributor nations that appropriate austerity measures would be implemented to reign in sovereign debt. From mid 2010, emergency and longer term measures have been pursued by Eurozone members and individual states that have included various bank-sponsored rescue packages including those offered through the European Financial Stability Facility,[19] European Central Bank interventions, European Financial Stabilisation Mechanism and the European Stability Mechanism.

Europe's sovereign debt problems, together with a reassessment of European and US growth prospects[20], have raised risk aversion, and helped trigger a period of heightened turbulence in global financial markets.[21] Downgrades of Europe credit risk in January and February 2012 has heightened tensions, with economists and politicians divided on whether austerity measures being required as a condition of bailouts by the larger economies are in fact counter-productive, with the potential to exacerbate weak economic conditions in several countries.[22] The continuing turbulence in Greece and uncertainty about rescue packages for ailing economies highlights the more general difficulties faced by Eurozone countries.[23]

Australia's economy – prepared for GFC and European sovereign debt crisis

When the Commonwealth of Australia was created in 1901, it brought together the various colonies that had operated almost as independent countries within a political union. Importantly, the various states shared a common language and similar cultures and the new Federal Constitution provided for free trade in goods and services. The political union was accompanied by economic and currency union, thus ensuring all the necessary prerequisites for a strong single entity were created. The Constitution that was adopted clearly allocated responsibilities for trade, defence, education and the like between the Federal and State jurisdictions.

In the case of the Eurozone, currency union may have been achieved but vastly different regulatory systems, cultures and languages have hindered the development of economic union and the third critical element is missing.

In understanding why Australia fared so well during and after the GFC, why the potential impact of the current European Sovereign Debt Crisis on its economy is relatively modest, and what lessons may be there for others to emulate, past and recent economic history must be appreciated.

Critical to this is recognising the near two decades of substantial economic reform that occurred in Australia in the 1980s and 1990s, and the consolidation of those reforms that subsequently occurred. These reforms, along with the underlying strength of the economy, the soundness of the financial sector, and the significance of trade with the Asian region are the most important factors in explaining these outcomes.[24]

Australian economic reforms

Reforming Australia's economy began with the Hawke-Keating Labor Governments of the 1980s and early 1990s and consolidated under the Howard Coalition Government from mid-1990s to 2007. The Rudd-Gillard Labor Governments subsequently inherited a fundamentally strong economy that would assist in meeting the challenges of the GFC and those associated with the current European difficulties[25], but must be credited with taking some immediate and effective policy decisions as outlined earlier.

The most substantial economic and social reforms of the 1980s and 1990s included[26]:

- Trade liberalisation – reductions in tariff assistance and the abolition of quantitative import controls saw the effective rate of assistance to manufacturing fall from around 35 per cent in the early 1970s to five per cent by 2000;

- Capital markets – the Australian dollar was floated in March 1983, foreign exchange controls and capital rationing (through interest rate controls) were removed progressively and foreign-owned banks were allowed to compete;
- Infrastructure – deregulation and restructuring of airlines, coastal shipping, telecommunications and the waterfront occurred from the late-1980s. Commercialisation, corporatisation and privatisation initiatives for government business enterprises were progressively implemented from around the same time;
- Labour markets – progressively were freed, commencing with the Prices and Incomes Accord, award restructuring and simplification, and the shift from centralised wage fixing to enterprise bargaining. Politics and reform accelerated and collided from the mid-1990s with the introduction of the *Workplace Relations Act 1996*, further award simplification and the introduction of individual employment contracts. Subsequent significant changes were introduced by the Rudd-Gillard Governments through the *Fair Work Act, 2008*;
- Human services – competitive tendering and contracting out, performance-based funding and user charges were introduced in the late-1980s and extended in scope during the 1990s; administrative reforms (for example, financial management and program budgeting) were introduced in health, education and community services in the early 1990s;
- National Competition Policy reforms – in 1995, further broad-ranging reforms to essential service industries (including energy and road transport), government businesses and anti-competitive regulation were commenced by all Australian governments through a coordinated national program;
- Macroeconomic policy – inflation targeting was introduced in 1993. From the mid-1980s, fiscal policy targeted higher national saving (and a lower current account deficit) and, from the mid-1990s, concentrated on reducing government debt, primarily financed through privatisation;
- Taxation reform – variously embracing capital gains tax; dividend imputation system; company tax; broad-based consumption tax (GST); and income-tax rates; and
- Superannuation reform – imposition of compulsory superannuation through employer contributions of nine per cent for every worker.

Of particular significance in shaping Australia's economy because of its impact and policy responses was the debt crisis that Australia confronted in the mid – to late 1980s. The Treasurer famously suggested that if substantial economic reforms were not undertaken, Australia would become a "banana republic"[27], and ratings agencies reflected these sentiments by downgrading the country's risk ratings. Subsequently this led to a focus on reducing the budget deficit, the current account deficit and public and private debt levels, and drove fiscal consolidation and other major reform proposals. The Howard Government extended this further with the introduction of the Charter of Budget Honesty legislation in 1998.[28]

Australia's underlying economic strength

The Australian economy was particularly strong going into the GFC, enabling it to weather the storm better than other advanced economies.[29] Strong demand for raw materials produced a sustained rise in global commodity prices, a once-in-a-generation upswing in Australia's terms of trade, and helped unemployment fall to a low of 3.9 per cent in early 2008.

Contrary to international experience where interest rates were already low, monetary policy in Australia was tight as the RBA battled rising inflation, leaving scope to cut interest rates when the GFC broke.[30] Australia's official cash rate reached 7.25 per cent in September 2008, and within seven months had been lowered to three per cent.

During the GFC Australia's financial institutions became more cautious in extending credit and business, consumers became more cautious in their borrowing and spending behaviour and business and consumer confidence plunged. These recovered earlier and much more strongly than in other countries due to the sharp cuts in interest rates, and the early and substantial fiscal policy response.[31]

The impact of the global shock was ameliorated somewhat by the sharp fall in the Australian dollar. This buttressed the Australian economy, moderating the impact of sharply lower global prices for Australia's commodity exports, and improving the competitiveness of Australia's manufacturers and services exports, and import-competing industries.

Additionally, the Australian Government's fiscal position was strong, allowing ample scope for a large stimulus to support growth.[32] An extended period of domestic economic growth and windfall gains from the commodities boom had reduced net public debt to zero.

Unlike most other OECD economies, Australian house prices did not collapse during the GFC. While house prices rose, they were supported by strong demand for housing and there were no significant pockets of excess supply. Importantly, non-conforming housing loans made up around one per cent of outstanding housing loans. The soundness of Australia's financial system reflected the fact that Australian banks, building societies and credit unions had almost no presence in the Australian non-conforming housing loan market.

A possible contributor to the resilience of the Australian economy during the crisis is that it has a relatively small manufacturing sector – and a relatively large commodity sector – compared with the OECD average. The global shock appeared to fall heavily on the manufacturing and related sectors, so having a relatively smaller proportion of activity concentrated in those sectors could help explain Australia's relatively strong performance during the global downturn.[33]

Strong financial institutions

The Australian banking system was well capitalised and profitable going into the crisis. Indeed, Australia's banks maintained their AA rating and profitability throughout the GFC – reflecting a combination of prudent regulation, less aggressive lending and securitisation practices, and having learned lessons from the heavy loan losses incurred in the recession of the early 1990s. Australia's four pillars policy shielded the major banks from competition that might otherwise have induced them to adopt more aggressive (i.e. riskier) lending practices.

Corporate financial distress was limited and isolated by comparison with experience overseas. Household financial stress increased but was limited in light of significantly lower interest rates (following the substantial easing of monetary policy), higher levels of household saving, and stimulatory expenditure packages funded by the Australian Government.

The Australian banking system remains relatively strong.[34] It is considerably better placed to cope with periods of market strain, having substantially strengthened its liquidity, funding and capital positions over several years. Growth in bank deposits continues to outpace growth in credit, and the major banks are ahead of schedule on their term wholesale funding plans. Profitability for the major banks has been quite spectacular, mainly due to further declines in charges for bad and doubtful debts.[35]

An inevitable consequence of rising funding costs and the need to maintain profit levels has seen the four majors announce jobs cuts and bucking the RBA interest rate settings process.[36] ANZ Bank and Westpac both have indicated they will cut about 1600 jobs as they adjust to weak demand for financial services. Despite earning about $24.3 billion in profit last year, the big four banks are looking at cost-cuts as a means to maintain those profit levels.[37] The major banks suffered a downgrade in their credit ratings to AA – in late February.[38] The political argy-bargy over interest rate movements will continue.[39]

There has also been progress over the past several months on a number of other international regulatory initiatives, including developing a policy framework to address the risks posed by systemically important financial institutions (SIFIs), the move towards central clearing of over-the-counter derivatives and developing policy frameworks to address the risks posed by shadow banks.

The Government has introduced legislation into Parliament that would permit deposit-taking institutions to issue covered bonds. It has also announced the permanent arrangements to be put in place for the Financial Claims Scheme, following a review by the Council of Financial Regulators (CFR) of how the Scheme should be configured in a post-crisis environment. More recently, the CFR has been examining a number of issues related to the regulation and crisis management arrangements for financial market infrastructures in Australia.

However, a recent IMF working paper has warned that Australian banks should hold greater capital levels to survive the shocks of a new GFC and in case of a collapse in the country's property market.[40] The banks' main vulnerability is their exposure to highly indebted households through residential mortgage lending with the four largest banks holding more than 80 per cent of Australia's mortgages. While a series of new rules (Basel III) will be easily met, more may be needed, although Australia's banks disagree.[41] IMF indicated it was working on a stress test of the Australian banking system.[42]

While there is no disputing that the cost of raising money from offshore markets has risen as the European debt crisis has deepened,[43] Australian banks do not rely on offshore markets to anywhere near the extent they did back in 2007. They are more geared to domestic markets and to longer term debt, making them less susceptible to sudden movements on wholesale funding markets.[44] However, the scope for banks' domestic balance sheets to expand is more limited than in the years preceding the GFC, given the more cautious approach of the household and business sectors towards leverage.[45]

Sound financial regulation

Australia has a coordinated and centralised framework for the regulation of most financial enterprises and it has benefited from years of rigid supervision by them.[46] Australia's "more coherent regulatory structure", with the Australian Prudential Regulation Authority (APRA) acting as the single prudential regulator for the financial services industry, has helped avoid some of the issues experienced elsewhere.

The evolution of Australia's system of financial regulation has been guided by a number of major reviews (Campbell [1981], Martin[48] [1991] and Wallis[49] [1997]), the lessons of the East Asian financial crisis in 1997[50] and the collapse of HIH Insurance in 2001. In addition, the capacity of financial institutions to withstand economic shocks was stress-tested by APRA and IMF (2006).

The strongest indication that Australia's financial regulators made a positive contribution to the country's benign experience of the GFC is the recommendations for improvements to financial regulations that emerged from post-GFC investigations overseas. Most of the recommendations for strengthening global financial regulations already applied in Australia, or were in the process of being applied, by its regulatory authorities.[51] These included a strong regulatory regime and licensing system for financial sales, advice and dealings in relation to financial products; APRA's Product Disclosure Statement (PDS) regime designed to shield the Australian market from riskier products offered by overseas investment banks; regulatory framework around managed investment schemes; and regulatory oversight of auditors, financial advisers and other intermediaries.

Importance of the performance of major trading partners

While Australia's major trading partners were affected by the global downturn, they recovered more quickly than the world economy as a whole (and advanced economies in particular) in the first half of 2009. This was particularly evident in China.

The large emerging and developing economies in Asia have become an increasingly important destination for Australia's merchandise exports and was an important factor underpinning its strong performance during the GFC and beyond.[52]

RBA has noted Australia's trade surplus reached a 40-year high as a ratio to GDP in the September quarter 2011, reflecting large increases in bulk commodity contract prices. More recently, a decline in iron ore and coal prices has resulted in a smaller trade surplus as well as a fall in the terms of trade from their record level. Solid growth in export volumes has been outstripped by more rapid growth in import volumes, reflecting the appreciation of the Australian dollar and the sharp upswing in mining investment.

While Australia's aggregate trade balance remains close to record highs, this masks diverging trends in goods and services trade where a sizeable deficit in services trade has emerged. The latter trend has been driven largely by the increase in Australia's exchange rate, coupled with strong growth in Australian incomes.[53]

Social/economic interconnectedness

Australia's current good fortune is not just about China's hunger for commodities, but also a rather admirable balancing act in targeting social welfare spending.[54] Australia's success has hinged on the ability to deliver a relatively high level of social safety (among the top half dozen or so OECD countries) while also being a relatively low-tax country (in the bottom third of the OECD).

Australia's economic performance – now and future prospects

Describing Australia's current economic circumstances is somewhat easy. The IMF's Country Report on Australia in October 2011 indicated Australia's performance since the onset of the global financial crisis has been enviable and is being driven by a mining and investment boom expected to be long lasting, given the favourable prospects for sustained growth in emerging Asia.[55]

In January 2012, intensifying risks to the international economy from the worsening European sovereign debt crisis prompted the IMF to slash its 2012 global growth forecasts.[56] Predicting the world economy will grow by only 3.3 per cent, down 0.7 percentage points from expectations of four months previously, it noted Europe would hit a mild recession that would create economic consequences for the world[57], echoing similar predictions by The World Bank.[58] However neither institution predicted the GFC. As a consequence it may be argued that the current figures and language being employed reflects a greater degree of caution than might otherwise be necessary.

In re-evaluating its previous report findings, the IMF noted that Australia's underlying economic fundamentals were still very sound, with unemployment half the levels of Europe, a massive investment pipeline, contained inflation and very low government debt (24 per cent of GDP, compared with United States 100 per cent, Italy 120 per cent and Greece 152 per cent). Australia's major trading partners, China and India, were forecasting solid growth, although these levels are more moderate than in past years.[59] Australia recently received the coveted AAA credit rating from all three global ratings agencies for the first time in its history.[60]

This reassertion of Australia's economic health was in line with that made by the Government in its November 2011 Mid Year Economic and Fiscal Outlook[61] and the RBA's February 2012 Statement on Monetary Policy.[62] Both confirmed the factors currently influencing Australia's economy include the sovereign debt problems in Europe, changes in household spending patterns, softness in the housing market[63], the investment and terms of trade boom and very high exchange rate.[64]

The once-in-a-century investment boom in the resources sector has witnessed business investment rising by around 20 per cent over the past year with more forecast. As a consequence, the RBA is expecting double digit increases in business investment in each of the next two years. It is occurring at a time when the terms of trade are also at a very high level, with the industrialisation and urbanisation of Asia supporting commodity prices and putting downward pressure on the prices of manufactured goods. The boom is having positive spill-over effects to a number of industries, with some of these effects being direct and others being indirect – hence the concerns about a multi-sector economy.

At the same time, the high exchange rate is having a contractionary effect on other parts of the economy, as it reduces the international competitiveness of some industries – notably manufacturing, tourism, education, agriculture and some business service sectors.[65] Over recent months, the Australian dollar has appreciated despite the uncertainty about the global economic outlook and some decline in commodity prices since mid 2011. After adjusting for differences in inflation rates across countries, the exchange rate is currently at around its highest level since the early 1970s.

RBA data has suggested that the pace of consumer spending has moderated, particularly in retail sales volumes and motor vehicle sales. While consumer confidence has recovered somewhat following the sharp decline in mid 2011, it remains below its long-run average with sentiment being affected by developments overseas, falls in asset prices and the softening in labour market conditions over 2011.

Household wealth was around 2½ per cent lower over the year, with a 3½ per cent fall in average dwelling prices more than offsetting a small rise in the value of financial asset holdings over the year. In contrast to wealth, incomes have been growing strongly. Households have continued to devote a significant portion of their income to rebuilding assets and paying down debt. Residential building activity was very soft in 2011 partly reflecting the earlier pull-forward of demand from the boost to grants to first home buyers in 2009, as well as lower expectations about capital gains from housing.

The Government's fiscal strategy envisages three pillars:

1. Achieving budget surpluses, on average, over the medium term;
2. Keeping taxation as a share of GDP below the 2007-08 level on average (23½ per cent of GDP); and
3. Improving the Government's net financial worth over the medium term.

To achieve this aim, the Government is committed to limiting spending growth. While the economy is growing at or above trend, real spending growth will be capped at two per cent annually until surpluses are at least one per cent of GDP.

Australia's unemployment rate has remained around 5¼ per cent in recent months, although employment growth has been soft and the participation rate has appeared to fall. Growth in total employment remains patchy, with mixed employment outcomes across industries and little net employment growth over 2011. In part this reflects structural adjustment to the resources boom and the accompanying high exchange rate.

Looking forward the RBA's central forecasts are for around trend growth in the economy over the next two years, and for underlying inflation to remain in the two to three per cent range. The unemployment rate is also expected to remain low (at around 5-5.25 per cent), although some increase is possible over coming months. At the industry level the economy is clearly going through a period of heightened structural change, and this is set to continue.

Conclusions

Australia's economy was in a much stronger position to withstand the fallout of the GFC than most other countries. Economic growth remained solid and the economy did not go into recession. Australia was a major beneficiary of the economic growth resulting from the industrialisation of emerging economies such as China and India. Furthermore, the Australian housing market did not possess the excess of physical stock that is evident in some overseas markets, particularly the United States.

The regulation and supervision of Australia's financial institutions was strong, effective and coherent. Australia's largest four banks are among only 11 of the world's top banks with AA credit ratings or above. The regulatory framework for the financial system implemented by high quality regulatory institutions helped Australia avoid the excesses that resulted from lax or ineffective prudential regulation in many other advanced economies.

A number of mutually reinforcing factors helped Australia outperform other advanced economies during the downturn, albeit some more important than others. Australia's recent economic history and the substantial changes that occurred in the underlying economic and social composition of the country are important determinants as to why Australia was able to withstand the dire effects of both the GFC and more recently the European sovereign debt crisis.

The Australian policy response was an important contributor. Rapid and large monetary and fiscal policy stimulus played a critical role in increasing effective demand and the early recovery of consumer and business confidence. The strength of the Government's fiscal position meant that it was well placed to undertake an appropriate policy response to these developments. Fiscal stimulus estimates imply that growth would have been negative for three consecutive quarters (and hence a technical recession) absent fiscal stimulus.

Measures to support the financial system were important in ensuring continued financial stability in Australia, allowing the flow of credit to households and businesses to continue (albeit at a slower pace). Improved policy and institutional arrangements in following a quarter century of reforms have made the Australian economy much more resilient to external shocks.

More competitive and flexible product and capital markets – along with the weakness in domestic demand – meant that the sharp depreciation in the exchange rate helped cushion the impact of the downturn on the real economy, rather than simply resulting in higher prices and wages.

The Australian economy also benefited from the relatively early, and strong, recovery in growth in most of our major trading partners throughout 2009, which in turn was driven by substantial macroeconomic policy stimulus in those countries.

Australia's massive resources boom, the consequential investment phase currently underway, the insatiable demand for its resources from the Asian region and its relatively low exposure to European financial markets, are all contributing to the current healthy state of the economy.

In practice, these explanations complement one another, with the combination of factors – both institutional and policy – working together to support the economy.

Finally, what lessons are there from Australia's economic experience that might be useful to other developed economies wrestling with recession or low growth?[66]

Currency union without fiscal union is an accident waiting to happen.

The longer term goal for monetary policy (low, single-digit inflation) remains much clearer than for fiscal policy. The achievement of this goal has important benefits, but also one serious drawback. It means that some economic shocks are now too big for monetary policy and the automatic stabilisers to cope with on their own. A significant discretionary fiscal stimulus is also desirable in response to such shocks.

What about fiscal consolidation? Can it be expansionary for the economy?

The answer to this question is yes, but mainly in countries where doubts about solvency have raised borrowing costs, and the consolidation could reduce these costs sharply.

There are undoubtedly substantial benefits from announcing and legislating far-reaching fiscal consolidation that begins once the economies have emerged from liquidity traps, and resumed good economic growth. However, in countries with high levels of government debt, political economy considerations can lead to a chosen path for fiscal policy that appears far from optimal.

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> CEDA'S SIR DOUGLAS COPLAND LECTURE

> 27 MARCH 2012

> MELBOURNE

Transitioning to a low emissions future: Implications for global energy systems

Professor Ottmar Edenhofer

Potsdam Institute for Climate Impact Research,
Deputy Director and Chief Economist, and Intergovernmental
Panel on Climate Change (IPCC), Co-Chair.

Professor Edenhofer provided an international perspective on climate policy at this year's Copland Lecture and importantly presented fresh views that had been lacking in the public discussions on climate policy in Australia. His presentation examined the renaissance of coal occurring at present and the importance of carbon capture and storage to achieving ambitious mitigation targets and no regret policies. The following is a transcript of his speech.

I'm very pleased, delighted and honoured to be invited to this important Douglas Copland Lecture. I've spent almost two days in Australia, and I was able to make new friends here and I'm really overwhelmed by your warm hospitality. I told my European fellows if they will throw me out of Europe I will seek asylum in Australia or New Zealand.

Now, what I intend to do today is, I would like to talk to you about the transition to a low emission future and implications for global energy systems. I have six points, and I'll try to answer the six points.

The first question I would like to answer is, has global warming stopped?

A lot of people have the impression that global warming is no longer a real issue and they argue that probably we have overestimated the impact of climate change.

I would like to address this issue in my first point. Then I will try to explain the scope of the challenge.

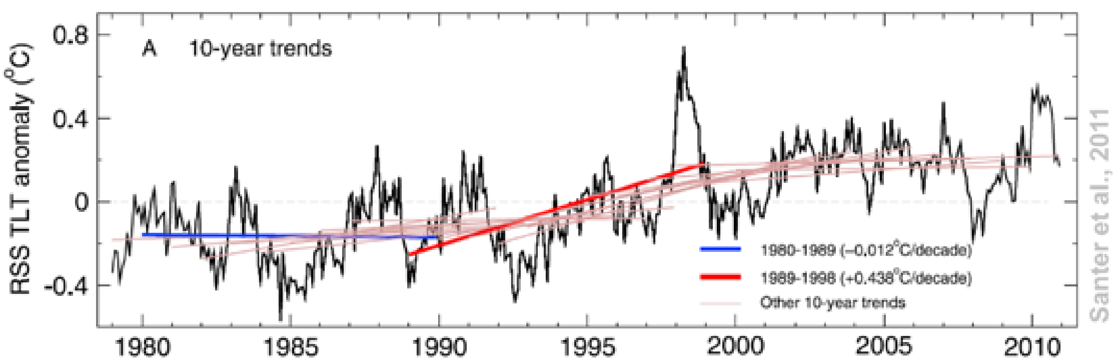
I believe climate change is a big issue, but at the same time I believe we can solve it with good will, with cooperation, and with our technological capabilities.

In my third point I will be talking about the energy transformation. Then I will provide a very rough assessment of current international climate policy and I will conclude with four ideas to improve international climate policy because, I think most of you will agree with me, that the outcome of international policy has been at the least disappointing.

Now let me start with my first point, has global warming stopped?

You might find this kind of picture in many publications. So at first glance it seems that global warming seems to have slowed down or even stopped in the last 10 years. And there is an immediate question, has the IPCC made a mistake?

FIGURE 1
HAS GLOBAL WARMING STOPPED?



Professor Martin (CEDA Chief Executive) mentioned that I am Co-Chair of IPCC but this is only one of my affiliations, I have two other ones. With your permission allow me to use the next 30 minutes to be a free man and express my own opinion. So you should not make the mistake of assigning my opinions to the IPCC.

In that sense, not everything I intend to say should be assigned as the official opinion.

In the last 10 years global warming has stopped, but this is to a certain extent a mistake. There are multiple reasons for the stable temperature in the last decade.

The slowdown of the last decade is within the range of natural variations. In the 90s we had an exceptional warm (period) due to El Niño, and we also had cooling effects from increasing air pollution, in particular sulphur.

The temperature is likely to be increased once again when clean air policies are commissioned in newly industrialised countries.

The basic message is, from looking at long term trends, it's obvious that global warming has not stopped at all. You have to take into account, a much longer time horizon. This is the time horizon since the end of the 19th century and the temporal slowdown of global warming has occurred already in the past and the recent independent examinations by the IPCC results has been confirmed.

Figure 1 clearly shows you an anomaly. The time range with the highest ranks in terms of temperature, is populated by the last 10 years. The last decade was warmest since the beginning of industrialisation.

This statistical analysis clearly indicates there is absolutely no reason why we should believe that in the long run, the increase of global temperature will be stopped.

Let me explain the scope of the challenge.

