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Review of the South Australian Economy, 1990-2003

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Editor's Note

Welcome to the eighth issue of *Economic Issues*, a series published by the South Australian Centre for Economic Studies as part of the Centre's Corporate Membership Program. The scope of *Economic Issues* is intended to be broad, limited only to topical, applied economic issues of relevance to South Australia

Review of the South Australian Economy, 1990-2003

Overview

South Australia's economic performance since 1990 has been subdued in comparison with the performance of the national economy. Lower economic growth in South Australia has been associated with slower population growth than in most other States. As per capita output and labour productivity rose in South Australia much in line with the national average, the slower economic growth rate does not derive from problems with the level of output per person or per worker. Nor does it derive from poor policy settings. The lower growth rate almost certainly reflects slower population growth, and differences in relative factor endowments and industry structure when compared with the other States.

Spending by households in South Australia rose faster than household income, sustained by large increases in house prices and the associated rise in household wealth. South Australia's share of national private business investment mostly fluctuated within the 5 to 7 per cent range between 1990 and 2001 but rose to 8¹/₂ per cent by 2003. Business investment on machinery and equipment more than doubled in real terms between 1989 and 2003 but there was little growth in investment on buildings and structures. Although investment in mining, manufacturing and other selected industries all increased in real terms between 1990 and 2003, it was dominated by investment growth in other selected industries reflecting the structural changes that have been occurring in South Australia's economy.

Building and construction activity fluctuated through the 1990s. The impending introduction of the GST on 1 July 2000 saw a stimulus to this sector as activity was brought forward in anticipation of rising costs. A marked contraction in building and construction activity followed to which the Commonwealth Government responded by introducing the *First Home Owners Grant*. This measure, low real interest rates and speculative activity based on rising prices for houses and apartments boosted activity from mid 2000 to 2003. By 2003, the number of dwelling units approved was back to the levels experienced in the early 1990s whilst there had been a very large increase in the value of approvals. Whilst growth in residential construction will probably slow in the near-term future as higher interest rates take effect, investment in major infrastructure projects is likely to remain strong and help sustain South Australia's share of private new capital expenditure.

For the most part, Adelaide's inflation rate diverged little from the inflation rate for the weighted average of the eight capital cities between 1990 and 2003. Average weekly earnings growth for South Australia was slower than for Australia, but wages growth as measured by the Wage Cost Index suggests that wages costs in South Australia were comparable with national wages costs by 2003.

Structural change from 1990 to 2003 led to an increase in the importance of services industries and a decline in the importance of manufacturing in South Australia's industry structure. Nevertheless, the traditional and slower growth industries of agriculture and manufacturing continue to play a larger role in South Australia's industry structure than they do across Australia.

South Australia's exports as a share of GSP doubled between 1990 and 2002. There was a particularly significant jump in exports between 1999 and 2002 - largely due to increased exports of wine and motor vehicles - followed by some downturn in 2003 caused by falling foreign demand, drought and appreciation of the Australian dollar. The major export markets for South Australia are the United States of America and the European Union. The increasing importance of exports to the sustained growth of the South Australian economy has important implications for policymaking at the State level to maximise South Australia's export capability and the Economic Development Board has outlined several specific objectives which are to increase the range of products and services exported, improve market penetration and enter new markets.

Conditions in South Australia's labour market reflected South Australia's slower economic and population growth rates. Growth in South Australia's labour force was weak compared with growth of the labour force across Australia between 1990 and 2003. Employment growth was also much weaker and was dominated by rising part-time employment. The unemployment rate in South Australia was consistently higher than the Australian unemployment rate although it did converge on the national unemployment rate in 2003. Also reflecting population movements and the prominence of slower growth industries in the State's industry structure, labour force participation also trended down in South Australia although there has been a substantial pick-up in participation since 2002.

The message of this review is one that the Economic Development Board has already put on the table: economic growth and population growth go hand-in-hand. Strong and sustainable economic growth can stimulate population growth and *vice versa*. Without one the State is very unlikely to achieve the other. This review suggests that economic policies that foster the faster growing services sector and increase exports are the most likely to contribute to economic growth. Long-term growth requires the infrastructure to support it and that requires investment. To that end, the Economic Development Board's recommendation that South Australia's share of private new capital expenditure be used as one of the initial benchmarks adopted for assessment of economic development in the State is to be applauded. Policies to stimulate population growth implemented in conjunction with sound economic policies should ensure a brighter economic outlook for South Australia over the medium-term future.

