The Tasmanian Experience

LESSONS FOR NEW ZEALAND

Jeffrey Rae

New Zealand Business Roundtable

January 2002

The New Zealand Business Roundtable is an organisation comprising primarily chief executives of major New Zealand businesses. The purpose of the organisation is to contribute to the development of sound public policies that reflect overall New Zealand interests.

First published by the New Zealand Business Roundtable,
PO Box 10–147, The Terrace, Wellington, New Zealand
http://www.nzbr.org.nz

ISBN 1–877148–75–X

Design and production by *Daphne Brasell Associates Ltd, Wellington*
Typeset by *Chris Judd, Auckland*
Printed by *Astra Print Ltd, Wellington*

CONTENTS

LIST OF FIGURES

ABOUT THE AUTHOR

Jeffrey Rae is a director of ACIL Consulting, an Australian economic and policy consultancy firm, and manages its Melbourne office.

He is an economic and policy analyst who has applied his skills to policy issues such as competition, business regulation, industry development and the environment. He has worked on most sectors of the economy including primary industries and natural resources, manufacturing, energy, transport and communications, and financial services.

Before joining ACIL Consulting Jeffrey Rae worked for the Australian Commonwealth government for over 30 years. He held senior executive positions in the Department of Finance, the Department of Primary Industries and Energy, the Bureau of Agricultural Economics and the Industry Commission. In the late 1980s and early 1990s, he worked in Paris for the Organisation for Economic Cooperation and Development and, in the early 1980s, he worked in the New Zealand Treasury.

ACKNOWLEDGEMENTS

I would like to acknowledge the contributions of the many people who assisted me in the completion of this project. It was originally conceived as a speech to the Rotary Club of Auckland in December 2000 but was subsequently transformed into the present report.

I received many valuable comments and suggestions from family, friends and colleagues on an earlier paper that formed the basis for this report. I specifically want to acknowledge the contributions of Michael Irwin, Roger Kerr, Cherylee Rae and David Trebeck. The responsibility for any remaining errors is, of course, my own.

I am grateful to Roger Kerr for his guidance and very considerable patience with this project. The process of updating the material I had originally prepared for the Rotary speech and then converting it to its present format took longer than either of us expected. I trust that the wait proves to have been worthwhile.

Finally, I wish to thank Ann Henare, the other staff of the New Zealand Business Roundtable and Cherylee Rae for their unflinching assistance in editing and preparing the report for the printer. No author was ever better served.

EXECUTIVE SUMMARY

One of the challenges faced by Australasia – that is, Australia and New Zealand – is the additional costs of doing business with the rest of the developed world, and vice versa. These costs go beyond the obvious – for transport and communications – to the costs of the infrastructure required to service customers and business partners, as well as of tapping global capital markets.

Australasia's economic challenge is not confined to its relationship with the rest of the world. Its 'outer regions' – particularly Tasmania and New Zealand – face a similar economic challenge *within* Australasia, even allowing for the differences between them.

Owing to its smaller size, the risks for Tasmania in this regard are more acute than those faced by New Zealand. For this reason it is useful to examine Tasmania's economic performance for clues about the risks for New Zealand.

During the 1980s and 1990s the economic performance of Tasmania compared with the rest of Australia was dismal:

- its economic performance was consistently and significantly inferior;
- there was a deterioration over the period in all the key economic indicators;
- Tasmania's rate of investment was lower than that for the rest of Australia and declined over the period;
- its labour market participation was lower, its unemployment rate was higher and there was no growth in full-time jobs;
- residents left the State in increasing numbers; and
- the population declined and the decline is expected to continue.

I have used the term 'Tasmanian' to describe a combination of economic outcomes, such as those noted above, that are generally agreed to be highly unsatisfactory.

While size and location factors are likely to have some bearing on a country's economic performance, the quality of its institutions[1] and policies are vastly more important in explaining the performance of peripheral economies.

Tasmania's unsatisfactory institutions have contributed to its dismal performance. The electoral system of proportional representation, for instance, has tended to deliver minority government. This, and the independent character of Tasmania's upper house, resulted in a reluctance by governments to address issues no matter how urgent they became.

---

1 Institutions are man-made rules that constrain possible arbitrary and opportunistic behaviour in all human interaction. They are shared in a community and sanctions are imposed if they are violated. In this technical sense institutions are distinguished from organisations. Institutions are the rules of the game whereas organisations are the players.

Poor public policy also contributed to the dismal performance by creating an economic environment unattractive to business.

- Government spending and borrowing have been excessive, and there have been poor returns on investment in state-owned enterprises.
- Tasmania has the second most severe taxation system of the Australian states and the burden falls heavily on business.
- Excessive regulation has stifled business innovation and competition. This is most pronounced in the environmental area where there has been a perception that Tasmania is opposed to economic development.
- Despite generous federal parliamentary representation, Tasmania has been unable to resist many federal policies that clearly disadvantage the State.

The Tasmanian experience of the 1980s and 1990s points to some critical lessons for other small and remote economies such as that of New Zealand.

The first lesson is that, while geography affects economic performance, governments can do little directly to reduce any adverse impact that it may have.

The second lesson is that small and remote economies have few inherent attractions and some inherent disadvantages for investors. The attractiveness of these economies to investors will be readily downgraded if their economic performance or prospects are only assessed as modest.

The third lesson is that appropriate labour market regulation that allows wages and other conditions of employment to be set in response to the demand for, and supply of, particular classes of labour in particular localities is necessary to foster employment and economic growth. When wages and conditions are set on a national basis without regard to local conditions, unemployment among people with skills in abundant supply and shortages of people with skills that are in demand are accentuated. Areas with high unemployment are unable to retain or attract industry by supplying labour at wage levels that are attractive to potential employees and offset any additional non-labour costs arising from size and geography. The upshot of inappropriate labour market regulation is lower investment, fewer job opportunities and higher unemployment.

The fourth lesson is that when economic performance suffers, residents will leave and migrants who might have taken their place will find other places to settle. Moreover, those who leave, or do not come, tend to be among the ‘best and brightest’ – those with the most valuable skills together with prospective entrepreneurs and business risk-takers.

There is the possibility that departures will increase the dependency ratio – leaving fewer workers to support a given number of social security beneficiaries. In such cases the consequences can be either cuts in government services or increases in tax rates, with the ultimate risk of a vicious spiral of tax increases and declining incentives to invest, work and stay.

The fifth and most important lesson is the crucial importance of sound institutions and sound public policies.

Of the institutional risks, perhaps the most immediate is the proportional representation system of voting. Proportional representation is not easily grafted on to a Westminster parliamentary system without the risk of a severe unanticipated reduction in the effectiveness and efficiency of government.

Proportional representation can institutionalise minority government and political instability, weaken political leadership, blur lines of responsibility, reduce accountability and lead to policy paralysis. In such instances economic development suffers.

The confluence of institutions and public policy can be profoundly anti-business in its effects, even if that result is unintended. The risk is greatest when there is an anti-business bias across the key areas of public policy – public expenditure, taxation and regulation.

When governments are not prepared to exercise fiscal discipline, there is a risk of growing levels of government spending and debt with attendant debt servicing burdens on the budget. High levels of public debt are an impediment to economic development.

However, even where governments avoid unsustainable fiscal deficits, many do so by maintaining high levels of taxation – rather than cutting public expenditure – and by concentrating the tax burden on business. This discourages business investment and, hence, economic development.

Excessive regulation discourages economic development that could benefit the community as a whole. Too often the marginal benefits of regulatory proposals do not outweigh related costs. Poorly conceived environmental regulation can bring economic development to a virtual standstill.

Government ownership of businesses, on average and over time, is detrimental to growth and development. There are many reasons for this. Such businesses are not subject to the same disciplines as private businesses. Political considerations affect their pricing, investment and employment decisions. Government-owned businesses may enjoy competitive advantages, and add to the risks faced by competing private firms.

The final lesson is that solutions to poor institutions and poor public policy are entirely in the hands of the community in question. They are not necessarily realised simply by greater economic integration with a few key economic partners.

Internal free trade, a common currency and the removal of economic barriers to growth and development within Australia have not been enough to ensure Tasmania's economic prosperity. On the contrary, Tasmania shows how easy it is for a peripheral economy to dissipate the benefits of economic integration through its own mismanagement.

This does not deny the importance for small and remote economies, like New Zealand, of pursuing opportunities for greater global economic integration – for example, by reducing their barriers to trade with the rest of the world. Nevertheless, selective economic integration – such as New Zealand adopting a common currency with Australia

– does not always make sense and does not reduce the crucial role of domestic choices in achieving good economic outcomes.

In short, while size and location may constitute some natural disadvantages for New Zealand, the basic conclusion of this study is that they are most unlikely to prevent it from achieving similar levels of prosperity to those of high-income countries. Despite New Zealand's improved economic record following the reforms of the 1980s and early 1990s, the subsequent weakening of its institutions and policies is the most likely cause of its return to a mediocre performance. New Zealand can avoid a Tasmanian future but to do so it will need to adopt and then maintain superior arrangements.

1

INTRODUCTION

In 2000 Roger Kerr approached me about preparing a speech to the Rotary Club of Auckland on the lessons for New Zealand that can be drawn from the recent economic experience of Tasmania. At the time, I agreed with some enthusiasm. My reasons for doing so were both professional and personal.

From a professional point of view, the public policy issues that the subject matter raised intrigued me most.

The recent economic experiences of Tasmania and New Zealand are so different, yet so alike. Both countries are small and peripheral parts of an Australasia that is, in turn, small and peripheral in global economic terms. Despite New Zealand's improved economic performance in the mid-1990s, Tasmania and New Zealand have been chronic economic under-achievers in a region that has not exactly been noted for the strength of its economic performance for much of the postwar period.

My interest in the public policy aspects of the story arose from the fact that Tasmania and New Zealand each chose to respond to what was, essentially, the same challenge in quite different ways. At least until recently, Tasmania's response could be characterised as policy inertia. This was in sharp contrast to New Zealand's bold innovations in economic policy that earned it plaudits worldwide. For me, this juxtaposition is as close as one can get to analysing and reporting a real live economic experiment.

In addition to this professional interest, I had a personal reason for accepting the assignment.

At the beginning of the 1980s I was employed by the Commonwealth Department of Finance in Canberra and was selected for a staff exchange with the New Zealand Treasury. In nearly a year and a half in New Zealand I formed a great affection for the country and was fortunate to make many friendships, social and professional, which continue to this day.

Upon my return to Canberra, John Peoples – the New Zealand half of my exchange – introduced me to the person who would become my wife. As it turned out, my wife-to-be was a fifth generation Tasmanian and Bass Strait Islander. Many subsequent visits to Tasmania have alerted me to the State's wonderful people and lifestyle. Unfortunately I have also been made very aware of the practical realities of raising a family on modest means and of finding work in difficult economic circumstances. It is a matter of some personal regret that younger family members have had to leave Tasmania because the job and career prospects were so much better elsewhere in Australia.

My presentation to Auckland Rotary in December 2000 on these issues apparently generated some interest on both sides of the Tasman. In the light of this interest Roger Kerr invited me to turn the text of my speech into a paper for publication. This is the result.

The rest of the paper is organised around five sections. In the next section (section 2) I canvass the economic challenge that collectively faces Australasia on account of its small economic weight and its remoteness in 'time and space' from the rest of the economic world. In section 3, I extend this analysis to the similar challenge that exists within Australasia for the peripheral economies of Tasmania and New Zealand. I then examine Tasmania's economic report card, point by point (section 4), and analyse the likely contributors to its poor performance (section 5). Finally, I conclude with an attempt to draw out some lessons for New Zealand.

2

THE AUSTRALASIAN CHALLENGE

When I was at primary school my geography teacher taught us that 'Australasia' was the accepted term to cover the geographical combination of Australia and New Zealand.

At the time, I thought it was an odd term. After all, if you add New Zealand to Australia why should the result be somewhat Asian. For that matter, should not the use of New Zealand ingredients require the title of the recipe to have a Polynesian flavour. I suspect that these anomalies were behind the reasons that the term never caught on among Australasians.

Unfortunately we have not bothered to think up a more popular replacement. In one sense this is surprising. After all, the Australasians have much in common and much that distinguishes them from the rest of the world. The point is obvious when we reflect on the ANZAC experience of the First World War that helped to define the national character of both countries. Nevertheless, it is also true of other shared experiences that are more commonplace.

In the sphere of economic activity, the nearest thing that Australasians have to refer to, that captures our common identity and experience, is the term 'CER' or Closer Economic Relations.[2] Australasian trade bureaucrats invented this prosaic acronym in the 1980s to describe a process of removing artificial barriers that separate the two countries' economies. Despite the success of these changes in allowing greater economic integration, the term CER has not entered into common usage to describe the economic or geographical entity that my geography teacher used to call Australasia.

For all these reasons I will revert to the advice of my geography teacher and use the word 'Australasia' to describe the sum of our two countries. I do so without imperial intent but out of practical necessity.

From a world perspective, Australasia is pretty insignificant in economic terms. A moment's reflection will highlight this fact.

To begin with, the population of Australasia is a mere 23 million and the region manages to produce only 2 percent of the gross domestic product (GDP) of all the countries belonging to the Organisation for Economic Cooperation and Development (OECD). To the rest of the world, the Australasian economy is based on the production of primary commodities – such as minerals, wool, meat, timber and seafood – rather than elaborately

2 The term CER is itself shorthand. The full title is a proverbial mouthful – the Australia New Zealand Closer Economic Relations Trade Agreement. I cannot even imagine how you begin to use such an acronym – ANZCERTA – in polite conversation.

transformed manufactured goods or sophisticated business services. Moreover, the rest of the world has traditionally viewed any prospects outside of primary commodity production as limited and unexciting. The perspective is often summarised as 'new world' countries with 'old world' economies.

From the vantage point of the other members of the OECD, Australasia is not only insignificant in size and prospects but it is also very isolated.

For the purposes of illustration I use Sydney as my Australasian reference point because it is located near the economic 'centre of gravity' of the region. As much economic output is produced north of Sydney as it is south, and as much is produced east of Sydney as it is west.

Sydney is about as far as you can go from the important business centres in the OECD and still be on earth. It is 17,000 kilometres from the City of London. Frankfurt and Paris may be nearer but the difference is irrelevant for all practical purposes. Silicon Valley is 12,000 kilometres away and Wall Street is in between these two at 16,000 kilometres.

Australasia's isolation from the rest of the developed world is, however, not just a matter of distance. It is also a matter of time.

Australasia occupies different time zones from most of its cousins in the OECD. Again, using Sydney as the reference point, Australasia is nine to 10 hours ahead of Western Europe and 14 to 18 hours ahead of North America. Normal business hours in the North Atlantic region of the OECD are, on average, night time in Australasia – not the most congenial time to be conducting business, particularly if you also have to service your Australasian customers during normal business hours.

These examples illustrate the tyranny of time and space with which economic development in Australasia must contend. Like all tyrannies this one exacts a price from those who live under it. In this case, the price is the additional transaction costs that are imposed on Australasians who do business with the rest of the developed world. And, conversely, on the rest of the world doing business with Australasia.

These transaction costs are not just the obvious ones, for example the costs of shipping goods to faraway places or of staying in touch with customers and business partners on the other side of the world. They also involve more indirect and subtle costs including those of establishing and maintaining an effective infrastructure to support critical business functions – such things as logistics, marketing, customer support and product development.

Other examples of less transparent costs include those incurred in tapping the major global capital markets centred on London, Frankfurt, Chicago and New York. Because Australasia only produces 2 percent of OECD gross domestic product, assets denominated in Australian or New Zealand dollars represent, at best, a niche market for lenders in these capital markets. At worst they will be ignored because much of the cost of obtaining the information and analysis required to assess investment possibilities does not vary with the capitalisation of the market segment.

Australasian businesses will therefore always have to work that much harder than their North American or European counterparts to attract the investment funds that they require to sustain or develop their operations.

The risks and cost of carrying out these critical business functions are greater when a business does not have the luxury of a large home base on which to build that infrastructure.

Given the small size of the Australasian economy and, at least until recently, its less-than-impressive growth performance, the disadvantages of time and space has meant that interest in business opportunities involving Australasia has been low and sporadic. Australasia has had to fight the whims of economic fashion and this has not been to its economic advantage.

The problem of time and space is such that even relatively large and successful Australasian businesses are finding it increasingly difficult to maintain their original character. If such businesses are to continue to grow and become truly global players, the commercial pressures to relocate their headquarters to North America or Europe are very considerable – as the recent experience of BHP, Brambles, the National Australia Bank and James Hardie Industries attest. These pressures are unlikely to abate.

BHP merged recently with Billiton plc to create a global mining house that could rival the likes of Rio Tinto, Anglo-American and Alcoa. While Billiton plc was headquartered in London, the terms of the merger agreement mean that the head office of BHP Billiton will be in Melbourne. In part, that decision reflects the sensitivity of BHP to the political risks in corporate emigration for an Australian icon with significant investment exposure in its country of origin. Nevertheless, most securities analysts believe that the company will eventually relocate – it is only a matter of time. BHP Billiton is listed on both the Australian and London Stock Exchanges and the majority of the senior executives who are responsible for its different commodity businesses are already located outside Australasia.

On the other hand, Brambles, a large Australian transport company, felt that it had no choice on the issue of location. As soon as it merged with London-based GKN plc, the new company set up its headquarters in London.

The National Australia Bank (NAB) is the largest bank in Australasia, although globally it only ranks thirty-first in terms of banking assets. The NAB has nearly half of its assets outside Australasia, with major banking subsidiaries in Ireland and the United Kingdom. For some time now, financial media sources in Australia and the United Kingdom have reported that the NAB is seriously considering acquiring another regional bank in the United Kingdom. If the NAB were to succeed, it is expected to list on both the Australian and London Stock Exchanges.

James Hardie Industries has announced that it will transform itself into a foreign company in a bid to reduce Australian withholding tax on its substantial earnings in the United States.[3] The company proposes to establish a subsidiary based in the Netherlands and list on the New York Stock Exchange. The move is seen as a model for other Australian companies with significant US earnings.