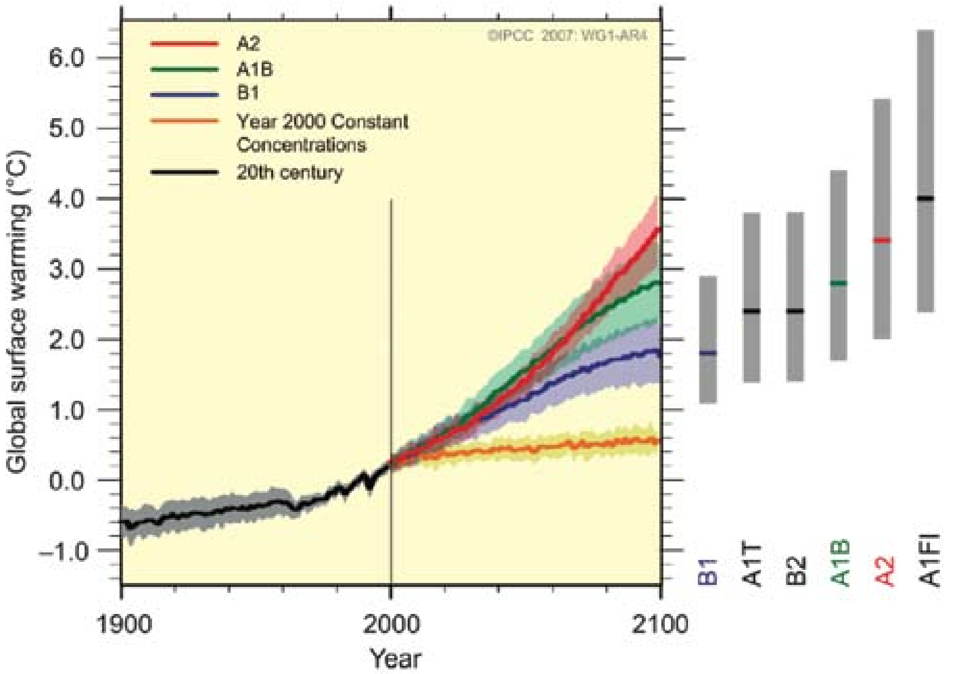
The global mean temperature has been increased by the burning of fossil fuels; the land use has changed due to deforestation, over the last 200 years, since industrialisation. There is no doubt about this. But there are two fundamental questions, the first question, what will be the future? What are the expectations for the future due to the increase of global mean temperature? The second point is why should we be worried about the increase of global temperature?

If you intend to become a climate sceptic, you should become a smart climate sceptic. It's absolutely useless to challenge the IPCC, arguing that humankind is not mainly responsible for the increase in global mean temperature. A smart question from my point of view is why should we be worried about the increase in global mean temperature?

Before I explain that, I would like to outline a few points about the future scenarios. By the way, the IPCC is not providing any kind of prediction, what we are doing is providing scenarios about the increase of global mean temperature.

Here, I would like to highlight one of these scenarios. This is the scenario where we will have for the rest of the 21st century, reasonable economic growth – around two per cent per capita, we use fossil fuels, in particular coal, and Figure 2 shows you that we have an increase of mean temperature of around four degrees. Nobody knows exactly, but it seems that this is the mostly likely scenario, which we have to take into account when we talk about the climate change issue.

FIGURE 2
GLOBAL WARMING – WHAT TO EXPECT



Source: IPCC (2007)

But now to my next question, why should we be worried about the increase of global mean temperature? What is at stake?

Here, I would like to highlight a class of risks which are quite important. This class of risks, this type of risks, can be classified in the following way: These are events which might have a very low probability but could have a very strong impact on planet Earth.

These kinds of risks are being characterised by some of my colleagues as tipping points. These tipping points show a strong reaction to small climate changes.

Let me list the kind of tipping, and then I intend to explain the underlying mechanics. The first is:

- The acidification of the ocean;
- The potential dieback of the Amazon Rainforest;
- The change of the monsoon dynamics in China and India; and
- The meltdown of the Greenland icesheet and the instability of the West Antarctic icesheet.

The ocean is one of the largest stores of carbon. It absorbs almost one-third of the emitted CO2. Due to the burning of fossil fuels and the fact that phytoplankton can no longer bind the CO2 and transport it to the ground of the ocean, the ocean acidification increases, and the capability of the ocean to bind CO2 is reducing more and more.

The dieback of the Amazon Rainforest: All of the Amazon Rainforest is a carbon sink, and if global mean temperature increases around five to six degrees, there is a risk that this carbon sink might be transformed into a net carbon source.

If the global mean temperature increases, the Indian monsoon dynamics through complex mechanics, might be suppressed for two decades and come back with additional force, and in this short time span, neither the Indian nor the Chinese agricultural system can adapt.

The meltdown of the Greenland icesheet and the instability of the West Antarctic icesheet is a quite important issue. Now we are dealing with predictions about the future sea level rise. Many scientists argue that the IPCC in the last report has underestimated the increase of sea level rises.

I'm not able to assign probabilities to these events and I accept that some scientists argue that the probabilities are low. But what I would like to highlight here is the potential impact on the planet Earth which might be quite significant.

Therefore, when we talk about climate change, we have to frame this in a framework of risk management. Risk management does imply we have to look not only at the average outcome, but also at the worst case scenarios. And it seems to me that we as human beings are not good at risk management.

Assume that you had asked the majority of economists in 2003 how likely a financial crisis is. Most of the economists would respond the likelihood is below one per cent. If you had asked the same economists what would be the impact of the financial crisis, they would have argued the impact of a financial crisis on our economic systems is severe.

So in that sense, our conventional risk management tools are not really adapted to a situation that deals with low probability and high impact events. And the climate change issue is one of the cases where we have developed tools in order to make rational and precise decisions.

In order to limit the risks of dangerous climate change, some of my colleagues argue it might be a good idea to limit the increase of global mean temperature at around two degrees. We now have a lively debate in the IPCC but most economists and most climate scientists would agree that we should not try to increase the global mean temperature far beyond the two degrees target.

What I would like to show you here is the following. Here you have different climate protection goals, some of them are consistent with the two degrees target, some of them are relaxed. But the basic message is, if we depart from a business-as-usual scenario, we should peek at around 2020 to 2030 with our emissions and then we have to decline the emissions in absolute terms, not in relative terms.

But this is our current threat, our current business-as-usual scenario indicates global emissions will in fact increase, in the next years, with an increasing growth rate.

I would like to explain to you why this is the case.

In this part of my talk I would like to argue that the most important environmental problem, even the most important economic problem in the 21st century, is the renaissance of coal.

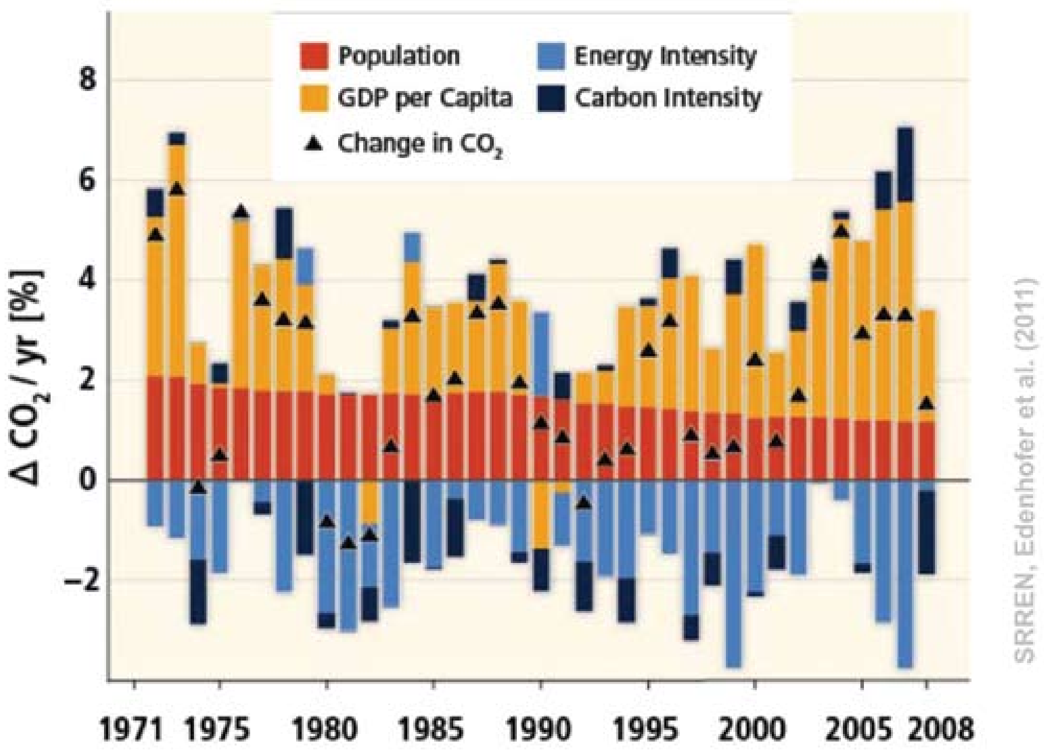
We are not at the beginning of the renaissance of coal we are in the middle of the renaissance of coal.

Here I would like to draw your attention to these price projections. You have the oil price, the gas price and the coal price. And the oil price has been increasing significantly over the last two years and an increasing oil price, partly due to institutional reasons, has also increased the gas price. The consequence of this is that coal has become incredibly competitive in the power sector in China, India and also in the US.

Many people in Europe believe that peak oil might rescue the climate policy; it might help support an international climate agreement. But from my point of view, the contrary is true. If the oil price is increasing, we will see a lot of additional investments in the exploration of new oil...and we will observe massive investments in South Africa and China into coal to liquids, to become more independent from the oil in the Middle East.

This is indeed a big challenge. What you can see in Figure 3 are the annual growth rates of CO2 emissions.

FIGURE 3
WE ARE NOT ON TRACK



Transitioning to a low emissions future: Implications for global energy systems

I have decomposed annual growth rates into four components – population growth, GDP per capita, energy intensity and carbon intensity. Over the 1980s we have seen a significant decline in energy intensity which means a significant improvement in energy efficiency.

Admittedly the improvement of energy efficiency has been over compensated by population growth and GDP, but nevertheless this was a significant achievement.

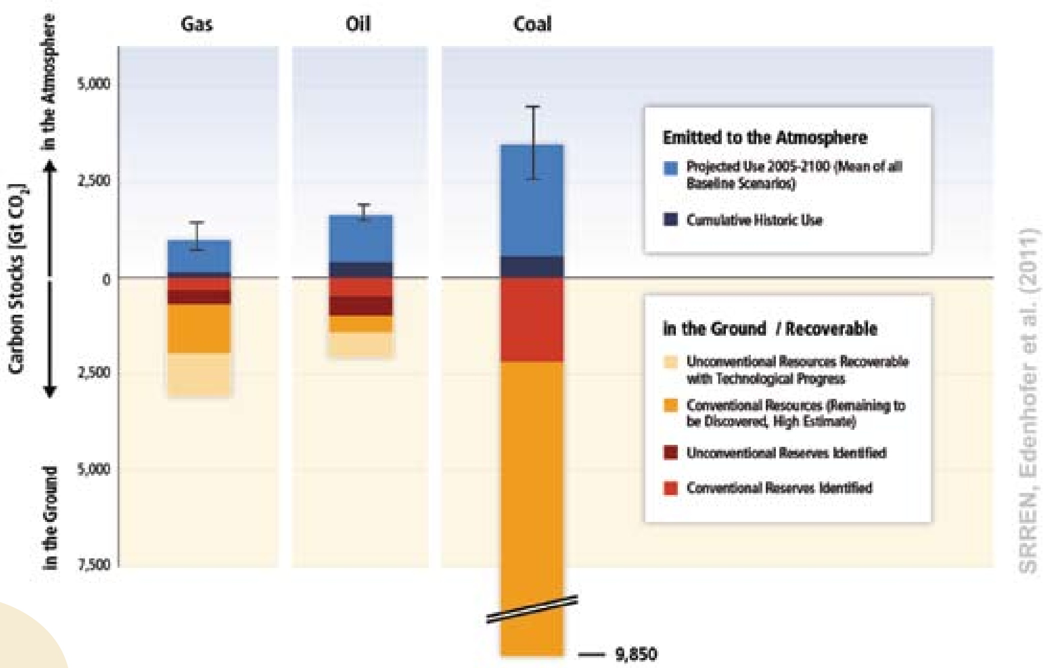
At the same time, we can see a decline in carbon intensity over the 1990s and even at the beginnings of the 2000s. But since 2003, the picture has been changed fundamentally. We again see an increase of carbon intensity again. This is what I call the renaissance of coal.

As one unit of primary energy becomes more and more carbon intensive, the data, after the financial crisis, clearly indicates that we perceive and observe an increasing growth rate of emissions partly due to the GDP per capita increase in population, but mainly due to the fact that we see a renaissance of coal.

This is the reason why we, by no means, are on track when we talk about international climate policy. Now you might ask the question is reducing emissions a sustainable pathway? Can humankind in the course of the 21st century take such a pathway? The answer is yes, humankind can.

In Figure 4 you can see the zero line. Below the zero line, you see the resource and reserves of gas, oil and coal. The bars above the zero line indicate the amounts we have disposed in the limited disposal space in the atmosphere since industrialisation. The bars below the zero line show what we will do when we have no climate policy in place.

FIGURE 4
FOSSIL FUELS ARE NOT SCARCE



This business-as-usual scenario might lead us to an increase in global mean temperature of around four degrees. But an increase of four degrees global mean temperature means that we are experiencing very dangerous climate change. What this picture clearly shows is that we have more resources of fossil fuels underground than we can dispose in the atmosphere.

This is an interesting bottom line. We have resources of around 12,000 gigatonnes resting underground. If we try to avoid dangerous climate change, we are allowed to dispose around 230 gigatonnes in the atmosphere.

The limiting factor in the 21st century is not scarcity of fossil fuels, it's limited disposal space in the atmosphere. And this has dramatic economic implications. It has the economic implication that we have to convince and incentivise the owners of coal, oil and gas to maintain a majority of resources and reserves in the ground. The economic implication being that we will devalue their assets.

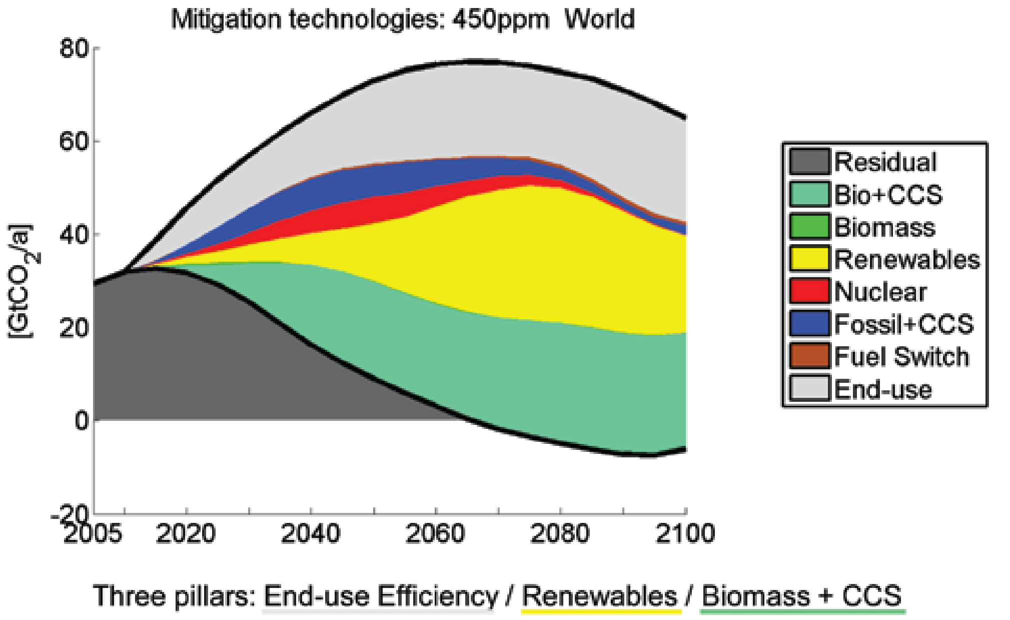
This is the most important reason why international negotiations are so incredibly complicated. Because what we are talking about is in the end, a transformation of the scarcity income for the owners of coal and gas into a scarcity rent for the climate. And basically what governments are doing with the international climate negotiations, is talking about what share of the climate rent they should get in the end.

This is the reason why I have stated publicly that climate change negotiations are not only environmental summits. They are in fact economic summits, very important economic summits indeed.

The crucial question is do we have the technologies at hand? Do we have a transformation pathway in mind, which allows us to innovate our global system in such a way that we can, over the rest of the century, get rid of the fossil fuels or at least save a bit more in order to use the limited disposal space of our atmosphere in an economic, reasonable way?

In general yes. And here I'll show this picture. This is not the global energy mix. This is a kind of mitigation share. This is the emissions trajectory which shows you what will probably happen under a business-as-usual scenario. And here you see what the emissions trajectory should look like if we are in accordance with a reasonable climate goal.

FIGURE 5
THE GREAT TRANSFORMATION –MITIGATION SHARES



AME Project (Luderer et al., 2011)

We have calculated contributions of the different technologies to the mitigation portfolio. This is just an example and many institutions like the IPCC and the International Energy Agency have done such calculations. Results from these scenarios are quite similar – one important part is energy efficiency. Energy efficiency improvements can be considered as a low hanging fruit but they are quite important. Here you see the use of fossil fuels in combination with carbon capture and storage.

I'll say a few words on carbon capture and storage (CCS) because I believe carbon capture and storage is necessary for any meaningful climate policy because coal is so abundant, it is so cheap and is relatively equally distributed across the globe, so many countries like to use coal. We can only use coal in a way consistent with climate policy if we have CCS available.

Some countries, not my own country, Germany, will use nuclear power. However, even if nuclear power is not constrained by political decisions, economically, it will not play a major role. You do have a huge share of renewables and then you have the combination of bioenergy plus CCS, which is quite an interesting part of the portfolio of mitigation options.

Why bioenergy and CCS?

According to the IPCC evaluations of the scientific literature, ambitious mitigation pathways are only affordable, if we are able to develop technologies which allow us to remove carbon from the atmosphere. One device to do this is the combination of bioenergy plus CCS.

This is a highly conflicting issue. I would like to highlight here, however, that this kind of technology is absolutely essential.

What about the costs? Can we afford this?

The costs depend on the stabilisation target. Some of the stabilisation scenarios argue that the cost of a low stabilisation target are around one or two per cent of GDP. In absolute numbers this is a lot. But relative to the GDP, it seems affordable. However, the cost can only be limited to such an amount if we use the potential of biomass. Furthermore, the availability of technologies, like renewables and CCS in particular, are of enormous importance to limit the costs of low stabilisation targets.

Let me move on to a quick assessment of international climate policy. The Copenhagen Climate Summit was disappointing but if you have a second look at it, it was not too bad. At least some of the countries pledged reductions, Japan, Europe, the US and Canada. The implementation of the minimal Copenhagen target means emissions in 2020 will be 10 to 20 per cent higher than today, but nevertheless it's a first step to limit the increase of global mean temperature at around three degrees. This is not sufficient, but it is a first step.

The Durban outcome was not too bad. The diplomats have been able to map the process in a way that allows us to see the next steps a little clearer. We had an ad hoc working group on the Durban Platform for Enhanced Action.

There is debate about the second Kyoto commitment period, there are some operations of the Cancun agreement in particular, and the establishment of a Green Climate Fund which might provide developing countries with some additional income, that can be used for financing mitigation and adaptation measures. It's not great but I wouldn't judge and evaluate the Durban outcome as a total disaster. I think what we should not do is blame the United Nations Framework Convention on Climate Change (UNFCCC) too much, I think we have to think in a fresh way at other options supplement and support the UNFCCC framework.

Before I share with you four ideas for that, I would like to make clear and explain why this international negotiations are such a hard thing.

First, many countries would agree that if humankind as a whole can operate on the climate change issue, it would be globally optimal. It would be good if we could avoid dangerous climate change. It would be beneficial for humankind and as a whole. However, every single country is better off, if only the other countries mitigate. There is a strong incentive to behave as a free rider, and if all countries decide rationally to behave as a free rider then in the end there is no global international agreement.

Rational decisions of individual governments will then be transformed in a global outcome.

Therefore, the climate gains are a prisoner's dilemma game, where you have a strong incentive to behave as a free rider. The crucial question is can we design an international treaty where people and governments no longer have an incentive to behave as a free rider?

Here, I have to reveal I have no clear cut answer but I would like to share with you four components which seem worthwhile of detailed exploration in the near future.

The first thing is we should find a mechanism to make cost benefit ratios of climate mitigation more attractive.

So my first proposal is to link climate cooperation with R&D cooperation.

My second proposal would be to create and link emission markets between Australia, New Zealand, Europe and China. Think about trade sanctions against climate free riders and also think more carefully about no regret policies.

It is very interesting to understand that the UNFCCC framework tries to bring together about 180 governments. But if you look at the coalition size, which might be able to reduce the majority of the emissions, this consists of a few countries – China, the US, Europe, Russia, India, and Japan. So we could reduce the complexity of the negotiation process remarkably by reducing the number of countries negotiating about climate policy, and in addition we should think more intensively about research and development cooperation in these countries.

Let me highlight, that CCS is an important component of any portfolio of mitigation options. We should set up an international research and development platform where we think carefully and share technological knowledge about CCS in a way that might be beneficial for Europe, Australia and in particular China.

But not only is CCS an important part of the portfolio, but renewables are also incredibly important.

Many of the renewables are already competitive even without any subsidies and without any penalising of CO2. There are a lot of devices and options here which are beneficial depending on the location where the renewable technology is used.

But again, we need a lot more research and development in this area, not only for the deployment of renewables. The most important area of research should be how to integrate renewables in a fossil fuel dominated energy system. In Europe we have created a research laboratory to find out what the most efficient integration options are. Why should we not build up an international platform for research and development in these areas?

What you can see is the role of technologies and in particular technological progress in this area of renewables has been remarkable over a number of years. I think we have to further promote technological progress in this area. If you are interested in these kinds on insights, have a look at the recent report on renewable sources and climate change mitigation that we have published last year.

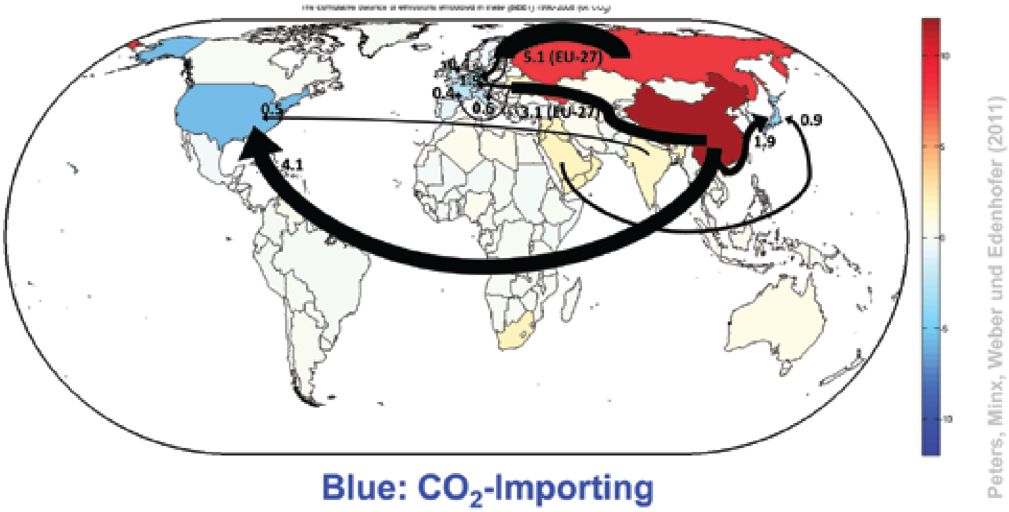
Linking regional cap and trade initiatives: Colleagues of mine and I have drawn a map indicating where we now have efforts to establish carbon pricing and cap and trade systems. I'm fully aware of what you are discussing now in Australia. China has announced that they intend to implement by 2015 a cap and trade system. And I believe these kinds of bottom-up initiatives are important for the top-down international negotiations because when we link these different bottom-up initiatives, we might in the end come up with a global cap and trade system designed in a way that allows us to identify what are the most cost efficient options to reduce emissions.

FIGURE 7

JUSTIFICATION FOR TRADE SANCTIONS

Trade tariffs

CO_2-trade balances for different world regions 1990-2008



Blue: CO_2-Importing
Red: CO_2-Exporting

This map shows you the net exports of CO2 emissions and it clearly shows that China is the most important manufacture. China has a highly carbon intensive energy system. The Chinese are the net exporters to the US but also to Europe.

I'm not arguing CO2 tariffs should harm free trade in the world, what I'm saying is we need a global solution. Bottom-up approaches, which might be incentivised through CO2 tariffs are really a promising pathway for the future.

