



Submission to Department of Industry

Australian Government Economic Review of South Australia and Victoria

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 **Institute of
Public Affairs**
THE VOICE FOR FREEDOM
70 YEARS: 1943-2013

January 2014

Executive Summary

The Institute of Public Affairs (IPA) is an independent, non-profit public policy think tank dedicated to preserving and strengthening the foundations of economic and political freedom. Our work is guided by the philosophy of free markets, small government and individual responsibility.

This submission calls for the introduction of policies that will increase South Australia's economic freedom and competitiveness as it vies to attract investment and promote innovation in an increasingly competitive global environment.

- South Australia is falling far short of its economic potential.
- Unlocking the potential of the state will require nothing less than a reversal of the high-taxing, high-spending and pro-regulatory policies pursued over the past decade.
- South Australia must reduce the size of its public sector which is characterised by high levels of taxation and public sector expenditures.
- Corporate welfare arbitrarily renders some industries more competitive at the expense of others and distorts private sector economic activity, and should be discontinued.

Improving South Australia's economic performance

According to most economic indicators South Australia falls far below its potential. In comparison to other Australian states and territories South Australia has sub-par economic growth, low levels of productivity growth, high levels of unemployment and persistent negative interstate migration levels.

South Australia possesses a range of advantages which can provide a basis for sustained improvements in economic competitiveness:

- The state is rich with metallic minerals, energy resources and agricultural raw materials.
- A diverse labour force, with workers possessing a range of medium to high skills, is highly adaptable to using new technologies, and is highly educated.
- A heterogeneous capital base exists within the state, and productive private ventures have ready access to domestic and foreign savings.
- The state is located in similar time zones with the fast-growing East-Asia region.

A robust economy, in which suppliers succeed in producing economically valuable goods and services, is a fundamental precondition for rising material living standards for all South Australians. Not only does economic robustness ensure appropriate reward for productive efforts undertaken within markets, but it equips those in difficult socio-economic circumstances with the best opportunities for improved wellbeing over time.

Contemporary and historical evidence convincingly suggests that regional locations that allow private markets to flourish, with the fewest inhibitions in place against the creation of economic value, are most conducive to delivering progressive improvements in material living standards over time.

Economically vibrant communities also tend to attract more capital, labour, and other resources from other regions around the world. As such, a virtuous cycle of sustained economic growth and development can be created.

However, concern in recent years has centred on the persistent underperformance of the South Australian economy. It is becoming increasingly apparent that the state will urgently need to rectify its poor economic record should it aspire to attract investment and labour in an increasingly competitive global environment.

The purpose of this submission is to illustrate the significant economic opportunities in attracting valued labour and investment, associated with reducing the cost of doing business and more proactively engaging in market-based economic activity more generally.

To do this, South Australia needs to think of herself as a global state: competing for capital and residents not just against other Australian states, but to leapfrog other states and provinces around the globe. The state needs to take its policy direction from global best practices, with a commitment to economic and social liberties providing the best destination for investment, job creation and quality of life.

Even today, potential sources of competitive advantage are opening up for South Australia. The vast deposits of minerals located within the state provide every potential of positioning South Australia as a global minerals province of international repute during the twenty-first century.

Potentially following the outstanding success of its local viticulture industry, the prospects for the substantial growth and development of other aspects of South Australian agribusiness appears to hold great economic promise into the foreseeable future.

With quality of life issues emerging as important considerations for individuals and families, recent lifestyle surveys indicate that Adelaide represents one of the most liveable cities in the world. This potential advantage is overlaid by the relative proximity of South Australia to an East Asian region whose inhabitants aspire to develop their economies to modern Western standards.

It is still possible to make one's fortunes in South Australia. Mahalia Coffee, for example, is a family-run business in the picturesque fishing town of Robe, manufacturing and distributing coffee across Australia.¹ Servicing the top end of the market with its high-quality product, the business is thriving even in spite of growing tax and regulatory obstacles.