As we will see, however, the economic challenge faced by Australasians is not confined to the difficulties they encounter in conducting business on a global level. The economic challenge *within* Australasia is similar in nature for some of its outlying areas even if the extent of the challenge is less pronounced and less obvious.

---

3 Peter Kormendy and Allesandro Fabro, 'Hardie leads way in tax shift offshore', *Australian Financial Review*, 25 July 2001.

3

THE CHALLENGE WITHIN AUSTRALASIA

When you look at a map of Australasia the one thing that stands out is that there are relatively few densely populated areas and those few are separated by a lot of space.

Closer inspection reveals a region that is dominated by the landmass of mainland Australia where some 18 million people produce 85 percent of the Australasian GDP. To the south and south-east of the Australian landmass are two clusters of small islands.

The southern group of islands is the Australian State of Tasmania. There, just under half-a-million people produce less than 2 percent of the Australasian GDP.

The south-eastern group of islands is, of course, New Zealand. It is substantially bigger than Tasmania with a population of nearly 4 million and it produces just under 13 percent of the Australasian GDP.

From a European perspective the differences in time and space *within* Australasia are immense. The Australasian region spans four time zones and is over 5,000 kilometres from west to east. These considerations mean that there is also a problem of time and space within Australasia and that this is particularly pronounced for its Tasmanian and New Zealand peripheries.

As a consequence, the transaction costs of doing business between Tasmania and New Zealand, on the one hand, and the Australian mainland, on the other, are quite high. Thankfully, these costs are generally not as high in absolute terms as those in dealing with the rest of the world, although there are some notable exceptions.

This internal disadvantage of time and space is one of the reasons why the level of economic integration that has been achieved within Australasia is lower than is the case for neighbours that are physically closer. In the past, government policy in each country compounded this problem by erecting high barriers to trade between the two.

Notwithstanding success of CER in removing trade barriers between them, Australia and New Zealand are not as integrated as either Canada and the United States in North America, or the countries of Western Europe. In the case of the European Union (EU), on average nearly half of the exports of each EU member goes to other members of the Union.[4] In contrast, Australia only sends some 8 percent of its exports to New Zealand and, in return, receives 22 percent of New Zealand's exports.[5]

---

4 *The Economist Diary 2001*, London, 2000, p 137.

5 *The Economist Diary 2001*, London, 2000, p 47.

Locally dominant businesses in Tasmania and New Zealand face strong commercial pressures to acquire other businesses in Australasia to grow. They may also be acquired by larger Australasian businesses. However, even where the local business is the acquirer, the company headquarters often ends up shifting to mainland Australia.

In Tasmania in recent years, these commercial pressures have seen Rolf Voss supermarkets acquired by Woolworths, the Trust Bank by Colonial and the merger of Websters and Roberts, the two Tasmanian stock and station agents and wool brokers. The trends are such that concern is increasingly expressed in the State about its drift towards a 'branch office' economy within the Australian Federation and the implications of such developments for the State's economic performance.[6]

On the New Zealand side of the Tasman, Lion Nathan, Fernz Corporation (now Nufarm), Baycorp, Carter Holt Harvey and Telecom have each moved to list on the Australian Stock Exchange and have relocated their headquarters to mainland Australia or have considered doing so. As a consequence of similar moves by many of New Zealand’s largest companies, the market capitalisation and liquidity of the New Zealand Stock Exchange has suffered and the Exchange is considering the possibility of merging with another exchange.

The isolation of Tasmania and New Zealand within Australasia therefore accentuates the risks that these two countries share with the rest of the Australasian region as a consequence of the region's isolation from the rest of the developed world. Due to its much smaller economy, the risks faced by Tasmania are likely to be much more pronounced than they are for New Zealand. For this reason it is useful to examine how well Tasmania has performed in the economic sphere over recent years compared with the rest of Australia because that experience is likely to contain significant lessons for New Zealand.

---

6 Some of the most recent expressions of concern are to be found in the Tasmanian government's second Industry Development Plan. For further information, see Tasmanian government, *Industry Development Plan 2000*, Tasmanian Government Printer, May 2000, p 26.

4

THE TASMANIAN ECONOMY AND ITS PERFORMANCE

Before proceeding, I will provide some brief details of the Tasmanian economy. These will serve as a backdrop to subsequent discussion as to how well the State has performed compared with the rest of Australia and why it has performed the way it has.

4.1 The Tasmanian economy in brief

Tasmania is the smallest of the six Australian states. This is true no matter what measure is used – physical area, population or economic output.

Despite its small size, the State possesses considerable natural advantages. It has been blessed with abundant and high-quality natural resources. Its temperate climate, reliable rainfall and fertile soils, as well as its forests, fisheries, rivers and coastal waters, are more productive than those in most other parts of Australia. The quality of its natural assets is also a significant reason why residents and visitors both rate Tasmania so highly on the non-economic dimensions of the quality of life.

The State has also been fortunate in inheriting many of the man-made foundations for economic success:

- the rule of law;
- stable constitutional government;
- a well-educated and industrious population;
- access to knowledge and ideas; and
- an absence of serious social conflict.

That said, one must also admit that the State does have some evident natural disadvantages.

First, Tasmania suffers from the disadvantages of time and space twice over. Not only is Tasmania a long way from export and international financial markets, it is also separated by Bass Strait from mainland Australia. Bass Strait may not be the widest stretch of inhospitable sea in the world but it is bad enough to add considerably to the costs for Tasmanian producers and consumers of accessing world and mainland Australian markets.

Second, the State's population is both small in numbers and low in density, even by the relatively sparse standards of Australia's inhabited areas located in the south-eastern corner of the continent. The net result of its low population density is an inability to exploit the potential economies of scale and scope in the delivery of many services – such as government services, retail, transport and distribution.

Third, the Tasmanian economy has been developed on a narrow industrial base. Most economic activity is associated with the production of commodities – principally minerals, wool, dairy, meat, timber and wood products, horticulture and seafood.

While Tasmania has a reasonably large manufacturing sector, its manufacturing activity has concentrated on the initial processing of raw materials and minerals – rather than on the production of sophisticated manufactured goods. There are, however, some notable exceptions. For example, the State is a world-class producer of large catamaran ferries.

As with other developed economies, Tasmania has a large services sector, but this sector has focused mostly on tourism, health and community services. The State produces little by way of financial or business services.

For most of the twentieth century Tasmania's economic development was underpinned by the exploitation of the hydro-electric potential of the State's rivers. The State has no other energy sources that it can draw upon on any scale. Since the early 1980s the development of new dams for hydro-electric generating capacity has come to a complete halt. Indeed, the State expects to become a net importer of electricity with the completion of the proposed Basslink interconnector to the south-eastern Australian electricity grid.[7]

There are striking parallels between the Tasmanian and New Zealand economies. They include reliance on producing primary commodities, the limited range of commodities produced, the relatively narrow scope of their industry sectors, the importance of hydro-electric energy and the virtual cessation of new hydro-electric development.

For all these similarities there are also significant differences between the two economies. New Zealand has a far more broadly based economy than Tasmania. Its greater economic breadth is best illustrated by its more sophisticated services sector, notably in the areas of financial and business services.

4.2 Tasmanian economic performance

Since it joined the other five Australian colonies to form the Commonwealth of Australia on 1 January 1901, Tasmania has not achieved anything approaching its economic potential. When one looks back over the past century one is struck by the glaring gap between Tasmanian achievement and Tasmanian potential.

---

7 The effective conclusion of the State's hydro-electric programme may be dated from the passage of Commonwealth regulations on 1 March 1983 to block construction of the proposed Gordon-below-Franklin dam by the Tasmanian government of the day.

What is particularly worrying is the deterioration in Tasmania's performance compared with the rest of Australia since the end of the 1980s.

The recession in 1991–92 adversely affected Tasmania in line with the rest of Australia. The recovery from that recession has seen mainland Australia perform very strongly but Tasmania stagnate. In short, the rest of Australia has achieved record highs on the economic front while Tasmania could only manage record lows. Peter Nixon, a former Commonwealth parliamentarian and cabinet minister, conducted an inquiry into the Tasmanian economy in 1997 on behalf of the Commonwealth and the Tasmanian governments. In his report, Nixon characterised the performance of Tasmania as 'dismal'.[8]

The extent and the duration of this relative decline by the Tasmanian economy is a cause of considerable concern, not least to those Australians who happen to live there but also to those in the rest of the country who are called to underwrite the State's living standards. Tasmania's dismal performance is reflected in each and every one of the following economic indicators:

- economic output and productivity;
- employment, unemployment and labour market participation;
- private and public investment;
- population growth and migration; and
- public finances.

To illustrate the full extent and severity of the Tasmanian problem, I have outlined the outcomes that have been realised in each of these areas in turn. One of the most striking and worrying aspects of this record is that there are so few positives to be drawn from it. It is hard to imagine a more sombre message.

4.2.1 Output and productivity

Peter Nixon concluded that:

> The output and productivity of the Tasmanian economy is a matter of serious concern.[9]

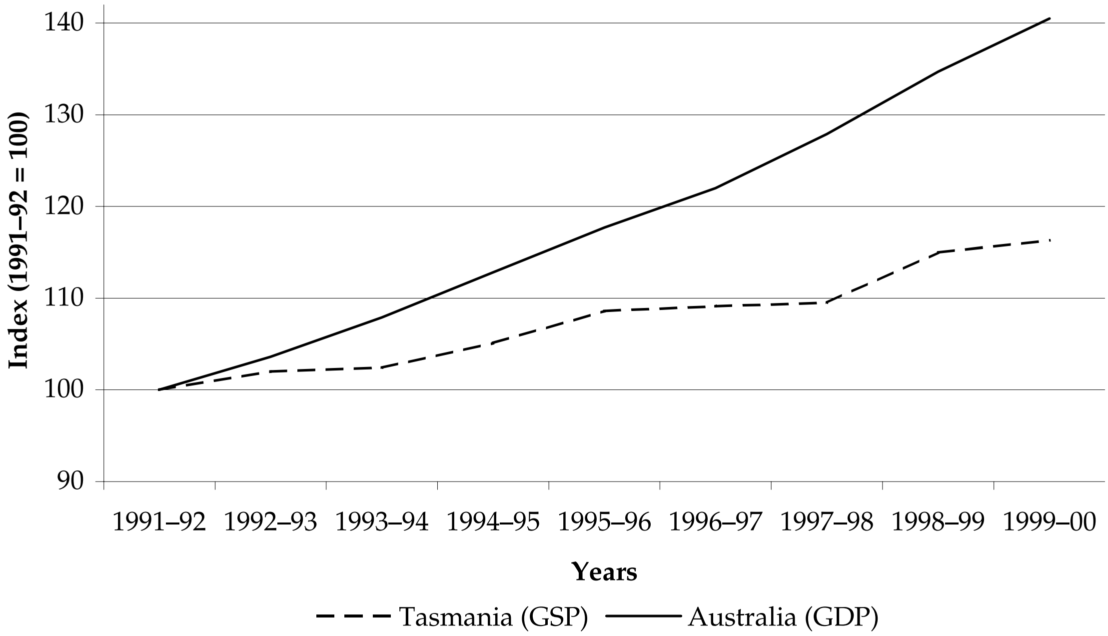
Given the centrality of output and productivity to economic performance, these spare words do not exaggerate the seriousness of the difficulties confronting the Tasmanian economy, as the following figures make abundantly clear.

---

8 Hon Peter Nixon AO, *The Nixon Report: Tasmania into the 21st Century*, Report to the Prime Minister of Australia and the Premier of Tasmania, Main Report, July 1997, p 35.

9 Nixon, *op cit*, p 39.

Figure 1: Gross domestic product (GDP)/gross state product (GSP) growth rates



Source: Australian Bureau of Statistics, *Australian National Accounts: State Accounts*, Cat No 5220.0, Canberra, 23 November 2000.

Output

Between 1985–86 and 1998–99, the Australian economy expanded by more than 53 percent in real terms.[10] Over the same 13-year-period the Tasmanian economy increased by only 17 percent in real terms, the smallest increase of any of the Australian states.[11]

This means that Tasmania has achieved just less than one-third of the gains in economic output that have been posted by the rest of the country.[12] Moreover, the 'output gap' was even greater between Tasmania, on the one hand, and Queensland and Western Australia, on the other, where State economic output has grown faster than the national average.[13]

10 The Australian Bureau of Statistics (ABS) measures the value of output in terms of the latest international standards for national accounting. At the national level, the national accounting concept of output is referred to as gross domestic product. For the Australian states and territories the equivalent concept is known as gross state product (GSP). While its GSP estimates are essentially a dissection of national GDP, there are no detailed international standards for this measure. The ABS, therefore, describes its GSP estimates as 'experimental' and subject to greater margins of error than its estimates of GDP, particularly the estimates for the smaller states and territories. For further details, see Australian Bureau of Statistics, *Australian National Accounts: State Accounts*, Cat 5220.0, Canberra, 23 November 2000.

11 See Nixon, *op cit*. The period examined was limited by the availability of GSP estimates from the ABS.

12 For the purposes of this and the subsequent discussion any economic indicator for Australia has essentially the same value as it does for Australia less Tasmania (or the rest of Australia) given the small size of the Tasmanian economy.

13 Nixon, *op cit.*

More recently the 'output gap' between Tasmania and the rest of Australia seems to have narrowed somewhat. Nevertheless, the performance of the State over the most recent economic cycle – that is, since the recession at the beginning of the 1990s – shows no sign of any consistent or sustained improvement compared with the rest of the country. For example, in the nine years since 1991–92, the Australian economy grew by 41 percent, compared with 16 percent for Tasmania.[14] Figure 1 provides the details. In only one year of this period – 1998–99 – did the Tasmanian economy grow at a faster rate than the Australian economy as a whole.[15]

According to traditional growth accounting, how much an economy produces at any one time is a reflection of how much land, labour and capital it draws on and how productive those factors are. For this reason when assessing an economy's performance it is important to examine its productivity performance as well as how much it produces in aggregate.

Productivity

At the economy-wide level, the broadest measure of productivity is the value of output produced per head of population. This measure shows that the productivity of the Australian economy as a whole grew by more than 28 percent over the most recent economic cycle – that is, from 1991–92 to 1999–00.

In contrast, over the same period, Tasmanian output per capita grew by only 16 percent, or less than 60 percent of what was achieved nationally. The State's performance was clearly the weakest of all the Australian states and was significantly less than South Australia, the next worst performer (see Figure 2). As the ABS has pointed out, these differences are significant.[16]

Output per capita is a very broad measure of productivity because it uses the total population as a proxy for the quantity of inputs used. The heterogeneity of the inputs means that estimating their total volume – for example, using multi-factor productivity measures – is quite difficult in practice and requires a lot of data. For this reason, most of the practical alternatives to output per capita centre on the use of partial productivity measures – that is, measures of the total output produced by each unit of labour (labour productivity) or of capital (capital productivity).

Partial measures have to be used with some care because they do not discount for the effects of any substitution of one input for another. Nevertheless, the message from

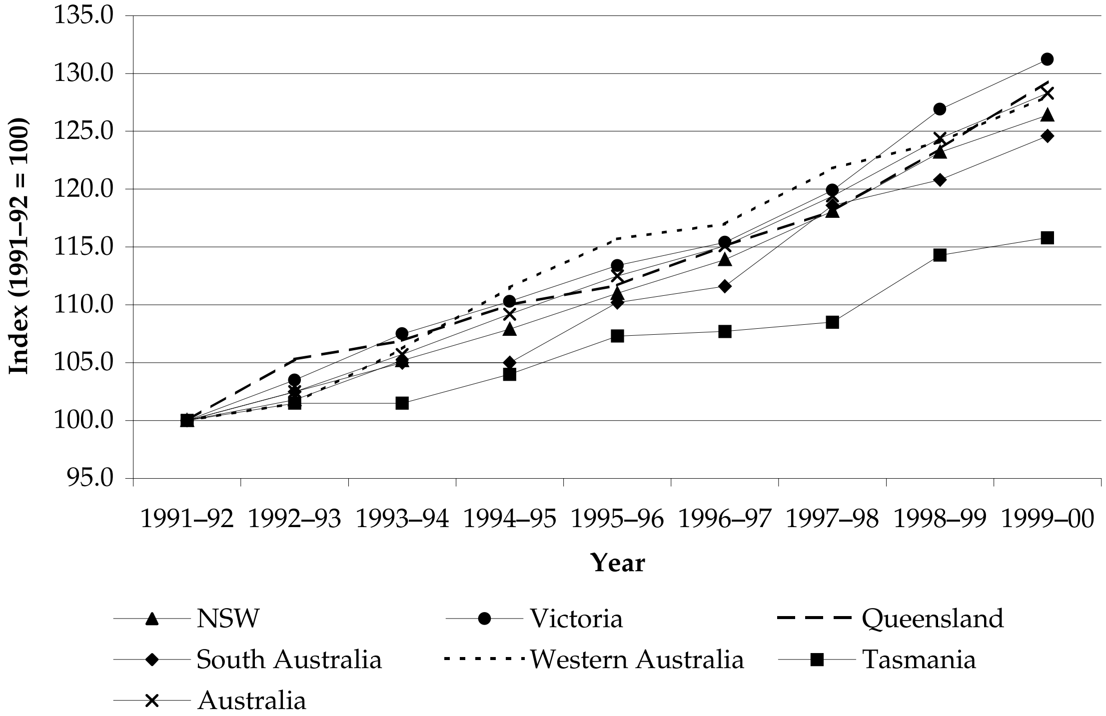
---

14 Australian Bureau of Statistics, *Australian National Accounts: State Accounts*, Cat No 5220.0, *op cit*.

15 Australian Bureau of Statistics, *Australian National Accounts: State Accounts*, Cat No 5220.0, *op cit*. The Tasmanian Department of Treasury and Finance has pointed out that, to date, the ABS estimates of GSP for Tasmania have been quite volatile. The department considers that the ABS estimates overstate the growth in the Tasmanian economy in 1998–99 and understate it in 1999–00 – see Tasmanian Department of Treasury and Finance, *Budget Paper No 1 1999–00*, May 1999 for details. Even if the department is correct in its assessment, two years' estimates are not enough to establish the existence of a sustained turnaround. In other words, they would be insufficient to confirm that the State was closing the output gap with the rest of the country.