1. Macroeconomic performance

Slower economic growth in South Australia than in Australia is due to slower population growth, differences in relative factor endowments and industry structure.

The South Australian economy has grown at an average 2.6 per cent *per annum* since 1990, more slowly than Australia's economic growth rate of an average annual 3.8 per cent. Lower economic growth in South Australia has been associated with slower population growth than in most other States. As per capita output and labour productivity rose in South Australia much in line with the national average, the slower economic

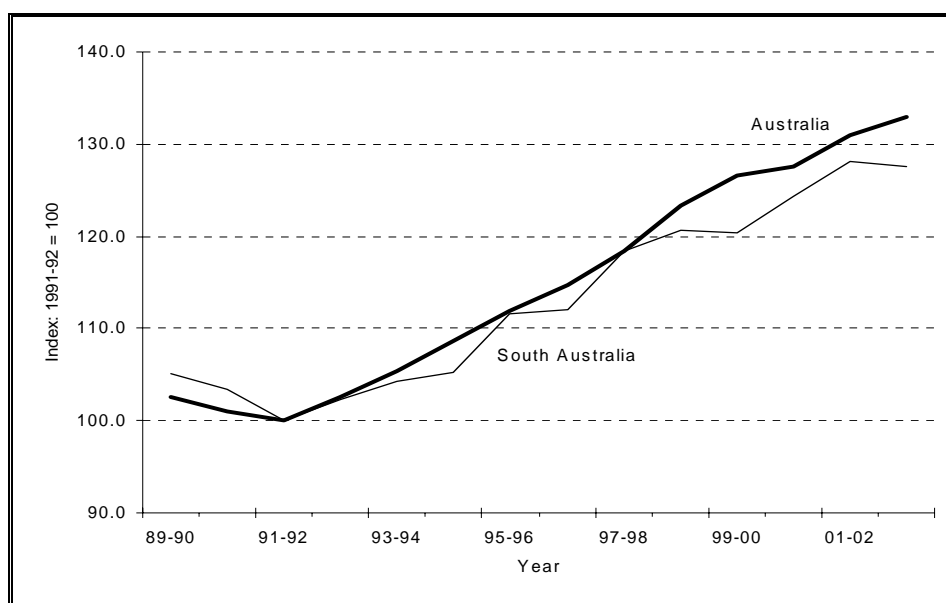
The South Australian economy grew, on average, by an annual 2.6 per cent, slower than Australia's growth rate of 3.8 per cent

...

*... resulting in a smaller
share of national output.*

aggregate (as opposed to per capita) gross product. The difference between the national GDP growth rate and South Australian GSP growth over the decade to 2002-03 was 1.2 percentage points per annum, whereas the gap between the per capita growth rates was just 0.4 percentage points per annum.

Figure 3
Index of Real GSP and Real GDP per capita
1989-90 to 2002-03



Source: ABS, AusStats, Australian National Accounts: State Accounts (5220.0).

This distinction highlights an important feature of the Australian economy: differences in state growth rates are to a large extent related to population movement, with differences in productivity trends playing only a modest role. The fact that Australia has free migration between States is fundamental to this. Nevertheless, Figure 1 does suggest that if South Australia wants stronger economic growth, policies to improve population growth will need to be put in place.

Although it is common to measure productivity trends with gross product per capita estimates, it is more appropriate to consider gross product per worker. Figure 4 shows South Australian and Australian GSP and GDP per worker moving very closely together over time. This indicates that South Australia's medium term growth in labour productivity was in line with the national rate. The divergence in 2003 was temporary with the setback being mainly due to unfavourable seasonal conditions and the severe impact of the drought on agricultural production (with flow-on impacts for service industries and the demand for business and personal services).