We also have some no regret options. Through reducing the fossil fuel subsidies: We subsidise fossil fuels at US$409 billion globally and the likelihood that these subsidies will increase over the next few years is remarkable. We have calculated that the current subsidies on fossil fuels create a negative carbon price of around €9 per tonne CO2. Just for comparison, the carbon price in the US system is around €3.

Without further reforms, subsidies for fossil fuels will reach $660 billion in 2020, and the phase out of subsidies, which has already been decided by the G20, should be implemented.

Let me come to an end.

What are my concluding remarks?

Climate change is a problem, it is a global problem, it will not be solved by the fossil fuel resources becoming scarce.

Climate policy should be seen as an insurance against catastrophic risks. It should be seen as a way to avoid dangerous climate change. Nevertheless, this has dramatic economic implications. The good news is that reaching a two degrees target is still possible at relatively low costs, but what we have to overcome the dilemma of international negotiations.

Linking of emissions trading schemes and cooperation in technology policy could break the negotiation stall. I have no solution and I have no silver bullet but I try to provide a tool box. It is worthwhile to explore this tool box further. I would like to encourage you as part of the people of Australia, to be part of the nations, who try to become problem solvers on this issue. And I'm very pleased that Australia is discussing and is implementing carbon pricing in July, I think this is really a promising step forward.

> AUSTRALIA'S AGEING WORKFORCE

> 22 MAY 2012

> ADELAIDE

4

Demography is not destiny: Age discrimination and the economy

The Hon. Susan Ryan AO

Age Discrimination Commissioner,
Australian Human Rights Commission

This speech by Susan Ryan was selected because it clearly highlights the issue of age discrimination in the workforce for older workers, which will become an increasing issue in our society with our ageing population.

How this issue is addressed in coming years is critical and this speech provides the hard facts and figures of the potential impact on not only the economy but also society if this issue is not appropriately addressed.

I will start by congratulating CEDA on the publication of its new report: *A Greater Australia: Population, policies and governance*.

I congratulate the editors Jonathan Pincus and Graeme Hugo, and each of the distinguished contributors.

Their expert work will assist SA business and the SA government to develop policies to harness more effectively the great but as yet untapped potential of its older citizens.

This new report is very timely as far as I am concerned.

It sets the right context in which we can examine tough questions, the top one being this:

Why do Australian employers, public and private, large and small, continue to waste the knowledge, experience and energy of workers over 50?

And a few other questions;

What are employers fearful of, when they push loyal, capable skilled workers out the door solely because they have had too many birthdays, then wonder how they are going to fill their ever growing skills shortages?

Why have governments, state and federal allowed the continuation of age bars, usually 65 years, in programs essential for workers wanting to continue in their jobs; workers compensation, income insurance, superannuation, and this in the absence of a compulsory retirement age and the widespread knowledge about increased longevity and the improved health of older people? And the policy that will see access to the age pension increase to 67 years by 2023?

And a really tough one...what lies at the core of age prejudice? Why do employers tolerate, even encourage, the expression of discriminatory attitudes, of demeaning and bullying behaviour towards employees because of their age?

What is all this about?

I am pleased to be discussing these difficult matters here in SA because it seems you have made a strong start in addressing these tough questions.

At official level at least, in SA there is a growing recognition of the great potential of an older population.

It is encouraging to learn that SA, recognising that it has an older population than any other mainland state, has already started a policy approach called "Active Ageing" and is already looking to identify and encourage the positive contribution to the social and economic well-being of this state made by older South Australians.

But taking a national perspective, I am convinced of two things in this space, and I invite your response to them today.

The first: age discrimination is driving, and has driven, millions of people out of the workforce long before they are ready to retire.

Secondly, this practice must cease and be reversed if Australian businesses are to prosper longer term.

I had been in the Age Discrimination Commissioner's role only a few weeks when I was riveted by this story in the financial press:

A report by Deloitte Access Economics entitled: *Where is your next worker?*, argues that the problem in Australia in coming years won't be a lack of jobs – it will be a lack of workers. Deloitte reports that the population aged 55-70 is a massive untapped source of productive capacity and in 2030 there will be over 5 million Australians in this age bracket. Yet based on current workforce participation rates of over 55s, only 1.73 million of the 5 million will still be in the workforce – only 35 per cent.[1]

That report was amplified for me by the following;

The National Seniors Productive Ageing Centre identified an economic loss of $10.8 billion a year to the Australian economy for not utilising the skills and experience of older Australians. This comprises:

- A loss of $8.7 billion a year for not utilising the skills and experience of older Australians who want to work but were not looking for work as at September 2008 (161,800 in total).
- A loss of $2.1 billion a year for not utilising the skills and experience of 39,331 who were unemployed and looking for full-time work as at March 2009; which doesn't include the loss from not utilising the skills and experience of 17,073 unemployed older Australians looking for part-time work.[2]

These findings, well supported by ABS and other quality research set the tone for my priorities as Age Discrimination Commissioner.

In this role I am charged with reducing age discrimination in all its forms, discrimination that can affect younger people as well as older people.

The Age Discrimination Act protects the rights of people of any age to be free of discrimination based on age, in areas and services defined in the legislation. Those areas cover employment and employment related matters, finance, accommodation, goods and services, and other commonwealth laws.

Illegal age discrimination, reflecting as it does deeply embedded community prejudice, affects many people negatively. It results in poverty, illness and homelessness.

My job is, essentially, to change that, and to help create a community and work environment where people are treated with dignity and respect, and assessed on their merits, regardless of age.

How am I approaching this objective?

Employers must be my top priority:

To move towards fairer employment practices, I believe the most constructive approach is to establish the business case, the productivity case.

Business owners, quite rightly, want to run profitable enterprises. They want to grow and to expand their operations.

Employers large and small, public and private, across all sectors need to recognise that the practice of discarding employees who have many years productive capacity left is bad for business, bad for productivity and impedes success.

Many employers do not recognise these facts. Recent research commissioned by the Financial Services Council found that three out of 10 older workers surveyed had direct experience of age-related discrimination.[3]

The ABS tells us that in July 2011, 18 per cent of people over the age of 45 said they couldn't get work because they were "considered too old by employers".[4]

Let me remind you of a few of the policy settings in which all this is happening.

Almost everyone needs to work at least up to the age of eligibility for the age pension, currently 65 years but moving towards 67 years for men and women by 2023.

Until they reach that age, most people without a job have either to try to live on scant savings, to draw down some superannuation if they have it and the rules allow it, or to apply for Newstart, the unemployment benefit. Beyond a few weeks, anyone surviving on this payment alone will be reduced to abject poverty, and possibly homelessness. Often long term unemployed people become ill, and may then have no option but to go onto disability benefits, a very poor outcome for the individual and for public policy.

We are living in an economy where we hear daily complaints from employers about skills shortages, and constant calls to government to bring in more skilled workers.

Immigration is important and beneficial but what about the 2 million experienced and willing people we have here, available for full or part time work, with decades of experience and skills to offer?

At the Australian Human Rights Commission we have our own evidence of widespread age discrimination in the workplace. Complaints about age discrimination in employment are up to 78 per cent of all complaints in this area. Over the last year the Commission has seen a 44 per cent increase in age-related complaints.

The disconnect between those who are capable of work but denied it through age prejudice and the costs of this denial to the economy must be addressed.

As your new report illustrates, population ageing is one of the major social challenges of the 21st century. Over the next 40 years the number of people in Australia aged between 65 and 84 will more than double, and those 86 and above will quadruple.

We are as a society getting older all the time. Nothing will stop or even slowdown this trend.

Women born today are likely to live until 95.

If we do retire at the "traditional" age, around 60-65, many of us will have to find the money to fund up to 30 years of retirement.

We are living in better health than ever before. Professor Ian Hickie (University of Sydney) was quoted in the Sydney Morning Herald on 28 January telling us that older brains are healthy, and that work keeps them that way. The health, mental and physical, of those who are employed is better than the unemployed, and this is true at all ages.

The Commonwealth Age Pension was introduced in 1909[5] at a time when the life expectancy for men was 55 and for women it was 59.[6] Women were eligible for the pension at age 60 and men at 65. Obviously, with life expectancy in the 50s, most people didn't live long enough to receive it.

We are still stuck with the 1909 model, but, now approximately 80 per cent of all Australians aged 65 and older are reliant to some degree on the Age Pension.[7]

Time to change!

What is to be done?

We must not allow ourselves to be paralysed by Treasury projections that show that an ageing population will add about $60 billion to government expenditure by 2050.[8]

It is true that without any intervention such massive costs of an older population will build up.

But...demography is not destiny.

We can intervene, we can change these projections

Lengthening the years Australians spend in the paid workforce would dramatically reduce these projections.

We know millions of Australians want to work longer and are capable of working for many years beyond the age pension age. The good news is that some of them are getting a chance.

One out of three Australians over 55 is in the labour force; approximately 1.9 million people. This accounts for 16 per cent of the total labour force.[9] The numbers of working men and women over 55 have increased during the last decade. In 2002, 32 per cent of men over 55 were working, now the rate is 42 per cent. For women it was 16 per cent in 2001 and it is now at 27 per cent.[10]

While we still rank only 13th in the OECD for mature age participation in the work-force, the situation is slowly improving.

We need a rapid acceleration of this trend.

Will we see it?

I am happy to report that several strategic and successful employers are right now moving away from the old stereotypes.

They are finding ways of using the talents and valuable qualities of employees regardless of age.

The result is that they are hiring older workers, and keeping their current older workers longer. This works, for the business as well as the individuals.

What do they have to do? Are we looking at some industrially complex, costly high risk strategy?

No.

The starting point is to looking at their own workforce. Who are the older employees, where they are placed in the organisation, what skills do they have, and, the key question, what are their intentions about retirement?

The companies that are making progress have consulted their workforce about their intentions and wishes about a retirement point.

All of them have found one requirement stands out: flexibility.

Older workers usually are prepared to stay on if they can have some flexibility around hours worked or days worked.

Usually they have caring responsibilities, for a frail parent, or grandchildren, or an ill partner, or a child with disability.

Just as over recent years parents of young children have been able to negotiate part time or flexible hours, to the benefit of their families and their employers, older workers can do this.

Often too the older worker would like to transition slowly to retirement by changing their role in the company and taking on a role with lesser pressure, fewer hours but perhaps new mentoring responsibilities. The new role would be paid at a lower rate, but from 60 on, individuals can top up this pay by drawing down some of their super, tax free.

Employers keen to maximise this pool of valuable labour often find that assisting employees to get independent finance advice helps. Many people need this advice to understand their true financial picture. They often then realise that they cannot afford to retire for some years.

Upgrading of skills is often needed and older workers should take a positive attitude to training, and to new ways of doing things. Like all successful relationships, the successful relationship between the older worker and the employer is two way.

Because we can already see some employers starting to rid their operations of age prejudice, I know that it is possible to get better practices accepted across the labour market, in all sectors.

I am confident that we can persuade all the stakeholders that we cannot afford age discrimination. The costs are too high, to our economy, to our society and those millions of individuals who have the wish and the capacity to continue their working lives.

I wish the SA government every success with its Active Ageing policy and I hope that CEDA SA will throw its power and influence behind the same objectives.

Endnotes

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> CEDA STATE OF THE NATION

> 18 JUNE 2012

> CANBERRA

Commentary on the White Paper – Australia in the Asian Century

John Lee
Centre for International Security Studies, Michael Hintze Fellow, Adjunct Associate Professor

This speech, delivered prior to the release of the Federal Government's *Australia in the Asian Century White Paper*, provided a fresh and candid examination of the likely developments within the Asia Pacific, from which countries are likely to take up nuclear arms to who is most likely to be open to Australian businesses.

John Lee spoke on issues many are afraid to examine providing new insight and perspective for the business community.

Thank you to CEDA for inviting me and thank you all for being here.

I obviously can't comment on the white paper (Australia in the Asian Century White Paper) yet because it hasn't been released but having looked at the terms of reference, and having spoken to some of the people on the taskforce it seems to me that there are two general aspects to the white paper.

One, we have to understand the opportunities out there, and two we have to develop the domestic capabilities both in terms of the Government and the private sector to take advantage of these opportunities.

When it comes to the Government's role in building domestic capabilities, it's clear that these capabilities are multifunctional, they touch on economics, on politics, on strategy, on strategic relations, on foreign policy, on industrial relations, on educational policy, on cultural education, and it's clear that nothing but a genuine holistic government approach is necessary to achieve the kind of things we want to achieve.

I won't talk about that because it is obvious the white paper drafter gets that. If you look at the taskforce, it is a government taskforce, I won't talk too much about that.

But I thought the best way I could add to the conversation following these two speakers (Australia in the Asian Century Advisory Panel Members Dr David Gruen and Dr Heather Smith), is to talk very quickly on the opportunities out there in the region.

Now Australia in the Asian Century is a very evocative title. And I don't normally quibble about titles but in my view I suspect the title, *Australia in the Asia Pacific Century*, is probably more apt. This is because an Asian century, and I endorse a lot of things that Heather has just said, the Asian century and Asian countries cannot reach their full potential without continued extensive and even pre-eminent American engagement in the region.

Now remember Asia is rising on the back of six decades of relative peace and stability underwritten by American power. If you remove America from the equation you're likely to see a nuclear armed Japan, a nuclear armed South Korea, possibly a nuclear armed Vietnam in the future and possibly a nuclear armed Indonesia in the future.

Most countries in the region, with some exceptions, but most countries have only spent one to 1.5 per cent of GDP on defence over the last few decades. And an Asia without a powerful America and an engaged America will be far more unstable, unpredictable and contested, which is a problem when you have a situation where all of the great and emerging rising powers in Asia are all rising on the back of maritime sea born trade.

Moreover, Asia as we all know is the fastest growing region in the world. But consumers in the advanced economies in America and also Europe will remain far more important to most Asian exporters over countries like China.

Remember that the domestic consumption market in America and the European Union each is worth roughly about $11 trillion US. This compares to about a $2 trillion domestic consumption market in China.

As we know China has become the largest trading partner of Japan, South Korea, Vietnam and Singapore, just to name four, but basically the largest trading partner of almost all of the significant countries in the region but at least two thirds of this trade is in process and trade, with the end consumer in western markets in America and Europe. The export dependent emerging economies in South East Asia will still disproportionately rely on the western consumer for the next few decades.

More broadly, Asia still relies on technology and know-how transfer for foreign direct investment originating in America and Europe and it is not from China or India.

None of these factors that I've mentioned will change appreciably in the next decade; they may in the next two or three decades but not so in the next decade.

Finally, when it comes to Asia itself, I'm really speaking to the stakeholders of the white paper not the drafters because once again I think they understand this, I think we have to be careful to not focus overly on China. We understandably look at China because of the great trade volumes between our two countries. But even now India and not China has the largest middle class in the world.

Remember I always say that China and East Asia generally is a rapidly ageing society. While populations in South East Asia, South Asia and America are still relatively young.

China will be the first major country in modern economic history to grow old before it grows rich.

Only around 10 to 15 per cent of the population in China have any kind of pension scheme and if you look at the ageing numbers in the country and the lack of preparedness of the country, in many respects China is in quite a bit of trouble.

There will still be huge opportunities in China but this will have potentially negative consequences on the domestic consumption market in the country.

Finally, opportunity is one thing, but getting access to opportunity is another. (Department of Foreign Affairs and Trade, Secretary and Australia in the Asian Century Advisory Panel, Member, Dr) Heather Smith touched on this and this is where political and sovereign risk comes in. For example, countries like China are denying meaningful access in almost all important and lucrative domestic markets preferring instead to give advantage to SEOs – State Owned Enterprises, even at the disadvantage of their own private sector.

China allows only a very few joint ventures into the country. This is designed to largely hasten technology and know-how transfer but the relatively close nature of the China domestic consumption market is intrinsically tied to the Chinese Communist Party's political and regime objective, and this is unlikely to change any time in the future.

In contrast, most South East Asian countries may be closed in some respects now but my bet is that they will offer much better access to foreign firms for the simple reason that they don't have the indigenous capital, the indigenous know-how or the established SEOs in order to fulfil their domestic requirements.

India as we all know is a difficult place to do business. But the long term political trend is towards openness to foreign firms in the country which I argue is unlike China.

I will end there because I want to leave time for questions (but) I will end on two points.

When it comes to opportunity I'll give two pieces of general advice.

First it's an Asia Pacific century not an Asian Century, I think that's a very important distinction.

Second, separate the reality from the hype. Avoid over reliance on long term linear extrapolation because they're almost always wrong. Don't rush to pick winners in the region ahead of time and seek the real rather than the imagined opportunities as the evidence comes to light.

Thank you very much.

> CEDA STATE OF THE NATION

> 18 JUNE 2012

> CANBERRA

Australia's place in the new global economy

Dr Martin Parkinson PSM

Department of the Treasury, Secretary

This speech provided insight into Treasury's view on Australia's economic position, where our strengths and weaknesses lie and what is needed to ensure Australia's long term prosperity.

Dr Martin Parkinson reflected on the success of past economic reform but also discussed candidly the reform that is needed now to foster prosperity in coming decades.

Introduction

Today, as is appropriate given CEDA's mission, I want to focus on how we ensure Australia's longterm prosperity in the new global economy.

In particular I will argue that to prosper in coming decades, we must foster and protect the economic frameworks that have served us so well as a country over the last three decades. The combination of sound macroeconomic frameworks and ongoing structural reforms that we have pursued over those three decades are key to our current success.

The 2012-13 Budget takes this approach. It returns Australia's fiscal policy to a more normal setting, appropriate for an economy forecast to grow around trend. And it does this while making further investments in future productivity and participation.

But there are two current – and contrasting – features of the short term outlook that warrant comment. These are the strong ongoing performance of the Australian economy, and the serious economic, financial and political turmoil in Europe and the implications that has for Australia.

Australia well-positioned in a volatile world economy

My first key message is that Australia is well-placed to cope with further global turmoil. This is due both to the underlying strength of the economy and to the significant resilience and flexibility we have across all arms of economic policy.

The Australian economy is growing solidly notwithstanding there are different rates of growth in different sectors and our expectation is for it to grow close to trend over the next year.

Importantly, this growth around trend has not been accompanied by signs of emerging economic imbalances. We have close to full employment and aggregate wages and prices are in check. Some imbalances that built up in the previous decade are receding, albeit slowly – for example, household balance sheets are strengthening on the back of higher levels of private savings.

While structural change is painful for some parts of the economy, this is happening in the context of overall economic strength. And that keeps getting lost in some of the public debate.

In contrast with the inherit strengths we are seeing in the Australian economy, the international economic outlook is marked by some areas of great weakness, and a high degree of uncertainty. In particular, there are deep-seated and deeply troubling problems in the Eurozone and there is little sign that they will be resolved in the near future.

The Eurozone's malaise reflects entrenched structural problems in a common currency area, compounded by deep weaknesses in the financial system, and in fiscal positions, and a lack of political will or accord to deal with them. The Eurozone challenge is not what to do, it's having the will to do what's required. This view underpinned the relatively pessimistic projection of European growth included in the Budget papers. Whereas other parts of the global forecasting community expect the European economy to shrink by about a quarter of a per cent, in the Budget papers we have it shrinking by about three-quarters of a percentage point. This is dramatically more than others have been anticipating at the time we did the Budget.

The Eurozone crisis is unlikely to be resolved for some considerable time to come. While the Greek election has been grabbing headlines and attention, we should not over-dramatise these events, but nor should we believe the election eliminates the risks emanating from Greece or from the Eurozone more broadly. The next challenge is, of course, the orderly creation of a new Greek Government. But even if this is achieved quickly, the key issue remains the absence of political will. Europe has to have the political will to implement policies better suited to the circumstances confronting the Eurozone member countries. If it doesn't, the prospects that they face are truly grim. The Treasurer covered these issues in his Ministerial Statement earlier today.

What I would emphasise, though, is Australia is well-placed to cope with whatever emanates from Europe.

Of course we would not be immune to negative impacts via financial, trade and confidence channels, but we have significant flexibility and capacity at our disposal to cope with a range of different global scenarios.

Given the nature of the problems in Europe, any sharp intensification of the crisis would likely be transmitted to us via the global financial system. As you would expect, a normal part of our role is to undertake contingency planning for a range of events – and a key conclusion of that work is that Australia's financial system is well-placed to deal with shocks emanating from Europe; indeed more so than at the beginning of the GFC in 2008.

Our banks are well-capitalised and have sufficient resources to withstand a freeze in international capital markets for several months. They are also well-regulated and, since the GFC, the regulatory framework has continued to be refined. Some 99 per cent of all deposit accounts in the country are protected through the Financial Claims Scheme. So in terms of the direct – and in some ways most dangerous – transmitting shock to us, we are well-placed.

We are also well-placed to respond to shocks if they were to come out of Europe.

As everyone here knows, our main trade links are with the emerging Asian economies, not with Europe. While these Asian economies, and particularly China, have significant trade exposure to Europe, they also, like Australia, have significant policy capacity in the event of a crisis.

In the event of a demand or confidence shock, emanating from Europe and eventually impacting us via our Asian markets and trading partners, our macroeconomic policy is well-placed to respond and in the first instance, we would expect the exchange rate to adjust to impacts. Remember the global financial crisis; we seemed to go through the Asian financial crisis relatively easily compared to many other countries. Why? A big part of it was our exchange rate buffered some of those impacts. There is no reason why those things can't happen again.

Importantly, any new situation would not be just a replay of 2008. In the event of a new crisis, the mix of instruments the Government might utilise would depend on circumstances, but the crucial point is if you're talking about exchange rate, monetary policy, or other interventions, we have the capacity to respond if required.

Obviously, we all need to be both vigilant and agile. However, there is every reason to be confident about the outlook for Australia.

Fostering Australia's policy foundations

Australia is not in this current strong position by accident.

Rather, this is the product of investments that have been made over the past few decades.

Which brings me to my second key point tonight. The current Australian economic policy framework has served us well and is the foundation of our current prosperity. To set Australia up for future prosperity over the coming decades, we need to foster and build on this framework that we have implemented today.

Australia's story of structural reform is entering its fourth decade. It has persisted through both good economic times and bad. In fact, many of these policies have been implemented in very difficult economic circumstances.[2]

Not only were they implemented in difficult economic circumstances, there were no attempts to derail those policies in the midst of those circumstances and indeed much of the framework was constructed to advert specific problems we could see coming.[3]

The three pillars of Australia's macroeconomic framework are: a floating exchange rate that acts as a shock absorber for the economy; independent monetary policy focused on managing the level of demand to keep the economy on a stable growth path consistent with low inflation; and fiscal policy aimed at running budget surpluses over the cycle in order to contribute to national saving.

Fiscal policy is not only important for the sustainability of the budget position in the short and medium term, it's also important in the longer term because we are going to see demand associated with an ageing population.

These macroeconomic pillars have been underpinned by structural policies that have fostered flexibility and growth. These include the creation of more open and flexible labour, capital and product markets, and policy settings that foster competition. An open approach to foreign investment has also contributed significantly to our economic performance, reducing excessive reliance on foreign debt.[4]

This combination of macroeconomic and structural policies is the reason we are responding so much better today to the mining boom and to the impacts of Europe than we would have done in earlier episodes. Anyone who knows economic history in Australia, knows that every time there has been a terms of trade boom, what's happened is we've seen very rapid wage growth and inflation. This boom is unique both in terms of its duration, and its magnitude but also importantly a decade in, with the way we have managed to handle the benefits of the boom. This combination of macro and structural policy did not come about by accident, but arose from a set of economic circumstances we confronted and a methodical attempt to build a set of policies that would enhance our robustness.

A more recent element of our policy framework is the Charter of Budget Honesty, introduced in 1998. The Charter has made fiscal policy significantly more transparent, and importantly, has led governments to think about fiscal policy over the economic cycle, not just looking at it in terms of this year or the next.

The Government's response to the GFC was driven by the imperatives confronting the Australian economy, but was entirely consistent with the intent of the Charter which requires governments to specify any actions that are designed to "moderate cyclical economic fluctuations", and to set out how they intend to reverse these decisions. As you will recall, the Government both responded to the crisis and laid out how it intended to return the budget to surplus. While the Charter wasn't designed for the GFC, the GFC was arguably the Charter's first big test – and it passed.

The next step in increasing fiscal transparency is the imminent establishment of the Parliamentary Budget Office – which we strongly welcome. The PBO will provide independent analysis of the budget cycle, fiscal policy and the financial implications of proposals. The announcement of Phil Bowen as the inaugural officer is an important step in establishing this institution. There will be further steps to underpin this important reform. Finance and Treasury will negotiate a Memorandum of Understanding to assist the PBO in carrying out its responsibilities while respecting its independence. The Treasury and Finance will publicly release our costing methodologies, which will assist the PBO but also give the broader community visibility of how we approach issues central to the PBO's remit.

Establishing Australia's current economic frameworks was not easy. Today Australia's macroeconomic and structural policy frameworks should be thought of as assets, forming an important part of the economy's productive base in the same way our human capital does or our physical infrastructure does.