16 Australian Bureau of Statistics, *Australian National Accounts: State Accounts*, Cat No 5220.0, *op cit*, p 3.

Figure 2: Australian states – GSP per capita



Source: Australian Bureau of Statistics, *Australian National Accounts: State Accounts,* Cat No 5220.0, Canberra, 23 November 2000.

the partial productivity measures is consistent with that shown in the output per capita figures in Figure 2.

In 1995–96, Tasmania had the second lowest labour productivity of the six Australian states. The value of output per hour worked in Tasmania was only $25.10 per hour in that year compared with $38.20 per hour in New South Wales. This made New South Wales the most productive of the Australian states and some 50 percent more productive than Tasmania.[17]

More worrying than the fact that Tasmania had the lowest *level* of labour productivity is the fact that the State has had virtually no *growth* in its labour productivity over the decade 1985–86 to 1995–96.[18]

This stands in very sharp contrast to the overall Australian experience in which real output per hour worked grew by more than 10 percent over the ten-year period.[19] Western Australia's labour productivity increased by more than 25 percent.

Recent research on multi-factor productivity in Australia by Dean Parham at the Australian Productivity Commission strongly suggests that Australia's productivity

17 Nixon, *op cit*, p 57.

18 Nixon, *ibid*.

19 Nixon, *loc cit*, p 57.

growth rate accelerated sharply over the 1990s.[20] As a consequence of this work, Parham has concluded that:

> Australia's productivity performance is now at an all time high. Productivity growth is faster now than in the … 1960s.[21]

Unfortunately, the Australian Bureau of Statistics (ABS) does not estimate multi-factor productivity at the state level so it is not possible to see how Tasmania compares with other states, or to the rest of Australia, on this score. Nevertheless, the evidence that is available points overwhelmingly to the likelihood that this acceleration in productivity growth has bypassed Tasmania.

A sectoral comparison of labour productivity performance between Tasmania and mainland Australia highlights the likelihood of such a divergence very well.

From 1985–86 to 1995–96, real output per hour worked in Tasmania either stagnated or declined in five of the 12 major industry sectors that are defined by the ABS.[22] These sectors included manufacturing, construction, wholesale trade, retail trade and cultural and recreational services.

In contrast, for Australia as a whole, each of these industry sectors recorded substantial labour productivity growth of between 1.9 and 8.2 percent a year averaged over the decade to 1995–96. Collectively they contributed around half of Australia's overall gain in labour productivity over this period.

There were only two industry sectors – mining and electricity, gas and water – in which the labour productivity performance of the Tasmanian economy seems to have been as good as it was in the country as a whole.

Implications for living standards

Productivity is a key determinant of living standards. As Paul Krugman, the noted US economist, has observed, growth in productivity may not be everything in raising community living standards but, over the long run, it is close to everything.

That said, material living standards are clearly a direct consequence of how much we consume. In its commentary on the *Nixon Report*, the Centre for Regional Economic Analysis pointed out that there have only been small differences in the rates of growth in real consumption per capita between the Australian states over the decade to 1994–95.[23] The average rate of growth in real consumption per capita was 1.5 percent a year for Tasmania and 1.8 percent a year for the country as a whole.

---

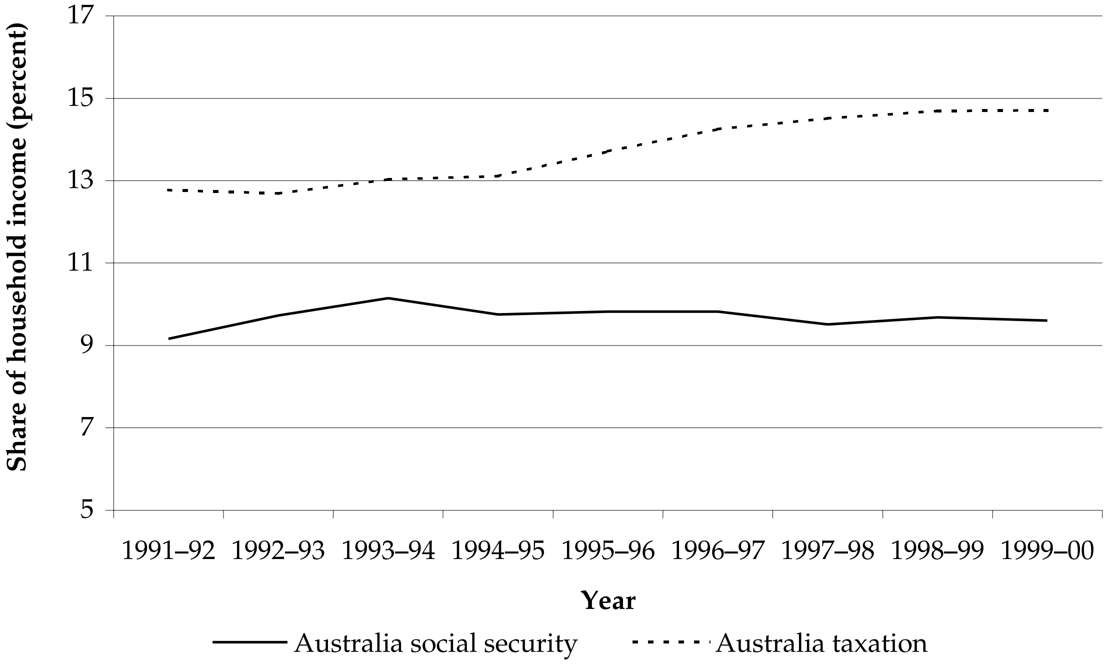
20 Multi-factor productivity measures seek to account for the contribution of each of the productive factors (land, labour and capital) in producing goods and services for the economy. For this reason they are more reliable than partial productivity measures – such as the value of output per hour worked – but they are also more difficult to estimate.

21 Dean Parham, *The New Economy? A New look at Australia's Productivity Performance*, Productivity Commission Staff Paper, Ausinfo, Canberra, May 1999. A more cautious view is expressed by John Quiggin, 'The Australian Productivity Miracle: A Sceptical View', *Agenda*, Vol 8, No 4, 2001, pp 333–348.

22 Nixon, *op cit*, p 58.

23 Centre for Regional Economic Analysis, *Nixon: The Issues*, Forum Facts prepared for the Tasmania 2010 Forum, University of Tasmania, August 1997, p 2.

Figure 3: Tax payable and social security payments received – Australia



Source: Australian Bureau of Statistics, *Australian National Accounts: State Accounts*, Cat No 5220.0, Canberra, 23 November 2000.

This means that Tasmanians have been able to enjoy a higher standard of living than is implied by how much they have produced or how productive they have been in doing so. However, this result does not confirm that all is well with the Tasmanian economy – contrary to what the Centre for Regional Economic Analysis at the University of Tasmania implied in its commentary on the *Nixon Report*.

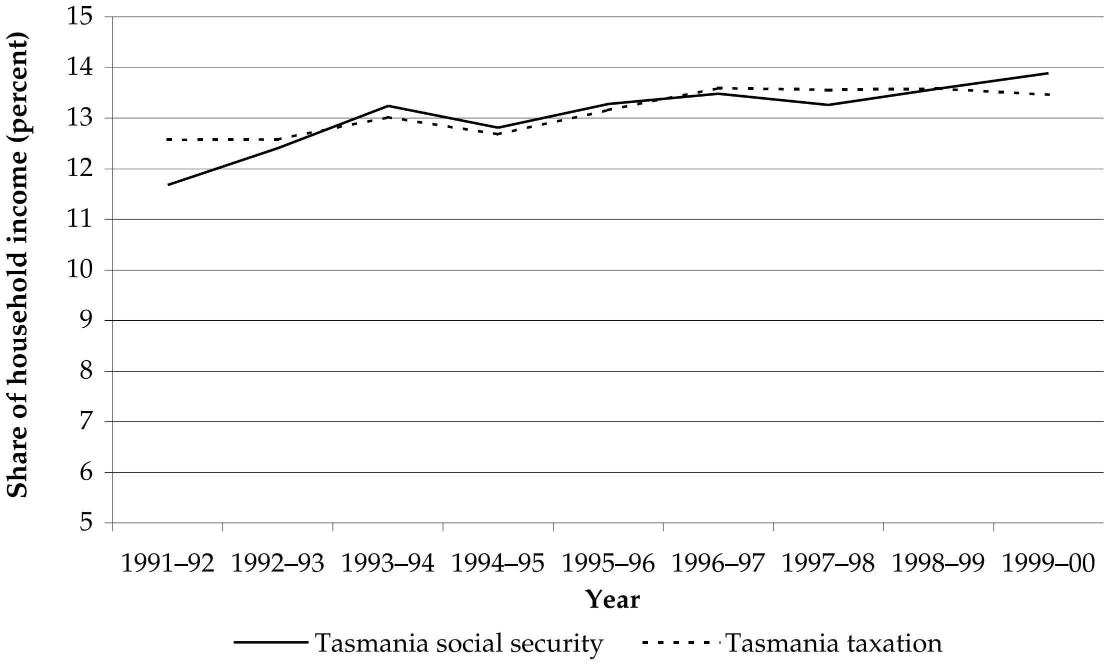
As the Tasmanian Department of Treasury and Finance has acknowledged, the fact that Tasmanian consumption has outstripped the State's output simply means that the value of its imports – from the rest of Australia and overseas – has exceeded the value of its exports. In other words, Tasmania has been running the equivalent of a current account deficit and has had to finance this deficit with funds from the rest of the world. These funds take the form of remittances, borrowing, direct capital investment and income transfers from the rest of Australia and from overseas.

Private capital transfers are voluntary and will only be made available to finance Tasmanian economic activity if the owners of the capital are adequately compensated for doing so – in other words they need to obtain at least the market rate of return that fully reflects the risks involved.

Income transfers, on the other hand, are involuntary. They are the consequence of the interplay of the Commonwealth government's social security and taxation regimes. From the national accounts we can estimate the broad-scale impacts of these two regimes on households in Tasmania and the rest of the country.

Overall, the average Australian household has paid substantially more in tax than it received in social security benefits and the gap has widened over the period from 1991–92

Figure 4: Tax payable and social security payments received – Tasmania



Source: Australian Bureau of Statistics, *Australian National Accounts: State Accounts*, Cat No 5220.0, Canberra, 23 November 2000.

to 1999–00 – to around 5 percent of household income (see Figure 3). In contrast, Tasmanian households receive back in social security benefits about the same amount they pay in income tax (see Figure 4). In other words, Tasmanian households make no significant contribution for the other services that they receive from the Commonwealth – their costs are borne in the other states.

In round terms the net income transfer from the other Australian states to Tasmania is more than A$500 million a year. Were it to be continued in perpetuity, this stream of income transfers would represent a transfer of wealth to Tasmanian households of around A$5 billion – equivalent to around A$50,000 for each Tasmanian household.

4.2.2 Employment

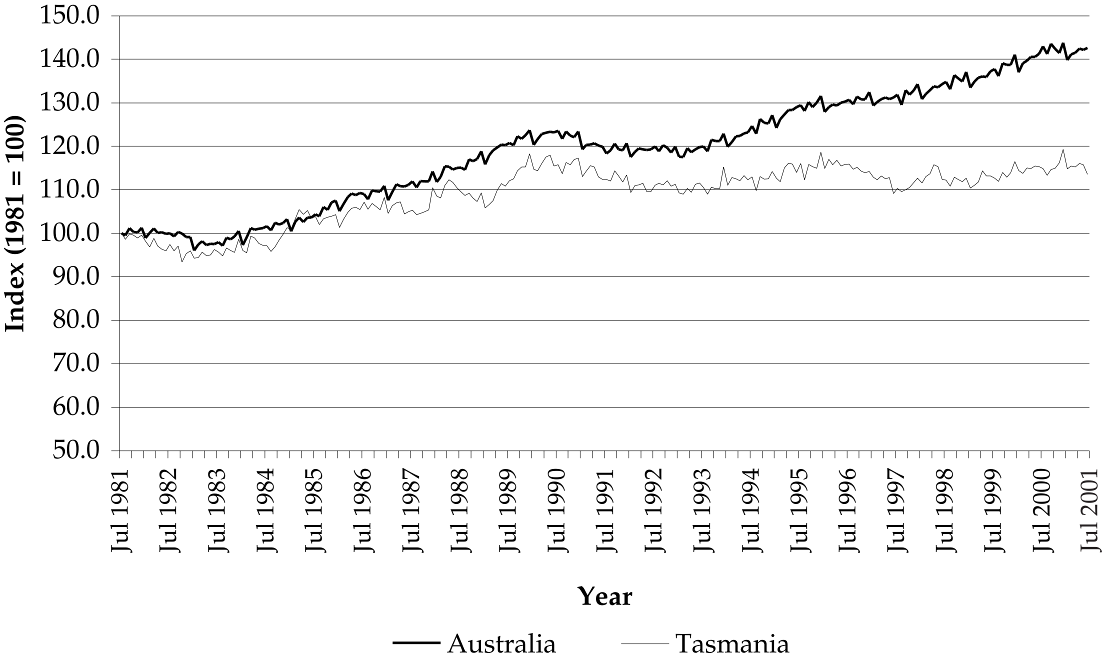
One of the strongest indicators of Tasmania's poor performance is its labour market outcomes. To illustrate this the following outcomes are examined:

- total employment;
- full-time employment;
- unemployment; and
- participation in the labour market.

Total employment

Tasmania's overall employment record is invidious. Its rate of job creation in both full-time and part-time jobs is simply the worst in the Commonwealth.

Figure 5: Index of total employment – 1981–2001



Source: Australian Bureau of Statistics, *Labour Force, Selected Summary Tables, Australia*, Cat No 6291.0.

Over the two decades to 30 June 2001, the total number of jobs in Tasmania increased by less than 14 percent.[24] In contrast, the growth in employment in the nation as a whole was over 40 percent – or more than *three times* what was achieved in Tasmania. The contrast between Tasmania and the Australian states with the fastest rate of growth in jobs over this period – namely Queensland and Western Australia – is more dramatic.[25]

More worrying than the fact that job creation is much slower in Tasmania compared with the rest of Australia is the fact that Tasmania's performance gap is worsening – see Figure 5. Since the last recession in 1990–91, job creation in the rest of the country has grown strongly but has clearly stagnated in Tasmania. Indeed, the total level of employment in Tasmania in July 2001 was *lower* than that recorded for July 1990.

Full-time employment

Tasmania's poor record in job creation is starkly illustrated by the long-term trend in full-time employment.

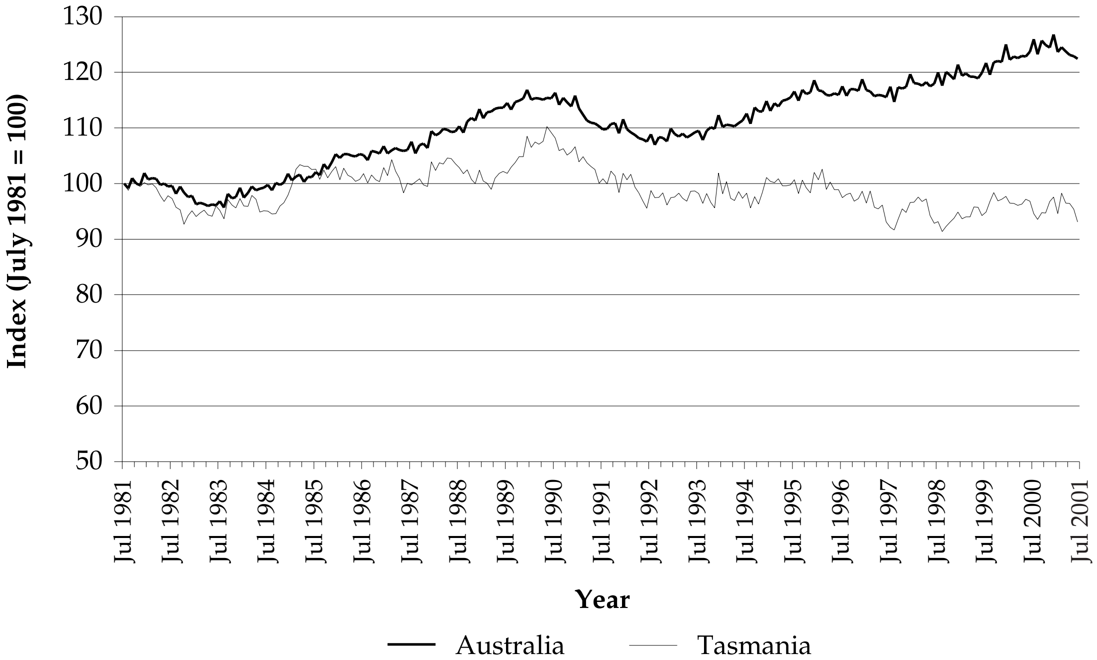
Uniquely among the Australian states, Tasmania now has fewer full-time jobs than it had 20 years ago. Since July 1981 full-time jobs in Australia have grown by 22 percent.[26] In this same period, Tasmania has lost around 7 percent of its full-time jobs.

24 Australian Bureau of Statistics, *Labour Force, Selected Summary Tables, Australia*, Cat No 62910.

25 Australian Bureau of Statistics, *Labour Force, Selected Summary Tables, Australia*, Cat No 62910, *op cit*.

26 Australian Bureau of Statistics, *Labour Force, Selected Summary Tables, Australia*, Cat No 6291.0, *op cit*.

Figure 6: Index of full-time employment – 1981–2001



Source: Australian Bureau of Statistics, *Labour Force, Selected Summary Tables, Australia*, Cat No 6291.0.