*... as did labour
 productivity.*

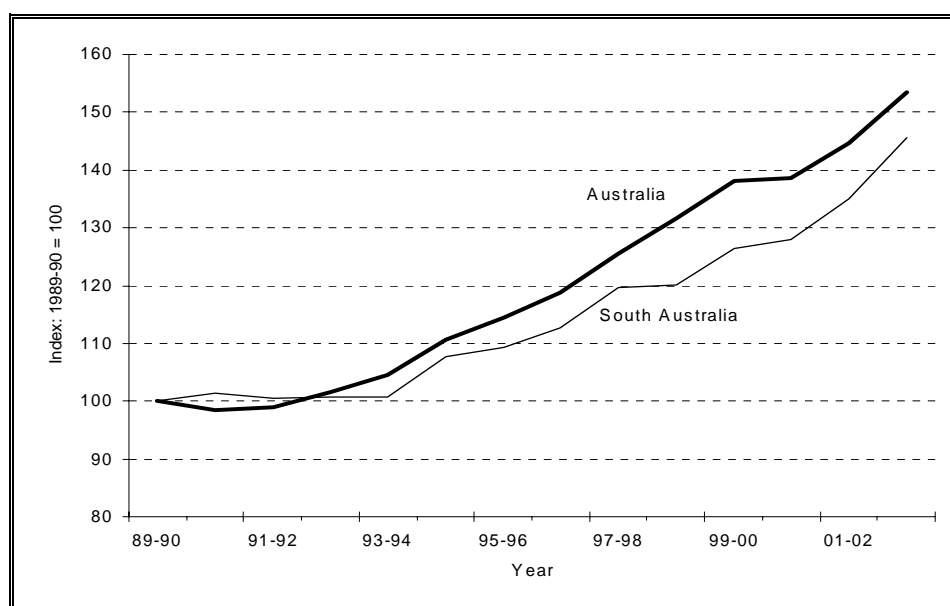
... but stronger economic growth over the longer-term will require strategies to increase population growth.

Nevertheless, the preceding discussion does suggest that population growth is an important contributing factor to aggregate GSP growth over the longer-term. Population growth is slower in South Australia than in all other States, except Tasmania, due in large part, to interstate migration to those States that have higher economic growth rates. As the Economic Development Board acknowledged, population growth and economic development go hand-in-hand.² South Australia's share of national output and economic growth rate relative to the growth rates of other States will continue to decline over the longer-term unless strategies to increase the population are implemented. The Government of South Australia has accepted the Economic Development Board's recommendation of a target of a 7.8 per cent share of the national migration intake over the next 10 years – a share equal to our population share. An important factor in attracting more people to South Australia will be a vibrant local economy with strong employment growth that provides jobs for the larger population.

2. State Final Demand

Between 1990 and 2003, State Final Demand increased by an average annual 2.9 per cent – somewhat higher than South Australia's economic growth rate. Spending by households in South Australia rose faster than household income, sustained by large increases in house prices and the associated rise in household wealth.

Figure 5
Indexes of State Final Demand – South Australia
and Gross National Expenditure - Australia
Chain Volume Measures^(a): 1989-90 to 2002-03



Note: ^(a)

Spending in South Australia has increased by an annual average 2.9 per cent since 1990 ...

State Final Demand (SFD) is a measure of the State's level of spending by the private and public sectors on consumption and investment goods and services. It excludes overseas and interstate exports of goods and services. From 1990 to 2003, South Australia's SFD grew at an average annual growth rate of 2.9 per cent, 0.5 percentage points lower than the average growth rate in gross national expenditure. However, in recent years consumption and investment spending rose more strongly in South Australia than in Australia.

Household consumption accounts for about 60 per cent of SFD. The closing gap between gross national expenditure and state final demand indices, shown in Figure 5, is due in part to rising household spending in recent years.

... with household spending rising more than one and a half times the increase in household income ...

Household spending in South Australia has been growing consistently faster than household income (represented by compensation of employees) over the past 13 years as summarised in Figure 6. From the June quarter 1990 to the September quarter 2003, household spending has grown by more than one and a half times the increase in household income.