It is important that we maintain and build on these assets. In the current environment of volatility and uncertainty, with what can seem overwhelming global and domestic pressures, some have been tempted to suggest dismantling or undermining this framework. I refer to a range of views – from questioning the value of the RBA's current mandate, proposing a return to industry protection or exchange rate intervention, to significant restrictions on foreign investment while ignoring the role of foreign capital in raising Australian living standards.[5]

It is our frameworks that have stood us in good stead through the GFC and recent period of structural transformation, and they will continue to do so. And if you don't believe this, do the exercise yourself, and ask the question: what would Australia look like today had any one of those policy pillars been missing in recent years? Had we not had a medium term approach to fiscal policy, an independent monetary policy focused on achieving low inflation, a free floating exchange rate, a focus on open markets that are competitive and welcoming of foreign investment?

Assuring growth in Australian wellbeing into the future

The success of this framework should give us confidence to build on it as we address the challenges of the next few decades.

My third key message is that if we can respond to these challenges, our next two decades can be as prosperous as the two just past. The prospects for this lie in the continuing story of structural reform. The current frameworks are the result of hard structural reforms in the past, the process of reform is never finished and will evolve with changing times.

I've spoken before about four big drivers of change sweeping across our economic landscape.

First of these is the re-engagement of China and India with the global economy, bringing with them a middle class that will soon outnumber the rest of the world's combined. The middle class in the Asia-Pacific region currently numbers around 500 million and is expected to grow to 3.2 billion by 2030. These people will want better services, goods and experiences. China's GDP is expected to overtake the USA's in the next five years. The combined GDP of China and India will likely exceed the total output of the G7 by 2025. The economic weight of the world is moving inexorably from West to East.

Second is the ageing of our population, with the proportion of Australians aged over 65 projected to rise from 13.5 per cent in 2012 to almost one quarter by 2050. That's eight million people over the age of 65.

This represents enormous success. But it will also pose a challenge for achieving sustained growth in living standards, and it will exert substantial pressure on fiscal sustainability – the impacts of demographic change first identified in the Intergenerational Report in 2002 are now reflected in our budget forward estimates. At the same time there are building pressures across a range of related fronts – health, aged care, disability.

Ageing in the population also means that the median voter is ageing. It is unclear what impact this will have on future Australian policy debates, but the experience in Europe and Japan hardly suggests that ageing populations are enthusiastic advocates of structural reform.

Third is the challenge of environmental sustainability, which includes water and climate change but also encompasses the range of pressures affecting our natural and built environments. I know it's become unfashionable in Australia to talk about climate change and water, but effectively these are biophysical forces that are going to come back and reassert themselves so we need to prepare ourselves for that.

Fourth are the emerging technology trends. We are only just grasping the implications of the digital revolution for business, for individuals, and for governments. And while we can be sure that these will be transformative over coming decades, we don't yet know how.

All of these trends present both challenges and opportunities.

We are now at a cross-roads. An ongoing national conversation about what we can do to meet these challenges is essential – one that asks: "How can we build and make best use of the social and economic infrastructure that will turn these sweeping changes to our advantage? How do we turn the challenges into opportunities to grow and prosper? And how can these changes be supported and sustained over time?"

Let me sketch out some of the broad factors relevant to the policy framework required to address these challenges over the years ahead.

The key factors affecting whether Australia succeeds in the Asian Century while also meeting our demographic challenge, start with our domestic policy settings.

Current economic circumstances bring this into sharp relief – we've seen the peak of the terms of trade. If we improve national income that we've seen over the last two decades, we will have to more than double our productivity growth rate. If not, the growth in our living standards will be slow. So we will have to pursue productivity improvement and innovation, we will not be able to rely on continued rises in the prices for our minerals and energy exports or falls in the price of imports due to a rising Australian dollar. In other words, we will have to go back to getting rising living standards the old fashioned way, by working for it.

The key domestic policy directions are to continue microeconomic reforms to improve the productivity of our economy. This includes governments at all levels working together to reduce inefficiency and remove constraints on innovation – for example by: progressing the seamless national economy; appropriate infrastructure investment planning, funding and use, including better price signals; and ensuring effective education and skills systems which focus primarily on improved outcomes rather than simply on funding. These are all issues CEDA has had a long interest in.

Governments must help manage sectoral transformations so industries adjust to sustainable futures, rather than attempt to protect declining industries from change. This is important both in its own right, but also in the signal it gives business – at the end of the day governments can enable productivity but productivity comes about because of the decisions that businesses take in consultation with their workforce.

We must continue to develop our tax system at Commonwealth and State levels to improve efficiency and assist in resource movement across the economy.

A second area of focus must be on maintaining and further developing an open, embracing orientation to our Asian neighbours in all areas of social and economic life.

This goes to our "soft skills" as a society – our social attitudes, our curiosity and tolerance. But it also goes to our policy settings – how we build our skill and knowledge base, and the incentives we provide for mobile factors of production such as skilled labour and capital.

A third focus is that we must have a sensible discussion on what we expect governments to provide, and the tax system needed to support these expectations.

Ageing and rising societal expectations are likely to put enormous pressure on budgets over coming decades. At the same time the taxation base is weaker than we had expected.

The specific choices will be determined politically and I do not presume that there is any "right" answer. Yet much of the debate over government provision assumes we can have it all, with people simultaneously believing we can maintain or even reduce taxation levels while keeping the current range of social policy interventions with limited targeting and self-provision – and indeed adding to this with a long list of worthy, but expensive, new proposals.

The key point is that choices need to be explicitly debated. The examples of the US and Europe, where decisions have repeatedly been put off in good times, are not models to emulate.

The fourth area of focus concerns sustainability. The key is to put in place policies that achieve sustainable outcomes at least cost over time, but that can be efficiently adjusted as circumstances change. There has been much debate on climate and water along these lines, but the same issues arise around urban air quality and biodiversity.

Finally, to take advantage of the opportunities arising from technology we will need to ensure our policy settings foster innovation. Government services are a key opportunity for gain – things like developments in e-health, as well as the push for more streamlined and responsive service delivery and improving the quality of provisions and services to regional Australia. But we also need to be alert to inadvertently blocking innovation as technology outstrips our legal structures around media, intellectual property and copyright.

Conclusion

A strong sustained focus on meeting these challenges can ensure our next two decades are as successful as our last two. Bringing the Budget back to surplus is the first step to strengthening our capacity for reform as we prepare for the next wave of challenges.

Everyone would agree these challenges go beyond this Budget, this electoral cycle, this decade. They require sustained attention and a long view of Australia's prospects in the world.

As I've said many times now, we have reasons for optimism, though not for complacency. We have reason to protect and progress our frameworks and institutions – especially when the going gets tough – not to trash them or bypass them in the name of short term expediency.

We need to continue to make good policy decisions and to maintain sound policy frameworks. And to be prepared for both short term shocks and long term shifts if we are to fully grasp the opportunities of the new global economy.

Endnotes

1 1990–91 to 2010–11.

2 For example, the tariff reduction in the early 70s during the global oil price shock; which was started again in 1989 and not slowed during the recession of the early 90s.

3 Such as the floating of the dollar in the 1980s, the progressive strengthening of independent monetary policy targeted at an inflation band through the 1990s, and the strengthening of the fiscal framework in the late 1990s.

4 This combination of policies is more subtle than the textbook dichotomy where structural policy focuses on lifting potential GDP while macroeconomic policy focuses or managing fluctuations around potential GDP. For example, fiscal policy contributes to the supply potential of the economy by enhancing incentives. Monetary policy seeks to keep the economy running as close to potential as possible without stoking inflation. And we can see internationally, and from experience, how large economic disruptions can leave a permanent scar on the output potential of the economy. We also know from experience that low inflation is critical to sustained growth.

5 In contrast, greater transparency around foreign holdings of agricultural land could help dispel the myths and uncertainties around this issue.

> CEDA STATE OF THE NATION

> 19 JUNE 2012

> CANBERRA

Opposition's address: State of the Nation

The Hon. Tony Abbott

Leader of the Opposition

With a Federal election due to be held in 2013, this speech provided the business community with an opportunity to hear the alternative prime minister's views on Australia's economy and policies the Liberal Government will take to the next election, including on the mining and carbon tax, the National Broadband Network and key areas where they will be looking to make cuts.

Thanks very much ladies and gentlemen. It's terrific to be here. It's always good to be at a CEDA conference because CEDA is one of those bodies which does take a deep interest in Australian public policy and the quality of our Government, the quality of our public conservation is immensely enhanced by organisations such as the Committee for the Economic Development of Australia.

These are interesting times. I suppose there is never a dull moment in politics and there is rarely an uninteresting time when it comes to the future of the Australian economy. We are making do as best we can in the Parliament without a Prime Minister this week. I think the G20 have obviously been benefiting from her wisdom over the last 24 hours or so. Let me just make a couple of observations. A government that has delivered the four biggest deficits in Australian history hardly has the credentials to lecture the G20 and the Prime Minister would be better advised to actually deliver a surplus as opposed merely to forecast one before she starts giving lectures to other countries on economic and fiscal rectitude.

Now ladies and gentlemen, the Australian economy is, as we all know, comparatively strong. But it's comparatively strong compared to other countries in rather weak circumstances and I think all of you who have been studying Australia's economic development over the last couple of decades would know that today's comparative strength owes far more to the reforms of previous governments than it does to the spending spree of the current one. And yes, if China continues to grow very strongly, if the United States gets its fiscal house in order, if the Europeans can avoid a deep recession, if all of these things come to pass, well the Australian economy should continue to be reasonably strong. But if they don't come to pass, our position could deteriorate very much quite quickly and that's why it is more important than ever that we should be doing everything we can here in this country to put our economy in the strongest possible condition.

A sensitivity analysis in this year's budget indicates that a 10 per cent deterioration in our terms of trade could reduce our GDP by 2.5 per cent in nominal terms. All other things being equal, that would produce a $17 billion a year deterioration in our budget position. So the Government can't assume that everything is going well. It shouldn't assume that the $1.5 billion surplus is in the bag because essentially everything has to go right, even for the wafer-thin $1.5 billion surplus that they have forecast to be delivered and it is, ladies and gentlemen, a cook the books budget that we've seen. It is based on fiddles, such as the energy security fund which is spending $1 billion this year, $1 billion the year after next, but just $1 million next year – the surplus year. It's based on bring forwards such as $1.1 billion of local government funding for next year that's being paid this year and it's based on moving large amounts of spending off budget that should be on budget, such as the $5.8 billion, mostly in infrastructure spending, that the National Broadband Network (NBN) will be spending in the next financial year.

Then, of course, there are the so-called saves in this year's budget. One of them is $4.5 billion for not proceeding with company tax cuts that never actually happened. This is typical of the saves that the Government has booked in this year's budget. Most of them are not proceeding with programs which the Government has previously announced but never actually delivered. If you actually go through what this Government has done, the bring forwards, the fiddles, and the moves of things off budget and you treated all of them in the way that an honest and straight Government ought to treat them, you wouldn't have a $1.5 billion surplus in this year's budget, you would have something like a $12 billion deficit in this year's budget and even the $1.5 billion surplus based on cooking the books still depends on growth of revenue of 10 per cent this year and 10 per cent next year. Now it may be achieved but if it is achieved, it will be the fastest real revenue growth at least since the 1980s and they are expecting to achieve that in quite difficult international economic circumstances. So this is a surplus that will only be achieved if everything goes right. And as we know from this Government, which has the Midas touch in reverse, most things don't go right for this Government.

So ladies and gentlemen, the challenge is to give Australia the better Government that we need in these difficult times and the Coalition has, as we have been saying, time and time again in recent months, a four-point plan to improve our economy. As you know, as students of public policy, the things that Government has to do are quite straightforward. They are not easy, but they are quite straightforward. And the first thing we need to do is to get Government spending down. At the last election, we announced $50 billion worth of savings. Now it will be tougher to get savings this time than last time because the stimulus programs that we were able to cut last time largely won't be available to us to cut this time. But as you know from your experience in business, a business which can't save five per cent from its expenditure is a business which is not seriously trying to economise.

There are 20,000 more public servants on the Commonwealth payroll now than there were in 2007 and I don't think anyone would say that the quality of the Commonwealth Government has improved that much over the last five years. If you go through some of the expenditure items, there are enormous Government programs that make very little difference to the way people actually live. Just in the last fortnight, we have been told by the Australian National Audit Office that more than $300 million has been spent by the Commonwealth with the states to improve literacy and numeracy rates without making any appreciable difference. We have been told by the COAG reform group that some $600 million has been spent by the Commonwealth with the states to reduce hospital elective surgery waiting times and these have actually got longer, not shorter, despite the spending of $600 million. We are going through the budget line by line, program by program to identify aspects of Commonwealth spending which we do not believe are making an appreciable difference to the lives of the Australian people because economies can and must be made. Government has to live within its means as families and businesses do, and we are determined that under the next Coalition government that is exactly what the Australian Government will do.

We must get taxes down. The mining tax has to go because it is a tax on success. It is a tax on Australia's most successful sector. The carbon tax will go. It will be the first order of business for an incoming Coalition government to get rid of this bad tax based on a lie. Now the Government is desperately putting it about that the carbon tax is here to stay, because no incoming government will be able to get rid of it. Let me remind everyone – there is a simple constitutional principle that no Parliament can bind its successor. What has been done by legislation can and will be undone by legislation and I see Minister Combet saying that regardless of the verdict of the people at the next election, the Labor Party will continue to support a carbon tax. Well, I think it's highly unlikely that a Labor Party which loses an election which is a referendum on the carbon tax would persist in supporting this policy. Rational politicians do not commit suicide twice, but let me assure you that should the democratic mandate of an incoming Coalition government be thwarted in the Senate, we won't hesitate to use the constitutional provisions available to us and go to a double dissolution. This is a toxic tax. It is going to hurt the standards of living of every Australian family. It is going to make almost every job in our country less secure and it is not going to achieve its whole objective of reducing emissions. If you look at the Government's own modelling released on carbon Sunday, notwithstanding a carbon tax at $37 a tonne by 2020, Australia's domestic emissions are not going down, they are actually going up under the carbon tax from 578 million tonnes a year now to 621 million tonnes then.

So, we'll get spending down, we'll get taxes down and we'll get productivity up. Again, not easy but doable. We have promised to reduce the red tape costs of business by at least $1 billion a year and we intend to replicate at the Commonwealth level a program which organisations such as the Business Council of Australia say has been working well in Victoria over the last few years where every government agency and instrumentality is required to quantify the costs of its compliance and regulatory requirements to business and every agency and instrumentality is given a target for reducing those costs and every head of every agency is required to meet that target in order to receive the sorts of bonuses which senior public servants typically enjoy. So we can and we will do it and in this particular area, I think we can and will do a better job than the Howard Government was able to do between 1996 and 2007.

We won't make vast infrastructure spending commitments such as the NBN without published cost-benefit analyses. Government, like business, should not make major spending commitments without the best possible analysis first. None of the current Government's major infrastructure spending commitments from the NBN down have been preceeded by published cost-benefit analyses and we won't spend more than $100 million without such an analysis because we need to make our decisions on the most rational possible basis.

And ladies and gentlemen, there will be workplace relations improvements under the next Coalition government. They'll be careful, they'll be cautious, they'll be responsible. They'll be based on an analysis of problems, not on ideology, but nevertheless, they will be real and the first thing that we'll do in the workplace relations area is fully restore the Australian Building and Construction Commission. I felt very proud of the Australian Building and Construction Commission (ABCC) because as Workplace Relations Minister, I established the Cole Royal Commission that was the forerunner to the ABCC, but the ABCC improved productivity in the commercial construction industry, in the order of $5 billion every single year and we need a restored and renewed the Australian Building and Construction Commission if the rule of law is to apply in this vital sector.

And finally ladies and gentlemen, there will be closer engagement with Asia. We won't close down the live cattle industry. We won't fail to sell uranium to India. We won't drop the ball when it comes to the study of Asian languages. As all of you who are in contact with the resources sector would know, there is a very substantial pipeline of investment, but as the BCA pointed out just a week or so ago, we need to be careful lest the pipeline become a pipedream and so many of these investment proposals are now highly marginal. Resource company CEO after resource company CEO has been telling the Coalition in recent months that at current values of the Australian Dollar, at current commodity prices and at current cost structures here in Australia, committed investment will go ahead, but uncommitted investment will not. We have a window of opportunity and we must be careful lest it closes prematurely, because we have failed to do what we need to do here in this country to make the most of the future that should be ours. There should be an Australian moment as part of the Asian century, but we must seize it before it's gone and that's my fear with the sorts of policies which the current Government has put in place.

Finally let me say to you ladies and gentlemen that in the marrow of our bones, members of the Coalition understand that you cannot have a strong society, you cannot have healthy communities without a strong economy to sustain them and a strong economy absolutely depends upon profitable private businesses. Governments don't create wealth. Governments can hinder wealth creation, they can't create it themselves. Only profitable private businesses in the long run can create the wealth that is needed to sustain a cohesive and strong society such as ours.

So you'll never find from a Coalition government the sorts of attacks on leading business figures that we've seen routinely from this government in recent months. You will never find a Coalition government trying to create a kind of phoney class war in a society such as ours. As Bob Menzies said all those years ago, in this country the class war will always be a false war and in this respect I and my colleagues, we are absolutely the inheritors and the descendants of Bob Menzies and we share his wisdom.

Ladies and gentlemen, this is a great country. I am convinced that our best years are ahead of us. I think that Australia can be a dynamic part of the Asian century but we have got to make the most of our opportunities and I fear that that's actually the last thing we are doing right now.

As all of you know I think that an election can't come soon enough for our country. I don't know when it will be but the sooner it comes, the better because the longer the current government goes, the more damage it's doing.

> INFRASTRUCTURE NSW: RELEASE OF THE 20-YEAR STATE INFRASTRUCTURE STRATEGY

> 3 OCTOBER 2012

> SYDNEY

In conversation with Infrastructure NSW's Chairman and CEO

The Hon. Nick Greiner AC and Paul Broad

Facilitator: Infrastructure Partnerships Australia, Chief Executive, Brendan Lyon

CEDA has run an infrastructure series across multiple states in recent years because meeting infrastructure needs has been identified as being a critical component in addressing Australia's productivity decline.

In contrast to all the other speeches selected for this publication, this speech has a state focus. However, it has been selected because the delivery of the NSW 20 year strategic infrastructure plan will have implications for other states seeking Commonwealth funding for projects.

It also shows the magnitude of spending required for one state alone to deliver on public infrastructure needs.

The following is a transcript of the discussion from this event.

QUESTION: What is the point of Infrastructure NSW (INSW)? What were you set up to do?

Nick Greiner: Well I think anyone who has lived in Sydney or NSW for the last 10 or 15 years wouldn't have to ask that question.

Essentially, this is the creation of Mr O'Farrell (NSW Premier Barry O'Farrell) in opposition and some of his advisors, Max Moore-Wilton who's here, and it's essentially the creation of an independent, evidence-based if you like, body to try and improve the quality, and quality is important, of infrastructure planning and infrastructure delivery.

It's essentially about ensuring, not just that things happen, although that's important, but that the right things happen, and it's creating a framework which is pretty tough on the politicians because now if politicians want to make political decisions about infrastructure, which they normally have done, they'll have to do so at least in the glare of the fact that there is some hard-edged economic advice that may be to the contrary.

The idea is simply that the record in NSW has been awful, both in terms of how we spend the money and how we produce results, and the notion is we are a part, but only a part, an advisory part, of helping the government make better infrastructure decisions.

QUESTION: You used the term evidence base and it's one that is often thrown around in the press as a reason to support or not support particular projects. Paul, perhaps you might tell us a little about the way you approached the construction of the infrastructure strategy and the principles you used to provide the evidence base.

Paul Broad: Look we're unashamedly about the economics. We were probably silly enough or brave enough to build a model of the NSW economy with the help of Access Economics and to test everything we did or propose against that.

And if we couldn't find the benefit-cost ratio, if we couldn't find the economic view, then we didn't recommend it.

What is clearly apparent to us, is that in the previous 10 years in NSW we have doubled the investment in infrastructure and gone backwards; doubled and gone backwards. The relative growth in NSW compared to Victoria and Australia generally, declined. In a relative sense we were slower

What's more interesting is that the movement of people out of NSW to Victoria, which I found intriguing given that when it was announced that Sydney was full and we stopped growing, stopped developing, people moved out.

You normally think of people moving from Victoria to south east Queensland and when you dug in behind all that, you start to see the investment in infrastructure was pretty poorly directed and when you scratch a bit further, the things we were coming up with had no dollars attached to it at all.

The most valuable pieces of road in the nation were the M4 and M5 and they finished at dead ends. The Port (Botany) was going to triple the size of its containers and couldn't get existing ones out. So the focus on the economic arch and the focus on Botany in particular became a key driver of us.

People often forget that the Sydney basin is as big as the mining industry - as big as the mining industry.

You often talk about China slowing and the economics of Australia slowing, to the extent that we are uncompetitive in the Sydney basin, the Australian economy becomes uncompetitive. So driving efficiency here is important not just for NSW but for Australia generally and once we did all that, and we structured the model up in a very rigorous framework, then we processed everything we thought of through that eye.

QUESTION: The centre piece project, certainly in a media perception sense, has been your WestConnex project. It's essentially the M4 and M5 East bundled into a single delivery package. Do you want to tell us about why it is you've selected that as the first among equals?

Paul Broad: A standout by miles and if you don't unclog the arteries, the major arteries of the Sydney basin, then you won't get the growth. The M4 finishing at Parramatta Road, the M5 is a car park now 13 hours a day. The M5 and M4 are key for getting containers out of the Port. There are 100,000 people coming to the airport a day.

What is even more saddening is that there is only one bus route a day to the airport, one bus route today.

And you think about congestion. Trains are a great idea, great track but you can't get on at peak hour. Trains works really well if it was just a dedicated train much like the Heathrow to Paddington in the UK.

So when you start the sort of selection process it became pretty obvious, and Nick and I very early on in the piece, our guess was these would emerge as the largest ones. I suppose the difficult thing is how you pay for it and we are very much in line with WestConnex on using tolls, a combination of different based tolling, access ease and other things to make sure that gets done.

Nick Greiner: Well look, I think it's important that WestConnex not be seen as just a road project or just an engineering project, even though there are lots of people here who like to build things. The truth is it's an urban renewal project and if it's not seen as an urban renewal project from the start then I don't think it will be successful.

It is about, not simply or only the economic things that Paul is describing, it is about changing the face of Sydney; it is about changing Parramatta Road, at least this end of Parramatta Road, but really most of it, into a different view of urban life in Sydney.

So I just wanted to add that it isn't just about building roads and tunnels, it is actually about renewing the urban fabric and I think that's very important.

QUESTION: When I read your report at 11.09 this morning, one of the things that struck me with the central recommendation is in fact it's almost an evidentiary reason why you need Infrastructure NSW. The M4 East had a corridor; it was sold off in the 70s by Neville Wran. We had the construction of the M5 in 1998, the government at the time was offered an extra lane in each direction for an extra $70 million but decided they'd keep the money, now it's in the order of $10 to $15 billion to deliver that corridor, those two corridors. Tell me what you've done around preservation of land corridors, about keeping options open and those sort of over the horizon things, much less sexy in an announceable sense, but critically important in terms of future infrastructure delivery.

Paul Broad: When our plans came out the Transport Master Plan identified lots of corridors and we have replicated that in our report, particularly out west when you're linking up over the divide, over the Blue Mountains, particularly linking up from north to south, around the west. I do think we have a really good corridor down the F6, down towards the Illawarra. That is a very good corridor, we delivered up a very efficient one.

But the Wran decision and the lack of decision on the M5 is a $10 billion mistake.

Nick Greiner: In another bipartisanship comment, can I say, we do say it is important to preserve Badgerys Creek and Badgerys Creek I notice is opposed by both Liberal and Labor parties, state and federal. That's an abomination. You cannot have a city of six million people, which is what it will be, with one functioning airport. It can't conceivably be the case 25 and 30 years out. So in terms of preserving optionality and corridors, the Government, the Federal Government, and it's their decision, it owns all the land at Badgerys Creek, we do think it's important that option be preserved for Greater Western Sydney.

QUESTION: One of the other interested groups that was also downloading the report at about 11.10am this morning was the Transport spokeswomen for the NSW Greens. She decided to step back from her usual balance and slam your report as entirely modally bias and an improper planning document for NSW. Do you want to comment on your modal bias or otherwise?

Nick Greiner: Well let me start by saying someone told me from our staff that the amount of money being spent on the north-west and south-west rail lines at the moment is more than we've spent on the Snowy Mountains Scheme.

You've just got to be real about this. We accept the existing Government's commitment; the Government is building the south-west rail line and is about to start building the north-west rail line.

They are huge investments on any basis, huge investments in heavy passenger rail in Sydney; more than has happened, I think, in any of our lifetimes.

