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The need for tax reform

The need for tax reform can be seen in terms of challenges and opportunities.

We will mention three challenges: the first being the living standards challenge for Australia; the second, the impact of technological innovation and globalisation; and lastly, the ageing of the population.

Promoting growth in living standards

Australia has been relatively blessed, experiencing almost a quarter of a century of uninterrupted economic growth and strong growth in our standard of living. Previous growth has been assisted by the rise in female participation, earlier waves of economic reform and the mining boom. However, the recent Intergenerational Report projects that income growth will slow over the next 40 years. Some of these things we have little control over, like demographic ageing and the world price of our exports. This emphasises the need to focus on reforms that boost productivity and participation as these are the key factors that drive living standards.

Many argue that comprehensive tax reform could provide a substantial boost to living standards – indeed, a bigger boost than any other single area of government policy.

Chart 1. Sources of growth in real national income per person

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<td>Per capita income growth</td>
<td>3.0</td>
<td>1.4</td>
<td>1.7</td>
<td>2.1</td>
<td>2.3</td>
<td>0.9</td>
<td>1.4</td>
</tr>
<tr>
<td>Labour utilisation</td>
<td>0.6</td>
<td>-0.3</td>
<td>0.6</td>
<td>0.0</td>
<td>0.0</td>
<td>0.1</td>
<td>0.0</td>
</tr>
<tr>
<td>Net foreign income</td>
<td>0.0</td>
<td>0.0</td>
<td>-0.2</td>
<td>0.1</td>
<td>0.8</td>
<td>-0.4</td>
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<tr>
<td>Terms of trade</td>
<td>2.2</td>
<td>1.9</td>
<td>1.2</td>
<td>2.1</td>
<td>1.5</td>
<td>1.3</td>
<td>1.5</td>
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<tr>
<td>Labour productivity</td>
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<td>0.0</td>
<td>-0.1</td>
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<td>Terms of trade</td>
<td>0.0</td>
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Technological innovation and globalisation

The second big challenge is technological innovation and globalisation. This is profoundly shaping our economies and our everyday lives. This has been of huge benefit to humanity. But it does also strike challenges, including for tax systems that were designed in a very different age. An example is the rapidly growing role of things that are intangible – that can be hard to value or to determine their source – in the global economy.

In the past 40 years, intangible assets have grown from less than a fifth of the market value of the S&P 500 to more than four-fifths. Furthermore, companies now have greater ability as to where they locate their operations. This poses a particular challenge to company tax going forward, and reinforces the need to ensure our tax rules, which are already robust, remain up to the task.

It is also reasonable to think that with globalisation, labour mobility may increase in future, particularly for highly skilled workers, which would raise the economic costs of our progressive income tax system.
The number of people (aged 15 to 64) per person aged 65+ is decreasing

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of people aged 15 to 64</th>
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<tbody>
<tr>
<td>1975</td>
<td>7.3</td>
</tr>
<tr>
<td>2015</td>
<td>4.5</td>
</tr>
<tr>
<td>2055</td>
<td>2.7</td>
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This will occur at a time when bracket creep will push more workers onto the higher tax rates. Left unchecked, a combination of inflation and real wage growth is projected to increase the percentage of taxpayers on the top two tax rates from around 27 to 43 per cent.

**Student activities**

1. Why has Australia been relatively blessed in terms of its economic performance since the 1950s?
2. What have been the key sources of Australia’s economic growth since 1950?
3. Which two factors could limit substantially future economic growth in Australia and how might these adverse factors be overcome?
4. How might changes in technology and innovation pose challenges to the future performance of the Australian economy?
5. Explain why the ageing of the Australian population might represent a challenge to future growth.

**Ageing of the population**

A third big challenge for our tax system is the ageing of the population. There will be a substantial decline in the relative size of the population of traditional working age – those who usually pay the most income tax – and this will put pressure on our tax system.

**Chart 3. The number of people (aged 15 to 64) per person aged 65+ is decreasing**

This diagram illustrates the decrease in number of people (aged 15 to 64) per person aged 65 or older is decreasing.