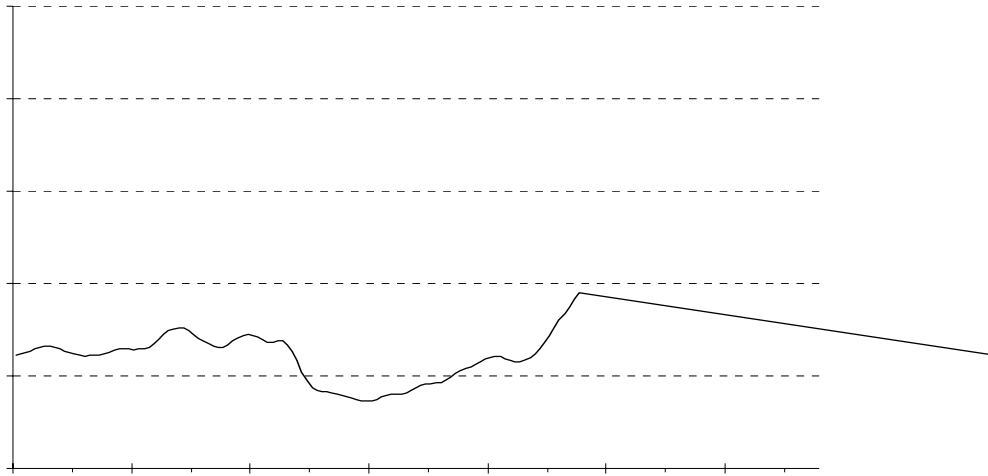
Figure 6
Index of Compensation of Employees and Household Spending
South Australia – Seasonally Adjusted Estimates
June Quarter 1990 – June Quarter 2003



... sustained by significant increased in housing prices and the associated rise in household wealth.

*South Australia's share of
business investment had
risen to 8.5 per cent of the
national total by 2003 ...*

Figure 10
Value of Building Approvals by Type of Building
South Australia – Trend Series at Current Prices
June 1990 – December 2003



*... due mostly to an increase
in the number of housing
approvals ...*

*... boosted by low real
interest rates and the
introduction of the First
Home Owners Grant.*

First Home Owners Grant partly explains the more recent boost in building activity as do real housing interest rates which continue to remain low when compared with interest rates earlier in the period under study.

Figure 11
Number of Private Sector Dwelling Units Approved
South Australia – Trend Series
June 1990 – December 2003



*Investment in major
infrastructure projects ...*

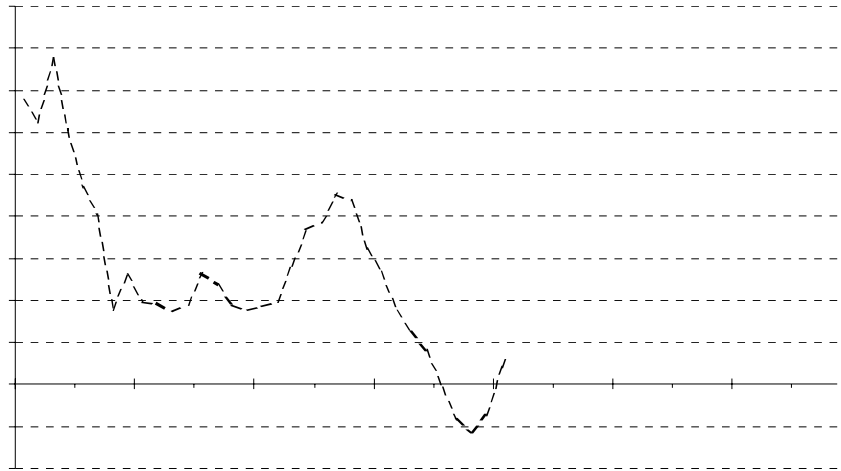
Figure 12
Engineering Construction Work Done and Yet to be Done
June Quarter 1990 – September Quarter 2003



... will help sustain South Australia's share of private new capital expenditure.

Inflation rates fell sharply in the early 1990s as the economy went into recession ...

Figure 13
Annual Inflation Rates: Adelaide and Australia
June Quarter 1990 – December Quarter 2003



... but the Adelaide inflation rate was higher than for Australia because of increases in State levies.

The introduction of the GST caused headline inflation to surge in 2000 but underlying inflation remained well within the Reserve Bank's target band of 2 to 3 per cent.

in the wage and salary cost of a fixed basket of jobs over time. Hence, it is not affected by changes in the quantity and quality of work and thus gives a more accurate measurement of wages growth.

... but increases in wage costs have been comparable with rising wage costs in other States.

Table 3 shows the wage cost index for South Australia and other States in the September quarter 2003. Between 1997 and 2003, wages in South Australia increased by 21.6 per cent, which was second only to wages growth in New South Wales of 22.8 per cent over the same period.