So you can't pretend for a minute that because WestConnex is our priority that there is a lack of balance. We obviously accept and count north-west and south-west rail, which is going to frame Sydney in a new way, and we're about what's in the middle of that.

So look we have no modal bias. We have no political bias. The only bias we really have is an economic one. There will be plenty of people, not just the Greens, with political bias, that's fine, that's the way the system works. But the truth is, yes, we do think far, far, and away the best projects in NSW are about completing the Sydney motorway network in benefit-cost terms. But all we're doing is providing that advice in the context of the Government's existing commitment on other modes of transport. So you've got to look at that in a balanced way.

QUESTION: Price signals won't be enough to get us there, Paul. You can't just put congestion charges on road corridors and build nothing more?

Paul Broad: Well given I'm someone who is very pro-pricing, (I agree) it just won't get us there.

But just a comment on our Greens friends, you've got to be honest to each other, let's not kid ourselves. Ninety-three per cent of the travel movements in Sydney are on a road; ninety-three per cent.

QUESTION: How many public transport journeys are on road?

Paul Broad: Out of 14 million movements in the city, one million are on a bus, one million are on a train and 12 million are in a car.

If you look at how we've funded over the last 10 years, that seven per cent attracted 50 per cent of the capital being spent. So you wonder why our productivity is going south. If you don't invest where the demand is, don't be surprised if you go backwards.

QUESTION: Tell us about the regions...if the Sydney basin is equivalent to the entire New Zealand national economy, if it is equivalent of the entire mining sector, how is it you can prioritise investments outside of the Sydney basin when the need is so great in Newcastle, Sydney and Wollongong?

Paul Broad: Again I think 70 per cent of economic activity in NSW is Sydney based, 30 per cent is regional based.

In the Hunter (Valley)…we have very efficient infrastructure. The delivery from a monopoly rail network, which Nick did a lot of work on in working on a bidding system for access to ports and rail, has driven efficiency immeasurably in the Hunter.

Although I have to say to you, in recent days the Hunter has now been passed as the largest coal port in the world, Indonesia has now gone past it.

So in the Hunter, it looms large in our thinking. The Illawarra, and connecting the Illawarra to Sydney, the Illawarra is probably lagging behind the Hunter, just in terms of activity to be honest, and parts of the west, as Roger has been pointing out, a lot of economics, a lot of stats coming out the west, show in fact a very dry period.

That change and as demand for food grows globally, the competitiveness of the west will be aided enormously by efficiently connecting to port.

Nick Greiner: Just to add we recommend a program called Bridges for Bush, that sounds pretty boring but it's actually got very, very high value because obviously you've got roads where you can take trucks along except you can't get those over various bridges because the trucks are too heavy in simple terms.

So a program like *Bridges for Bush*, has tremendous capacity to open up transport opportunities for regional NSW, to reduce cost; improve productivity. So programs like that, which aren't essentially sexy, certainly not politically sexy, are, I think, tremendously important and again, given our view and what we've been set up to do, it's those sorts of projects that... we recommend because they simply come up very, very high in terms of the benefit – the bang for your buck.

And given the scarcity of public finance, doing bang for your buck projects, whether it's collections of pinch points in the city or improving bridges in the bush, it's just an obviously sensible thing to do if you want to reverse the economic performance of NSW that Paul mentioned.

QUESTION: One of the things, if you haven't been reading the newspaper over the last 11 and a half months, then you would have picked up this current that's running through the media about there are substantial differences between the views of Infrastructure NSW and the views of, particularly the transport agencies but the rest of government as well. But when you look through the document released today, 99 per cent of the priorities are common and there really are only a few longer term projects where you depart. Do you want to comment on where those departures sit, what the relationships of government are like, and what we can expect over the next few months?

Paul Broad: Debate around this part of the world is not for the faint hearted and I think Nick and I enjoy that enormously, probably too much at times.

The Government set us up and it's always going to create difficulties. We are supposed to take the politics out of infrastructure and we have. We are supposed to speak frankly across the bureaucracies and the silos that existed, and we have.

We are supposed to breakdown their priorities. When you look at someone and their spending dollars, when the priorities for our projects are so high and there is not one dollar attached to it, it makes you wonder how they have made the decisions for the last 10 years.

So yes, it will create controversy. Yes, it will be difficult but I think the Premier was incredibly brave establishing us. I suspect at times he might have wondered why, but I think the facts are that the Government has done it, they appreciate what we say, we get the chance to brief the Premier directly - and that's a strength not a weakness - and the fact there is robust debate shouldn't be something that anyone feels is a negative.

Nick Greiner: Perhaps I could add on - not to duck the specifics of the question - where are the areas where we differ? Well, firstly where do we agree? I mean, WestConnex is in fact a joint project of Transport RMS and Infrastructure NSW. I think the points of difference; we are worried about the city, CBD. We are very, very worried about the constipation gridlock, call it what you like, of the city.

We are scared that, and we have good relations with the City Council, we don't think putting a tram down George Street is a priority as a public transport exercise. We're perfectly on board, not that it's our problem, for pedestrianising George Street, as a goal it is a nice, good amenity thing to do. But we disagree fundamentally, with Transport and I think with the City, the notion that a light rail that runs down a city street is a mass-transit option…that runs very real risks.

So our view is you've got to sort out the city first. We think light rail is something that comes at the end if you like. The other people seem to think it comes at the beginning; the Government will have to decide.

We have a different suggestion in terms of underground buses. Rather than people getting out of buses at the edges of the city, we think you can take them underground and through the city and there is reasonable argument on both sides about that.

I think the only other thing which gets media publicity that is more apparent than real, is the second Harbour crossing for rail capacity.

Our view is that you have to improve the productivity of what you've got first. We are very, very poor by world standards, in fact atrocious, in the productivity - the number of people we move by rail across the Harbour Bridge every morning.

We think you should do what the Minister (for Transport, Gladys Berejiklian) is doing, which is improve the operations of what was RailCorp and is now called CityRail, I think. You've got to start with using what you've got first.

It is our view that a $10-15 billion second harbour crossing is something that should:

a) Be deferred if possible: and

b) Be avoided if possible.

It has very low benefit-cost ratios and if it's to happen, it needs to happen in a broad context and, perfectly obviously given the financial position of the State and the nation, spending $10-15 billion, it will be $15 billion by the time it's built - if it's ever built - is something you should be very careful about doing.

So I think apart from that, which is a very long term issue, and the city itself and light rail in the city which is a current issue, I don't think there are too many fundamental strategic differences. And I think we both agree Transport (NSW) and INSW that getting the operations of the railways right, and indeed the operations of the buses right to a degree, is important and isn't independent of capital.

Obviously if you run things better you don't need to run to build things as quickly. The NSW bureaucracy tends to say "there is a problem, let us build something to fix it". And the truth is there just ain't no money and a lot of the returns on these projects are extraordinarily low anyway.

So, there are some differences in culture and attitude about those, but to come back to a positive note, the media overblow these things. It would be amazing if we agreed on everything. But what would be the point of our existence?

The notion is: We are capable as a government and a society of having reasonable public debate, not only about what ought to be built but about how you run what you've got, and how you pay for things you want to build.

And the fact that we've avoided some of those debates in the last 10 or 20 years is part of the reason we're in the mess we're in.

QUESTION: Just before we get a little deeper into how you pay for these things, I was a little bit surprised when I saw such a detailed section on the future of water security and supply, which I thought was an excellent part of your strategy. Do you want to talk to us a little bit about the Hawkesbury and Nepean scheme that you've outlined, the water security schemes that you've outlined?

Paul Broad: I think anyone that has been living in the Sydney basin for any length of time would understand the risks that we take in the Hawkesbury Nepean system for flooding.

Hawkesbury Nepean is quite unique. It's a massive catchment going further south than Goulburn and the Blue Mountains, all funnelling down to a very narrow outlet at Sackville.

The potential for flooding in Western Sydney is enormous. The impacts economically are astronomical. The cost-benefit ratio to do something is probably the highest cost-benefit ratio we've found in the report, let alone the threat to life and destruction of property that would occur.

The enormity of that flood is something that should not be dismissed easily and I think Nick made the point this morning that it's something where governments have probably ducked that issue for a long time. We put it very much as one of the key recommendations in our report.

Obviously, the question is how you go about it.

Do you put mitigation into Warragamba (Dam)? How do you go about what will become a crucial decision in the near future.

Nick Greiner: And just to add, given what happened in Brisbane in a, I don't know, one in a thousand year basis last year, early last year, the notion that a government in NSW would not take seriously an assessment of the risks of the Warragamba Dam and that part of the Sydney basin, is sort of bizarre.

And that is essentially what governments have to do is worry about their citizens. So the potential, while it is a small risk, it's obviously a small risk, but the potential cost and damage in both economic and social terms, not just for Sydney but for Australia, of a Sydney version of what happened in Brisbane last year, is just monumental.

So you know, we've said, and yes governments starting with mine and probably before mine have sort of duck shoved this issue, so that's a quarter of a century.

I guess that's the advantage of having non-political, independent people to say, well, on any rational basis one should be open and have a sensible risk mitigation process around these issues. It's politically probably a bit difficult but the notion of not thinking about it openly seems to me to be unacceptable.

QUESTION: One of the constant reframes that we've heard from the business sector, from the community and from others has been the need for long term planning, but in fact there has been no shortage of long term planning in NSW. What we've had a shortage of is long lived plans that have come out of government. What is it about INSW strategy and ultimately the Cabinet response that's going to stop this from being just another plan?

Paul Broad: Look we built this around looking through political cycles. I think a good example was in Victoria when they started their reform agenda in the Kennett era through to the Bracks era, all through the political cycle and they got enormous benefits out of it in the year 2000-2003 and on.

The train system in Victoria, they operated a train network, about 80 per cent of NSW, with one third the staff. They have capacity increases per year of five per cent in Victoria. We have one per cent here.

So the growth is inefficient and we don't attract many customers.

On the road network, they built them, put tolling on, distance-based tolling, an efficient tolling mechanism. That led to an increase in productivity.

So if you look out at this 2002 to 2003 era through to now, Victoria grew significantly higher obviously reaping the benefits from early reforms done in the Bracks-Kennett era.

And I think we're the same. I think once we start on WestConnex, we get bipartisan support hopefully - the drivers to do so will be powerful, provided we put the private sector at the heart of it - delivering it, and the expectations, will see us through the political cycles.

QUESTION: Everybody says that funding is a constraint; I know there are a few people from Treasury who are here to keep a careful eye on both of you, but funding is a challenge. I've never really understood the magic of funding the capital program, I mean when I want to buy something at home I try and earn more, I try and spend less and I sell excess things that I've got, to fund it. What is it that you do within your funding section, how can we implement it, how can we start to see some of these projects get off the shelf, most of which have been there, certainly signature projects, have been sitting in the street directory since 1951?

Nick Greiner: Indeed 1947 the year I was born most of the projects were in the directory.

I recommend if you're sleepless tonight you read chapter 16 of our report. It is actually very good, it tries to explain in simple terms, a bit like Brendan's question, what the options are for funding.

And this is not the occasion for talking about public finances in a great way, but everyone understands that there will be no serious surpluses run by any Australian Government in the next five-seven years.

The normal way of funding things is you make a profit, if you like, and you reinvest. Well it's not going to happen. Not going to happen in any big degree.

Second thing you can do is borrow money if people will lend you money. Clearly NSW has got an appropriate commitment to the Triple A. It means that the amount of borrowing capacity available is very, very little.

So the traditional ways, if you like – debt and equity – is really not available. So you've either got to reprioritise, that's important. Most of the public sector in NSW doesn't believe you can reprioritise. They ought to change their mind.

Secondly, you can of course recycle assets and the Government has started that and set up the *Restart NSW Fund* which *Infrastructure NSW* is involved with. Where the net proceeds, if you like go, we make recommendations and work with Treasury as to how that money is used. So you can do that and you can have user charges and that's about it.

The only people who can pay for infrastructure are users or taxpayers. It's not private sector paying. They might put the money up front but someone has to pay. And this is not a secret to anyone by now, it's all of you; it's all of us, all the people. It's taxpayers, it's users, it's residents.

So there is a very serious financial problem for the State in both an operating and a capital sense. And what we are saying, and we've tried with WestConnex to have a real life example of it, we're saying roughly, that if it's $10 billion, and this is early in its planning, if it's $10 billion we think you can get somewhere north of $2 billion from Federal and State Governments together, and that the remaining 7 or 8 (billion dollars) in that example comes from user charges which is not a fancy word for tolls - it is tolls; it is people who drive along the thing paying for it.

And there is no other option other than not having the project. So we think that debate is progressing, we are on the same page as *Infrastructure Australia*, I think federal and state treasuries are on the same page. There is no magic solution, or silver bullet in this; it is a combination.

Yes, there will be some state funding. There will be a large amounts of user pays and yes, asset recycling does have a role to play and it's perfectly obvious - the more assets you sell for a greater net return to the government balance sheet, the more you will be able to accelerate projects whether they are the ones we recommend or other ones.

So I think it is really time we were fair dinkum about this. No easy solutions. If you want more infrastructure:

a) You should make better use of what you've got; and

b) You've got to use the available levers you've got, and in the next five years they're basically asset recycling and user charges.

QUESTION: Paul, with your economic hat on, do we need a AAA credit rating? Do we drop it to AA credit rating? Or is that like solving drink driving by doubling the legal limit?

Paul Broad: I think it is the best instrument the Treasurer has to control spending in public service. I think Nick put it in actually and it's been a great instrument to apply.

I'll just make one other comment, if you don't invest and you don't get the productivity, the cake doesn't grow, you can't sustain it. The implications as Nick was saying – if you don't have fares to pay, then the other side of the argument is that, of course the other thing, to go with social things attached to what you want in a modern society, just don't happen. Full stop.

QUESTION: Nick, Paul where is the plan weak? Where would you have liked to have done more? You had a legislative homework due date, the dog couldn't eat it, you had to deliver it. Where would you have liked to put more effort or work and where will you be focussing as you move forward?

Nick Greiner: I don't know the answer to the second part because I think with the (NSW) Government, we have to decide what this organisation really does, and I think it's fair to say Paul and I are not totally clear as to the path forward.

But on the weaknesses thing, you've got to remember what we do, and this is not a cop out of the question, we're prioritising projects that others create. We don't create the Nick Greiner memorial rocket ship to the moon. We take projects that are suggested and we assess them and prioritise them – that's what we're asked to do.

The area where the plan is weakest, and it's weakest because the ideas are weakest, I think is Western Sydney. I mean the truth is the plan is strong about the area this side of Parramatta and it's weak about the area that side of Parramatta.

The truth is out there. Lots of councils try hard and have good ideas that are council based, Parramatta in particular. But clearly, you know it's why a second airport in 30 years' time makes sense. You're going to have another city effectively Parramatta, Greater Western Sydney, but clearly there are not enough good ideas, especially in the north-south direction, in my view, between Parramatta and Penrith, where the great bulk of the additional people in Sydney over the next 20 to 30 years are going to live.

So yeah if you want a concession I think that's where more work is needed as to what happens in that part of Sydney.

Paul Broad: I think I'll say a bit on the pricing. I think I should have gone harder on pricing.

And secondly, I think on the technology argument we had a huge debate internally about what is the world going to look like in 20 years and I'm very pro this idea under cloud based computing, the life we live will challenge the notion that we've all got to come to work in that one hour in the morning and go home within that one hour at night.

And it's certainly a key part in the private sector, they're embracing it far, far quicker than the public sector is; the notion that you come to work when you click on, not when you walk in the door.

QUESTION: In 20 years, 25 years' time, you'll both still be alive. What do you want to turn around and say your legacy has been?

Nick Greiner: I would hope that if people looked back from the advantage of 20 years out, they will think that the report today was genuinely independent, that it was balanced, that is was coherent, it came together and it worked together with other levels of government, that it was practical, in other words, it could actually happen and most of all, that people will say it was a small step towards an improvement in the quality of infrastructure provision in NSW.

At the end of the day, all this is, is a piece advice. It's a step; it's not the end of the process, although it is for a lot of people who work for Paul, it is rather the beginning of a process where hopefully good things will happen in terms of infrastructure for NSW. So I think that's the test 10 years and 20 years out, it's what's happened. Not so much, how much has happened but what is the quality of what has actually been delivered?

Paul Broad: I think we are part of South East Asia. I think in 20 years' time to be the leading city which drives the State, in South East Asia. We are a financial services based economy. Seventy two per cent of our employment comes from it, so being the leading institution in South East Asia, the leading place to live and invest and grow your business in the service sector would be my hope.

Q and A with audience

Q. **Where does industry change or adapt to work more effectively with government in the delivery of this strategy?**

A. **Paul Broad:** Well in my view the private sector is built to take risks. And to share risk differently, to be a much more proactive discussion between government and the private sector more so than in the past, where I think the Government sector has tended to say: "You take all the risk and run away".

The risk sharing model needs to be challenged. That doesn't mean, you know, governments take all the risk, it's this notion somehow builders are going to come and you can sit back, this is not going to occur.

But I do think the private sector has got to see itself more at the heart of the initial planning, of the thinking stage of infrastructure. I think there's too much of a sit back and hands off approach, and we've certainly found that in the preparation of Docklands.

We've had a very small group of people internally engage the private sectors extensively to come up with what we've come up with.

I think we do have the pleasure of Peter Regan (from NSW Treasury) here and a few others, who are far more proactive about how the models might work in the relationship, and I think you'll see a far more constructive relationship going forward than you might have seen in the past.

And the final thing, I think we've been hampered in the past by projects that started and went nowhere and that hurts everybody. It's certainly about projects getting on and delivering – it will be key.

A. **Nick Greiner:** Could I just add NSW has unreasonably high costs in procuring infrastructure. That means that Leighton, Lend Lease and all the other major players are, at the end of the day, costing too much.

That's not their fault, or not primarily their fault - they respond to what the procurement process is. If you have a built edge procurement process, if you have crazy contingency planning, we have got absolutely nonsense contingency planning processes, and I know it sounds a bit boring at lunch, but if you add to what the Government departments do, 50, 60, 70 per cent of contingency, it's all a fudge. It's all about trying to manage money and keep money away from Treasury.

So I think the private sector would do itself a favour by not sitting back and saying: "If they want the world's deepest tunnel somewhere that's great we'll build it, we like projects". If they actually contributed to the process of improving the procurement, reducing costs without reducing in any significant way the value of what is being produced, I think that isn't just a government exercise, a sort of, we're the buyer and they're the supplier. I think there needs to be broad infrastructure engineering, and a lot of engineering industry, Warren Centre (for

Advanced Engineering) and various other organisations are doing good work on that, and I think it is a communal responsibility to see that we can be better, not just planners, but procurers of infrastructure.

I think the private sector has got a very real role to play in that, as they operate around the world. But the truth is NSW is about the worst in Australia in terms of cost and it's by no means anywhere near world standards obviously.

So I think there is a real challenge for the private sector. It's fine to say the Government ought to have a pipeline and the Government ought to do all these, involve contractors early - all good stuff, paying some big costs is appropriate in some circumstances is fine but it's a two-way street.

It's a two-way street and the private sector needs to contribute to the quality of the process.

Q. **The big question is, is there enough funding for public transport compared to roads?**

A. **Paul Broad:** Well I think public transport does extremely well.

As I said before at the start, 93 per cent of trips are on roads, seven per cent are on trains. If you look at the expenditure over the last 20 years, 50 per cent of capital expenditure for transport has been on the seven per cent.

The Government has already committed the largest investment of all time in the north-west rail $8 billion, they have already committed to south-west rail, if you add all that up, I think the investments in rail infrastructure are gigantic.

What we are under invested in is buses, bearing in mind just as many people travel on a bus as they do on a train. The poor relation in public transport is buses.

We are very pro bus; we think they are a good idea. Not just the people like me, who rides down Oxford Street on them, but the buses are under invested in and that's why they're a big focus in what we do.

Public trains...we move 20,000 people per line. At best we'll do 40,000. We're that inefficient.

So what we're saying is don't go spending on big projects on rail, you've got them in place, get what you've got to work extremely well. Why can't we get the train between Gosford and Central half an hour quicker? The trains can do 100 kilometres an hour. They run at 48 kilometres an hour, for heaven's sake.

There was a train that ran the other day between Newcastle and Central. It came down in two hours and seven minutes, one stop at Gosford. That is 40 minutes quicker. The reason it was able to do so was because it took the speed limiter off on the long straight. It ran at 120 kilometres per hour. The train can do 140 kilometres.

Our mind set in how we run public transport has to change first.

We have to ensure that public transport is there for the customers it serves. It's clean, you're on time and it's rapid. You can get to work far better than what you are and I'm really pleased to see the NSW Minister for Transport, Gladys Berejiklian really taking that challenge up.

It's a big ask we've all got to back her. We've got to work hard. The ride will get very rough. Very shortly those in control of state rail will start to ark up and push back.

Fundamentally, state rail will be a key part of having real infrastructure much like they did in Victoria all those years ago. It's a reason why Victoria has grown at five per cent and we're growing at one per cent.

A. **Nick Greiner:** Can I just underscore that. I said at the press conference the most important reform in NSW is none of the stuff we're on about. None of the stuff you've seen on the video.

It is the reform that NSW Minister (for Transport, Gladys) Berejiklian has foreshadowed for rail. And it's about the operation, it's about the productivity. If you get that right, as Paul says, it's a big challenge, it's far and away the most important thing to do.

You can subsequently worry about further capital investment. You may need some capital investment in terms of signalling and systems and that sort of thing. And then you can further worry about, new tunnels, new bridges and new whatever.

But that is the absolutely crucial investment reform for NSW, the reform of rail operation and it is very important that the community and the business community get behind the Minister and the Government on that. You can't overstate how important it is. You really only get one chance at these things every 30, 40, 50 years and it's well overdue in NSW.

Q. **Procurement is one thing but the first thing is to get planning approval, and I was wondering if you've actually pondered the feasibility of getting planning approval within a reasonable timeframe within the current legislative framework.**

A. **Nick Greiner:** Yeah look we've had a very good experience with Minister (for Planning and Infrastructure and Minister Assisting the Premier on Infrastructure NSW, Brad) Hazzard and Director General (of NSW Department of Planning, Sam) Haddad. That applies to a project which isn't part of today, the Convention Exhibition Entertainment Centre. Your Question, of course, is right about what has been the traditional planning risk, and why would anyone in the private sector bother?

I think the Government is heading absolutely in the right direction, that shouldn't sound like we are too positive about the Government but they're actually doing a really good job in a directional sense on planning.

As I think someone said the other day, planning for the north-west rail has essentially the big picture planning approval and you're right, none of this will happen if the Government does not cut through the traditional approaches, the traditional multi-stage approaches, to planning approval.

And this may come back to bite me, but I have some confidence in the reforms of planning in NSW and I think you'll find, and the private sector will find, that traditional planning risk in NSW will be much reduced in the future.

If it's not, a lot of the stuff, not only will it be delayed, it won't happen at all.

Q. **When you were talking about the funding issues, I was surprised you didn't also mention some facts which relate to the position of the Commonwealth Authority. They borrowed 80 basis points more cheaply than an AAA state, 130 basis points more than an AA state. Their net debt to GDP ratio was 10 per cent which compares with around 100 per cent for most other developed economies. And their direct responsibilities for infrastructure are probably 10 per cent of the nation. Why didn't you mention or advocate a more prominent role for the Commonwealth Authority with regard to the funding issues?**

Chair Brendan Lyon Chief Executive, Infrastructure Partnerships Australia: And of course he leaves out the fact that the Commonwealth has about $140 billion in head room in its budget.

A. **Nick Greiner:** The reason is that we're occasionally accused of going outside our remit and I think that would be going outside our remit.

I actually agree with you and I've had discussions with federal opposition shadow ministers and the Shadow Treasurer about using effectively the Commonwealth borrowing strength. There are various ideas around as to how you can use the Commonwealth's greater capacity and lower pricing to help fund infrastructure, even though the states deliver it.

So I agree with what you say, but it really has to be driven by the Commonwealth and I think there is some movement at the station. But unfortunately at the moment, the nature of the Federal political debate makes ideas like that get lost in the debates about how are we going to produce a $1 billion surplus and the Budget and that sort of nonsense.

So it is a very real asset that Australia hasn't properly utilised in terms of getting the cost of funding down.

Q. I was wondering there has been a lot of talk appropriately about new infrastructure that Sydney needs and NSW needs. But we also have an existing sock of infrastructure some of which is probably capable of being used more intensively. Is this something your report looked at and if so did you consider ways that the Government can encourage or facilitate some more intensive use of existing infrastructure, for instance by the intense use of land in key urban areas?

A. **Paul Broad:** You're absolutely spot on. That is the corner stone of exactly what we're saying, that is leverage that you've got.

In the private sector we all understand that. You make money by the first lot losing their shares and the second lot buying it cheap and leveraging it.