**What are the opportunities available to us?**

So the tax system and our economy more broadly, face some big challenges. What are the opportunities or benefits we could get from reform? It is commonplace in discussing tax reform to talk about the three tax axioms: efficiency, simplicity and fairness, and these are covered in the Government’s Tax Discussion Paper. Each presents important reform opportunities.

**Efficiency**

By economic efficiency, we mean the effect the tax system has on overall economic output or living standards. It is well recognised that almost all taxes have a negative effect on economic growth but some taxes have a greater effect than others.

Treasury modelling suggests that there is a wide variation in the relative costs to society of the marginal dollar of revenue raised by various taxes.
In line with other studies, it shows that stamp duties and company tax have high economic costs, while municipal rates have a low economic cost. Stamp duties, like other turnover taxes, dampen exchanges which would otherwise be mutually beneficial. Company tax has a high burden because capital is highly mobile and so the tax has a significant dampening effect on the level of investment.

The chart also shows that a progressive labour income tax, i.e., one with increasing marginal tax rates, has a higher economic burden that either a flat rate labour tax or a flat rate GST.

But what about our reliance on these tax types relative to other countries? It is worth noting that Australia has a relatively low tax burden compared to other OECD countries – so the analysis is about our relative, rather than absolute reliance on these taxes. The other thing to keep in mind is that while comparisons are instructive, there are limitations in what they can tell us, for example countries may have different economic characteristics which will tend to be reflected in differences in national tax systems.

We rely more on corporate taxes and more on progressive personal income taxes than other countries, and rely less on flat rate labour taxes and consumption taxes. And while we rely more than the OECD average on land tax, the US, Japan, United Kingdom, Canada and France have a significantly higher reliance on land taxes.

The concept of ‘efficiency’ can be challenging to translate in a tangible and relevant way for the community. Some taxes, like stamp duty, are relevant to their own experience and the impact is relatively intuitive. Others, like company tax, are more challenging. We are working to address this, by approaching community engagement in new ways, including by developing short and simple animations to explain concepts and issues.

So far we have talked about the efficiency of our tax bases, but there are also important issues within tax bases.

To give just a few examples relating to income tax:

- what are the economic efficiency implications of the current tax treatment of saving and investment?
- What is the impact of the treatment of taxation of dividends, superannuation and capital gains?
- What are the consequences of the gap between the corporate tax rate and the personal tax rate?
- What is the effect of our capital depreciation rules on investment and international competitiveness?

Further, developing tax policy requires much more than maximising efficiency. The second tax axiom is fairness and as the Government has made clear, it wants taxes that are fairer.
Fairness

While fairness, or equity, is widely accepted as a fundamental design principle for the tax system, it is intrinsically subjective. At the same time, this does not mean there are no analytical tools, principles or frameworks to help inform judgements about the fairness of the tax system. Some of these include treating people in like circumstances similarly, the ability to pay principle, giving people time to adjust to new rules and rewarding effort.

One of the big challenges for people in thinking about the fairness of the tax system is to understand the difference between the legal incidence of tax and who actually bears it. While workers understand they pay for the GST (even though the legal incidence falls on businesses), they might be surprised to hear that they bear much of the economic cost of company tax and payroll tax. Recent research by the Treasury\(^1\) indicates that, in the long run, much of the burden or incidence of company tax falls on Australian workers – this point is made in the animation I showed you earlier.

Another big challenge is that it is much easier to think about the fairness of a particular tax, rather than the whole of the tax/transfer system. In fact, Australia has a highly progressive tax/transfer system by international standards.

Complexity

Whilst some complexity in a tax system is inevitable, you more than most know that our system is incredibly complex and this imposes substantial costs to the community, both directly and indirectly through increased uncertainty and risk.