The picture that emerges from these two decades is worse still. The trend in full-time employment in Tasmania was increasing up to June 1990 but it has been declining since – see Figure 6 – to the point where the State has lost 15 percent of the full-time jobs it had at the peak in full-time employment in June 1990.

In other words, the growth in full-time jobs in Tasmania over the 1980s had been completely reversed by early 1992 and, since then, further losses in full-time jobs have been sustained in the State. Even South Australia is unable to quite match Tasmania's record for the decline of full-time employment.

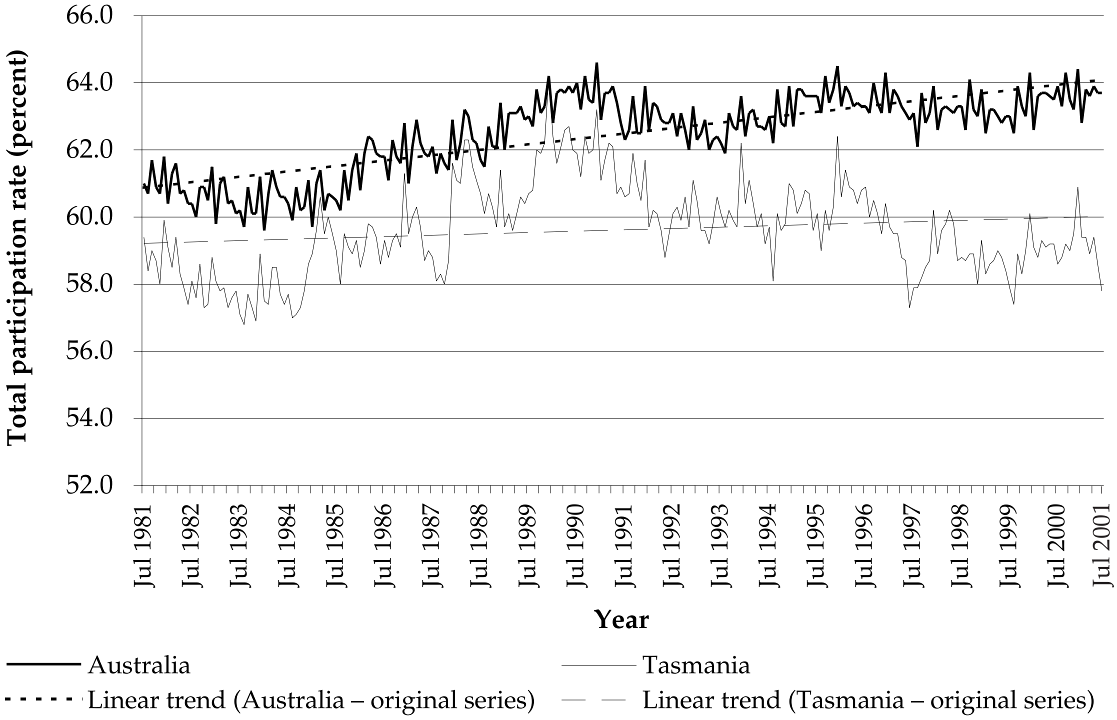
In Oscar Wilde's play, *The Importance of Being Earnest*, Lady Bracknell observes that to lose one parent was a misfortune but to lose two parents looked like carelessness. The same comment can be applied to employment and Tasmania. Any regional economy can have the misfortune to suffer serious job losses in any year but it looks like carelessness for it to continue to lose jobs over a whole decade.

Over the 1990s, the only net jobs that have been created in Tasmania have been part-time ones. The end result of the Tasmanian employment experience has been the progressive replacement of full-time by part-time employment. This process has reached the point where Tasmania now has the highest ratio of part-time to full-time employment among the Australian states.[27]

---

27 Tasmanian Department of Treasury and Finance, *Budget Paper No 1 1998–99*, May 1998.

Figure 7: Labour force participation – 1981–2001



Source: Australian Bureau of Statistics, *Labour Force, Selected Summary Tables, Australia*, Cat No 6291.0.

Labour market participation

Historically, the working-age population of Tasmania has had the lowest labour force *participation rate* among the Australian states.

Over the past two decades, the labour market participation rate has been increasing across Australia as a whole – see Figure 7. While Tasmania followed suit with increasing participation for the first 10 years of this period, the State has diverged from the rest of the country over the last 10 years in that its labour market participation rate has declined significantly.[28]

The State's low labour market participation rate and the increased share of part-time employment are likely to disguise the true extent of the unemployment problem in Tasmania. The *Nixon Report* estimated that under-utilisation of labour due to hidden unemployment and under-employment has had the effect of more than trebling the official unemployment rate for the State to nearly 30 percent.[29]

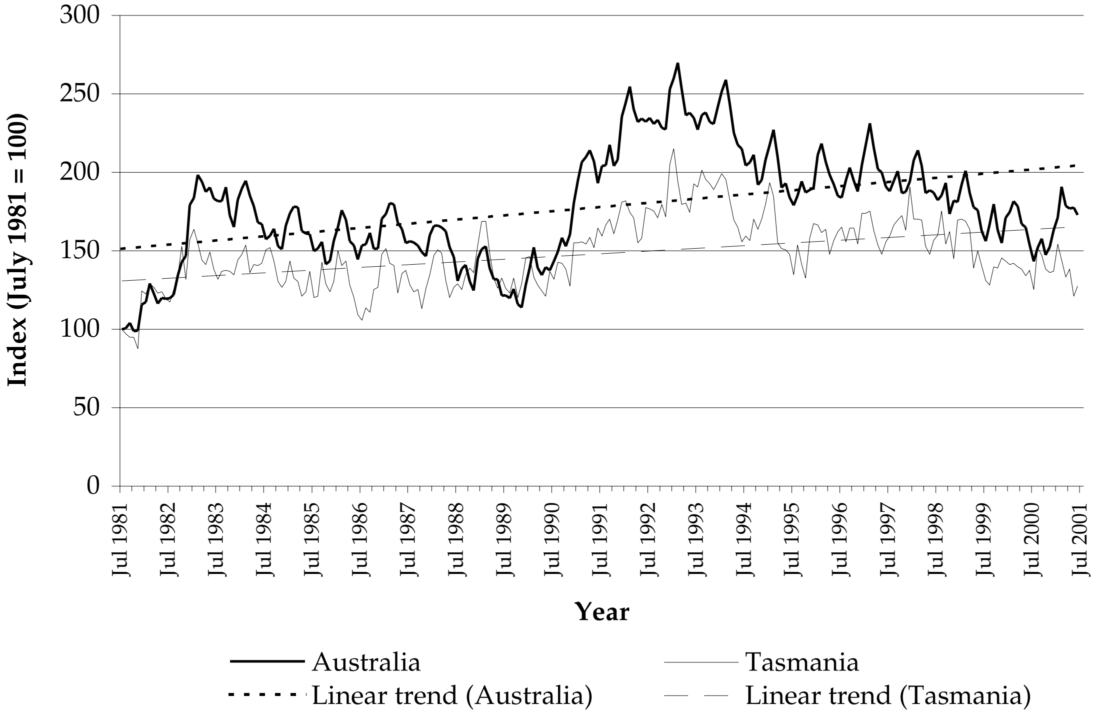
Unemployment

Not surprisingly, Tasmania's poor employment creation record is reflected in the fact that it has the highest rate of unemployment among the Australian states.

28 Australian Bureau of Statistics, *Labour Force, Selected Summary Tables, Australia*, Cat No 62910, *op cit*.

29 Nixon, *op cit*, p 37.

Figure 8: Index of total unemployment – 1981–2001



Source: Australian Bureau of Statistics, *Labour Force, Selected Summary Tables, Australia*, Cat No 6291.0.

Since the beginning of the 1980s, the estimated rate of unemployment has, on average, been around 25 percent higher in Tasmania than in Australia as a whole. As noted already, the gap is widening. This is due to the combination of a rising trend in the rate of unemployment in Tasmania and a falling trend in the rate for the country as a whole – see Figure 8.

Tasmania's poor record in total unemployment is reflected in both its rates of youth unemployment and long-term unemployment. Both are substantially worse than the relevant national averages. Youth unemployment in Tasmania has been in excess of 20 percent for virtually every one of the past 20 years.[30] Tasmania's long-term unemployment rate has been over 3 percent of its workforce for all but two of these years.[31]

4.2.3 Investment

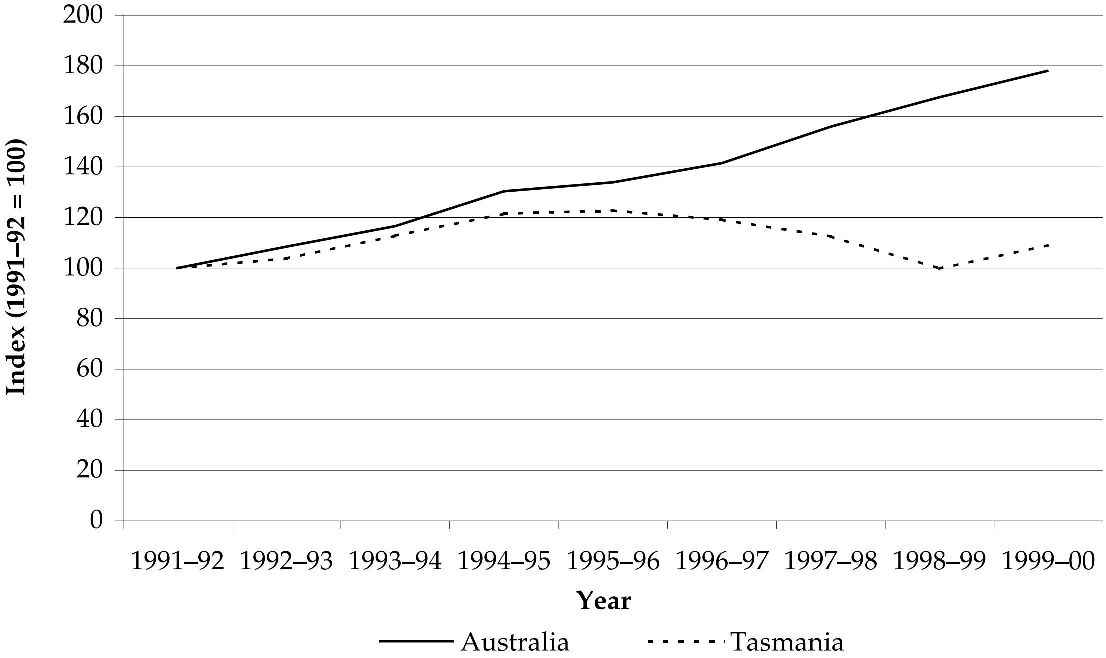
Investment is the mechanism by which most innovation is introduced into the economy. It is therefore an engine for productivity gains, economic growth and sustainable gains in material living standards.

---

30 Australian Bureau of Statistics, *Labour Force, Selected Summary Tables, Australia*, Cat No 62910, *op cit*.

31 Australian Bureau of Statistics, *Labour Force, Selected Summary Tables, Australia*, Cat No 62910, *op cit*.

Figure 9: Total gross fixed capital formation – 1991–2001



Source: Australian Bureau of Statistics, *Australian National Accounts: State Accounts*, Cat No 5220.0, Canberra, 23 November 2000.

Total investment

The value of annual investment in Australia, as measured by Total Gross Fixed Capital Expenditure, grew by nearly 80 percent over the period 1991–92 to 1999–00.[32]

In contrast, the value of annual investment in Tasmania increased by only 9 percent over the same period.[33] Moreover, by the end of the 1990s, Tasmanian investment was still largely below the level that it had reached in the middle of the decade – see Figure 9.

As we saw earlier, output growth in Tasmania over this period was a great deal lower than it was in Australia as a whole. Hence at least part of the explanation for the slower growth rate in aggregate investment in Tasmania is undoubtedly its more subdued rate of economic growth.

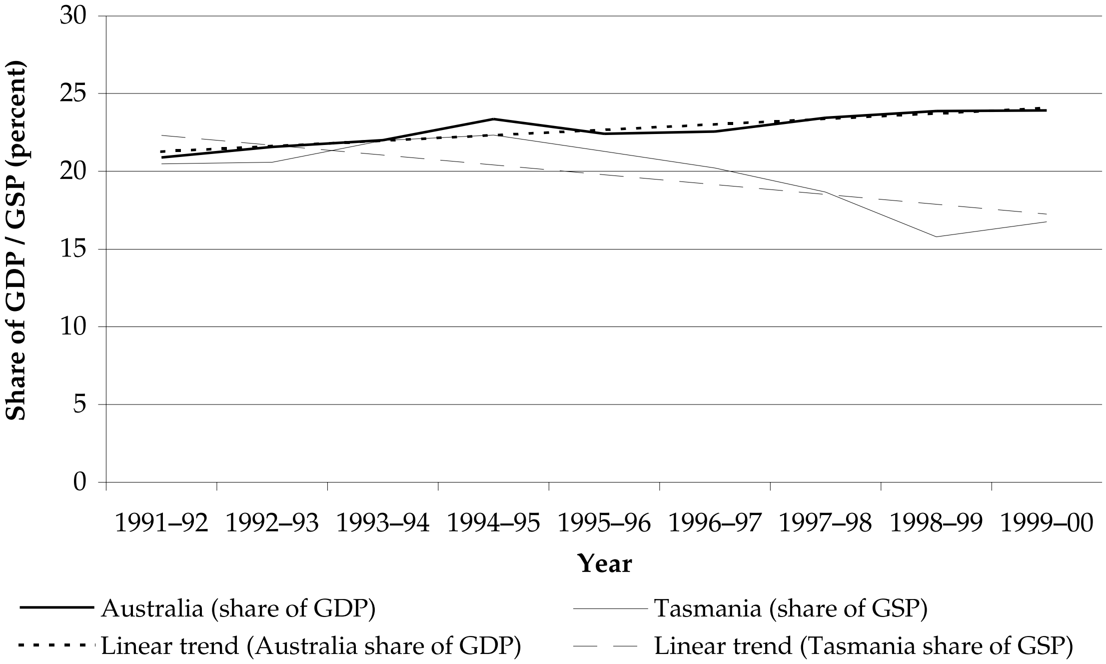
A slowdown in investment has both short-term as well as longer-term impacts on economic growth. In the short term a slowdown reduces the level of aggregate demand and, as a consequence, the overall level of economic output. Over the longer term such a slowdown can lead to a lowering of the amount of plant and equipment that each worker has at their disposal, thereby reducing the productive capacity of the economy. This process of lowering the 'capital depth' of the economy is likely, in turn, to lower the scope for businesses to innovate by developing new products, markets and business processes. Reductions in 'capital depth' and the rate of business innovation both have negative implications for productivity growth.

---

32 Australian Bureau of Statistics, *Australian National Accounts: State Accounts*, Cat No 5220.0, *op cit*.

33 Australian Bureau of Statistics, *Australian National Accounts: State Accounts*, Cat No 5220.0, *op cit*.

Figure 10: Total investment share of GDP/GSP – 1991–2000



Source: Australian Bureau of Statistics, *Australian National Accounts: State Accounts*, Cat No 5220.0, Canberra, 23 November 2000.

The key question, therefore, is to what extent Tasmania's inferior investment is due to a lower *rate of investment*. This question is best answered by looking at the share of aggregate investment in GDP or GSP, as appropriate – see Figure 10.

This examination reveals two things. First, the rate of investment in Tasmania has been consistently less than that for Australia over the 1991–2000 period. Second, the Tasmanian rate of investment has declined by about 5 percentage points, while that for Australia has risen by around 3 percentage points. Other things being equal, this means that the Tasmanian economy will find it more difficult to close the productivity and output gaps with the rest of the country.

Another question that is prompted by these observations is whether the Tasmanian slowdown in the rate of investment has occurred generally or whether it is concentrated in the private or public sectors.

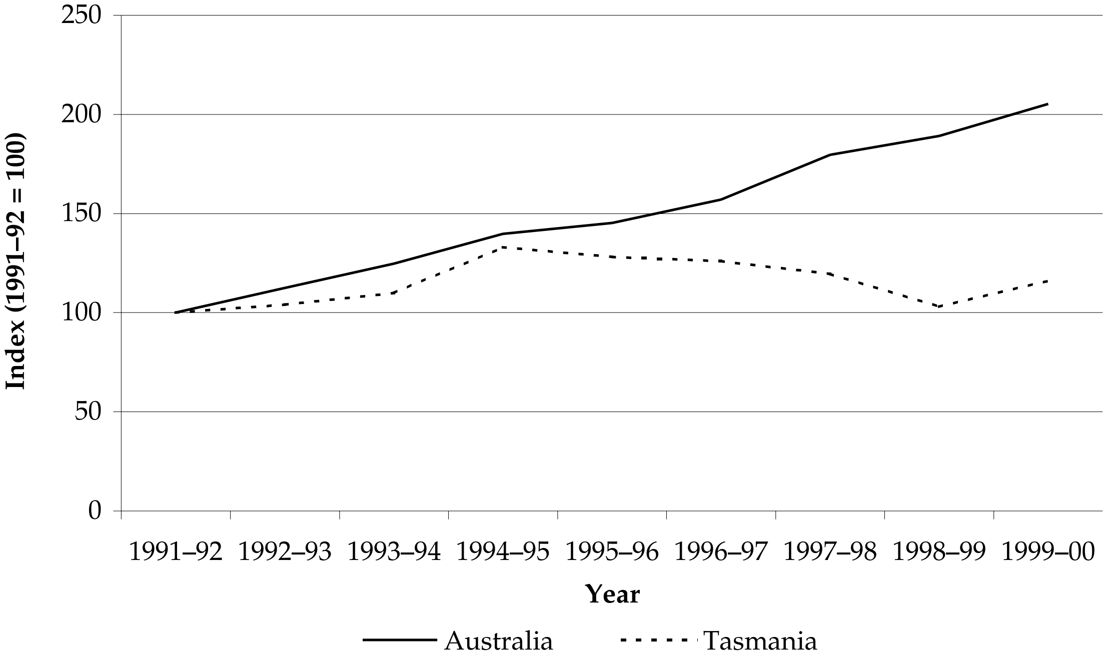
Private sector investment

In aggregate terms the private sector is the most important source of investment and its importance as a share of total investment is growing. This is true for both Tasmania and the other Australian states. In broad terms the private sector accounts for more than three out of every four investment dollars.