In the Government you don't get that argument. For example our rail, physical rail system track are fantastic, second to none. And we could leverage the hilt out of that, to extract value.

Secondly Nick was making the point very strongly that the roads systems are about urban renewal, changing the nature of how we are going to live.

And you'll notice in our report we talk a lot about down the south-east. We have lots of infrastructure and the most beautiful part of the world, down the back end of Malabar, South Randwick, heading down towards La Perouse.

We think that's a fabulous part of our city which has gone under the radar for far too long.

We think connecting up the lifestyle, from one end of the spectrum, an ageing population, to the fastest growing households, single person households, and 85 per cent of new houses will still be infill rather than refill, and I think that's probably going to go to 90 per cent.

So the concept of regenerating what we've got, leveraging off, you know, we've got more water, waste water, infrastructure, roads, existing rail, light rail, trams, trains and buses...we can leverage them; there is no doubt about that.

That's what we talk a lot about.

The change that we can embrace so the generation that come afterwards, will live the lifestyle we should have got if we got it right 20 years ago.

> ENERGY WHITE PAPER LAUNCH

> 8 NOVEMBER 2012

> MELBOURNE

Australia’s energy transformation

The Hon. Martin Ferguson AM MP

Minister for Resources, Energy and Tourism

Energy generation, prices and reform has been key public policy issues across Australia in recent years. This speech marked the release of the Federal Government's much anticipated Energy White Paper, a document that preceded by one week the release of CEDA's final energy research publication.

Australia is going to need to fundamentally transform its energy sector for the future and the Energy White Paper, and the Minister's speech, provides the roadmap and sets the agenda for all in the energy sector.

Introduction

Ladies and gentleman thank you for your attendance.

Today is a very important day for my department and I express my appreciation to Drew and the team and my office. The huge amount of work that has actually got us to the opportunity to launch what is an exceptionally important paper for Australia and for the region in which we live—the Energy White Paper.

It has been almost a year since I launched the draft Energy White Paper on behalf of CEDA here in Melbourne.

This follows an extensive process of public consultation, including public forums in every capital city and consideration of almost 300 written submissions.

I would like to thank all of those individuals, businesses, organisations and government agencies who contributed to this thoughtful process. You have helped create an invaluable policy framework for developing and transforming our energy sector and its resources for the next decade and beyond.

Building on this feedback, I am very pleased to present to you today and to the Australian community the 2012 Energy White Paper.

Australia and energy

Energy provides an essential service to our people and underpins the economic competitiveness of our economy.

We should never forget that Australia is an energy rich economy.

Australia draws on an enviable natural endowment of fossil fuels, uranium and renewable energy resources that have underpinned our wealth for generations.

Additionally, nearly two decades of cooperative reform have built a world-class energy sector that is the envy of, and model for many other nations.

The Energy White Paper builds on these strengths that have been achieved in a cooperative way across political parties over many decades.

It provides a roadmap for how we can further transform our energy sector to improve the prosperity of all Australians.

The Energy White Paper seeks to do this by clearly outlining the Australian Government's principles and objectives for developing Australia's energy future.

Central to this is a continued commitment to the Labor Government's traditions since Hawke and Keating – to open and transparent markets.

Markets that allow competitive pricing, efficient resource allocation and innovation.

This is what will drive Australia's economic and income growth, while ensuring we protect those most vulnerable in our society.

Australia's energy transformation

The title of the Energy White Paper is Australia's Energy Transformation. The change our energy and energy resource sectors are embarking on is profound.

Domestically, we are facing pressure to move to cleaner fuel sources and at the same time the cost of delivering this energy is increasing.

For our energy resource sector, the pipeline of investment is huge but again keeping the costs down remains a continuing challenge to each and every one of us.

There are three key pressures driving this:

1. The growth of our population, economy and wealth;

2. The growth of our energy exports, particularly to key Asian markets; and

3. The need to dramatically reduce our carbon emissions to create a clean energy economy.

Ongoing changes in international markets are also playing a role.

This includes long-lasting shifts in trade balances, the emergence of new energy sources and technologies and the effects of sustained turmoil in key economies.

These forces are further increasing Australia's integration into international energy markets.

That is why the Asian Century White Paper is so important to ensure Australia is well positioned to capture these new opportunities emerging out of Asia.

Opportunities we are already seeing in our resources sector, with unprecedented flows of investment in our coal and gas sectors to meet growing demand.

The dramatic changes in our energy sector can be quantified by comparing the situation today with 2004, when the last Energy White Paper was released by the prime minister (John) Howard.

Since that time, trade in our liquefied natural gas has increased almost fourfold to more than $12 billion per annum. The value of our annual thermal coal exports has tripled to about $17 billion. Wind and solar energy generation capacity has multiplied tenfold. And we are now sourcing close to 20 per cent of our domestic gas from coal seam gas; up to 90 per cent in the South Eastern division of Queensland.

Ladies and gentleman the pace of change confronting the energy sector is further evidenced in a number of key updates to the final Energy White Paper since the draft was released.

These include:

- Downward revisions of forecasts in average electricity demand;
- Changes in expectations across various electricity generation technology costs;

- Updates of our known gas resources and gas market outlook; and
- The decline in our domestic refining capacity.

We must get our energy policy settings right, if we are to manage these dynamics effectively.

Positive outcomes can only be assured through policy frameworks that shape effective market outcomes, manage uncertainty and attract investment in energy resources and infrastructure.

These are the clear goals of the Energy White Paper.

Thankfully, Australia has many competitive advantages that provide a head start in this respect.

We have a huge natural resource endowment.

We have one of the most competitive electricity markets in the world.

We have, and we are all proud of this, a well-educated and skilled workforce.

We have well established links to international markets, particularly on the door-step of Asia and a competitive energy export industry.

For those reasons, in my five years as Minister for Resources and Energy, I have sort to develop with industry and the broad Australian community a clearer vision of how we can build on these strengths and create an even more positive energy future and a stronger and more prosperous Australian community.

Vision for Australia's energy future

This vision has four essential elements.

Firstly, developing a truly national approach to our energy markets.

Markets underpinned by consistent regulation across the country that create a level playing field that stimulates competition, innovation and consumer choice.

Markets that are an attractive place to invest and maintain a reliable and affordable supply of electricity to all consumers.

Secondly, an Australia that is the number one investment destination for resource development.

Where production costs are highly competitive, approval processes are best practice, fast and efficient and where our labour force is internationally regarded for its expertise and innovation.

Thirdly, developing Australia's natural gas reserves to become one of the world's largest LNG exporters, while effectively and appropriately servicing the domestic market.

This growth in gas would increase Australia's pipeline infrastructure and gas trading hubs to service a mature and transparent domestic gas market.

And lastly, an Australia that transitions to cleaner forms of energy over time in a way that does not impede our economic competitiveness either domestically or internationally.

In a way that is driven by the market, so as not to lock in Australia to higher cost technologies than would otherwise be the case.

And where we nurture Australian research and development and foster innovation with the private sector and I might say our leading edge research institutions.

At the heart of this vision and the policy framework set out in the Energy White Paper is a commitment to competitive and well-regulated markets that operate in the long term interests of consumers, users and the entire nation.

Realising the vision

How do you go about realising this vision?

Firstly, we realise the potential of our energy future depends on how well governments, businesses and consumers respond to the significant challenges we face.

The role of this Energy White Paper is not about spending measures in response to the immediate political debate, too often the approach to major policy announcements internationally and domestically.

Rather, it is a long term, strategic policy document that articulates the Australian Government position on the full gamut of energy policy issues.

It provides assurance that we are heading in the right direction in helping to transform our energy sector, while refocusing our attention on key areas.

We set out four priority areas that require action in this respect:

- Delivering better energy market outcomes for consumers;
- Accelerating our clean energy transformation;
- Developing our critical energy resources, particularly natural gas; and
- Strengthening the resilience of our energy policy framework.

Addressing the key challenges

Let's go to each of these challenges.

The Energy White Paper highlights a number of challenges but today I want to focus on six I think are most significant.

They include:

- Minimising energy price pressures and growth in peak demand;
- Tightening in our east coast gas market;
- Ensuring our liquid fuel security;
- Transitioning to clean energy;
- Retaining our competitive energy resource development; and
- Informing a constructive, non-political energy debate.

Energy prices and peak demand

Let's go to the first of these challenges.

I think we can all agree on the prominence of rising prices within the current energy debate.

Australia's strong dollar has to some extent sheltered us as a community from petrol and diesel prices from rising global oil prices.

But the same can't be said for electricity, which has seen average retail price rises of about 40 per cent nationally over the past four years and well above 50 per cent in some states.

We all accept that this is hurting households and businesses and it is simply not sustainable.

But unfortunately we must also accept there is no quick fix or easy solutions to this issue.

High prices result from a range of complex factors, many of which lie outside the control of any single government or regulator.

They include higher production costs and the need to replace or upgrade ageing infrastructure which tends to come in investment cycles.

Just like the one we have experienced in networks – said to have peaked this year.

Electricity costs have also been driven up by the fact that the rising demands of our small, and geographically dispersed consumer base must be served by a large and growing network.

The need to meet high reliability standards in the face of projected continued growth in peak demand complicates matters.

Energy policy is after all a seesaw between cost and reliability.

And as Energy Minister I recognise the high value that consumers place on a reliable electricity supply, and I do not underestimate the immediate and devastating impacts from loss of supply.

Recent incidents such as the dislocation in New York and the electrical storm in South Australia remind us of the value of reliability.

It must also be acknowledged that the transition to a clean energy economy, including the carbon price, adds marginally to costs.

But in the Labor Government tradition, generous compensation and adjustment measures are in place to ease the impacts of this on the most vulnerable in the community.

I believe it is time to minimise future pressures by ensuring markets, regulatory frameworks and their institutions operate in the long term interests of consumers.

The good news is that sound policy can make a difference.

Governments at all levels must embrace key reforms to improve regulatory efficiency and stimulate market competition and innovation.

And many of the key reforms that may ease future electricity price pressures are already well underway, such as improvements to network rules and a review of the appeals mechanism.

But there are many reforms needed to drive greater efficiency in our energy system.

Another is renewing our focus on how consumers manage their personal demand for energy.

Pricing structures are resulting in inefficient peak demand. This means that additional capacity is required to be built that might only be used for one per cent of the year at all the associated costs to the broader community.

Current market arrangements are distributing the costs of this across the entire consumer base.

The Productivity Commission estimates consumers who don't use the additional capacity are subsidising others by as much as $330 per year.

This is clearly in my opinion an unfair cost, particularly on those less able to afford it.

Rectifying the situation requires an integrated approach: consumers must be given the right signals, through flexible time-of-use pricing to make decisions about their energy use.

(If) we are to provide consumers with more choice then we also need to promote better information through tools, like smart meters, to assist consumer decisions.

There also must be strong consumer protections.

The Energy White Paper in this regard contains an ambitious reform agenda targeting these issues.

This includes strengthening market institutions and governance—we need to ensure the Australian Energy Regulator has the resources to do the job expected of it and required of it.

It also involves improving network efficiencies and providing for a strong consumer voice in market outcomes.

If I could highlight one area of critical reform needed to improve competition and deliver innovative solutions to consumers it would be retail price deregulation.

The key to delivering on this reform agenda – and locking in the benefits to consumers – will depend on the agreement that can be reached by the Standing Council on Energy and Resources and then COAG in December of this year.

Victoria in many respects has led the way.

The willingness of other state governments to take on these hard reforms is essential.

It will take political courage where others have failed.

But the Australian Government will continue to strongly advocate for, and where appropriate, lead the reform process.

I say short term fixes, such as intervening to hold down prices for temporary relief might be tempting, but it is not in the long term interests of consumers.

It inevitably lowers investment, competition and standards of services.

Most critically, as we have recently seen in Western Australia, it creates a larger shock to consumers when the price inevitably catches up with the real cost because of such decisions.

Gas market pressures

Let's next go to a very topical issue, gas market pressures.

This second major challenge.

This has resulted from increasing overseas demand for Australian gas.

The Government acknowledges that there will be tightness in the east-coast gas market as new coal seam gas and LNG projects ramp up to full production.

While Geoscience Australia and the Bureau of Resources and Energy Economics analysis indicates we have sufficient gas to meet projected export and domestic needs until at least 2035 – this is not a call for complacency.

Transitional pressures on the east coast are emerging, creating price pressures and tightening supply conditions.

Once again, it is the Government's view that this is best achieved by open and efficient markets, where price is allowed to balance the market and provide incentives for developing new supply.

Interventions such as reservation policies to force price or supply outcomes are more likely to impede than promote supply.

Let's not forget that the boom in American domestic shale gas was preceded by high prices that drove significant new investment.

The current low Henry Hub prices is in part a reflection of the supply that high prices brought on.

In terms of adding to domestic supply, the Energy White Paper sets out a cooperative agenda.

The Government is committed to working through Standing Council on Energy and Resources (SCER) to improve gas market development, transparency and trading opportunities.

The National Harmonised Framework for Coal Seam Gas is an example of this.

All jurisdictions must work to remove impediments to the timely development of domestic gas supply.

The consequences of avoiding these hard decisions will be far greater.

It is also incumbent on the gas industry itself to maintain a balanced supply for both the domestic and export markets. It is a collective responsibility not a government responsibility alone.

Liquid fuel security

Let's go to an emerging issue of fuel supply.

The third challenge being our requirement to ensure our future fuel needs continue to be met.

Our refining industry is re-structuring, faced with economic pressure from new Asian mega-refineries.

The announced closure of the Clyde and Kurnell refineries will see domestic refining capacity decline by about 28 per cent in 2014 from 2012 levels.

From that time Australian refineries will supply only around half of our refined fuel needs.

But it is important to recognise that over 80 per cent of our crude oil and other refinery feedstock is already imported.

And in turn we export about 80 per cent of Australia's crude oil and condensate production, because its proximity to Asia and quality makes for higher value products – maximising the return to Australia.

To suggest that recent refinery closures imperils our energy security is to miss the point that most of the crude oil previously refined in the domestic market already comes from overseas.

Domestic oil production is expected to further decline over the next decade in the absence of new discoveries.

This decline, coupled with continued growth in demand for fuel, means Australia will have a growing reliance on imports of crude oil and refined product.

And regardless of our refinery capacity, Australia will continue to pay world market prices for oil.

Our ongoing liquid fuel security will be supported through the introduction of equivalent importing capacity from well-established international supply chains and ready access to regional fuel supplies.

The Government acknowledges these changes are of concern to many downstream industries that depend on petroleum refining.

We will continue to work closely with the industry, and respective state and territory governments to ensure the timely construction of import receiving facilities.

A two-yearly National Energy Security Assessment from 2014 will continue to assess our energy security risks.

As part of the National Energy Security Assessment, the Government intends to also undertake the National Energy Risk Preparedness Audit to map risks and response measures.

The availability of secure, adequate and competitively priced petroleum supplies, either as fuel or feed stock, is of paramount importance given the jobs and economic returns involved.

Clean energy

I then go to what my government regards as an important part of the challenge, the issue of clean energy.

While rightly focused on cost and efficiency outcomes, government and industry must also look to move to cleaner forms of energy.

Energy generation, supply and use accounts for about three quarters of Australia's greenhouse gas emissions.

To meet our long term emission reduction targets we need to significantly reduce our CO2 output by the middle of this century.

This requires development of a diverse range of new cleaner technologies and processes, including renewables, low emissions fossil fuels, hybrid systems and new generation distributed energy.

Energy storage and smart network capacities will also be critical in managing any intermittency issues.

This task is significant but ultimately achievable.

Modelling within the Energy White Paper shows that, while fossil fuels will underpin our energy security for many years to come, clean energy generation could grow to provide over 40 per cent of our electricity needs by 2035 and potentially up to 85 per cent by 2050.

If this clean energy transformation were to be realised it will require more than $200 billion in new generation investment between now and 2050, including around $50– 60 billion in gas and $100 billion in renewables.

But these results are far from guaranteed, and a range of technologies included in the projected energy mix are yet to become commercially available.

This is evidenced by a new website to be released today by CSIRO called eFuture.

The website allows the user to choose a range of variables and show how these impact on Australia's electricity costs, technology mix and carbon emissions, through to 2050.

Flattening average electricity demand is one such variable currently minimising the need for new investment.

While there will undoubtedly be calls from some interest groups for a faster or slower rate of deployment of their favoured technologies, the principal policy aim is to meet Australia's greenhouse gas emissions targets at the least cost while maintaining energy security.

To deliver on this, the Government has established key reforms like carbon pricing, the Renewable Energy Target and a further $17 billion in funding for technology development and commercialisation to drive the transformation.

This includes the $10 billion Clean Energy Finance Corporation to begin on 1 July next year.

And the new $3.2 billion Australian Renewable Energy Agency, or ARENA, which began on 1 July this year.

These initiatives will help harness Australia's world-class clean technology research and development capabilities and pull new technologies through to commercialisation.

Retaining competitive energy resource development

We now go to retaining competitive energy resource development. We now go to the heart of the fact that Australia is a high-cost producer compared to many other potential energy suppliers.

The prospects for establishing new projects are becoming more challenging due to declining commodity prices, the emergence of new suppliers, rising production costs and more intense competition for the investment dollar.

Simply put, we must work harder than ever to lock-in robust investment across the energy supply chain.

The Government is working to improve our skills base and address labour market constraints through major reforms in education, training and worker migration.

Realising the potential of our energy future will require significant levels of investment in domestic infrastructure and further development of our resource base.

Almost all of it will come through private domestic and international financial markets.

We currently have a pipeline of $270 billion in advanced projects on our books, with a second tranche of potentially $230 billion in less advanced projects not yet committed.

If we are to secure this second pipeline we must reduce the costs of production to remain competitive in Australia.

We must continue to actively work through COAG to reduce business red-tape and streamline best-practice environmental approvals for major projects.

In doing so, industry and government also need to promote additional opportunities for local businesses and Indigenous communities to participate in new resource projects.

Constructive debate

I will now consider how we can go forward in a constructive debate.

This is the final challenge to promote an informed debate on Australia's energy future.

We must have a mature, candid and on-going public dialogue about our energy future.

This is the best means of ensuring sound policy underpins decision making at a state or Federal level.

We simply cannot afford to miss opportunities through a lack of understanding or a failure to retain a social licence to operate.

The energy industry – both upstream and downstream – needs to step up its engagement with the community, because without their support your business will face increasing challenges.

Governments too have a role to play in public education and in setting transparent, safe and effective standards for energy resource development.

National energy policy too must not be ad hoc.

In an energy economy such as Australia, it must be a routine analytical process, so that governments and industry are forced to regularly review actual outcomes, changed circumstances and challenge their assumptions.

The Energy White Paper released today seeks to change the way Australia makes national energy policy.

Locking in four-yearly strategic reviews of energy policy, from 2016 onwards – backed by two-yearly security and technology assessments – provides a hopefully predictable and robust framework for ongoing policy development and informed debate in Australia.

Conclusion

The overview of the Energy White Paper I have outlined today provides a hard-headed no frills policy assessment of the opportunities and challenges facing our energy future.

I believe it provides an honest account of the reality facing the sector.

It provides clarity regarding the Australian Government's energy ambitions.

And central to this is a continued commitment to market based solutions.

Now it is released we must ensure it is acted on.

The Australian Government will be seeking to work cooperatively with our state and territory counterparts to deliver on much of this agenda through the SCER and COAG meetings later this year.

This will require making some hard decisions and sometimes overcoming populism for what is in the long term interests of consumers, users and the Australian nation.

But where bi-partisan support can be achieved, I am confident we can achieve this ambitious agenda.

Thank you for the opportunity to address you and present the Australian Government's Energy White Paper 2012 and in doing so simply say thank you for your input and cooperation and more importantly thank you to my department and office for all the hard work and I know a few of you will be looking to have a beer tonight.

Thank you.

Q and A

Q. You mentioned the importance of institutions and specifically identified the Australian Energy Regulator (AER) and the issue of resourcing; there has been some media and some discussion around removing the AER from the ACCC from the point of view of resourcing and governance. What's your view?

A. The view of the Commonwealth Government is that it should remain in the ACCC. Clearly this is an issue that, in my opinion, is potentially not going to be agreed at the Standing Council on Energy and Resources (SCER) in a couple of Fridays' time, and it may have to go to COAG for a final resolution. Clearly a number of states, and I must say many in industry, have a different view. Putting aside the potential differences, I think we can begin to guarantee one outcome. Irrespective of whether the AER is inside the ACCC or stand alone and potentially, as is the alternative model, funded by industry, I think the ambition of all involved in this debate irrespective of the final outcome is that the AER has to be better resourced, more accountable and capable of engaging with industry on equal footing. For example, in terms of its engineering and commercial capacity. That is the agreed ambition of all engaged in trying to resolve this issue. Can I also say in that context, one way or another, within the institutional framework, and this will take some time to work through and will not be resolved prior to Christmas, is a requirement by all of us to think about how we can improve the consumer presence, in a constructive and informed way, in the regulatory process. Both from a major energy user's point of view, and from the point of view of those well-meaning institutions such as St Vincent de Paul who are currently trying to best represent the needs of the more needy in the community.

Q. **Minister, what observations would you have about the way in which we look at energy security in Australia versus the concept of energy security which shone through in the US presidential debate?**

A. I'll partly touch on the US. The nature of the energy debate has changed in the US in the last couple of years because of the growth in shale gas. It was brought on by the high rises plus they've got pipeline infrastructure, plus unlike Australia, it's rich in liquids so hence they've been able to in some ways cross subsidise operations. So they, in some ways, have become consumed with the fact that they must produce all their own energy.

We as a nation cannot have that narrow view because we are a major energy exporter in my opinion. We live off the back of exporting coal, LNG, uranium, and we can actually, through innovation and research, develop wonderful export opportunities out of renewables. But if we expect to be a major supplier of energy to other countries such as the energy thirsty countries of Asia, then we are expected to be able to produce our energy at a reasonable cost and supply on time and in accordance with the purchaser's expectations. Having now reached a point by which we are not producing enough oil or not producing the right oil, we can't therefore turn around and expect refineries to continue to operate in Australia even though they are losing hundreds of millions per year. Alternatively the issue is how we make sure we have sufficient shortage capacity while ensuring the mega refineries in Asia, as they do, meet our fuel standards and can guarantee to meet our expectations from a logistics point of view. So in some ways we are having to try to rethink our approach to energy as a nation, having never had this problem in the past. But we can't say we want to be a major exporter with other nations depending on our supply chain and our capacity to produce, but for that one instance – liquid fuels where we have a challenge at the moment – have a different approach to life, we will have to embrace those opportunities just like other nations embrace the export opportunities out of Australia. And that's why the Department is paying close attention to this and it is an issue we are regularly focusing on and we will be doing more work on over the next couple of years.

Q. **Minister, my question is in two parts. The first is that it has been suggested, for example you make mention of coal seam gas and gas more generally in the US and the affect it had in terms of pricing, my question goes to whether or not in an Australian energy context looking to the longer term and looking at those cost advantages for Australian consumers, do we simply look for energy supplies, mine it and sell it overseas, and in some way does that present some sort of cross subsidy to offshore consumers at the expense of Australians – it's been put that may be an issue, so what is the Government's position in respect to that?**

The second question which I know you expect me to ask, nuclear energy Minister, where does that fit in the White Paper this time round?

A. Let's first go to nuclear, the easy one. The Energy White Paper appropriately refers to the fact that nuclear power is a fact of life especially for nations that are not as energy rich as Australia. We have got the largest known uranium opportunities in the world in terms of our natural endowment and we will continue to develop it, and I must say I very much welcome the decision of the Queensland Government to now open up a uranium mine and the willingness of the NSW Government to now consider opening up further exploration opportunities. It's no different to exporting, in my opinion, coal, iron ore, LNG, or our capacity in the future to develop the renewables sector. It's never been cost competitive in Australia and is still not cost competitive as I've said on numerous occasions. Our requirement is to invest in clean energy opportunities as we will do through the Australian Renewable Energy Agency (ARENA), the price on carbon, and the RET will bring on those investment opportunities and research opportunities. If we get to a point in the future by which we are not achieving our outcomes in terms of reducing emissions, and we need to look at some other forms of clean energy then there will be, as there is in Australia, an ongoing debate about nuclear energy at the moment. But being frank, it is not commercially viable at the moment even if we had reached that point in terms of deciding there are no alternative baseload clean energy opportunities.

Let's go to the issue of gas. We are very lucky. We have $170 billion committed in LNG capital investment in Australia, seven of the 10 projects in the world at the moment. We are the envy of the world. Pluto is now operating and will go from about 20-25 million tonnes per year in terms of export tonnes this financial year. By 2015-16 we should go to about 70 million tonnes per year.

These investments have been brought on by demand and brought on by price. Plus we are lucky we have the resources and we are capable of developing them. In actual fact, the development of Prelude, from a floating point of view and other considerations at the moment, we could become the centre of excellence in Perth in terms of floating LNG technology as a result of this investment cycle.