In fact, the Australian Taxation Office (ATO) estimates that total tax compliance costs are in the order of $40 billion per year.\(^2\)

Now it is fair to say that past reform efforts have not been spectacularly successful in reducing complexity. And over the years ‘business as usual’ tax changes have added rather than subtracted complexity to our system. While there is no silver bullet, this tax white paper process does provide an opportunity for rebalancing our approach to drive down complexity and cost. The tax community can play a particularly important role in helping shape how we can make the system simpler over time.

Trade Offs and Community Choice

Public policy is about choices and tax reform is a prime example of this. There will often be a tension between efficiency, equity and simplicity. For example, sometimes to address an integrity issue (which may go to both fairness and efficiency) very complex rules may be needed, and choices have to be made as to whether the integrity benefits are worth the complexity cost.

This progressivity is primarily due to the combination of our targeted transfer system, the absence of social security taxes and our relatively high tax free threshold.

So far we have discussed efficiency and equity, and now I will touch on complexity.

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\(^1\) For further information, see the Treasury's research on the incidence of company tax.

There also are features in our tax system that are contentious. We have seen, for example, an active debate on issues like superannuation, negative gearing and dividend imputation. I don’t want to go into the details on any of those issues today, as they are worthy of a substantial discussion in their own right. The point I would like to make is that it is important these issues are considered from a broad perspective, and consultation is very important to achieve that. It is also important that the trade-off between changes in one part of the system with potential changes in other parts is considered. A tax preference in one area may be desirable, but is it more desirable than a reduction in tax elsewhere?

The reform of the Federation is also an opportunity

One of the things that sets this tax reform process apart from predecessors is that it is occurring in tandem with the Federation reform process. The Prime Minister has described aligning the processes for the reform of Australia’s tax system with the reform of Australia’s Federation as ‘a once-in-a-generation opportunity’ for change.

This is because reforms to the federation and the division of spending responsibilities are unlikely to be effective unless we also consider how they are funded – including an appropriate division of revenue raising responsibilities within the federation. The South Australian Government recognises this and timed its recent tax discussion paper accordingly, to inform the tax and federation white paper processes.

Getting involved in the tax reform conversation

So hopefully we’ve given you a taste for the scale of opportunities available through tax reform and why it is worth doing. I’d like to turn briefly to the review process and how you can be involved in the community debate on tax reform.

Many of you would have long memories and recall previous reviews of our tax system. One of the key lessons learned from these reviews, is the importance of engaging the public on why tax reform is worth doing, perhaps with just as much focus as on the technical aspects of any reform package. Reform can impose costs on the community – directly and through uncertainty. Benefits can take time to accrue and may not be as visible.

With this in mind, the Tax White Paper process has been designed is to encourage as much community debate as possible, with a myriad of ways people can have their say.

The challenge for us, as part of the Tax White Paper process, in facilitating an informed debate on tax reform, is to translate the legal and economic concepts around taxation, to something tangible and relevant to the Australian community. We do not expect people to have conversations about marginal excess burdens around their dinner table! We are working in non-traditional ways (particularly for Treasury!) to do this, including by providing readily accessible information on our website www.bettertax.gov.au.

We would welcome your feedback about how we are doing on this.

We are also seeking community views through different means. There is the formal submission process and we look forward to receiving these. However, there is also ongoing stakeholder engagement, as well as the opportunity for individuals to make informal comments on our website. Reform ideas can be big or small. The Government is keen to hear from all interested parties on any issues regarding the tax system. The Board of Tax is also undertaking consultations on business tax issues, which will feed into the process.

In conclusion, there are some major challenges facing our tax system, but there are also many opportunities – big and small - to make it better: to drive higher living standards, to make it fairer and to make it simpler. To make that happen, important trade-offs and choices have to be made. And it is vitally important for the community to be involved in the journey, as ultimately the tax system serves the community.
Student activities

6. Identify the three tax axioms and assess the importance of each in the tax reform process.

7. How is the effect of a tax on economic efficiency estimated and why is such a measure important?

8. Compare the structure of Australia's tax system to that of the OECD average.

9. Discuss the issues that are currently being debated concerning the fairness of the Australian taxation system.

10. Examine some of the problems that arise from a tax system that is too complex.

References


2. ATO analysis of commissioned Newspoll survey data, to be presented at a forthcoming conference in 2015.


4. See, for example, speech by Dr Ken Henry “Lessons from tax reform past’ Address to the Committee for Economic Development of Australia, 15 October 2009.