For the nine years to 1999–00, the value of annual private investment in Tasmania grew by only 1 percent a year. This growth rate is far below that achieved for the other Australian states.[34]

[34] Australian Bureau of Statistics, *Australian National Accounts: State Accounts*, Cat No 5220.0, *op cit*.

Figure 11: Index of private capital formation – 1991–2000



Source: Australian Bureau of Statistics, *Australian National Accounts: State Accounts*, Cat No 5220.0, Canberra, 23 November 2000.

The effect of this low rate of growth in private investment is that the value of private investment in Tasmania increased by a total of less than 10 percent over the nine years to 1999–00. This compares with nearly 80 percent for the country as a whole – see Figure 11.

Over the period 1991–92 to 1999–00, the share of private investment as a proportion of the value of economic output in Tasmania was consistently lower than that for Australia. In addition, the clear trend has been for the two rates of investment to diverge strongly over time – see Figure 12.

Of perhaps greater concern is the fact that this trend is driven, in significant part, by a declining rate of private investment in Tasmania. In trend terms the gap suggested by the latest ABS national income estimates is of the order of 7 percentage points. This is equivalent to about one-third of the rate of private investment in Australia.[35]

Public sector investment

Since 1991–92 there has been virtually no growth in nominal investment by the public sector in Australia – see Figure 13. The nominal growth rate up to 1999–00 in public sector investment in Australia was less than 0.5 percent a year.

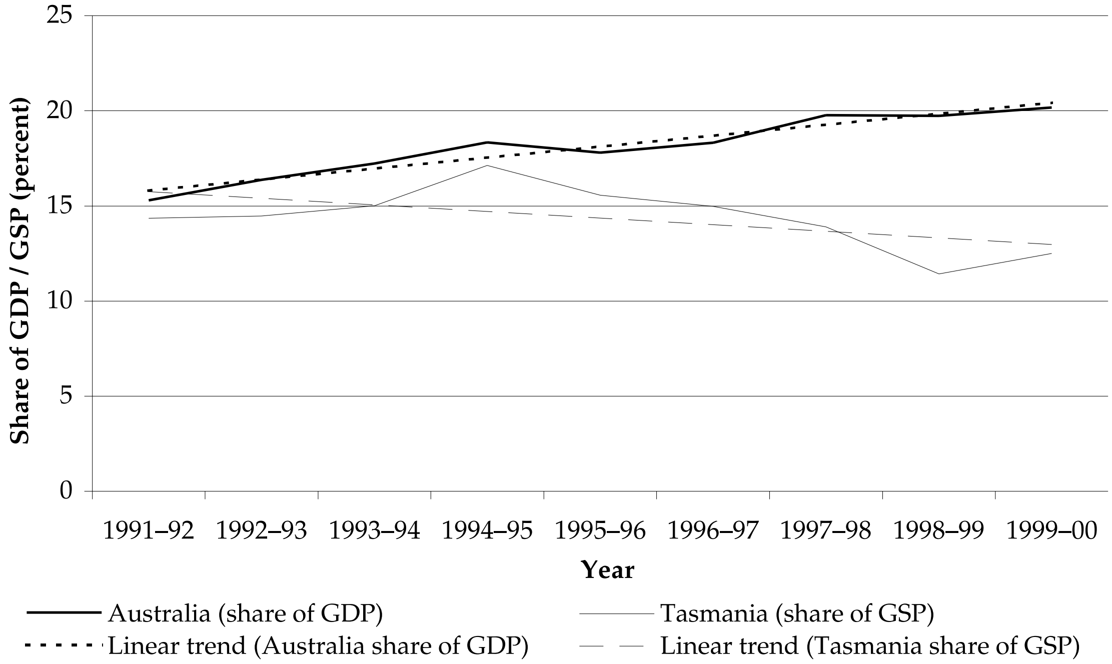
In Tasmania, public sector investment has not grown at all in nominal terms but has dropped by nearly 8 percent overall.[36] The effect of the fall in the rate of private investment

---

35 ACIL trend estimate using ABS data – see Australian Bureau of Statistics, *Australian National Accounts: State Accounts*, Cat No 5220.0, *op cit*.

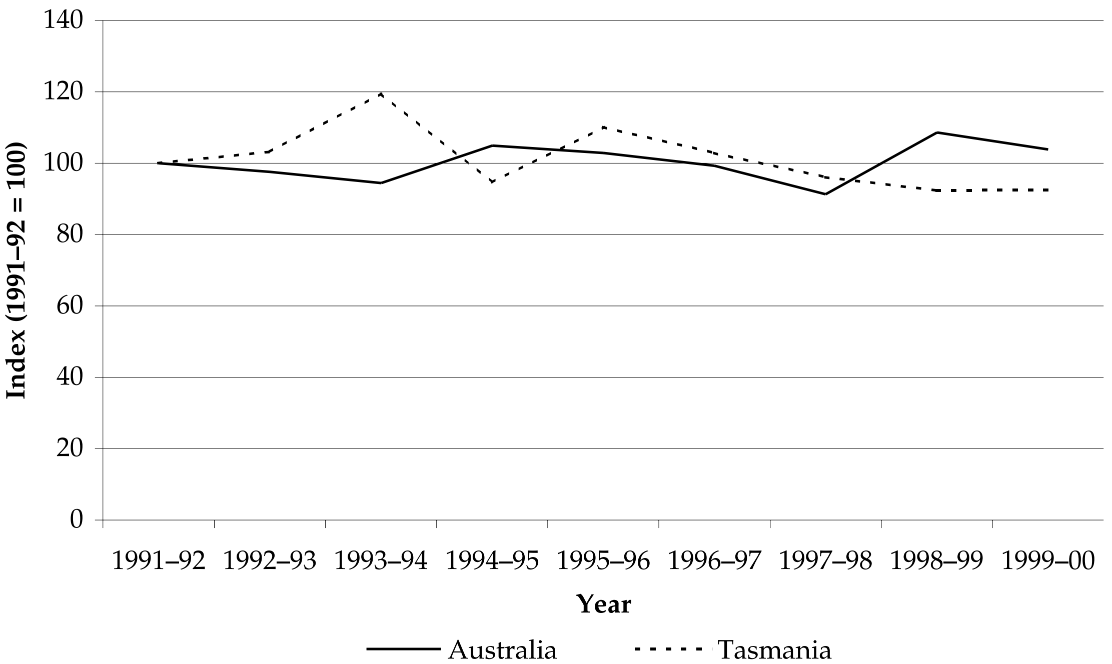
36 Australian Bureau of Statistics, *Australian National Accounts: State Accounts*, Cat No 5220.0, *op cit*.

Figure 12: Private investment share of GDP/GSP



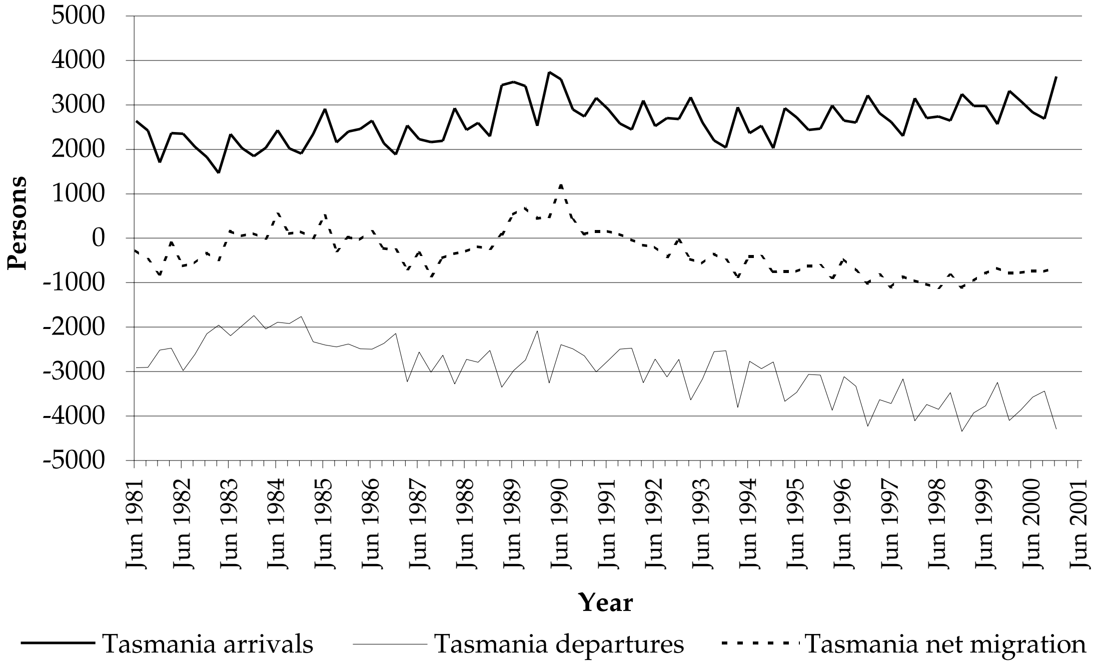
Source: Australian Bureau of Statistics, *Australian National Accounts: State Accounts*, Cat No 5220.0, Canberra, 23 November 2000.

Figure 13: Public gross fixed capital formation



Source: Australian Bureau of Statistics, *Australian National Accounts: State Accounts*, Cat No 5220.0, Canberra, 23 November 2000.

Figure 14: Interstate migration – Tasmania 1981–2000



Source: Australian Bureau of Statistics, *Australian Demographic Statistics*, Cat No 3101.0.

in Tasmania has, therefore, been compounded by a fall in the real value of investment by the public sector. The fall in the value of investment by the public sector has been largely due to the completion of the construction programme of the Tasmanian Hydro-Electric Corporation and to budgetary constraints on public sector expenditure.

4.2.4 Population and migration

Since 1971–72 Tasmania's rate of population growth has equalled the national growth rate on only one occasion. Moreover, the gap between the two has progressively widened over the 1990s to the point where the State has been losing population since December 1996. In the three years to 1999–00 the population loss averaged 0.24 percent a year.[37] In 2000–01 there was no further loss of population.[38]

Interstate migration

The movement of people across Australia is an important determinant of the distribution of the Australian population among the states and territories.

Historically, population mobility within Australia has been high. Of all the components of population change at the state and territory level – births, deaths, net overseas migration and net interstate migration – the latter has easily been the most volatile factor and its influence is increasing. The total number of interstate migrants in 1999–00 was 6 percent greater than it was 10 years earlier and 47 percent greater than it was 20 years ago.[39]

---

37 Tasmanian Department of Treasury and Finance, *Budget Paper No 1 2001–02*, May 2001.

38 Australian Bureau of Statistics, *Australian Demographic Statistics*, Cat No 3101.0, December 2001.

39 Australian Bureau of Statistics, *Australian Demographic Statistics*, Cat No 3101.0, December 2000.

In broad terms the Australian population has been migrating from the 'rust belt' – the regions with lower economic performance, often associated with substantial industrial restructuring – to the 'sun belt' – the warmer regions with an attractive lifestyle and an expanding industrial base, usually to work in services such as tourism.

In the case of Tasmania, net interstate migration is the major reason for the low or negative rates of population growth that it has experienced over the past two decades. Since June 1981, the total net loss of population to Tasmania from interstate migration has been more than 27,000 persons, equivalent to around 6 percent of the State's current population.[40] In addition, the trend in net interstate migration from Tasmania is an increasing one – see Figure 14. As a consequence, the State has the highest rate of population turnover among the Australian states.[41]

Those leaving Tasmania tend to be concentrated in one or more of the following groups, people:

- aged 20 to 44 years;
- with tertiary qualifications;
- in professional occupations; and
- employed in service industries, particularly financial, property and business services.[42]

The median age of the people departing Tasmania is only 26 years – the lowest such age for those migrating from any Australian state. Moreover, some 70 percent of those leaving the State were less than 35 years of age.[43] Most of those who leave are in the workforce at the time of their departure.[44]

Tasmania is losing the very people that it can least afford to lose – the young and the tertiary qualified – and it is losing them when it can least afford to – relatively soon after they graduate or enter the workforce.

The Tasmanian taxpayer is investing substantial resources in primary, secondary and tertiary education for its young people in the expectation that they will subsequently contribute their newly acquired skills and knowledge to the State's economic development. When young people migrate interstate so soon after finishing their education, this implicit compact with the taxpayer is broken and taxpayers, as a group, are made worse off as a result.

Overseas migration

Not only has Tasmania had trouble retaining its residents, it has also been unsuccessful in attracting overseas immigrants to Australia to settle in the State. For example, since

---

40 Australian Bureau of Statistics, *Australian Demographic Statistics*, Cat No 3101.0, *op cit*.

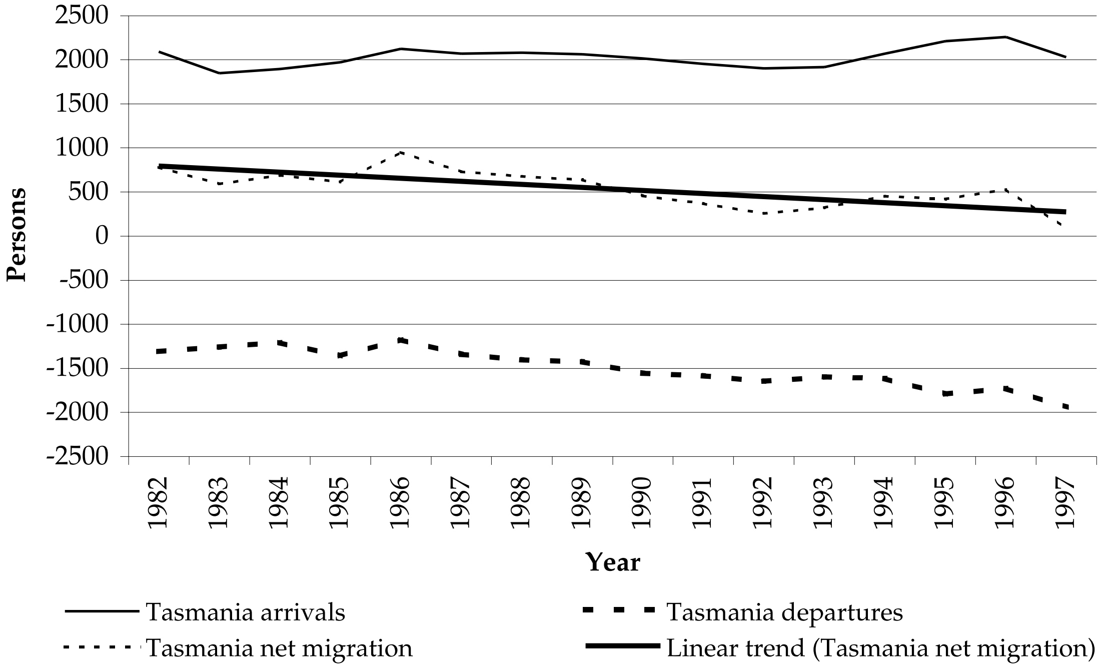
41 Australian Bureau of Statistics, *Australian Demographic Statistics*, Cat No 3101.0, *op cit*.

42 Nixon, *op cit*, pp 18–20.

43 Australian Bureau of Statistics, *Migration*, Cat No 3412.0, 1999–00.

44 Nixon, *op cit*, pp 18–20.

Figure 15: Overseas migration – Tasmania 1982–1997



Source: Australian Bureau of Statistics, *Australian Demographic Statistics*, Cat No 3101.0.

1971–72, only about 0.6 percent of overseas immigrants to Australia have taken up residence in Tasmania.

Tasmania has, nevertheless, been able to record a net population gain from overseas migration each year – see Figure 15. Overseas arrivals in Tasmania have consistently outweighed the number of Tasmanian residents who permanently depart the State for overseas. However, the size of this net gain has been very small relative to the population that has been lost from net interstate migration.

The fact that permanent departures overseas by Tasmanian residents have been increasing over time, while the number of permanent overseas arrivals has remained essentially stagnant[45] means the net population gain from overseas migration is declining over time. On present trends, this net population gain could be reversed to a net loss within a decade, thereby exacerbating the net loss from interstate migration.

Population projections

The ABS regularly publishes long-term projections of the Australian population based on different combinations of assumptions for:

- mortality;
- fertility;
- interstate migration; and
- overseas migration.

---

45 Unpublished data from the ABS reported in Tasmanian Department of Treasury and Finance, *Budget Paper No 1 1997–98*, May 1997.

The latest ABS population projections indicate that Tasmania will lose population over the next 50 years, even under a range of assumptions about the components of population change.[46] Tasmania is the only state of Australia for which the ABS is projecting an absolute decline in its population.

4.2.5 Public finances

Public debt

The *Nixon Report* found that the total net debt of the Tasmanian public sector was A$3.3 billion as at 30 June 1996.[47] This was equivalent to nearly A$7,000 for each resident, which was the highest level in the Commonwealth and more than two-and-a-third times the level in New South Wales.

At that time, about 42 percent of Tasmanian net public debt related to general government expenditure. The balance of the debt was held by the State's public trading enterprises.

General government debt in Tasmania as a proportion of GSP was the second highest in the Commonwealth, after South Australia. It reflected the effects of continuous deficit spending by successive state governments since 1980. As a consequence, by the end of the 1990s Tasmania had the lowest credit ratings of all the States.[48]

In Tasmania, government outlays on net interest payments were only exceeded by outlays on education and health – and this is despite the favourable effects of the reduction in inflation and interest rates that have occurred since the early 1980s.

Since its election in August 1998, the Tasmanian government has progressively reduced the burden of its net financing requirement. Budget deficits have been reduced to the point where the budget moved into surplus in 1999–00 and the size of the surpluses has continued to increase since then. As a result, the net debt of the Tasmanian public sector as a proportion of the State's GSP has been halved since 1996.