Table 3
Wage Cost Index – September quarter
September Quarter 1997 = 100

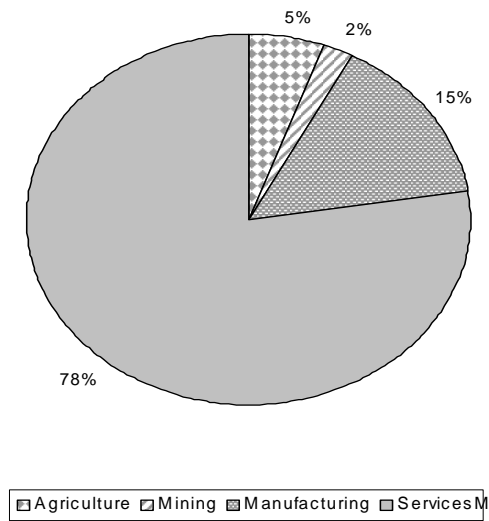
	2003
New South Wales	122.8
Victoria	121.5
Queensland	120.2
South Australia	121.6
Western Australia	121.3
Tasmania	119.0
Northern Territory	118.8
Australian Capital Territory	120.8
Australia	121.6

Source: ABS, AusStats, Earnings, hours and employment conditions, 6345.0.

Figure 15 compares the rise in South Australia's and Australia's wage cost indices from 1997 to 2003. South Australia's wage costs rose more slowly than the national average until the September quarter 2003, when wage costs in South Australia were once again comparable with the Australian level. AWE figures suggest South Australia retains a competitive edge over all other States and Territories other than Queensland and Tasmania. WCI figures suggest that wage costs in South Australia have been rising no faster than the national average. Relatively subdued growth in AWE and wages costs is important from the

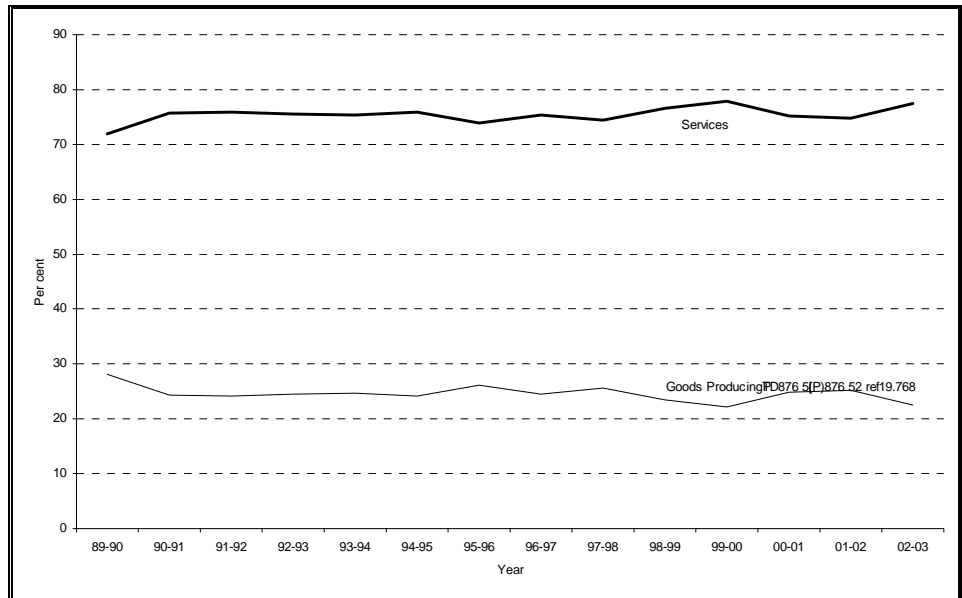
*Structural change from
1989-90 to 2002-03 led to*

Figure 16a
Share of Total Factor Income 2002-03: South Australia
Agriculture, Mining, Manufacturing and Services



... although services income was more important accounting for a 77.5 per cent share of total factor income in South Australia in 2002-03.

Figure 17
Share of Total Factor Income: Services and
Goods-Producing Industries, South Australia
1989-90 to 2002-03



Finance and insurance services exhibited strong growth.

(representing 8.1 per cent of total factor income) as compared with Australia (6.3 per cent). This almost certainly reflects South Australia's older population and associated higher costs of health care. Finance and insurance accounted for a smaller share of the services sector in South Australia (6.4 per cent) than in Australia (7.7 per cent).