Source: Address to the Tax Institute Australia’s 48th South Australian Convention, 7-9 May 2015
Outcomes at a Glance

China is Australia’s largest trading partner. In 2014-15, China bought $90 billion of Australian exports, more than a quarter of Australia’s total exports to the world, and is our top overseas market for agriculture, resources and services exports. Chinese investment in Australia has been growing strongly in recent years, reaching almost $65 billion by the end of 2014.

The China-Australia Free Trade Agreement (ChAFTA), which entered into force on 20 December 2015, builds on Australia’s large and successful commercial relationship with China, by securing markets and providing Australians with even better access to China across a range of our key business interests, including goods, services and investment. Trade and investment with China is central to Australia’s future prosperity.

For Australian goods exporters

More than 86 per cent of Australia’s goods exports to China (by value in 2014) now enter duty free thanks to ChAFTA, and this percentage will rise to 94 per cent by 1 January 2019 and 96 per cent when ChAFTA is fully implemented (1 January 2029).

China buys more of Australia’s agricultural produce than any other country. In 2014-15, this market was worth $9 billion to Australian farmers and the broader agricultural sector. ChAFTA provides Australia with an advantage over our major agricultural competitors, including the United States, Canada and the European Union. It also counters the advantages Chile and New Zealand currently enjoy through their FTAs with China.

For agriculture, ChAFTA completely eliminated tariffs on barley and sorghum on 20 December 2015, and will see a rapid tariff reduction on other agricultural exports, including seafood, sheep meat, pork and a variety of horticulture. Other key agriculture outcomes include:

- Dairy: tariffs up to 20 per cent eliminated by 1 January 2026
- Beef: tariffs of 12 to 25 per cent eliminated by 1 January 2024
- Wine: tariffs of 14 to 20 per cent eliminated by 1 January 2019
- Wool: a new Australia-only duty free quota (commencing 1 January 2016), in addition to continued access to China’s WTO quota.

China is by far Australia’s largest market for resources and energy products. In 2014-15, Australia exported more than $70 billion worth of resources, energy and manufactured products to China. Starting from 20 December 2015, 92.8 per cent of China’s imports of these products from Australia now enter duty free, with most remaining tariffs to be removed by 1 January 2019. On full implementation of the Agreement (1 January 2029), 99.9 per cent of Australia’s resources, energy and manufacturing exports will enjoy duty free entry into China.

Key outcomes include:

- Iron ore, gold, crude petroleum oils and liquefied natural gas: ChAFTA locks-in existing zero tariffs on these major exports providing greater certainty for Australian exporters
- Coking coal: tariff of 3 per cent was completely eliminated on 20 December 2015
- Thermal coal: tariff of 6 per cent was reduced to 4 per cent on 20 December 2015, fell to 2 per cent on 1 January 2016 and will be completely eliminated on 1 January 2017
For Australian services suppliers

China is Australia’s largest services market, with exports in services valued at $8.8 billion in 2014-15. In ChAFTA, China offers Australia its best-ever services commitments in an FTA (other than China’s agreements with Hong Kong and Macau). Most valuably, this includes new or significantly improved market access for Australian banks, insurers, securities and futures companies, law firms and professional services suppliers, education services exporters, as well as health, aged care, construction, manufacturing and telecommunications services businesses in China.

The agreement also includes a Most-Favoured Nation (MFN) clause, under which Australia’s competitive position into the future will be protected if China extends any more beneficial treatment to other trade partners in the sectors of education, tourism and travel-related services, construction, engineering, securities, environmental services, services relating to forestry, computer and related services, and certain scientific and consulting services.