State-Owned Enterprises

The Tasmanian government owns a diverse portfolio of 24 business enterprises. They range in size from Hydro Tasmania, with total assets of A$3.2 billion, to the Tasmanian International Velodrome Management Authority, with assets of less than A$0.5 million.[49]

As at 30 June 1999, Tasmanian State-Owned Enterprises (SOEs) in aggregate employed approximately 3,600 people, held total assets valued at A$10.6 billion and earned operating revenues of nearly A$1.7 billion.[50] The SOE operating revenues were equivalent to nearly 20 percent of the State's GSP.

---

[46] Australian Bureau of Statistics, *Population Projections, Australia*, Cat No 3222.0.

[47] Australian Bureau of Statistics, *Australian Demographic Statistics*, Cat No 3101.0, *Government Finance Statistics, Tasmania*, Cat No 5501.6 and *Public Sector Financial Assets and Liabilities, Australia*, Cat No 5513.0.

[48] Tasmanian Department of Treasury and Finance, *Budget Paper No 1 1999–00*, *op cit*.

[49] Tasmanian Department of Treasury and Finance, *ibid*, p 254.

[50] Tasmanian Department of Treasury and Finance, *ibid*, p 255–256.

Unfortunately, the financial returns to the Tasmanian government from its SOEs are derisory. In 1998–99 the government's portfolio of SOEs earned profits of only A$56.7 million on net assets of A$3.2 billion.[51]

On average, this represents a nominal rate of return of less than 2 percent, which is a loss in real terms. Only three of the State's 24 SOEs made a nominal rate of return in double figures for 1998–99 and the largest of them – Hydro Tasmania – could not even manage a return of 1 percent on net assets of A$1.7 billion.

Had Tasmanian SOEs merely matched the average rate of return of all businesses listed on the Australian Stock Exchange, they would have collectively earned profits of around A$400 million in 1998–99. This implies that under-performance by Tasmanian SOEs could be costing Tasmanians around A$340 million a year – or about A$725 per person per year.

Taxation

On the revenue side, Tasmanian public finances are characterised by a taxation system that relies heavily on a narrow tax base combined with a high average tax rate that is concentrated on the business sector.[52] Payroll and land taxes are the major source of State revenue.

This approach to taxation produces serious economic distortions. The extent of the concessions and exemptions that Tasmania has built into its tax base means that its tax rates are higher than they would be otherwise. Payroll and land taxes are the worst offenders in this regard.

The Commonwealth Grants Commission has assessed the level of severity of the Tasmanian tax system on the basis of the State's capacity-to-pay.[53] On this measure, the commission concluded that, if the State tax systems were identical across the country, Tasmania would collect over 20 percent less in tax revenue than it actually does. On the same measure of severity, Tasmania has the second most severe taxation system of the six Australian states. As the ANZ Bank has noted, one of the consequences is that:

> Tasmania is the only State in which the taxpayers are paying above-average levels of State taxation and receiving in return below-average levels of State services.[54]

4.3 Summary

This examination of the performance of the Tasmanian economy over the 1980s and 1990s has highlighted the following themes and findings.

Tasmania's economic performance has been consistently inferior to that of the rest of Australia. The shortfall in performance is significant and has occurred right across the

---

51 Tasmanian Department of Treasury and Finance, *ibid*, p 255–256.

52 Committee for the Review of State Taxes and Charges, *Tax Reform in Tasmania Towards 2000, Today's Problem – Tomorrow's Opportunity*, June 1983.

53 Commonwealth Grants Commission, *Report on General Grant Relativities*, 1997.

54 ANZ Bank, *Submission to Commonwealth–State Inquiry into the Tasmanian Economy*, p 28.

key indicators of economic performance – output, productivity, investment and labour market outcomes including job creation, participation in the labour market and unemployment.

Tasmania's economic performance has deteriorated over time compared with the rest of Australia, particularly since the recession of the early 1990s. Again, the State's slide in relative performance has been evident right across the key economic indicators. The Tasmanian government is making serious attempts to turn around the State's dismal economic performance. However, it is too early to say whether the economic development initiatives that it has put in place will be able to stabilise, let alone close, the performance gap and how long it might take to do so.

The impact of this declining economic record on Tasmanian households has been cushioned, to some extent, by Commonwealth government fiscal policy. The combination of progressive income tax scales and targeted social welfare assistance has transferred at least A$500 million a year from the rest of the country to Tasmanian households.

As a consequence of this poor record, Tasmanian households, on average, make no contribution to the costs of running Commonwealth government programmes, such as the Defence Force and the federal judiciary. In other words, they get the benefits of these programmes without having to make any contribution towards their upkeep.

The rate of investment in Tasmania has been lower than the rest of Australia and appears to be declining. Given the critical role that investment plays in output and productivity growth, the State's investment performance suggests that the longer-term prospects for the Tasmanian economy are, at best, subdued and deteriorating.

Participation in the State's labour market has been lower than in the rest of Australia, unemployment is higher than in the rest of Australia and there has been no growth in full-time employment in the State. The few new jobs that have been created have been part-time. Overall, these labour outcomes strongly suggest that the State's labour market is performing very poorly and that the impediments to better performance are both extensive and deep-seated.

The gloomy prospects for the Tasmanian economy have encouraged increasing numbers of Tasmanians to leave the State and seek their fortunes elsewhere. Those leaving are concentrated among the State's young adults and those with tertiary qualifications – in other words those with the potential to make the greatest contribution to the State's economic development. They have left despite the fact that significant income redistribution due to Commonwealth fiscal policy has helped cushion the impact of the State's poor economic record on household incomes.

Tasmania has not been an attractive place for either interstate or overseas migrants to settle permanently. In addition, the numbers of those from outside the State who have settled permanently have not been anywhere near sufficient to offset the numbers of Tasmanian residents leaving. As a consequence, the State's population has been declining. The population decline is expected to continue for the foreseeable future.

5

CAUSES OF TASMANIA'S POOR PERFORMANCE

There are two remarkable features of the poor economic performance of Tasmania compared with the rest of Australia. The first is that it has been evident for so long that it has the well-worn status of the 'Tasmanian problem'. The second feature is that the causes and consequences of the 'Tasmanian problem' have been examined extensively over almost as long a period.

There have been more than 75 reports on the problems of the Tasmanian economy since federation.[55] The latest of these was the joint State-Commonwealth inquiry conducted by Peter Nixon in 1997.[56] The major inquiries that preceded Peter Nixon's were those by Sir Nicholas Lockyer in 1926,[57] Sir Bede Callaghan in 1977,[58] the Centre for Regional Economic Analysis at the University of Tasmania in 1987[59] and Charles Curran in 1992.[60]

All of these reports have pronounced adversely on the State's economic performance. They have diagnosed a common set of causes. Few have been acted upon in any comprehensive sense.

In conducting his inquiry into the 'Tasmanian problem' – as he rightly termed it – Peter Nixon consulted extensively with a range of business people, politicians, and public servants as well as individuals across the whole of the State. He also received over 230 written submissions from the public and commissioned extensive independent research into the issues under his terms of reference.

These consultations, and his own research, lead Nixon to conclude that there was an overwhelming consensus within Tasmania on the nature of the 'Tasmanian problem'.

Overall he detected widespread despair about the poor prospects for the State, as well as a sense of inertia and lack of leadership on turning the State around. This despair manifested itself in the following concerns:

---

55 Nixon, *op cit*.

56 Nixon, *ibid*.

57 Sir Nicholas Lockyer, *Inquiry into the Financial Position of Tasmania*, April 1926.

58 Sir Bede Callaghan, *Inquiry into the Structure of Industry and Employment Situation In Tasmania*, June 1977.

59 The Centre for Regional Economic Analysis, *The Tasmanian Economy: A Survey*, December 1987.

60 Charles Curran AO, *Tasmania in the Nineties*, April 1992.

- Tasmania was over-governed;
- parochialism was a problem;
- the legislative process was heavily bureaucratic;
- rent seeking was endemic;[61]
- minority groups were able to block reform; and
- issues were often politicised.

Nixon's diagnosis of the nature of the 'Tasmanian problem' mirrors the findings of earlier official inquiries.

The nature of the 'Tasmanian problem' was so acute and so persistent that Nixon quoted, with approval, one of his predecessors in the Preface to his report.[62] In 1926, Sir Nicholas Lockyer concluded that:

> Not the least of the disabilities under which Tasmania is suffering is the pessimism on the part of some of its leaders … It was explained to me that the spirit of optimism had been tried for many years, but that it had not proved successful.

Although there is little to disagree with at a fundamental level in his report, Nixon's diagnoses are a mixture of symptoms and underlying causes. The distinction is important because it affects the likelihood that changes that might be proposed to fix the 'problem' will actually work or, if they do work, will constitute efficient solutions.

For my purpose, I believe that it is more informative and more useful to try to distil the underlying causes of the 'Tasmanian problem' out of the copious amount of research that has been conducted on the nature of it over the years. Such a distillation needs to take account of the disadvantages of the location of the Tasmanian economy within the Australasian and global economies, as sketched out earlier in section 3 of this paper.

On this basis I suggest that the possible candidates for the fundamental and underlying causes of the 'Tasmanian problem' are as follows:

- the disadvantages of space and time;
- flawed institutional arrangements;
- poor policy choices by state and Commonwealth governments; and
- the cultural impediments to performance.

I propose to elaborate on each of these in turn.

5.1 Disadvantages of space and time

As we have seen from section 3, Tasmania clearly suffers from a number of natural disadvantages owing to its small population and its geographical isolation, both within Australasia and the global economy. These disadvantages add considerably to the cost

---

61 Rent seeking is the practice of lobbying government for favoured treatment by a government programme.

62 Nixon, *op cit*.

of doing business in and with Tasmania, and those who live and work in Tasmania are only too aware of many of the additional costs.

The size and geographical disadvantages of Tasmania have also been a recurring theme in official reports at both the Commonwealth and state level over many decades. Unfortunately these inquiries have tended to diagnose the 'Tasmanian problem' as being, to a significant extent, a result of the State's small size and its isolation from the rest of the country. This sort of diagnosis has helped to entrench an erroneous and unhelpful response – that the Tasmanian and Commonwealth governments should subsidise those who have to bear the additional costs involved in undertaking business with the State.

This diagnosis of the 'Tasmanian problem' is erroneous because it frames the discussion of economic health purely in terms of an economy's physical disadvantages when there are many other factors that should be taken into account. It is unhelpful because it ignores the fact that all economies have disadvantages compared with their competitors and that the successful ones are those that achieve higher productivity growth despite their disadvantages.

The key question is whether the problem of time and space can explain the sharp deterioration in economic performance that the State has recorded over the 1990s compared with the rest of the country.

Certainly this problem increases the cost of producing things in Tasmania. It is a major influence on the economy's comparative advantage. This is not in dispute. However, Tasmania's size and geography have not changed fundamentally since the early 1990s – continental drift is slower than glacial and the population loss that the State has suffered over the decade has been relatively small. In other words, these elements of Tasmanian comparative advantage remain essentially unchanged.

Moreover, the effect of much technological change over the past two decades has been to reduce the dominance of scale economies in service delivery, on the one hand, and to drive down substantially the costs of transport and communications, on the other. So dramatic have been the advances in information technology over the past two decades that some respected economic commentators are proclaiming that technological progress has lead to the 'death of distance'.[63]

Given all this, it is difficult to see how size and geography, on their own, could have caused the level of deterioration in economic performance that has been observed since the beginning of the 1990s.

As we have seen, one of the key symptoms of Tasmania's poor economic performance compared with the rest of Australia has been the difference in productivity growth since the early 1990s. On the one hand Australia's productivity performance accelerated sharply over the 1990s. In contrast Tasmania's productivity growth stagnated, if not deteriorated. These two productivity trends cannot be explained by differences in absolute size or remoteness of the Australian and Tasmanian economies. They can only

---

63 Frances Cairncross, *The Death of Distance: How the Communications Revolution Will Change Our Lives*, Harvard Business School Press, Cambridge, Massachusetts, October 1997.

reflect significant changes to the institutional and policy framework. Changes to this framework, by changing incentives, alter the structure and operation of the economies in question. A similar observation may be made about the visible differences between Tasmania and the rest of the country in other areas of economic performance, such as investment and labour market outcomes.

5.2 Flawed institutional arrangements

The institutional[64] arrangements that have been adopted in Tasmania have numerous flaws. The problems touch on every aspect of government – from the design of the system of parliamentary representation to the non-parliamentary institutions and statutory offices.

5.2.1 Flawed parliamentary representation

Tasmania has the highest level of political representation of any developed democracy. If representative democracy were the key to economic success, Tasmania would be basking in a golden economic age and *The Economist* would be publishing survey articles extolling the virtues of the Tasmanian path to prosperity.

Tasmania has 57 state and federal parliamentarians to represent the interests of a population of less than 500,000. This is equivalent to more than 12 politicians for every 100,000 residents. In contrast New Zealand has only three for every 100,000 people. If local government were included, the disparity would be even higher, given the large number of local government authorities that Tasmania has seen fit to create.

In the Federal parliament, Tasmania has 12 senators and five members of the House of Representatives. The generosity of the State's federal representation is due to the fact that the Australian Constitution requires that all the states have equal representation in the Senate and that no state may have fewer than five members in the House of Representatives.

At the state level, Tasmania has a bicameral parliament. Prior to 1998, the Tasmanian parliament had a total of 54 members in its two houses – 35 in the Lower House and 19 in the Upper House. In August 1998, the parliament reduced its total numbers to 40 members – 25 in the Lower House and 15 in the Upper House.

Members of the Lower House of the Tasmanian parliament – the House of Assembly – serve a maximum of a four-year term. Tasmania uses the Hare-Clarke system of proportional representation based on five multi-member electorates to select its Lower House members.

The Upper House of the Tasmanian parliament – the Legislative Council – is made up of members elected from single member constituencies. Each member of the Legislative Council holds office for six years and elections are held on a rotating basis – with four

[64] Institutions are man-made rules that constrain possible arbitrary and opportunistic behaviour in all human interaction. They are shared in a community and sanctions are imposed if they are violated. In this technical sense institutions are distinguished from organisations. Institutions are the rules of the game whereas organisations are the players.

members elected every sixth year and three members elected in each of the other five years.

The general convention has been for independents to be elected to the Legislative Council, although there are no formal impediments to political parties nominating candidates for election to it. Currently, the Legislative Council is dominated by independents. There are no constitutional provisions for the Legislative Council to be dissolved or for any impasse between it and the Legislative Assembly to be resolved.

Since its introduction in 1908, the Hare-Clark system of proportional representation has delivered a majority government in fewer than half of the elections held for the House of Assembly.[65] From 1959 until 1998, a candidate for the Lower House only needed 12.5 percent of the vote to get elected. This allowed the Greens to hold the balance of power in the House of Assembly between 1989 and 1998, leading to a succession of minority governments over this period. Following the parliamentary reforms of 1998, a majority Labor government was elected in August 1998.

The lack of certainty that has been created by minority governments and the largely independent character of the Legislative Council have tended to create parliamentary inaction. For example, the Tasmanian parliament has been reluctant to address difficult or contentious issues no matter how persistent or urgent they have become.

Nixon concluded that successive Tasmanian governments have sought to second-guess opinions in the Legislative Council by altering legislation to accommodate perceptions of the views of the members of the Council.[66] This strategy has tended to reduce significantly the preparedness of successive state governments to propose or support significant reform to public policy in the parliament.

Examples of the consequences of the Tasmanian government's reluctance to address difficult or contentious issues over recent years have been considerable delays in the parliament enacting reforms to shopping hours, the regulation of transport and the legal prohibitions on homosexuals.

As the next section will show, both the Commonwealth and the State governments have, over recent decades, made many policy choices that have had a negative impact on the State's economic performance. Hence there is considerable need for policy reform.

The gridlock on economic reform was at its height during the decade of minority governments up to 1998. Policy gridlock was undoubtedly a factor – and probably a significant one – in the sharp deterioration in private investment in Tasmania over the 1990s. As outlined previously, that deterioration in private investment had knock-on effects with regard to employment creation and productivity.

---

65 Majority government is defined as one where either the Labor Party or the non-Labor parties won more than half of the seats in the House of Assembly. On this basis majority governments have been elected 14 times under the Hare-Clark system – in 1909, 1912, 1913, 1919, 1931, 1937, 1941, 1964, 1972, 1976, 1979, 1982, 1986 and 1998. Minority governments have been elected 15 times – in 1916, 1922, 1925, 1928, 1934, 1946, 1948, 1950, 1955, 1956, 1959, 1969, 1989, 1992, and 1996. See the Tasmanian parliamentary website at www.parliament.tas.gov.au.

66 Nixon, *op cit*, p 104.

In 1982, and again in 1993, the governments of the day attempted to reduce the number of members in the Tasmanian parliament, but without altering the Hare-Clarke system of proportional representation. Neither attempt was successful. These failures could only have had a negative impact on business confidence and the investment outlook at the time. In July 1998, in the wake of the Tasmanian government's consideration of the *Nixon Report*, the Tasmanian parliament finally passed legislation to reduce the number of state parliamentarians.

One consequence of the reduction in parliamentary numbers is an increase in the voting quota for the House of Assembly from 12.5 to 16.7 percent. Ostensibly, this change should reduce the probability of minority government and the policy gridlock that tends to go with it.

It remains to be seen, however, whether this increase in voting quota will be enough to offset, to any significant degree, the bias inherent in the Tasmanian system of proportional representation against delivering governments with a clear parliamentary majority. On this issue it is interesting to note the experience from 1909 to 1959 when the voting quota for a seat in the House of Assembly was 14.3 percent. Over this period nearly 60 percent of Tasmanian governments did not hold a majority of the seats in the House of Assembly.

5.2.2 Dysfunctional quangos

The institutional problem in Tasmania is not simply confined to the arrangements for parliamentary representation.