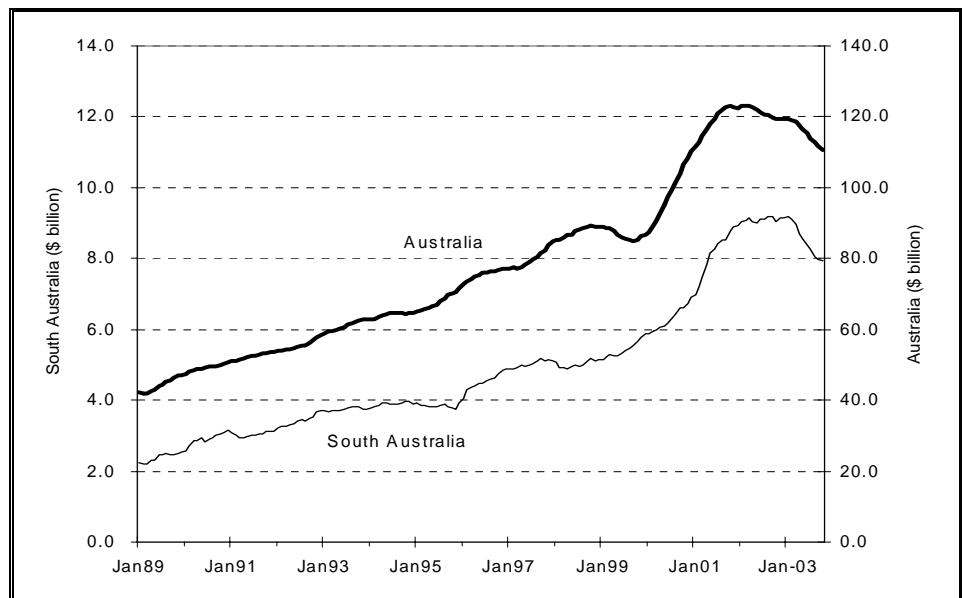
Table 4
Share of Total Factor Income – Service Industries
South Australia and Australia

*South Australia is still more
reliant than Australia on
the traditional and slower
growth industries of
agriculture and
manufacturing rather than
the faster-growing service
industries.*

There was a sharp rise in exports between 1999 and 2002 ...

Between 1989-90 and 2002-03 South Australia's annual growth in merchandise exports was 8.3 percent, higher than the Australian average of 6.6 per cent. As illustrated in Figure 21, the period between 1999 and 2002 saw a significant jump in the value of South Australia's merchandise exports which was also a period of impressive growth for Australian exports. By 2002, the total value of merchandise exports had risen by 84 per cent (SA) and 54 per cent (Australia) above their 1999 values.

Figure 21
Overseas Merchandise Exports
Australia and South Australia: January 1989 to October 2003
(Moving annual totals)



Source: ABS, AusStats, International Trade.

... but this was followed by a downturn in 2003 ...

However, more recently, commencing in December 2002, both Australia's and South Australia's merchandise exports turned sharply downwards. South Australia's merchandise exports fell 12.3 per cent in the 12 months to October 2003, compared with exports for the twelve months to October 2002. Australia's exports fell by 7.5 per cent. The main reasons for these sharp declines were falling foreign demand (reflecting a marked slowdown in economic growth in overseas markets), the damaging impact of drought on agricultural production (a significant component of South Australia's exports are agricultural products) and the strong appreciation of the Australian dollar.

... caused by declining foreign demand, drought and \$A appreciation.

Table 5 shows the value of the Australian dollar in terms of the US dollar and Australia's trade weighted indices from 1998 to 2003. From 1999 through 2002 exports rose as the Australian dollar depreciated against the United States dollar to a low of \$US .51 in 2001. The Australian dollar subsequently rose to a high of \$US .66 in 2003 and this abrupt appreciation helps to explain the underperformance of exports in 2003.

Table 5
Exchange Rates and Trade Weighted Indices

Year	1998	1999	2000	2001	2002	2003
\$US per 1 \$A	.63	.64	.58	.51	.55	.66
TWI	103.9	103.1	96.3	92.2	96.9	107.1

Source: RBA statistics.