Key outcomes include:

• Legal services: Guaranteed market access for Australian law firms to establish commercial associations with Chinese law firms in the Shanghai Free Trade Zone (SFTZ)

• Education services: Within one year of entry into force, China will list on a key Ministry of Education overseas study website 77 Australian private higher education institutions registered on the Commonwealth Register of Institutions and Courses for Overseas Students

• Telecommunications services: Guaranteed market access for Australian companies investing in specified value-added telecommunications services in the SFTZ, providing greater certainty for Australian telecommunications investments in the SFTZ

• Financial services: China has committed to deliver new or improved market access to Australian financial services providers in the banking, insurance, funds management, securities, securitisation and futures sectors

• Tourism and travel-related services: China has guaranteed that Australian services suppliers will be able to construct, renovate and operate wholly Australian-owned hotels and restaurants in China

• Health and aged care services: China will permit Australian service suppliers to establish profit-making aged care institutions throughout China, and wholly Australian-owned hospitals in certain provinces. This will greatly expand the Australian private health sector’s offering of medical services through East Asia.

Student activities

1. Using information in the whole article, list the key statistics illustrating Australia’s large commercial relationship with China.

2. When did the China-Australia Free Trade Agreement (ChFTA) come into force and in what general areas does it affect?

3. What are tariffs and how can the reduction of tariffs on Australian exports benefit Australia?

4. Prior to the ChAFTA what were the levels of some of the tariffs affecting Australian exporters? When will they all be eliminated?

5. Using your knowledge of Australian businesses, identify some of the Australian businesses that have benefited from exporting to China in recent years.

6. How will the ChAFTA help Australian service suppliers gain greater access to the Chinese market?

7. What is a Most Favoured Nation clause and how might such a clause help Australian service suppliers in the future?
**Business and skilled worker mobility**

ChAFTA supports increased trade and investment between the two countries by reducing barriers to labour mobility and improving temporary entry access within the context of each country’s existing immigration and employment frameworks and safeguards.

ChAFTA provides improved access for a range of Australian and Chinese skilled service providers, investors and business visitors, supporting investment and providing business with greater certainty. Innovative new Investment Facilitation Arrangements (IFAs), which will operate within the framework of Australia’s existing visa system, will also provide greater flexibilities for companies to respond to unique economic and labour market challenges. IFAs will be available for large infrastructure projects above $150 million, strengthening investment in this key area and leading to the creation of jobs and increased economic prosperity for all Australians.

**Other outcomes**

ChAFTA includes additional commitments which:

- Provide a framework for the growth of electronic commerce between Australia and China
- Reaffirm existing international intellectual property obligations and provide a framework for future cooperation
- Promote cooperation and coordination between relevant agencies on competition policy
- Provide for future negotiations on access to China’s government procurement market
- Facilitate trade through streamlined customs processes.

**Work and Holiday Arrangement**

Alongside ChAFTA, Australia and China have also implemented a Work and Holiday Arrangement (WHA) under which Australia will grant visas for up to 5,000 Chinese work and holiday makers annually. The WHA will increase demand for tourism services and support the development of Australia’s tourism sector, particularly in rural Australia.

**For investors**

ChAFTA improves opportunities for investors in both countries. China’s commitments on investment in ChAFTA protect the competitive position of Australian businesses in China into the future. Increasing numbers of Australian businesses are entering the Chinese market with great success, with banking and wealth management the leading sector of Australian direct investment in China. At the end of 2014, Australia’s stock of investment in China totalled $57.9 billion.

The investment obligations in ChAFTA can be enforced directly by Australian and Chinese investors through an Investor-State Dispute Settlement (ISDS) mechanism. The ISDS mechanism includes safeguards to protect government’s’ ability to regulate in the public interest and pursue legitimate public welfare objectives such as public health, safety and the environment.

Chinese investment in Australia has been growing strongly in recent years - up from $2 billion 10 years ago, to around $65 billion at the end of 2014. ChAFTA will promote further growth of Chinese investment into Australia, in particular by liberalising the Foreign Investment Review Board (FIRB) screening threshold for private Chinese investors in non-sensitive sectors from $252 million to $1,094 million. The Government will continue to screen Chinese investments at lower thresholds for agricultural land and agribusiness, and in sensitive sectors, including media, telecommunications and defence-related industries.