My personal view is that we have a window of opportunity through to 2020 for another round of major LNG investment opportunities in Australia. You've got Browse, you've got the question of Scarborough, does Hess progress? You've got the potential for Sunrise, we are rich in onshore in terms of tight gas, and it's there to be grabbed. But if you think you can artificially hold down the price and attract investment then you're kidding yourself, you will not get that investment.

Our responsibility is to ensure that we attract investment but at the same time meet our own personal demand requirements and that's why in the White Paper, this issue is focused on in a very big way. There is ramp up in Gladstone in years to come. On the east coast now we are very much dependent on coal seam gas and potentially more dependent in the future.

The barrier at the moment is not the potential availability of gas; the barrier is getting state governments to actually make regulatory decisions to bring that gas into the market. That's why the SCER (Standing Committee on Energy and Resources) agenda to be finalised hopefully in December, goes to how we work with the broader communities, you can have farming plus gas development. Look at the changes in technology, the horizontal drilling, the well heads down the fence lines; think about the income to the farming community over a life of 20 years that makes the farms actually more economically viable.

But more importantly, you've got to face up to the fact that not only do you have to engage with the community, but you have to have best practice in terms of development of the industry, the use of chemicals, the proper assessment of the aquifers, hence our independent scientific committee and the additional $150 million from the Commonwealth. We can do it. But if people think an easy fix is a reservation policy then I suggest there will be no new investment.

And the last thing you could therefore do is raise issues of sovereign risk by seeking to retrospectively impose reservation policy on existing projects because it would send a most unfortunate message to future potential investors in Australia. It is the responsibility of all of us to have best practice in place by Christmas, and then, and I'm not offering criticism of the state governments in question, they are working with my department and my office and me to get to that point, we have to back those state governments, all of us, in making these tough decisions or we will have the supply demand constraints, we will have even bigger prices that might come in the system now because of the operation of the market and we will have problems with the broader community especially on the east coast. I end with this point, if you think reservation policy is the answer well the highest prices in terms of gas for Australia have been on the west coast where we have had a reservation policy.

Q. **Minister thanks for your support of this whole program. I see some contradiction in the remaining renewable energy targets, in some of the state schemes, and for solar subsidies and so on. You've advocated moving towards free markets and perhaps that's an area that could be looked at.**

A. Hopefully we end up with two interventions. The carbon price and the RET. Then the responsibility of government, be it in this sector or other sectors will be to actually invest in research, development and innovation, be it in the universities sector, in the health sector, or the clean energy sector. I'm pleased to say that in my opinion; there is a willingness by states to actually work to roll back all those state interventions. They were developed and put in place at a time when state governments wanted to be seen to be green and to work out their own market interventions because there was no national outcome. That's the ambition of industry and state and territory governments over the next 12 months, bar potentially one government – the ACT Government, where we're going to have 90 per cent renewables.

Q. The key platforms obviously are with the amount of investment required in the industry in the coming years – billions of dollars, the other key plank is to keep energy costs down, just interested in your comments, how do we find the sweet spot with construction costs potentially blowing out and having that other platform of having least cost electricity?

A. I think in terms of our projects at the moment, the pipeline and the cost pressure we've got, to be frank we are all to blame, all of us. From a state and Commonwealth perspective, our job is to get the regulatory framework right. One of the Prime Minister's ambitions for example is to stop the duplication of environmental approvals. It is an absolute priority. It used to take a coal mine in the Hunter Valley three years to get approval and now it takes four and a half to five years, delay, cost etc, so there is a government responsibility.

There's also a responsibility on industry. I believe while commodity prices were high, we forgot how to manage our projects. And everyone in this room in business in this room knows I'm right because you didn't have to worry about it because commodity prices were so good. With the significant reduction in commodity prices, companies are now putting their house in order. You only had to look at Marius Klopper's speech at the Brisbane Mining Club a couple of weeks ago to get the message, reinforced by other people such as David Peever out of Rio, pulling back of activities by FMG (Fortescue Metals Group) etc, stripping out head offices etc.

We also have been so stretched with so many projects, I think we've taken our eye off project management. We've got to start paying more attention, in my opinion, to project management, rather than just letting things slip and slide adding to cost because we could get away with it.

And I also say to my old friends in the union movement, we've got to appreciate it, and this is not an attack on the industrial relations system. When iron ore is at 180 or 90, as against 115 or so, or when coking coal is at 320 a tonne as against about 150 tonne at the moment, when thermal coal is about 180 a tonne as against 70 or 50 or whatever it is depending on the quality at the moment, the capacity of industry to pay actually changes. And we all have to have regard for getting our cost structure right otherwise the benefits all of us with our different interests to present at the moment, will not have those same opportunities in 10 and 20 years' time. And that's what it's about not pointing the finger at any one but pointing the finger at all of us because we are all to blame for potentially undermining the second pipeline. Can I also say, it means we have to get the migration structure right, EMAs (Enterprise Migration Agreements) ect, to add to the supply of labour and to take pressure off the labour market.

Q. Maybe a question on the electricity market, you mentioned on the way through about retail price deregulation, and you mentioned that Victoria had led the way there, what do you think the appetite is going to be like in the other states to take on this challenge?

A. Firstly to the credit of the NSW Government that has now asked the AEMC to actually effectively test the market. So that is appropriate, and John Pierce now has the responsibility to produce that report next year. We've raised this because it's about competition but it's not automatic. It flows from an analysis of the strength of retail price competition. If the analysis shows through the report that it's there then we are asking state governments to think about lifting the capping. Alternatively, the review could show that it's not ready at the moment but if you make these adjustments overtime, it's ready at a point in the future. It's not automatic but we are simply asking the state governments to act on the original national energy agreement which provided for this particular outcome, it is not new. We're simply saying the time has come based on the experience of Victoria to have another look at this and to assess the potential benefits for consumers. In my opinion, and this won't be resolved potentially this financial year, if the analysis proves the potential benefits to consumers, then frankly state governments in my opinion will be held accountable publicly by consumers if there are benefits to them. And that's how I am confronting the debate, it's not about direction, it's not about saying to the state governments you've got to do this, it's about saying this is what you signed up to in the original national energy agreement, there are processes potentially to be embraced, we approved the necessary outcomes, please act in the best interests of consumers and we want to work with you to achieve that outcome.

> CEDA ANNUAL DINNER

> 20 NOVEMBER 2012

> MELBOURNE

Producing prosperity

Glenn Stevens

Governor, Reserve Bank of Australia

Any contribution by a Governor of the RBA is going to be significant for any number of reasons. Commentary on the current economic performance of Australia, and decisions related to monetary policy, will always attract attention.

In this speech, covering a wide range of topics, the Governor provided insight to the RBA's direction and expectations for the year ahead on key issues such as interest rates, the global economy, the Australian dollar, infrastructure investment, the mining boom and household savings.

What I want to do this evening is to take up from where I left off last time I was here two years ago and then because I don't have that many new ideas really, then I want to move on from there to talk about productivity. I note with interest in some of the CEDA material that you have a productivity program that is going to engage Gary Banks (Productivity Commission Chairman), I can't think of anyone better and so I want to also, in the end of my remarks tonight, come to productivity.

Financial markets and policymakers have been living in a more or less continual state of anxiety for over five years. While it was poor-quality lending in the US mortgage market that proved to be a key cause of problems, from quite early on it became apparent that European banks also had serious difficulties, because of their exposure to securities of doubtful quality, their high leverage and their need to fund US dollar portfolios on a short term basis. It was in August 2007 that those acute funding difficulties first became apparent in European markets.

Five years on, US banks have made a lot of progress in working through their asset quality problems and their capital deficiencies. At times the process was not pretty, but the US system is in better shape today as a result. US taxpayers have earned a positive return on the investments in major banks that were made at the height of the crisis.

In Europe progress has been much slower. There are various reasons for that, not least the sheer complexity of coordinating the process of evaluating and strengthening balance sheets across so many countries, where the national capacities to assist are so different, and within the strictures of a currency union. This exacerbates, and in turn is compounded by, the deterioration in economic conditions in Europe, which feeds back to bank asset quality and sovereign creditworthiness.

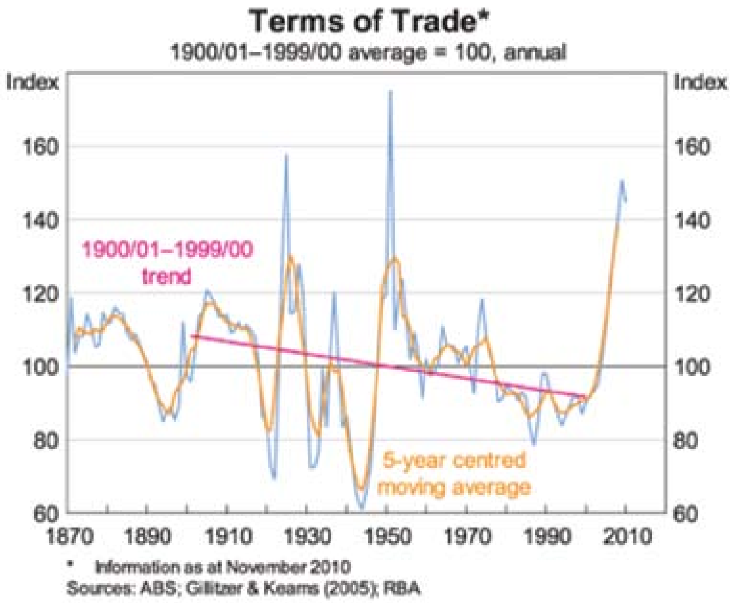
It is perhaps no surprise then that the news seems to have been dominated by the ebb and flow of anxiety over things like: whether or not the "troika" will recommend further funding for Greece; whether a national constitutional court will strike down a government's participation in initiatives that will assist other countries; or whether the populace in a country under pressure will reach the end of its tolerance for "austerity" – and so on. There is "event risk" almost weekly. This is the European drama.

Unfortunately, it is, I suspect, set to continue that way for quite some time. Over recent months financial market sentiment has improved, from despair to mere gloom, as a result of a number of important steps that have been taken and commitments that have been made. It is right that this improvement in sentiment has occurred – it recognises the determination of the Europeans to save the euro, which should not be underestimated. But there is much more to do, and it will take a considerable time. So while good progress is being made, we will not, any time soon, see a point at which the "euro problem" can be seen as past. The world will have to live with euro area anxiety for some years yet as a normal state of affairs.

In the meantime the US economy has continued its slow healing. The US housing sector has, it would appear, finally turned. Now the election is past, the so-called "fiscal cliff" is rapidly coming into focus – a new source of event risk. But if one is prepared to assume that the US political system will not, in the end, preside over an unintentional massive fiscal contraction next year, the risks to the US economy probably look more balanced than they have been for a while. An upside surprise would be as likely as a downside one. It would be fascinating if, in another year, we find ourselves looking back at a US economy that had outperformed expectations. (There is still of course a critical need for the US to craft a measured and credible path back to fiscal sustainability. That particular drama could continue as long as the European one.)

But it is appropriate to turn our gaze to our own part of the world, especially in the current period of discussion about the Asian Century. Two years ago, when I last spoke to CEDA's Annual Dinner, a key feature of my presentation was this chart.[1]

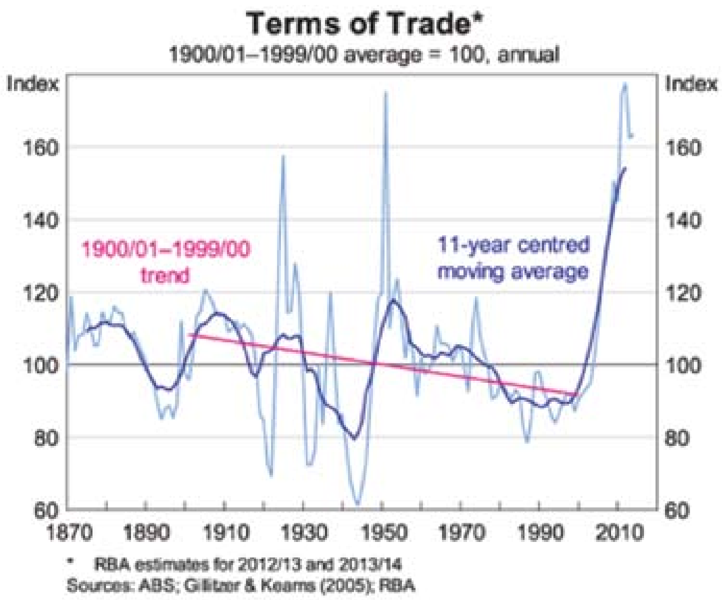
GRAPH 1



This evening I can show how the chart looks when updated for two more years of data and our revised estimates for the near-term outlook. The terms of trade ended up rising further than assumed two years ago, and have then fallen back from the peak, though the level recorded in the most recent quarter is about seven per cent higher than was in the forecast two years ago.[2]

The event is sufficiently unusual that we can add one twist to the chart. Instead of a five-year average, we can show a decade-long average. The chart in fact shows an eleven year average, which allows the measure to be centred on the current year. To do this of course we need to make a five-year-ahead assumption. We have assumed that the terms of trade decline steadily, at a pace a little faster than implied by forecasts of private analysts. What is unusual about this event is not just the peak level observed, but the apparent persistence of high levels. The terms of trade will very likely record over a decade an average level 50 per cent higher than the previous long term mean. That is a big deal. Even with a more pessimistic assumption – say that commodity prices fall by twice as much over the next five years – there is no doubt that this is easily the biggest, and the most persistent, terms of trade event for a very long time.

GRAPH 2



Still, the terms of trade *have* peaked, and will probably have fallen by about 15 per cent by the end of this year. Further declines over time are likely. So while a high level of the terms of trade continues to add to the *level* of national income, we can no longer expect that a rising terms of trade will be adding to *growth* in living standards. We are entering a new phase.

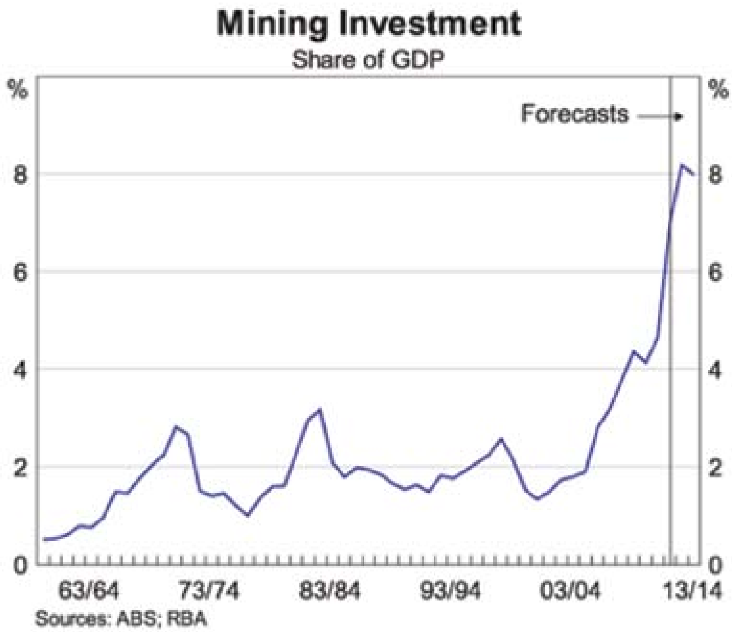
This is not so much because of the end of the mining boom. As a matter of fact, talk of the end of the mining boom has been somewhat overhyped. The boom is not so much ended as simply evolving, as these events would be expected to. Thoughtful commentators have already pointed out on a number of occasions that there are three phases to the boom.

The first was the rise in prices – something that began as far back as about 2004. The peak in prices was more than a year ago now. The Reserve Bank began noting that prices had declined in our monthly interest rate announcements in October 2011. But relative prices for natural resources are still high. At this point, the terms of trade are down to the "*peak*" seen in the September quarter of 2008, which was of course a 50-year high.

The second phase of the boom is the rise in resource sector physical investment. This is aimed at taking advantage of expected high demand for iron ore, coal, natural gas and other commodities over the medium term, at prices which are attractive relative to costs of production, including the cost of capital. The peak in this build-up lies ahead. It has, for some time, been our expectation that it will occur in 2013 or 2014; that expectation seems to be firming up. The actual level of the peak is probably going to be a bit lower than we thought six months ago, in view of the somewhat lower, and more variable, prices for iron ore and coal observed in recent months.

But it's worth putting that downward revision into perspective. For 50 years, resource sector investment was typically between one and two per cent of GDP, with cyclical peaks at about three per cent (Graph 3). The uncertainty now is over whether it will peak at closer to eight per cent of GDP than nine per cent. What isn't uncertain is that either number is very high by any historical standard.

GRAPH 3



It's also worth observing that, in any episode of this nature, there will always come a point when some potential projects, conceived at the time when prices were at their highest and when costs were about to start mounting quickly as well, have to be shelved. Actually, if projects that rely on extremes of pricing and optimism can be shelved before they get too far, that is preferable to having them continue. More generally some important parts of the resources sector have now reached a point where the costs of further expansion in capacity, relative to those that might be expected elsewhere in the world, are a much more important factor in investment decisions than they were a couple of years ago.

The third phase of the boom is when the capacity to extract and export higher quantities of resources is actually used. This phase has begun for iron ore but it is mostly still ahead of us, especially for gas. The main uncertainty is really over the prices that will be achieved as higher supply – and not just in Australia – comes on stream. Such uncertainty is, and always has been, part and parcel of the business of investing in resource extraction.

Perhaps what people have found a little unnerving over the past year is that as the prospect of rising supply of key natural resources gets closer, and prices have declined from their peaks, the Chinese economy has been in transition to slower growth. It was inevitable that China would slow to some extent, from the very rapid pace seen for much of the past decade. The signs it needed to do so were quite evident: increasing general price inflation, escalating property prices, doubts about the process of credit growth and credit risk management, and so on. But just how big a slowing was occurring? For much of this year, that was the question that people have been trying to answer. My assessment is that the slowdown has been more material than had been expected a year ago, but not disastrously so. There are some signs that the moderation may have run its course, though further data are needed before such a view could be offered with confidence.

So the Chinese economy has not crashed. But neither is it likely to return to the sorts of double-digit percentage rates of growth in real GDP, and 15 per cent growth rates for industrial production, that we saw for some years. People expecting that to resume are likely to experience disappointment.

These trends are entirely consistent with two propositions that we have advanced over the past several years. The first was that China's economy would have an important and increasing weight in the regional and global economies. China's economy is nearly three times the size it was a decade ago. One corollary of this is that even moderate growth in China is quantitatively significant. If China grew by, say, only seven per cent in 2013, that would add more to global GDP than the 10 per cent growth recorded in 2003.[3]

The second proposition was that China, like all economies, has a business cycle. It is affected by what happens elsewhere in the world, and by its own internal dynamics, including the decisions of its policymakers. Swings in China's economic performance are increasingly affecting Australia's economy and that of the region – and the world. Hence the focus on monthly data reports from China these days in our business press, in addition to the focus on the Chinese political situation. The Chinese purchasing managers index is now as keenly awaited, and is as potentially market moving, as the original US PMI measure, known these days as ISM.[4] There is some tentative evidence that Chinese data "surprises" have become increasingly influential in driving movements in Australian financial prices such as the exchange rate and share prices.

Turning then to Australia, two years ago I noted that we could not know how much of the rise in the terms of trade would be permanent, and that there was therefore a case to save a good proportion of the additional national income until it became clearer what the long-run prospects might be. In a manner of speaking, we have, as a community, done something like that. The marked rise in the rate of saving by households in 2008 and 2009 has been sustained. Corporations have also increased their saving considerably over the past five years, opting to repay debt and lower their gearing ratios.

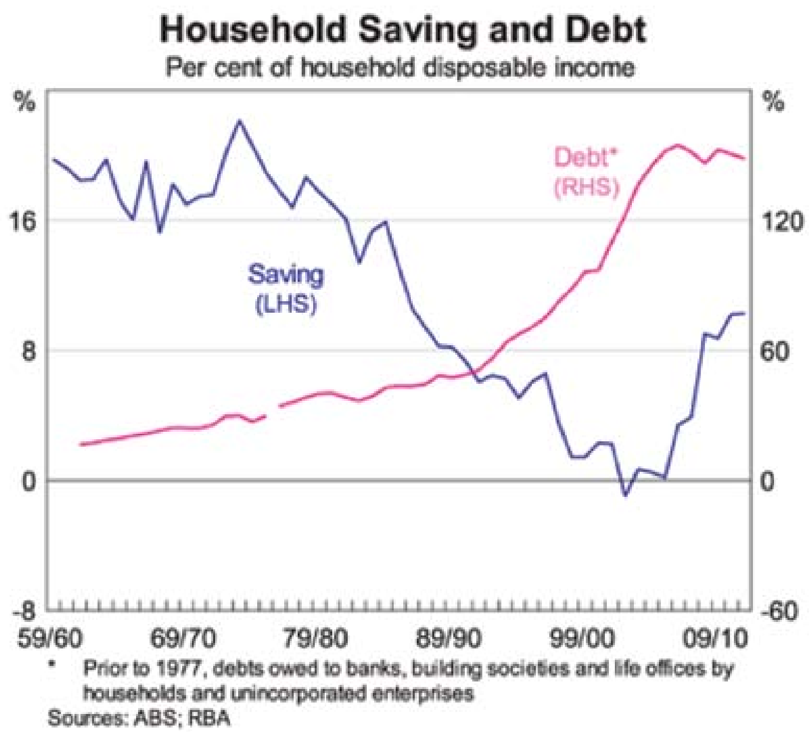
Admittedly, government saving has been lower for a time, for countercyclical purposes, though that is now scheduled to rise as well. For the nation as a whole, the fact that the current account deficit has been lower on average in the past few years than in the period from 1985 to 2005, at the same time as the share of business investment in GDP has been exceptionally high, indicates that national saving has been higher. In fact it has been at its highest share of national income since the late 1980s.

This change can be seen as a sensible response to an unusually high level of the terms of trade. Something else has also been at work, though, in household behaviour. I have spoken about this before but it bears saying again, because it is fundamental to understanding the current economic situation.[5] After a period in which high levels of confidence, macroeconomic stability, easy availability of credit and rising asset values saw Australian households borrow more and save less; households have over recent years changed their behaviour in respect of spending, saving and borrowing. They have gone back towards what was once considered as “normal”.[6]

This really had nothing to do with the resource boom. But it has had important implications for some key business sectors. Financial institutions are finding that growth in credit is now a single-digit number, not a double-digit one as it had been for so long. Businesses that in the earlier period of optimism derived earnings from high rates of turnover in asset markets – real estate agents, stock brokers, for example – face challenges, given that turnover is now greatly reduced.

The retail sector now faces different consumers. It is not actually that consumers have no income to spend, nor that their confidence levels are *that* low, nor that their saving rate is *that* high. Measures of confidence that date back to the 1970s show it to be roughly at its long-run average. The household saving rate as measured by the Australian Statistician, at just over 10 per cent, is not, in fact, high in the broader sweep of history (Graph 4).

GRAPH 4



To be sure, confidence was persistently very high for years up to 2008, and saving was very low – even falling to about zero, as measured, at one point. But that period was unusual. I don't think it will return. Moreover consumers are much more knowledgeable about prices as a result of information technology, and have at their disposal ways of responding to information that a decade or more ago they did not have. This is putting pressure on retail business models, on wholesaling and distribution, and also on segments of the retail property sector.

Given that the change to household behaviour was probably inevitable, the income boost from the terms of trade arrived at a rather fortuitous time. It helped to accommodate a rise in household saving and a slowdown in the build-up of debt in a fairly benign fashion. The weakness of some other parts of private demand, and openness to imports with a high exchange rate has also meant that a very large expansion in mining investment has been accommodated without overheating the economy overall. As it was, total real private final demand in Australia rose by six per cent in 2011/12, well above trend.

With the peak in the investment phase of the mining boom now coming into view, the question naturally arises as to how the balance between the various types of demand in the economy will unfold. Mining investment will contribute less to growth in domestic demand in the current fiscal year than it did last year, and less again next year. Working in the other direction, it is likely that export volume growth will begin to strengthen as the capacity being installed in the resource sector is used. That would show up as GDP growth, though it may be predominantly reflected as higher measured productivity rather than generating a large volume of extra employment.

The question will be whether other areas of domestic demand start to strengthen. Many households have made progress in reducing debt burdens. At some point that might be expected to lead to such households feeling more inclined to spend. But a complex interaction of factors – asset values and expectations about job security to mention two – will be at work in ways that are not amenable to accurate short term forecasting. Overall, our assumption is that consumption will probably continue to grow at about trend pace, in line with income.