The *Nixon Report* identified in excess of 260 quasi-autonomous government organisations (quangos) and concluded that its enumeration was probably incomplete.[67] Nixon observed that:

> … whenever there is a problem in Tasmania, there is a move to establish yet another of these bodies, rather than addressing the problem directly.[68]

Many of the quangos are structured as though they are the decision maker on an issue, even though it may appear that a minister, a state department or a local council should have the decision-making responsibility.[69]

For example, although the Transport Commission decides the issuing of all public vehicle licences, the real decisions are made by the Public Vehicles Licensing Tribunal, which re-hears any contested approvals.[70]

In the area of land-use planning, it is not the Tasmanian local government authorities that decide the planning issues associated with proposed developments. The Resources Management and Planning Appeals Tribunal may assess the exercise of the nominal discretion given to local government in these matters.

---

67 Nixon, *ibid*, p 67.

68 Nixon, *loc cit*.

69 Nixon, *loc cit*.

70 Nixon, *loc cit*.

In like manner, the minister for fisheries must seek the advice of the Board of Advice and Reference before the minister can offer a marine farm lease.[71]

Many Tasmanian quangos have roles delegated to them by a minister of the Crown. Often the Government appoints the members of the quango but there are no effective mechanisms for holding quango members accountable for their overall performance – either to the government or the parliament.

This practice detracts from the ability of the government of the day to be held ultimately accountable to the community for all decisions made within government – including decisions made by those who exercise powers delegated to them by the government. Where responsibility is delegated to an independent body – as frequently occurs in Tasmania – the government of the day may be unable to pursue the mandate that it has been elected to implement.

5.3 Poor policy choices

Poor design and execution of public policy have contributed to Tasmania's dismal economic performance by creating an environment that is unattractive to business. The policy failure is evident across the range of public policy and by both the State and the Commonwealth governments.

The problems of poor policy choice are highlighted by the:

- extent of the tax burden on business;
- nature and the extent of the regulation of the business sector; and
- actions of the Commonwealth in key policy areas.

Each of these issues will be canvassed in turn.

5.3.1 Heavy taxes on business

During World War II the Australian state governments ceded the right to levy income tax to the Commonwealth. Since then successive Australian High Court judgments have progressively widened the scope of the Commonwealth's indirect taxation powers. The end result has been that the Australian states have been forced to rely on a narrowing tax base to fund increasing public expenditure demands.

While this imbalance of taxation powers has done Tasmania few favours, its authorities have, nevertheless, managed to worsen the economic consequences of this imbalance by the way that they have used their tax base. The problems are twofold. They are evident in both the nature and the extent of the tax burden.

As we saw earlier, the Commonwealth Grants Commission assesses the extent of the burden imposed by the taxation systems of each of the Australian states on the basis of their capacity to pay. On this measure, the Commission found that Tasmania has the second most severe taxation system of the six states. In addition, a 1993 review of

---

71 Nixon, *loc cit*.

the Tasmanian tax system found that it was fundamentally unsatisfactory in terms of the nature of its taxes.[72] Tasmania relies excessively on taxes that have adverse impacts on the business sector – notably payroll and land taxes. In both cases, the taxes contain significant concessions and exemptions, the effect of which is to make their tax rates higher than they would otherwise be.

The 1993 review recommended a broadening of the tax bases and reducing tax rates on businesses. However, successive Tasmanian governments have failed to implement these recommendations to any significant extent.

While the Tasmanian government has made some changes in line with the recommendations of the 1993 review, it has also implemented others that are clearly inconsistent with the thrust of the report. For example, since the review, payroll tax exemptions have been widened and the land tax base has been further narrowed. Although the payroll tax rate has been shaved from 6.53 percent to 6.3 percent from 1 July 2001, Tasmania will continue to have the highest payroll tax rate among the Australian states.[73]

Generally speaking, the tax systems that do the least economic damage are those that observe the principle of good tax design. This means that taxes should be levied where they are least likely to change economic behaviour. This is most likely when each tax is levied at a single rate on as broad a base as possible. This was the principle behind replacing an array of indirect taxes by a single broadly based Goods and Services Tax – as was done by New Zealand in 1986 and Australia in 1999.

Other things being equal, the economic damage from raising a given amount of revenue will be greater the narrower is the tax base or the higher is the tax rate. Unfortunately this describes the Tasmanian tax system only too well.

5.3.2 Excessive business regulation

The regulation of business in Tasmania is generally excessive. There is an over-emphasis on highly detailed and prescriptive regulation. This has stifled business innovation and tended to protect the status quo from competition.

Barriers to competition

As a signatory to the suite of inter-governmental agreements on National Competition Policy, Tasmania is obliged to review all legislation for any anti-competitive effects.[74] Having done so, the State is expected to remove any provisions that do not produce net

---

72 Committee for the Review of State Taxes and Charges, *Tax Reform in Tasmania Towards 2000, Today's Problems – Tomorrow's Opportunity*, *op cit*.

73 Tasmanian Department of Treasury and Finance, *The Competition Index: A State-by-State Comparison*, Government of Tasmania, May 2001, p 48.

74 In 1992 the Council of Australian Governments – which comprises the six State, the two Territory and the Commonwealth governments – commissioned Professor Fred Hilmer to chair the Independent Committee of Inquiry into National Competition Policy. After considering the Hilmer report in 1995, the Council agreed on a package of competition policy reforms that came to be known as National Competition Policy.

benefits for the community as a whole and have anti-competitive effects that are not essential to the realisation of those benefits.

The *Nixon Report* found that the intent of National Competition Policy was not being achieved in Tasmania. It concluded that the regulatory review process under the policy:

- was overly complex and bureaucratic;
- focused too much on the process and not enough on the outcomes envisaged by National Competition Policy;
- failed to address the hard issues such as transport and planning regulation;
- allowed poorly designed regulation to persist; and
- ignored the compliance burden on business.[75]

Nixon pointed to the fact that there was extensive overlap between the multiple systems of licensing for businesses in Tasmania.[76] For example, if a prospective investor wanted to establish a wine business to export and retail wine, distil wine into brandy and provide tourist accommodation, the business would have to acquire up to 28 separate licences from 15 different government agencies.

Environmental regulation

The system of environmental regulation in Tasmania is hindering rather than facilitating economic development. In combination with a tendency for environmental issues in the State to become highly politicised, the regulatory regime has led to a perception that Tasmania is opposed to further economic development.[77] Such a perception is a strong deterrent to the business investment that is sorely needed to create new jobs and to raise productivity in the State.

Planning in Tasmania is administered through the Resource Management and Planning System (RMPS). The RMPS was introduced in 1993 to focus the planning system on promoting 'sustainable development'. Many of its provisions were modelled on the New Zealand Resource Management Act 1991.[78] A recent review of the RMPS has concluded that the *design* of the RMPS represents the world's best practice but that there is considerable scope to improve its *operation*.[79]

Despite these plaudits about its design, the *Nixon Report* found that there is widespread concern in Tasmania – and elsewhere – that the RMPS is simply not delivering its goal of sustainable development. The main concerns identified by Nixon were as follows:

---

75 Nixon, *op cit*, p 141.

76 Nixon, *ibid*, pp 139–140.

77 Nixon, *ibid*, p 143.

78 Industry Commission, *A Full Repairing Lease: Inquiry into Ecologically Sustainable Land Management*, Report No 60, 27 January 1998.

79 A Edwards, *Committee for the Review of the State Planning System*, April 1997, p 5.

- The RMPS is too complex and its users and administrators do not understand it.
- The RPMS has failed to produce any significant reduction in the number of planning schemes at the local government level.
- There is a lack of direction from the government in key areas so that assessments are often made on a narrow basis.
- The requirements of the system are unclear such that developers face considerable uncertainty regarding planning proposals.
- There are too many opportunities and grounds for appeal.
- There are five independent bodies involved in the planning system with little direct accountability for their actions.
- The respective roles of state and local governments are unclear and too often the state government gets involved in decisions that should be left to local government.[80]

The Tasmanian Department of Treasury and Finance has acknowledged that business perceives that Tasmania has an environmental regulatory regime that is likely to frustrate or prevent economic development. In doing so the Department concedes that the rights of objection to development proposals are more generous in Tasmania than in any other Australian state.[81]

As a result of these policy flaws, environmental opposition has been able to terminate many major investment projects that have been proposed for Tasmania since the early 1980s. This coincided with the political institutionalisation of environmental politics – particularly the emergence of the Greens holding the balance of power in the Tasmanian House of Assembly over the decade to 1998.

The most public casualty of environmental opposition to economic development during this period was the kraft pulp mill that Associated Pulp and Paper Mills had proposed to establish at Wesley Vale in the northwest of Tasmania. The pulp mill project would have involved a capital investment of around A$1 billion and would have resulted in exports of 420,000 tonnes of pulp a year once the mill was fully operational.

The protracted delays caused by federal and state interventions over the setting of environmental standards for the proposed pulp mill caused the proponents to cancel the project. The most ironic outcome was that the project would have met the guidelines that emerged from the environmental assessment by the Commonwealth Scientific and Industrial Organisation (CSIRO).

Environmental activism has also lead to the complete cessation of hydro-electric development in Tasmania. Environmental opposition to further hydro-electric generation

---

80 Nixon, *op cit*, p 144.

81 Tasmanian Department of Treasury and Finance, *The Competition Index: A State-by-State Comparison*, *op cit*, p 31.

means that Tasmania will have to become increasingly reliant on energy imports when, and if, it is connected to the mainland Australian electricity and gas grids.[82]

The real issue in the recent Tasmanian experience concerns the sovereign risks that are associated with the way environmental goals are pursued in Tasmania – not the environmental goals themselves.

A very good illustration of the sovereign risks is to be found in the area of forestry. Like New Zealand, Tasmania is richly endowed with world-class forest resources. It is the Australian state with the highest proportion of its land area available for logging outside of those areas that have been set aside for conservation purposes.[83] Despite having extensive exploitable resources, the *Nixon Report* has highlighted the fact that high levels of sovereign risk have been associated with the Tasmanian forestry industry.[84]

Tasmania's approach to environmental regulation has led to increased sovereign risk – or at least the clear perception of increased sovereign risk by potential investors in Tasmania.[85] Either way investors will demand a higher expected rate of return before they contemplate investments in the State. The end result is increased costs to business, less investment and fewer jobs.

5.3.3 Disadvantageous federal policy

In a political sense, Tasmania has done very well out of the Australian Federation. As we have seen it has by far the highest level of representation in the Federal parliament in terms of population.

As a result, Tasmania is able to exert a political influence in Canberra that far exceeds its relative size, whatever the measure. Its influence has seen it consistently obtain a significantly greater share of Federal financial assistance to the states than would be justified by the size of its economy or its population.[86] Nevertheless, Federal financial assistance has not necessarily been used wisely by successive Tasmanian governments, given the extent of the tax burden that the State imposes on business.

Despite the considerable financial assistance that Tasmania receives from the Federal government, overall Tasmania's superior political influence in Canberra has proved to be a mixed blessing for the State from an economic perspective. This is because the State has not been able to prevent the implementation of policies at the Federal level that have adversely affected the economic interests of its residents.

---

82 The Tasmanian government is sponsoring the Basslink interconnector to link the Tasmanian electricity grid with the Victorian region of the National Electricity Market. The government is also sponsoring the Tasmanian Natural Gas Project to reticulate natural gas sourced from Bass Straight into Tasmania.

83 Tasmanian Department of Treasury and Finance, *The Competition Index: A State-by-State Comparison*, *op cit*, p 2.

84 Nixon, *op cit*, p 29.

85 Nixon, *op cit*, pp 20–21.

86 Commonwealth financial assistance will account for over two-thirds of Tasmanian government revenue in 2001–02. See Tasmanian Department of Treasury and Finance, *Budget Highlights 2001–01*, Government of Tasmania, May 2001, p 25.

Three examples will suffice.

The first example is the Commonwealth's 'heroic' attempt over a period of six decades up to the late 1980s to promote industrial development through a regime of high tariff protection and selective assistance measures, largely for the manufacturing industries. This policy was clearly at the expense of states such as Tasmania that were more heavily reliant on primary industries – particularly agriculture, forestry and mining – and far less reliant on manufactures.

The second example concerns the federal system of centralised conciliation and arbitration originally set up in the 1920s to regulate wages and working conditions. The federal system of regulated labour arrangements has been complemented by a series of state-based regimes that regulate those labour relationships that fall outside the federal sphere.

A key result of this system has been a loss of flexibility in setting wages and conditions to reflect the demand for and supply of particular categories of labour at different localities. The states with smaller and more narrowly based economies such as Tasmania were less able to accommodate the loss of flexibility that this system entailed. While there have been a number of reforms introduced into the Federal industrial relations regime over the 1980s and 1990s, significant rigidities remain – both at the Federal and at the state level.

The final example is cabotage – the policy of reserving coastal shipping services to vessels registered in Australia and crewed by Australian seamen. Cabotage has meant that the cost of coastal shipping services in Australia has been well above international levels and has worked against the use of sea transport for interstate trade in those areas where Tasmania may be expected to have a competitive advantage. Given Tasmania's reliance on shipping for moving most of its imports and exports, cabotage has had the effect of limiting its capacity to export to both mainland Australia and the rest of the world.

Tasmania's political counterweight in Canberra has been unsuccessful in protecting its fundamental economic interests in each of these cases. In addition, where it has been able to extract significant concessions in return, they have generally tended to exacerbate Tasmania's long-term economic problems and to entrench a mendicant mindset within much of Tasmanian business and the State government.

For example, the Tasmanian solution to cabotage has been to get the Federal government to subsidise Tasmanian shippers across Bass Strait. The Tasmanian Freight Equalisation Scheme has been rationalised as a practical application of the 'Theory of the Second Best'.[87] Reduced to its essence, this theory says that if a government cannot remove an economic distortion, it can neutralise its adverse effect with a judiciously designed subsidy.

---

87 RG Lipsey and K Lancaster, 'The General Theory of the Second Best', *Review of Economic Studies*, Vol 24 (1956), p 11–32.

The theory of the second best is fine as far as it goes. But it does not go nearly far enough to demonstrate that it has practical value.

The theory ignores the fact that the Federal government is unlikely to have the information to design and operate an appropriately discriminating subsidy that would improve economic welfare. The information that is required is very costly and much of it is informal. Natural ignorance is likely to mean that the probability of getting the design and operation right is relatively low in most cases.

The theory also ignores the fact that the provision of a subsidy will tend to encourage 'rent seeking' by businesses and their sponsors in the Tasmanian government.[88] This has indeed been the experience of the Tasmanian Freight Equalisation Scheme.

5.4 Cultural impediments to performance

Culture is an elusive concept as far as its definition and measurement are concerned. Nevertheless, there is an emerging body of theoretical and empirical literature that points to cultural influences as being important determinants of economic development.[89]

Many of the recent official inquiries into the 'Tasmanian problem' have commented on the fiercely local parochialism that bedevils policy debates in Tasmania and on the adverse impacts that it has had on the policy choices that have been made there.

Nixon saw this parochialism as manifesting itself in the different regions of the State vigorously competing to retain government services to the point where it has led to the duplication of service outlets and higher costs of service delivery. For example, Tasmania has four under-utilised ports operated by the State government of which three are on the northern coast of the State. Nixon concluded that this parochialism was diverting the focus of the community from attracting new and viable business to Tasmania.

Cultural factors such as parochialism undoubtedly explain some of Tasmania's poor economic performance. But exactly how much they have contributed to economic outcomes in the State remains a matter of some conjecture.

While the cultural contributions to economic performance are notoriously difficult to pin down, for our purposes they can be ignored for at least two reasons. First, many of these cultural issues are not unique to the economy in which they are observed –

---

88 See for example, Max Weber, *The Protestant Ethic and the Spirit of Capitalism*, Scribners, New York, 1958; GL Hicks and SG Redding, 'The Story of the East Asian "Economic Miracle" ', Parts I and II, *Euro-Asia Business Review*, Vol 2, No 3 and Vol 2, No 4, 1983; Douglass North, *Institutions, Institutional Change and Economic Performance*, Cambridge University Press, Cambridge, United Kingdom, 1990; Lawrence Harrison, *Who Prospers: How Cultural Values Shape Economic and Political Success*, Basic Books, New York, 1992; and Depak Lal, 'Unintended Consequences: The Impact of Factor Endowments, Culture and Politics on Long-Run Economic Performance', Ohlin Lectures No 7, The MIT Press, Cambridge, Massachusetts.

89 Nixon, *op cit*, pp 19–20.

Tasmanian parochialism is a good example. Tasmania shares with the rest of Australia many features of culture that were inherited from Britain such as language, values, acceptance of the rule of law and key institutions of government. Second, cultural factors are, by their nature, not a product of conscious design. They are informal, arise spontaneously, evolve slowly and are not able to be changed rapidly by any individual or organisation – even the coercive power of government is unable to shape culture to conform to a particular design. However, culture tends to evolve over time as individuals adjust to changing circumstances.

6

SOME LESSONS FOR NEW ZEALAND

I now turn to the key issue that I have been asked to address, namely the risks of a 'Tasmanian future' for New Zealand.

I have used the term 'Tasmanian' to describe a combination of economic outcomes that are generally agreed to be highly unsatisfactory. Such outcomes are reflected across a range of indicators of economic good health – economic growth, productivity, material living standards and their sustainability, employment creation, unemployment, labour force participation, welfare dependency and net emigration – and they persist over time. Most would readily agree that continuing under-achievement in these areas is the economic equivalent of being seriously ill.

The description of an unsatisfactory combination of such outcomes as 'Tasmanian' may strike some as a little unfair to Tasmania. However, few people would wish a similar fate to befall any community. For this reason the term is intended to be used as a positive contribution to the debate about how to improve economic performance rather than as mere criticism.

The characterisation of such a future as 'Tasmanian' is also useful because it emphasises that whether or not it is realised is a matter of social choice. No particular economic 'state of the world' is preordained – whether in Tasmania, New Zealand or anywhere else. The institutions and policies that a society adopts will largely shape the economic outcomes that it subsequently enjoys.