Moreover, FIRB also continues to screen all direct investments, new business proposals and acquisitions of interests in land (including agricultural land), by Chinese state-owned enterprises, regardless of transaction size. ChAFTA does not change these arrangements in any way, consistent with the Government’s practice in other FTAs.

**For Australian consumers and businesses**

Consistent with Australia’s other bilateral trade agreements, remaining Australian tariffs on Chinese imports will be eliminated progressively. This includes removal of the five per cent tariff on Chinese manufacturing exports, electronics and white goods, with consumers and businesses to benefit from lower prices and greater availability of Chinese products.
**Student activities**

8. Compare the flow of Chinese investment into Australia with the stock of Australian investment in China.

9. What is direct foreign investment and why does the free trade agreement require the use of Australia’s Foreign Investment Review Board and an Investor-State Dispute Settlement mechanism?

10. Why is worker mobility a feature of the ChAFTA?

11. With both the Australian and Chinese economies in a period of transition how might the ChAFTA assist this process?
Dr. Glenn Stevens, Governor, Reserve Bank of Australia, Address to an Australia-Israel Chamber of Commerce (WA) Corporate Breakfast, Perth – 2 December 2015

It is very good to be back in Perth. As you know, the Reserve Bank Board held its meeting here yesterday.

We decided to leave the cash rate at 2 per cent. The reasoning was given with the decision, and so I don’t propose to discuss that. Instead I want to reflect on the nature of the adjustments going on in the economy, and in which Western Australia is very important.

It is four years since the Board last met here. The previous occasion was in September 2011. I don’t need to tell you that quite a lot has changed in the intervening period.

At that time, the price of a tonne of iron ore was about US$170. A tonne of hard coking coal was bringing in about US$300. These were among the prices that saw Australia’s terms of trade soar to a level some 75 per cent above their average for the preceding century. Few countries have seen such a windfall.

These extraordinary prices had already, by that time, triggered a massive investment program, which was lifting capacity. Four years ago, Australia was shipping about a million tonnes of iron ore each day, which was already double the rate of 2004. A bit under a million tonnes of coal left our shores daily.

By 2011, capital spending by the resources sector had already roughly trebled since 2005. It would peak the following year after rising by a further 50 per cent.

The results of that investment have come on stream, or soon will. Today, Australia ships around 2 million tonnes of iron ore and 1 million tonnes of coal per day. The investment was not just in iron ore and coal. On forecasts of strong demand from Asia – not just China but Korea and Japan as well – massive investments are under way in gas. LNG exports have begun from some of the Queensland projects and are expected to increase strongly over the coming years. As the WA projects come on line in the next few years, Australia’s total LNG production capacity will reach over 80 million tonnes per year. This compares with a production capacity of around 10 million tonnes a decade ago.

I should note in passing here that I have felt that we have been given a pretty good steer on the magnitude of the investment build-up and the early stages of the reversal, on the back of the very good work done by our regional liaison people, especially here in Perth. As a result, we’ve been much better at forecasting investment in the resources sector than in the other industries. That’s because of the help we were given by the large players in the resources industry. I know that many of you have participated in these discussions, which have been extremely helpful in understanding the nature of the episode. So I want to thank you for helping in that way.

As it happens, about the time the Board was meeting here in 2011, resource prices and Australia’s terms of trade were about at their peak. And what a peak it was. On a ten-year average basis, the terms of trade exceeded anything seen for at least a century. This was not just a very brief spike like some commodity price events have been (such as the early 1950s rise in the price of wool). It was quite persistent. Not permanent, but quite persistent.
Nonetheless, the peak was four years ago. Since then, as you know, prices have fallen considerably. Today the price of iron ore is about US$40 per tonne, and coking coal around US$75. At a national level, Australia's terms of trade, having been through an extraordinary surge, have fallen by a third and are still declining.