Public demand is scheduled to be subdued as governments seek to return budget positions to surplus. The near-term outlook for business investment spending outside the resources and resource-related sectors is subdued, judging by currently available leading indicators. In most cycles, it takes time for this sort of investment to turn; this episode looks like no exception. The exchange rate may also have some role in helping the needed re-balancing. While it's not surprising that the Australian dollar has been very strong given the terms of trade event we have had, it is surprising that it has not declined much, at least so far, given that the terms of trade peaked more than a year ago. A lower exchange rate would, of course, need to be accompanied by a pace of growth of domestic unit costs below that seen for much of the past five years, in order to maintain low inflation.

One area of stronger potential demand growth is dwelling construction, which has been unusually weak. It is not clear, actually, that the degree of weakness has been adequately explained. Various explanations have been offered – interest rates too high, housing prices falling, zoning restrictions, planning delays, construction costs, lack of confidence, all have featured. At present, at least some of the pre conditions one might expect to be needed for higher construction seem to be coming into place. Interest rates have declined, dwelling prices seem to have stopped falling, rental yields have risen, and the availability of tradespeople is assessed as having improved. We have, moreover, seen a rise in approvals to build. So there is some evidence of a turning point, albeit a belated one.

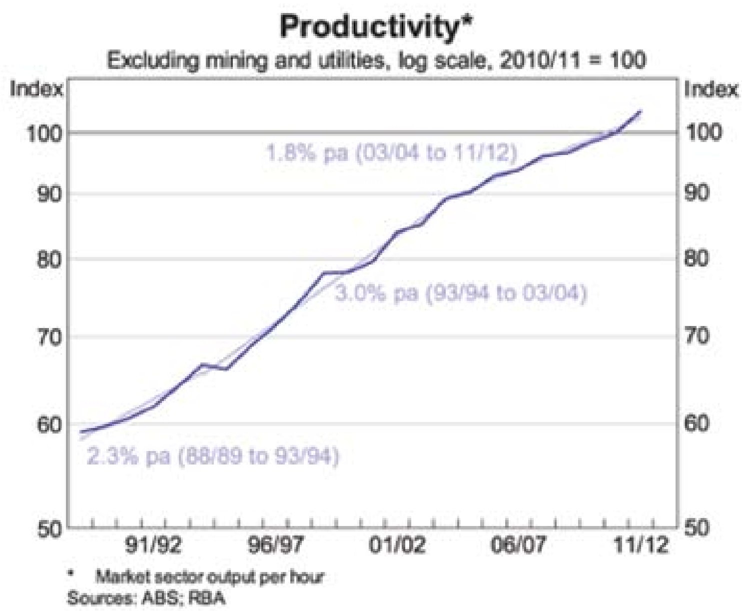
Will the net effect of these developments mean that aggregate demand rises roughly in line with the economy's supply potential over the next couple of years, or will a significant gap emerge? That is the question the Reserve Bank Board is trying to answer every month when it sits down to decide the stance of monetary policy.

As of the most recent meeting, as the minutes released earlier today show, the Board felt that further easing might be required over time. The Board was also conscious, though, that a significant easing of policy had already been put in place, the effects of which were still coming through and would be for a while. In addition, the latest inflation data, while not a major problem, were a bit on the high side, and the gloom internationally had lifted just a little. So it seemed prudent to sit still for the moment. Looking ahead, the question we will be asking is whether the current settings will appropriately foster conditions that will be consistent with our objectives – sustainable growth and inflation at two–three per cent.

Over the long run, though, the bigger question, for all of us here tonight and in the business and policy making community generally, isn't about the monthly interest rate decision. The big question is: what is the sustainable growth rate of the economy? Beyond its role of preserving the value of money, monetary policy can do little to affect that sustainable growth rate. Moreover, the initial contribution of rising mineral prices to our standard of living has now run its course. To be sure, a higher capital stock devoted to extracting resources at high prices, assuming they continue, will make its contribution for many years – to the extent that Australians own some of that capital, work with it or receive tax revenues. But the biggest contribution to growing living standards will be what it has always been other than in periods (usually not long-lived) of exceptional luck, and that is productivity performance. I noted two years ago that while our terms of trade are handed to us, for better or worse, by international relative prices, the efficiency with which we work is a variable we can actually do something about.[7]

For some years there had been evidence of a slowing in productivity growth, beyond the unusual factors clearly at work in a couple of sectors (mining and utilities). The most recent data on productivity show signs of a pick-up in the year 2011/12, which is encouraging (Graph 5).

GRAPH 5



It is much too soon to conclude that a new, stronger trend is emerging – in this field much longer runs of data are needed. In my opinion, the accelerated structural change we are seeing in the economy for various reasons is likely to result in some improvement in productivity performance. But the most that can be said, at this stage, is that the data are not inconsistent with that hypothesis.

At this point when talking about productivity, I usually become circumspect. One reason is that I know that people might ask what we might do to improve productivity performance, and I am acutely aware that the improvement has to be delivered in enterprises all around the country – the ones associated with CEDA and millions more. Productivity does not rise simply because of exhortation or official pronouncements.

As for policy measures, at a meeting in Brisbane earlier this year, I said:

"The Productivity Commission has a long list of things to do. My answer to what we can do about productivity is: go get the list and do them."[8]

That comment elicited some attention. The Chairman of the Productivity Commission was, I am led to understand, inundated with media demands for "the list" and had to explain that it didn't quite exist in that form. But (Productivity Commission) Chairman Gary Banks has very kindly drawn one together, in his final public speech at the end of a very distinguished tenure in that position.[9] His list is a rather more complete one than mine. In fact it is a set of lists, under three headings: things that affect incentives, things that affect capabilities and things that affect flexibility. What was perhaps most striking was the comment in the conclusion that no single policy offered the secret to success.

To quote:

> *"Rather, what is needed is an approach to 'productivity policy' that embraces both the drivers and enablers of firm performance, and is consistently applied. That in turn requires policy-making processes that can achieve clarity about problems, reach agreed objectives and ensure the proper testing of proposed solutions (including on the 'detail' and with those most affected). The beneficial and enduring structural reforms of the 1980s and 1990s are testimony to the value of these policy-making fundamentals. Good process in policy formulation is accordingly the most important thing of all on the 'to do list', if we are serious about securing Australia's future productivity and the prosperity that depends on it."*[10]

It couldn't have been better put.

As the mining boom moves from its second to its third phase over the next year or two, the world economy will continue to present its own challenges. Australia will, as always, need to adapt to the changing circumstances. Looking much further ahead, to the Asian century, our opportunities are large. But to grasp them, that same adaptability, combined with a clear focus and steadiness of purpose will be key. We need to produce our sought after prosperity; it won't just come to us. All of us have our role to play, CEDA and its members included. I wish you every success.

Q and A

Q. **Governor, how concerned are you over the medium to long term about the level of monitory stimulus going on around the world and the implications that might ultimately have for inflation?**

A. Well there's certainly attempts being made by the major countries to stimulate economies which are facing severe financial dislocation, the potential threat of inflation being too low, possibly even deflation that's why the Fed Bank of Japan, European Central Bank (ECB), UK, are doing these things. I suppose what we were taught in the textbook was large monitory expansion is, to use Friedman's words, always and everywhere inflationary, but I think the thing we can't observe at the moment is the counterfactual of what would have happened in the absence of these measures.

I think the central banks concerned would claim that the price level would be much lower and so what they're doing is inflationary compared with that but that unobservable base line scenario is not, it's not observable and you wouldn't want to experience it and so their claim would be they've headed that off.

I think there's room for a fair bit of discussion actually about how effective these measures are I think there is a fair bit of, you know, what we once learned about as pushing on a string, really about what's happening, but they have to do what they can. Whether it proves ultimately to be inflationary, it's a good question.

The Bank of Japan has been doing this; they've had zero interest rates since about 1999 or 2000. They've had quantitative easing for a little bit shorter time than that but still quite a long time, they're still deflating. So in their case it's proven very difficult to generate the inflation that they say they are actually seeking. So it's hard to say. There will, at some point, need to be an exit plan and I think the Fed probably has thought a lot about this and I think they would say at a technical level, they know how to go about reversing this out when the time comes.

There will always be a judgement call about when is the right time to do that but in any cycle where you tighten monitory policy you've got that call, so that in a sense it's not an unknown problem.

The difficulty might be that by then a lot of people have gotten very used to very very cheap money, not the least their government and that may create complications.

In between then and now we may well face a long period of very very low rates in these major countries which I think one has to say is doing damage to the world's retirement income system and the insurance system because there is no yield anywhere.

That I find a bit troubling, without being able to fully articulate what all the costs might be but I think we will be discussing those potential costs of these policies over the years ahead, which isn't to say they're doing the wrong thing by pursuing these policies but there are costs and benefits to be weighed.

Q. **I've got a question about consumer sentiment and consumer confidence. That graph that we've seen since 2008-09, the household savings ratio's been broadly constant, at least according to the National Accounts Measure, and yet some other confidence surveys are suggesting that people are still quite cautious, which is what I'm hearing from the street as well, the asset markets are choppy at best. If you were to be called by the Treasurer tonight and he said I understand your forecast is for the household savings ratio to broadly remain unchanged, where do you think the risk lies in the next two to five years with that household savings ratio? Are we going back to where we were in the 60s or 70s or are we just going to hang about where we are here or are people about to unlock and start spending again?**

A. Well no one knows. I have two comments. The first is that it is a common saying that consumers are cautious, if enough people say that, obviously many people believe it, but actually the index that is supposed to measure it is at pretty much its long run average, so I think we got used to a particularly ebullient period and we have come to think of it as normal but it wasn't really normal.

Secondly, and relatedly, I don't know whether a 10 per cent saving rate is optimal, correct or sustainable. It strikes me though as much much more normal and likely to be persistent than zero, which is where we were and I think in the long run we have to count as a strength that the household sector is taking, I would say, a much more prudent course with its attitude to saving and borrowing. As difficult as that is in the short term for some sectors to adjust to it actually builds resilience for the future whereas I think what we were doing before was we were degrading our resilience as households.

But on particular quantitative contribution probably the worst forecast variable in economics is the exchange rate, that's just to head off the question that's otherwise going to get asked. The second worst one is probably the saving rate.

Q. **I think in your graphs on four previous occasions there were spikes in the terms of trade, they both went up and down again. This one has gone up and stayed up longer, but do you think the enormous energy discoveries in the Middle East and the enormous energy discoveries in America, threaten another very sharp fall in our terms of trade because they will reduce the price of gas and coal?**

A. I don't know. I think we too see the intelligence that says the gas phenomenon in the US is quite transformative for that country. That's actually another reason to suspect that the US could eventually surprise us on the upside because in that country there's nothing like cheap energy to kind of get things going. So there will be more supply.

You've still got to think about demand as well and the Asian demand that isn't just China but Asia generally, demand for energy will also likely rise a lot so how the net of those two things work out I don't know.

I certainly fully accept the point that history says that the terms of trade, they don't stay super high indefinitely, they come down. My point was simply this episode more or less, whatever happens from here has been a very unusual, very big and quite persistent one and that's a big part of the story of the economy over recent years, that's my main point. I would say that our standard presumption is they will fall, they won't fall all the way back, they will be lower than they are today and probably higher than the mean over history. But you know that could be wrong and if it is wrong, then the economy will have to adjust to that as it unfolds, it's ever been thus.

Q. Governor, in your earlier comment you talked about the current circumstances in Europe. I think this week's Bulletin, no this week's Economist magazine, talks about in a 10 page spread, issues associated with France and the impact that decisions been taken by the current government potentially could have not only on the future of the euro, but again a major economy, that seems to be going counter-cyclical to what the Germans are looking at. Have you got any comments as to likely impacts that some of the political decisions translating into economic decisions are having in France as it may affect the overall composition of the euro and perhaps what then that might mean for Australia.

A. That's a pretty big question and I admit to not being a regular reader of The Economist, so I haven't seen the piece but I think it is a very difficult time for governments in Europe to articulate what needs to be done. You know if you are in a currency union with Germany and Germany has spent the last 10 years grinding away on costs and getting its productivity up, these people are super competitive.

So if you're coupled to that train, you've got to be up to the game because it's going to be tough otherwise, and that's, apart from the banking problems, and the government problems in countries like Greece and others, the competitiveness problem is acute as well.

So there are great tensions there within the Eurozone because of those things and I don't have any particular comments on an individual government's policies but it remains true and as every Anglo-Saxon trained economist would say, that if your fundamentals on the supply side of the economy are going in different directions to your trading partners, and you're in a currency union, you're going to put acute strain on the system and really these things have to be, they have to dovetail.

They have to be consistent and coordinated not uncoordinated otherwise you're going to run into more trouble.

So if they are in fact doing the sorts of things you're implying it would be troubling for a region which is already got more than its share of difficulties.

Q. I was interested in your comments on China, in particular where you're talking about, despite the lower growth and larger GDP will produce a greater GDP contribution globally. Do you see a change in the mix of demand that's going to come from China in the near term or do you think it's still going to be dominated by energy and resources?

A. I think they're seeking to engineer one important transition which is to rely less on exporting to the rest of the world and more on generating their own demand at home. The rest of the world is preaching at them to do that but it's in their interest to do that anyway. The economy of that size cannot keep growing by expecting the rest of the world to absorb that size of growth of exports continually.

So they're making that change. That transition has I think some time to go but it's underway. The resource intensity or otherwise of that demand is an interesting question. It's commonly thought I believe that, while urbanisation continues you'll have a high steel intensity. I admit to a little bit of uncertainty there because at a very sort of aggregated level, the steel per unit of China's GDP has already risen to pretty close to where preceding fast developing nations got to before they sort of stabilised.

So I would have thought that the steel intensity of GDP doesn't go up much further from here. That still means demand for steel rises seven per cent here if in the world's market for steel, if GDP grows at that, so it's still quite a big story but maybe not to the same extent it was.

But other people have different views. Some people think that the ongoing urbanisation in the sort of interior part of the country will lead to resource intensive production and I would imagine generally that society's demand for energy overall will continue to rise because it's a lot lower than ours is per head and it's quite likely that it will keep rising I'd say.

Q. You commended to us Gary Banks' last speech which has an outstanding to do list in terms of productivity. But he gave another speech a few weeks earlier which got almost as much publicity, when he talked about the proper application of competition policy to labour markets. The publicity perhaps wasn't quite as favourable let's say for certain sections. How do you react to the issue of the suggestion we've got more rigidity in our labour markets and that's having a significant effect on labour productivity?

A. It depends who you ask. In an audience like this I'd expect that, and I'll get into trouble when I say this – I know exactly what's going to happen, but many people in business say that is their perception that things are more difficult now than they were. That's what people say and I've got into a lot of trouble with some other people for repeating that but that is what people say. There must be something to that and, it's a serious point and what I'd say is, let me make one point, I think when we're talking about productivity which is really the biggest gain; I think it's a mistake to narrow that down solely to its all about labour markets. It isn't all about that it's about a whole bunch of other things as well in product markets and so on and Gary's three lists go to that.

But by the same token I can't see any logic why labour market arrangements would be excluded from any discussion of these general matters, that as a matter of logic doesn't, you wouldn't think so. That would be my answer.

Q. Glenn, you've talked about your organisations bigger issue really being around not setting interest rates, but more about the question being in terms of sustainable growth and the rate of that and the level of that for the country. So the question is really about, and it follows on from the previous question, the conditions under which or the way in which that debate might reasonably unfold in Australia and how we get to have a conversation that's bigger than a quarter?

A. My answer has been what we're talking about in terms of raising the sustainable pace of growth is we're talking about faster productivity growth because that's what does that.

We're not coming out of the back of a really large recession where we have a massive amount of unutilised capacity, we've got some but by enlarge from our present point, if we want to speed up the growth of the economy on a sustained basis, it's about raising productivity performance which is why I get asked by a lot of people what can we do?

And that's why my answer is you've got a body called the Productivity Commission. They've got I don't know how many PhDs that spend all their time thinking about this stuff. Let's ask them because they know about this. It's actually not a very popular answer because they are vested interests that resist some things the Productivity Commission proposes. One side of politics or the other doesn't like certain things they propose. Many of these things are in the state/federal relations sphere which is very very difficult because it only takes one state minister for whatever, to not agree and it kind of, you know, the thing stalls.

So it's very very hard but we've got this body who's professional duty is to advise on these things and my answer is the way to have a conversation is to do a bit more to put them front and centre of it.

That strikes me as pretty simple and pretty obvious.

Q. Governor, the Aussie dollar as you've mentioned is very high relative to the terms of trade and it's been at a sustainably high level for a period of time. Last night we saw the International Monetary Fund (IMF) suggesting the Aussie dollar may be added to its preferred reserve currency names. Given that's taking place, do you have any comment to make on whether that in the medium term will have an upward push for the Australian dollar, and is the spike we're seeing in deposits from the foreign institutions at the moment with The Reserve Bank indicative of a way of leaning in or passive intervention in the currency?

A. Well there are three questions in there which gives me the option of answering the one I want to, but I'll have a go at the three.

The terms of trade and the exchange rate, we've got models, we've got a few, and it's a bit high. You wouldn't actually say it's more than a standard deviation away from the mean fit of the model right now which is why what I've been prepared to say is I think it is a bit on the high side given what's happened I'm a bit surprised it hasn't come down which isn't to say it won't do so at some point. And I predict that if it does do so, we will go from complaining about it being too high to complaining about how fast it is falling without passing go. That's my first point.

My second point actually what the IMF said, is that in the category of reserve assets that are presently labelled, "other"; they may take Canada and us out of that and label us on our own.

That actually isn't any sort of particular endorsement that makes us more of a reserve currency than we were. We've in fact been a small reserve currency for quite a few countries for probably 25 years.

Asian central banks in particular, most of them have had substantial Aussie dollar holdings for quite a while. We don't actually know how much exactly because they don't say but in fact if the IMF does this reclassification we may find out, which would be probably handy.

But I don't think there's as much significance to that, it's a classification change, it's not really any more than that. As for the recent so called "passive intervention" let's say that was customer business that we decided to keep on the balance sheet because of the prices seemed attractive to do that as this time.

Q. In the discussion about productivity one could be forgiven for assuming that it's happening against a static economy, of course it's not. The Australian economy is undergoing some pretty fundamental structural shifts and according to the Treasury it will continue to do so. What are the implications, from your perspective, of the structural change for productivity and for other economic factors?

A. Well I think that, as I said in my talk, structural change is another name really for improving productivity. The reason we do structural change is not because we enjoy it, we don't. The reason it happens is that businesses are under pressure to adapt to changed conditions and they have to do that by lowering costs, raising output per head, being more efficient, in order to survive.

So that is to say the structural change that I think is occurring as a result of a very large shift in relative prices, that's what the terms of trade is, that structural change, as I say, that's really a synonym almost, a synonym for improved productivity performance. That's my hypothesis.

What I'm saying tonight is I've only got one observation in the data that is consistent with that so far and I hope I get some more but time will tell.

Q. Stephen Martin mentioned you are one of two Australians officials who are members of the Financial Stability Board. And I wonder if I could draw you on your views about the evolution of financial regulation both internationally and here in Australia since the Global Financial Crisis. So to be specific, are you comfortable about the trends that are emerging from the Financial Stability Board (FSB) and their application to our circumstances here in Australia. And depending on the answer to that question, can I draw you on the likely impact of the regulatory trends that have emerged and that we've observed and their impact on the structure of the Australian economy over the next five to six years or so?

A. Well you asked a question of someone who, when he attends Financial Stability Board meetings travels further than others and therefore endures more jetlag and has the latest start time to the conference calls, usually 11.00pm.

So at times I sort of may have an unduly jaundice view of the process.

The first point is, I don't think there were any, having seen what happens when we've had a major financial crisis, there were clearly some failings in the supervisory and regulatory process. I think it's hard to deny that. We didn't have them here I don't think. I think our supervisor did a good job and I would say, as I've said before I think by and large our major financial institutions were quite carefully managed and that's to their credit.

But in other countries they did have problems so you're always going to have some kind of regulatory response to that event. I don't think there is any doubt that the largest global players, the dozen or 15 really genuinely G-SIFIs to use that expression, did not have enough capital. They were over leveraged and they suffered liquidity problems as well, partly as a result of the balance sheet strains.

You can't let that persist. You have to try to, I think, reform the system to have more capital in institutions like that, higher quality capital, genuine loss bearing capital and at least some more attention to liquidity management and so on. Then there are a whole lot of agendas under the FSB but let me just stick with the major institutions.

That set of arrangements by and large has had very little bearing on our banks. Our banks are not G-SIFIs they will be D-SIFIs, they will be under the systemic framework for domestic institutions they will be captured and that will say to hold a little bit more capital, (but) not on the same magnitude as the JP Morgans and these other very very large global banks but a little bit more.

I don't think actually it will be that hard for them to meet that by the time it comes in which is some years away. I think one has to accept that it's likely that in the global banking system, yes, insisting on more capital to lessen the probability of the State having to step in again, it raises the cost of intermediation to the community that's correct. But I think in all honestly, the community, just has to accept that because the price of intermediation appears to have been too low before, and I think we have got to accept some change there.

Of course we have to modulate that, calibrate it, and I suppose to come to your question, the thing I found perhaps a bit unnerving about all the regulatory reform process is the shear speed with which very important decisions are being made.

I understand the sense of urgency that we don't feel here but my peers in America or Britain or Europe do feel and you can see why they feel that.

Nonetheless, Basel II took 20 years to negotiate. Basel III took 18 months to agree, it comes in over a long time but that was a very accelerated process of agreement. We're already finding in certain areas that some quite influential countries are feeling the need to tweak some of the parameters.

So there's a risk of unintended consequences if you're not careful that comes with speed. I've felt myself a little uncomfortable with that. Most of these things I don't think are going to be a great drama for us, you know some attention to capital but Australian Prudential Regulation Authority (APRA) has always had pretty conservative definitions of capital. Therefore the capital shortfall that would exist under the new rules is much smaller generally for our banks than it would be for many others. That reflects very well in APRA.

And on the liquidity side, which was the other big thing we've managed to find a way of handling the needs there. So I think for Australia this is manageable. For the globe, it's a lot of progress in a very short time and we need to be very attentive to the possibility of unintended consequences and I think that extends not just to bank regulation, it extends to the work on OTC derivatives clearing, it extends to things like Volcker Rules etc and the European equivalents.

All these things, it's going to be some time I think before we know for sure whether we've pitched them exactly right, but I think that's just almost you know unavoidable in the circumstance we're in, that's a long winded answer but I think that is an important question.

Endnotes

1. See Stevens G (2010), 'The Challenge of Prosperity', RBA *Bulletin*, December, pp 69–75. [back to text]
2. I noted two years ago that a ship load of iron ore, which five years previously had had the same value as 2,200 flat screen television sets, was by late 2010 buying 22,000 such TVs – an increase in that particular 'terms of trade' of a factor of ten. As of the current quarter the figure is 28,000. At the peak, it reached 38,000. [back to text]
3. In 2003, China's growth in real GDP of 10 per cent added 0.8 of a percentage point to global GDP. If China's growth in 2013 is 7 per cent, that will add a full percentage point to global GDP. [back to text]
4. I am old enough to remember when the ISM index was referred to as the 'NAPM' index, compiled by the National Association of Purchasing Management. [back to text]
5. Stevens G (2011), 'The Cautious Consumer', RBA *Bulletin*, September, pp 77–82. [back to text]
6. The focus on households is not to deny that businesses have also become more circumspect about debt as well. But corporate leverage did not really rise much in the preceding decade, at least outside a few celebrated instances. It was the change in household debt that was the defining feature of the period from the early 1990s to about 2008. [back to text]
7. See Stevens G (2010), 'The Challenge of Prosperity', RBA *Bulletin*, December, p 75. [back to text]
8. The background to this is that, as part of our preparations for possible questions about productivity from the House Economics Committee, I had at one stage asked the Reserve Bank staff to compile a list of areas of reform that the Productivity Commission had covered at various times. It was this list I had in mind when I made the comment in June. At one hearing of the House Economics Committee I in fact read from such a list. See House of Representatives Standing Committee on Economics (2011), *Reserve Bank of Australia Annual Report 2010*, HRSCE, Melbourne, 26 August. Available at <http://parlinfo.aph.gov.au/parlInfo/download/committees/commrep/306ee889-2f7e-4661-964b-5264b58b7169/toc_pdf/Standing%20Committee%20on%20Economics_2011_08_26_393_Official_DISTRIBUTED.pdf;fileType=application%2Fpdf#search=%22committees/commrep/306ee889-2f7e-4661-964b-5264b58b7169/0001%22>. [back to text]
9. See Banks G (2012), 'Productivity policies: The "to do" list', Speech at the Economic and Social Outlook Conference, 'Securing the Future', Melbourne, 1 November. Available at <http://www.pc.gov.au/__data/assets/pdf_file/0009/120312/productivity-policies.pdf>. [back to text]
10. See Banks G (2012), op. cit. p 20. [back to text]

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