The trade-weighted index is a more comprehensive indicator of Australia's exchange rates than the exchange rate against a single foreign currency. The trade-weighted index is a measure of Australian currency relative to the currencies of Australia's main trading partners (up to 20 countries). In a sense, it is a calculated aggregate exchange rate. As shown in Table 5, the trade-weighted index followed the same pattern of rise and fall as the USD/AUD exchange rate. The spectacular growth in the value of merchandise exports between 1999 and 2002 can be explained in terms of the depreciation of the Australian dollar (in terms of foreign currencies) whereby the slow down into 2003 can be attributed, in part, to currency appreciation. A marked slowdown in the economic growth rates of some of Australia's major trading partners exacerbated the decline in exports. Appreciation of the trade-weighted index in 2002 and 2003 was largely due to the depreciation of the US dollar. The \$US together with some Asian currencies that are directly linked to it, account for approximately 50 per cent of the trade-weighted index for Australia.

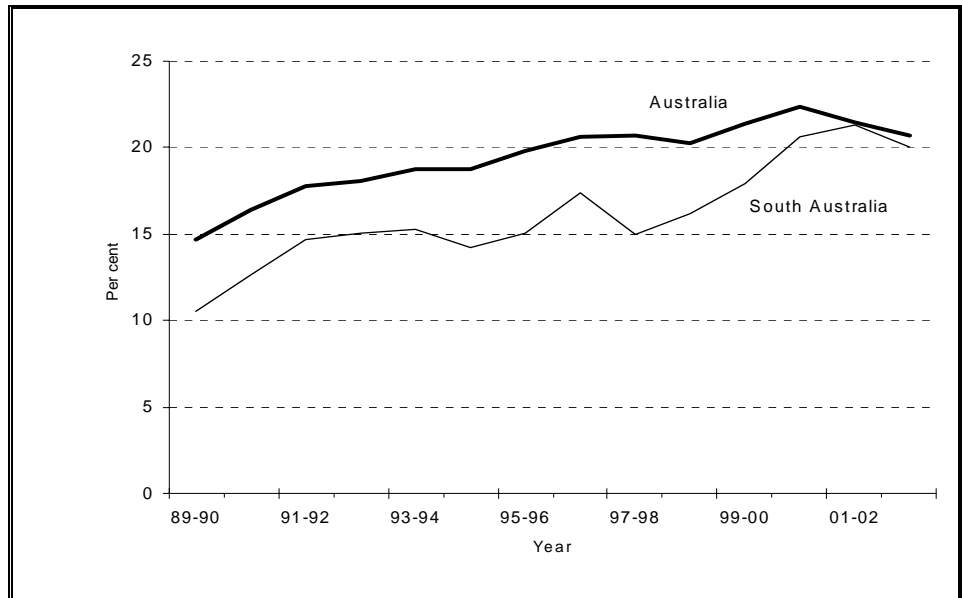
South Australia's exports as a share of GSP doubled between 1990 and 2002 ...

Figure 22 shows the level of importance of exports to the South Australian economy. South Australia's exports as a share of the state's GSP in 1990 was 10.6 percent and reached a peak of 21.3 per cent (about double the 1990 share) in 2002. Contributing to this improved performance were exports of wine and motor vehicles. In 1990 South Australia's exports as a share of GSP was well below the national level of just under 15 per cent but exceptionally strong growth between 1999 and 2002 raised the South Australian exports to GSP ratio to a level very close to the national exports to GDP ratio.

... with important implications for policy making at the State level.

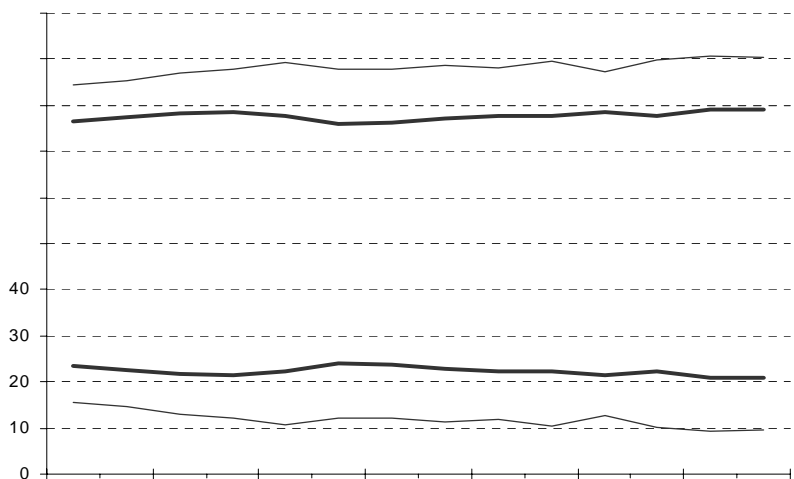
Exports have become increasingly important to the sustained growth of the South Australian economy. This has important implications for policy making at the State level. The Economic Development Board (EDB) in *A Framework for Economic Development in South Australia*, May 2003, stressed the need to maximise South Australia's export capability. The EDB enunciated several specific objectives, which involve expanding the range of products exported, improving market penetration and entering new markets (target markets include the USA,