But even at those reduced prices, iron ore is still bringing a price 60 per cent higher than it did in 2000. Natural gas prices are 50 per cent or more above their 2000 level. The terms of trade, though down a long way from the peak, are still nearly 30 per cent higher than their 20th century average. Of course they may yet fall further. Time will tell. In the meantime, many resource companies are making significant strides in reducing their production costs so as to remain viable, and in some cases still very profitable, at these reduced prices. That's consistent with most experience in the long history of the resources business. Australia's presence in these markets is greater now. It would be true to say that, though weaker demand is part of the story, a significant part of the fall in prices is a result of increased supply from this continent.

The 'super-cycle' in commodity prices, and the associated surge in capital spending, have been of national and international significance. At times, the price of iron ore has even, on occasion, displaced from page one of newspapers the price on which Australians typically focus most intensely - that of a house. The spillovers of these activities have been felt around the country. For the fifty years up to 2005, resources sector investment had averaged just over 1½ per cent of national GDP. Periodically, in a boom it tended to reach a peak of perhaps 3 per cent of GDP.

This peak was about 8 per cent - nearly three times the size of the 'normal' peak, and easily the biggest such surge for over a century. The resources sector was doing 40 per cent of the nation's total business capital spending. And, as you know, a big share of that was occurring here in WA.

On other occasions, these types of events have ended up being very disruptive for the national economy. Terms of trade surges in the 1950s and the 1970s produced significant inflation on the way up and were followed by very major slowdowns or recessions in economic activity as the terms of trade fell back. That hasn't happened at a national level on this occasion. Inflationary pressure was relatively contained on the way up, and while aggregate growth has been a little disappointing for the past couple of years, in the circumstances we face - including very difficult global conditions in the aftermath of the financial crisis - the outcomes are, I think, quite respectable.

In fact, in a number of respects the economy has adjusted to the shocks in the way you would hope. Productive resources were redeployed to sectors where returns looked like they would be higher. This was true for capital but also for labour - relative wages shifted upwards in WA, for example. Population shifted in response, we had fly-in-fly-out and an immigration response, facilitated by visa arrangements and so on. These were helpful parts of the adjustment process.

Likewise, the exchange rate adjusted, as would be expected in a flexible system. When we were here in early September 2011, the Australian dollar was trading around US$1.07 and had been as high as about US$1.10. Today it is about 35 per cent lower than that against the US dollar, and about 20 per cent lower against a relevant basket of currencies. This movement - both up and down - was part of what helped the economy through the commodity super-cycle without seriously inflating or crashing.

Through all that, tested macroeconomic policy frameworks have aimed at overall stability, and the financial sector has been kept in good shape by sensible regulation and generally competent management.

While the episode is not yet over, at this point the economy overall has been recording growth. We will very shortly get a reading on GDP and the various expenditure and income accounts for the September quarter.

Looking ahead, nationally, the outlook appears to be for a continuation of moderate growth. The Reserve Bank issued its latest forecasts a few weeks ago. I won't go into detail here, but, in brief, year-ended GDP growth is forecast to be in the range of 2 to 3 per cent in June 2016 and to pick up a bit during the following year. Domestic inflationary pressures are expected to remain subdued. Inflation is forecast to be in the range of 1½ to 2½ per cent over the year to June 2016, and 2 to 3 per cent over the year to June 2017. The unemployment rate is projected to remain around 6 per cent or a little above over the next year, before gradually declining.
We do not make detailed forecasts at state level, but obviously the picture for WA relative to the rest of the country looks different from the way it did a couple of years ago. Previously, economic activity was very strong in the west and the north-east, driven by the investment boom, while in the south-east of the country it was somewhat subdued. Now, as the mining investment boom in the west is in the reversal phase, economic activity here in WA is more subdued, while in the south-east it is picking up.