In many respects the future of South Australia cannot solely rest on positioning as a minerals and energy powerhouse of Australia and the Asia-Pacific, as important as this may be for the state's future. Much more than potential, or even luck, will revive the state's long term economic fortunes, and politicians attempting to 'pick winners' assuredly can never succeed in a dynamic, complex economy.

¹ Richard Blandy, 2012, 'Paper-shufflers, wake up and smell the coffee', The Australian, 12 November.

The state government needs to adopt significant unilateral reforms founded on the principles of low taxation, low and efficient government expenditures and streamlined regulation, so that all businesses, regardless of the sector in which they participate and the location in which they exist, can prosper.

Reducing the public sector

To fully capture the opportunities that would be presented by fundamental reform, there will be an associated need for all sections of the community to embrace economic and social change and, as part of this, shake off the institutional inertia and lack of confidence that has bedevilled previous generations.

Implementation of transformative government reforms, accompanied by a 'can-do' attitude to take on the best in the world in all facets, will ensure that South Australians realise the hopes, dreams and ambitions set forward by the state's founders.

A relatively large public sector built up over generations in South Australia has required the maintenance of high tax burdens. Spectacular expansion at the state level occurred particularly during the 1970s. While South Australian government employment fell from 102,200 people in 1984 to 93,900 people in 2004 – primarily as a result of economic reforms, such as privatisation, during the 1990s – state public sector employment has subsequently increased to 113,500 people in 2012.

As a result of this rapid rise, by 2012 South Australia had the largest share of government employees among the Australian mainland states. As a percentage of total labour force, public sector employment totalled 16.1 per cent in 2012, more than two percentage points higher than Victoria.

This rise has contributed to a downward fiscal spiral in which low growth induced by high taxes encouraged politicians to pay for today's public spending by borrowing heavily, but a lack of tax competitiveness has contributed to a brain drain of some of the state's best and brightest entrepreneurs and workers to other states or nations.

Ending corporate welfare

The tax revenues necessary to fund government subsidies to selected firms or industries artificially expands economic activities in the politically favoured sectors of the economy. However, they generally destroy more jobs than are created by imposing tax and associated costs upon non-beneficiary firms or industries.

Similarly, many critics of corporate welfare point to the effect of such policies in wastefully shunning investments and jobs across economic space, for little or no overall economic benefit. For example, the South Australian government provided incentives for Berri Fruit Juice to retain its manufacturing operations there, only to have Queensland subsequently poach its export operations from South Australia (and NSW) in 2001.

It is possible that subsidised ventures absorb labour, capital and other resources that would otherwise have been allocated to market-driven ventures, which receive no special inducements. In growing economies in particular, this phenomenon would tend to increase the cost of inputs, and hence dilute general economic competitiveness of a jurisdiction.

Corporate welfare policy poses broader challenges for the integrity of economic policy more generally. There is a risk that the provision of corporate welfare distracts policy attention from what is needed to facilitate a market-friendly economic climate, suitable for the growth prospects of all firms in all industries.

The economic adjustment process, governed by changes in relative prices, technologies, consumer tastes and other factors outside of public policy control affects the viability of all firms in market-based economies, regardless of whether they receive corporate welfare assistance or otherwise.

Conclusion

South Australia must take measures to boost per capita incomes, reduce government spending, ameliorate cost of living pressures, lift educational outcomes and encourage additional innovation.

Handouts and subsidies, although financially lucrative for the industries that receive them, generally have a detrimental overall outcome on the economy as they distort the most efficient allocation of resources. This has become apparent with regard to the heavily subsidised South Australian automotive sector, which has proven increasingly economically unviable in the face of international competitive pressures and domestic economic changes.

In order to increase innovation and drive economic growth, South Australia must pursue policies which increase economic freedom and allow the free market to flourish, to the benefit of all industries that seek to invest and growth in the state.