In the process of canvassing this issue I propose to address two sets of questions. The first arises from the recent Tasmanian experience as to the nature of the economic risks that confront other small and remote economies, such as that of New Zealand. The second set of questions concerns the lessons that we can infer from the Tasmanian experience as to how such an economy can best avert these risks.

6.1 The nature of a 'Tasmanian future'

Tasmania has much in common with the other Australian states. For example, it shares with them a common currency, external tariff and income tax system, much commercial law and many Federal institutions.

Despite the absence of differences between Tasmania and the other Australian states across such an important and extensive range of institutional factors, Tasmania has under-performed over recent decades compared with the rest of Australia. The State's poor performance has been comprehensive – ranging across every significant economic indicator from output through productivity and investment to labour market outcomes. It has also been chronic, having persisted for decades, rather than a few years. This combination defines the nature of the 'Tasmanian future' that is the focus of this paper.

A Tasmanian future is a product of an institutional and policy environment that is significantly and comprehensively detrimental for prosperity. In the Tasmanian case this has been due to the following factors:

- excessive regulation;
- heavy taxation; and
- significant risks associated with political decision making.

At some point an unfavourable business environment will adversely affect the rate of private investment in the economy. Rates of investment, in turn, are a good barometer of the outlook for future growth in economic activity and, therefore, material living standards. The Tasmanian experience shows that such prospects can be poor where low rates of investment are recorded over an extended period.

Another important dimension of a Tasmanian future is a chronically depressed labour market. It is characterised by low rates of job creation and workforce participation, and high rates of unemployment. These outcomes have a major negative impact on living standards and the quality of life.

A Tasmanian future, however, is one where many in the community will simply not be prepared to put up with persistently dismal economic and job prospects. Rather, increasing numbers of people will seek their fortunes elsewhere. Their departure tends to depress economic performance further for two reasons.

First, those who leave reduce the population that is available to contribute to economic growth and further development. In some cases the reduction may only be relative. The population may continue to grow – albeit at a slower rate than otherwise – because of natural increases, immigration from overseas, or both. However, the loss from emigration can be so severe that the population actually begins to decline. Such an environment is singularly unattractive to most business people.

Secondly, people who depart are normally concentrated among groups that can be expected to make a relatively large contribution to economic growth. They are likely to consist of the more geographically and occupationally mobile members of the population. These people tend to be among the 'best and brightest' – those in the community with the prospect of the longest time in the workforce and those with the more economically useful skills and abilities.

By definition entrepreneurial people – those prepared to take risks and create or grow businesses – tend to leave. Their loss can only reduce the ability and preparedness of the population that is left to invest and innovate.

Finally, a Tasmanian future is one where the economy is not attractive to permanent migrants from overseas. When this occurs, it becomes that much harder to make up for those residents who leave permanently.

6.2 How to avert these risks

Before addressing this topic, I should acknowledge that there have been developments in the recent economic history of Tasmania that are almost certainly unique to the State or to the time in which they occurred.

For example, many of the recent official inquiries have commented on cultural impediments to economic performance. As argued earlier, cultural factors are notoriously difficult to identify and measure and, for our purposes, can be safely ignored. Many of the factors unique to Tasmania are unable to be changed directly by the government, but it may be able to influence their evolution over the long term. Culture changes over time as individuals within particular societies adjust to new circumstances.

With this in mind, I canvass the broad lessons that I believe can be generalised from the Tasmanian experience. They concern:

- the implications of size and location; and
- the importance of sound institutions and policy.

I discuss each of these in turn.

6.2.1 Do size and geography really matter?

Tasmania's experience may appear to suggest that size and geography matter. More generally, it may suggest that states and countries that are small and geographically isolated are destined to suffer from persistently poor economic outcomes.

There is, however, no reason to believe that a Tasmanian future is unavoidable for small and remote countries. Trade among states and countries allows them to specialise in those activities in which they have a comparative advantage. If labour and capital are mobile, wage levels in small and remote economies (and also in large and proximate countries) will tend to reflect the average world price of labour in the activities that they undertake.

Small countries can achieve average income levels comparable with those of much larger countries, as the experience of Ireland, Switzerland, Luxembourg, Hong Kong and Singapore demonstrates. Large countries are not necessarily prosperous as China, India and Indonesia illustrate. Similarly, small countries that are close to large countries are not necessarily wealthy. Cuba's proximity to the United States illustrates this point. Despite being small and remote, New Zealand was one of the wealthiest countries in the world in the early 1900s and up to the 1950s.

Small, remote economies such as New Zealand risk being backwaters unless they can overcome natural disadvantages. They must 'stand out from the crowd' in other ways in order to achieve high living standards, attract international capital and retain the potentially mobile and prospectively productive among their population. To do so successfully they have to ensure that their institutions and policies contribute to these outcomes to the greatest degree possible. The Tasmanian experience shows how damaging poor design and execution in each of these areas can be to economic performance.

It should not be assumed that all aspects of size and location disadvantage small and peripheral economies. New Zealand has the advantages of temperate climate, good ports and (for some purposes) time zone differences with other countries. The costs of external transport and communications have been falling for many years and this trend seems likely to continue.

On the other hand, spatial and temporal proximity can be of some importance in conducting business relationships. Physical proximity in business relationships can be as important as it is in personal relationships – after all, few couples find that they can conduct a successful relationship by relying solely on telephone, fax and email for communications.[90] The need for executive and technical staff to undertake long-distance travel regularly to supervise offshore operations, maintain contact with customers and deal with technical problems exacts a personal and financial toll. Nevertheless, multinational companies find ways of minimising these disadvantages. Unless they provide benefits that compensate, they would face difficulties in retaining quality staff.

Interestingly enough, the industry that created the internet revolution agrees implicitly that proximity can be beneficial, whatever its marketing hype may say. This is the reason we observe the many clusters of information technology businesses around the world – Silicon Valley in California, Silicon Glen in Scotland, Silicon Desert in Utah and Arizona, and Silicon Forest in Washington State. The opportunities for relevant clustering may be limited in small and remote economies. In that event such countries may not have a comparative advantage in the particular industry.

Any attempt by governments to compensate for perceived geographical disadvantages by subsidising existing or new businesses is likely to make matters worse. Such subsidies distort the use of scarce economic resources. Moreover, a subsidy to one industry or firm requires a direct or indirect tax to be imposed on other industries or firms. The net effect is likely to be lower output than otherwise.

In summary, size and location factors are likely to have some bearing on a country's economic performance. However, as argued below, the quality of institutions and policies is vastly more important in explaining the performance of peripheral economies.

6.2.2 Sound institutions and policies are crucial

Sound institutions and policies are vital for all countries but especially for small, remote economies like Tasmania and New Zealand. They are essential if such countries are to match the living standards of better-placed countries.

---

[90] Customer call centres provide a good example of this. Call centre technology has reached the point where a centre can be physically located well away from the area where customers reside and thereby take advantage of cheaper wage rates. In the extreme the call centre can even be located in another country provided that a common language is spoken. However, businesses that take advantage of this potential have to take steps to ensure that a 'foreign' call centre can provide an acceptable level of customer service. An electricity retailer in New Zealand that trialled a call centre in Australia found that Australian-based staff did not know enough about the geography of the area in New Zealand that they had to service.

Institutions

The main function of institutions is to facilitate order and reduce uncertainty in exchange. In doing so institutions structure incentives. Institutions that inspire trust and confidence reduce the cost of coordination. When order prevails people are better able to make reasonable predictions, cooperate with others and have the confidence necessary to undertake innovative experiments. More useful knowledge will be discovered and applied as a consequence and the potential gains from trade are more likely to be realised.

Key institutions encompass such things as the proper observation of the rule of law, the existence of well-defined and enforceable property rights, the ability to make and enforce contracts, an independent judiciary, representative legislatures and constitutional government. Well-defined and appropriately enforced property rights encourage individuals and firms to undertake activities that benefit other people as well as themselves.

The arrangements governing the establishment and operation of parliament and executive government are vital in shaping economic outcomes. As we have seen with Tasmania, proportional representation encourages fringes of political opinion to be reflected in the parliament at the expense of efficient and effective government.

Judged against an idealised view of what parliamentary democracy should entail, proportional representation may seem to be highly commendable. The idealised view tends to overlook the fact that entrenching the range of political differences does not necessarily deliver high or growing standards of living, let alone protect the interests of the community as a whole.

Tasmania shows that political instability and a succession of minority governments works against good economic outcomes for the community as a whole.[91] Such outcomes are associated with a lack of political leadership, blurred lines of responsibility, weak accountability and entrenched policy paralysis. Controversial issues have not been properly or seriously addressed, let alone resolved. They just linger for the next government to avoid doing anything about them. The end result has been a lack of investment, a rundown in the economy's capital stock and stagnating economic activity.

Of course, majority rule, of itself, does not produce sustained economic improvements. The government needs to be able and willing to adopt policy reforms that are necessary to correct institutional and policy weaknesses.

The unfortunate combination of institutional weaknesses increases the sovereign risk facing businesses and encourages rent seeking. Many businesses find it easier to advance their interests through the political process than in the commercial arena. This is neither efficient nor equitable.

The most immediate risk for New Zealand concerns proportional representation and the particular form that it takes in New Zealand – the Mixed Member Proportional (MMP)

---

[91] The Hare-Clark voting system has also been adopted for the House of Assembly in the Australian Capital Territory (ACT) and has produced a succession of minority governments to date.

electoral system. Unlike in New Zealand, the adverse outcomes in Tasmania that have been associated with proportional representation cannot be explained in terms of the unanticipated consequences of a novel system of choosing its political representation. In Tasmania, the Hare-Clark system of voting was first trialled in 1896 before being adopted State-wide from 1907.[92]

Nevertheless, the Tasmanian experience does seem to confirm that proportional representation cannot be easily grafted on to a traditional Westminster parliamentary system without a risk of a significant unanticipated reduction in the effectiveness and efficiency of government. The Westminster system seeks to achieve a clear and unambiguous outcome. Proportional representation, on the other hand, is primarily concerned to replicate better the range of political opinion in the wider community. The clarity and force of any mandate to govern is secondary.

For these reasons, there is an inherent tension between proportional representation and a traditional Westminster parliamentary system. Countries that have attempted to reconcile the two have tended to use proportional systems of voting for their upper house of parliament while retaining first-past-the-post voting – or a variation on it – for their lower house. Australia's Commonwealth parliament is a good example of such a compromise.

This sort of compromise is, however, not a practical solution for a unicameral parliamentary system, such as in New Zealand.

Policy

A key requirement for small countries to prosper is openness to the rest of the world. Provided their economies are open to international trade and capital flows, investment is not constrained by the level of domestic savings. Moreover, domestic costs and prices (at least for traded goods) are disciplined by world prices, and competition spurs efficiency and innovation. Firms are also able to tap into the demand for goods and services generated by large world markets, and raw materials and other imports can be obtained at world prices.

Governments are progressively pulling down many of the regulatory barriers between their domestic capital markets and those of the rest of the world. A small economy such as New Zealand may not generate sufficient savings to finance all worthwhile investment proposals. The savings of other countries will make up the shortfall if barriers to international capital flows and trade are low. By contrast, the level of investment may be limited by the amount of domestic savings when international capital flows, trade, or both, are prohibited.

Capital inflows include foreign direct investment. Foreign direct investment is often associated with the introduction of new technology, new production and management techniques and better access to overseas markets. Foreign investment may also enhance competition in the domestic market and thereby help to raise productivity. International

92 Nixon, *op cit*, p 101.

linkages such as these are important for small and remote economies. New Zealand has benefited from liberal foreign investment policies and the removal of exchange controls, and its firms now have access to efficient financial markets on a worldwide basis.

Economies that are not attractive to investors are generally unattractive to workers. Capital and labour are the two sides of the same value-adding coin. A successful and growing economy needs plentiful supplies of both. A stagnant and under-performing economy discourages investment, and without investment there is little prospect for sustained employment growth, let alone improving terms and conditions of employment.

Inappropriate regulation of the labour market simply worsens outcomes for those in the workforce. When wages and conditions are set on a national basis without regard to local conditions, unemployment among people with skills in abundant supply and shortages of people with skills that are in demand are accentuated. Areas with high unemployment are unable to retain or attract industry by supplying labour at wage levels that are attractive to potential employees and offset any non-labour costs that arise from size and geography. The upshot of inappropriate labour market regulation is lower investment, fewer job opportunities, and higher unemployment and migration than otherwise.

Residents who are mobile will tend to leave to find work elsewhere and immigrants who might have been attracted will find more attractive places in which to settle. People who are the most mobile are also likely to be the very people the economy needs the most. Once they are gone they are unlikely to return except for holidays or to retire.

Tasmania's experience illustrates these risks well. Its labour market is characterised by a declining number of full-time jobs, low participation rates and high rates of unemployment, particularly for the young and the long-term unemployed. Tasmania is not an attractive place in which to look for a job, let alone develop a career. Its young adults and those with professional or tertiary qualifications have tended to vote with their feet and sought an economic future elsewhere.

The attraction of staying on is often least for those near the bottom of the educational and occupational scales with few family responsibilities. Leaving the State at an early age is frequently the only way for young people with modest qualifications to find a job. Unless they leave early in their working life, they run the risk of watching their relatively few job skills atrophy.

At the other end of the educational and occupational scales, the choice people face is not between having a job or not, but where to realise their potential return on substantial private investment in vocational or tertiary education. High-achieving people are critical to economic development and the growth of community living standards for the reasons noted above.

A long-term problem created by the emigration of an economy's best and brightest may be an increase in the dependency ratio – with fewer workers supporting the same number of social security beneficiaries – as is happening in Tasmania. In this case the maintenance of a given level of government services requires increases in tax rates.

The ultimate risk, of course, is a vicious cycle of successive increases in tax rates – to support relatively more dependents – eroding the attractiveness of investing and working in the economy in question, and thus leading to escalating waves of outward migration. Tasmania has yet to reach such a position. Nevertheless, the risk for the State is real, particularly with its current institutional and policy settings.

Even a well-governed country may have difficulty in maintaining the quality of its labour force if it is small and remote. Many countries are experiencing a 'brain drain' with increased mobility of labour internationally and less restrictive immigration policies in North America and Europe as labour markets have tightened in recent years. This trend may be interrupted by the current global slowdown but is likely to resume later. Talented professionals and entrepreneurs are attracted by higher paid jobs, opportunities to increase their specialisation and the attractions of lively, diverse cities.

When firms in countries such as New Zealand raise salaries to match competing opportunities for highly qualified staff, as they must, there is a risk of creating resentment among other staff in their organisations or the wider society of a small country, which again encourages people to leave. The retention problem can be exacerbated by excessive rates of tax. They tend to be reflected in higher gross salaries for people with internationally transferable skills.

A confluence of institutions and public policy can be profoundly anti-business in its effects, even if that result is not what was intended. Tasmania's experience shows what can happen to an economy when policy develops a consistent anti-business character in each of the three key public policy areas – public expenditure, taxation and regulation.

First, there is little evidence that successive Tasmanian governments of all political persuasions are prepared to impose fiscal discipline in their public spending. Over recent decades the end result has been high levels of government spending, deficits and debt. As a consequence, debt servicing is a significant budgetary cost. The present government has been able to wind back public debt by moving the budget into surplus but this has largely been achieved by tax increases.

Secondly, Tasmania has placed heavy taxes on the business sector. Tasmania has narrowed its tax base with a plethora of exemptions and concessions, which has meant that its tax rates are higher than otherwise. This tax structure, combined with the high level of debt servicing over the last decade, have been negative for economic development.

Although the State government cut some taxes in the 2001–02 Budget there is still some way to go before Tasmania can be said to have a tax system that is more attractive to business and residents than those of the populous Australian states.

Thirdly, the Tasmanian regulatory system has clearly discouraged economic development that would benefit the community overall. In many cases – for example hydro-electric development – it has almost stopped development projects altogether. The system of environmental regulation, in combination with the voting system for the Tasmanian parliament, has virtually allowed environmental organisations to dictate the economic development of the State. The interests of the Tasmanian community as a whole have been largely ignored.

Tasmania's membership of the Australian Federation has neither prevented flawed policies from being introduced nor significantly ameliorated their adverse impact on Tasmania. In other words, free trade within the Commonwealth, a common currency and the removal of other barriers to economic integration have not been enough to protect Tasmania's economic position. Tasmania has dissipated a significant part of the potential benefits from membership of the Commonwealth through a combination of poor institutional arrangements and policies.

New Zealand has already achieved virtual free trade in goods with Australia under the CER agreement and the largely common capital and labour markets, and the two countries are in the process of extending the agreement's key principle of non-discrimination to trans-Tasman investment and trade in services.

While a common currency would help to reduce the transaction costs of New Zealand firms doing businesses in Australia, and vice versa, it would come with a cost for New Zealand – a loss of economic flexibility. Any economic shock that affects New Zealand would no longer be able to be accommodated by currency realignment with Australia. The adjustment would depend on other policy, instruments such as fiscal policy, and on wages and the mobility of New Zealand labour and capital. It is not clear that the benefits to New Zealand would be such as to justify the cost and risks of such a change. Even if the net benefit were positive it is unlikely to be particularly large.

6.3 Conclusion

It is most unlikely that geography explains much of New Zealand's sluggish economic performance in recent decades. Its geographical position did not prevent New Zealand achieving average income levels that were among the highest in the world in the first half of the twentieth century. Almost certainly the cumulative effects of poor institutional and policy choices are the dominant factor in New Zealand's subsequent under-performance. Economic reforms from the mid-1980s clearly improved the economy's performance and outlook, an outcome that also tends to discount the importance of geographical factors.

Closer trade and economic integration with Australia is unlikely to compensate for poor decisions about institutions and policies, as Tasmania's experience confirms.

In short, while size and location may constitute some natural disadvantages for New Zealand, the basic conclusion of this study is that they are most unlikely to prevent it from achieving similar levels of prosperity to those of high-income countries. Weaknesses in institutions and policies are the most likely cause of New Zealand's return to a mediocre performance after the improvement in the mid-1990s. New Zealand can avoid a Tasmanian future but to do so it will need to adopt and maintain superior institutions and policies.