These differences are plain in most of the economic data. Whereas business investment in NSW and Victoria is growing (albeit modestly), in WA it is, of course, contracting very sharply (as it is in Queensland). I think most people have understood for some time that this was on the cards. Consumer spending and employment growth in WA, which had outpaced the national average by a wide margin, have come back to be a bit below the national average. The rate of WA’s population growth has slowed. Housing prices have declined a little, while those in Sydney and Melbourne have, at least until recently, risen at quite a clip. Measures of business conditions in WA are at about their long-run average, having been a long way above that for some years.

So WA has ‘come back to the pack’, though the pack has actually picked up some speed in the meantime.

Yet even with all that, employment in WA is still increasing. The unemployment rate has increased, though only to the national average so far. Going back a few years, WA had, at times, the lowest unemployment rate recorded of any state at any time over the past 40 years; on occasions there was a ‘2’ before the decimal place. That was obviously not going to be sustained indefinitely. And while labour market performance is not as strong as it was, it is still a good deal stronger than it was in episodes like 1983 or 1991–92. Interestingly, those periods of serious weakness in the labour market in WA were part of a national event. In the early 1990s, that event had little to do with mining and a lot to do with an asset price boom and bust, coupled with high corporate leverage.

Of course, further adjustment in the resources sector is still ahead. Although most of the construction employment losses in the iron ore sector have probably occurred, the large LNG projects in WA are still in the investment phase. Over the next few years some labour presumably will be released from these projects. So it will be a while yet before we will be able to say that the difficult phase is completed.

That aside, the point I want to offer is that it’s worth remembering the positive legacy of the events of the past decade.

The sheer scale of the investment that has been undertaken makes WA production, already a powerful force in some key commodities, more powerful. To be sure, prices are lower, but the quality of the resources, the attention to cost reduction and of course a lower Australian dollar are likely to leave many producers well placed.

Of perhaps more direct relevance to the ordinary person has been the trend in income per head. In 2000, WA’s per capita income was about the same as in Queensland or South Australia but lower than in either NSW or Victoria. But WA has seen easily the largest increase over the intervening period. Today WA enjoys the highest per capita income of any state, at around $50 000 per person per year. It is true that the ACT and NT boast higher figures, but they are very unusual cases, being heavily influenced by the effects of government employment and/or subsidies, not to mention being quite small. It would take quite a few years at the current pace of growth for the other states to catch up to WA.

Household net worth in WA in 2013/14 (the latest available data), at about $950 000 per household, was a good deal higher than in any other state. Since then, housing prices in WA have declined while those in some other places have risen, so this gap may have diminished. Nonetheless, my guess is that, among the Australian states, the citizens of Western Australia are on average, probably still among the richest. Even if the others gradually close the gap over time, as they well might, you are better off for having had the boom.

WA has unique endowments of resources. Mining has always been a cyclical business, which has long been understood. On this occasion, given the size of the boom, you’ve done a pretty good job of managing it. As a result, there will be permanently more income and wealth than there was before.
Conclusion

I expect that, in a few years’ time, the Reserve Bank Board will once again meet in Perth. I imagine that, by then, the current contraction in capital spending will probably have reached an end. New opportunities for growth will have emerged, resulting from things like the growth in the middle class of Asia, with all what that means for demand for services as well as for energy and agricultural production. The growth of India is surely also a potential opportunity for WA – facing as you do the Indian Ocean, and with the advantage of relative lesser distance. A mere eight hour flight time! No doubt Western Australians will be looking to seize those opportunities.

At the same time, this vast part of the Australian continent, endowed by nature with so many resources, will still be a major player in key commodities. Even if the extraordinary boom in investment was hard to digest, and even if some of the investments don’t pay off quite as handsomely as hoped, it still seems that Western Australians will be richer for the experience.

Student activities

1. Identify some key features of Australia’s mining boom when it was at or near its peak in 2011.
2. How have conditions changed in the mining sector since 2011?
3. Describe the contribution of the mining sector to the Australian economy at the peak of the investment boom.
4. Explain why the mining investment boom was not as disruptive as it could have been to the Australian economy.
5. How has the decline in mining sector investment affected Australia’s economic outlook for 2016?
6. What has been the legacy of the mining boom for the people of Western Australia?