Figure 22
Exports as a Proportion of GSP and GDP
South Australia and Australia
1989-90 to 2002-3



Source: ABS, AusStats, Australian National Accounts: National Income, Expenditure and Product (5206.0).

Figure 23
Value of Merchandise and Services Exports as a Share of Total Exports
South Australia and Australia
1989-90 to 2002-03



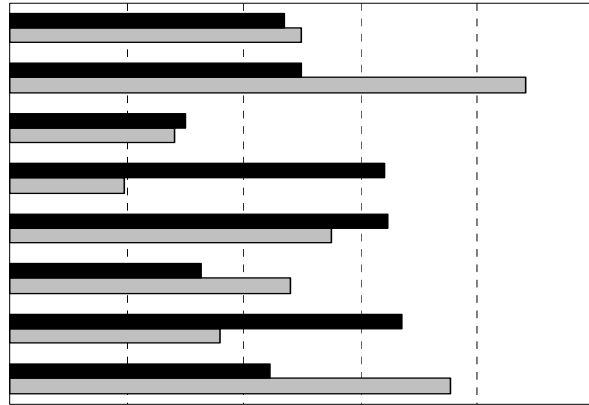
Merchandise goods accounted for about 90 per cent of exports from South Australia, much higher than its share of 78 per cent in total exports from Australia.

This illustrates the importance of merchandise exports to South

*Wine and motor vehicles
were the largest
contributors to exports
growth from South
Australia.*

*South Australia's major
export markets are the USA
and the EU ...*

Figure 26
Major Export Markets
Share of Total Exports - 2003

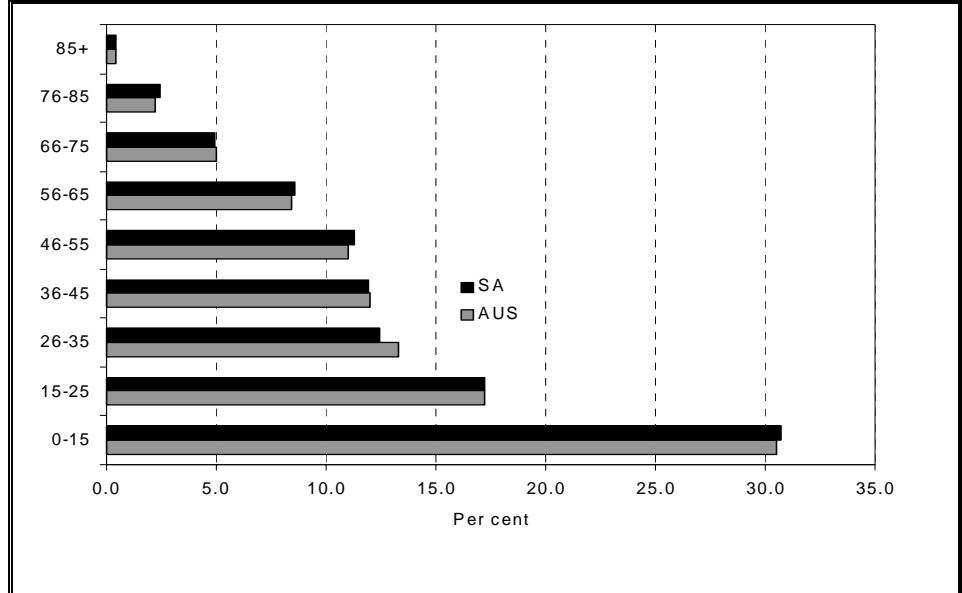


Free trade agreements offer prospects for future export growth.

South Australia's

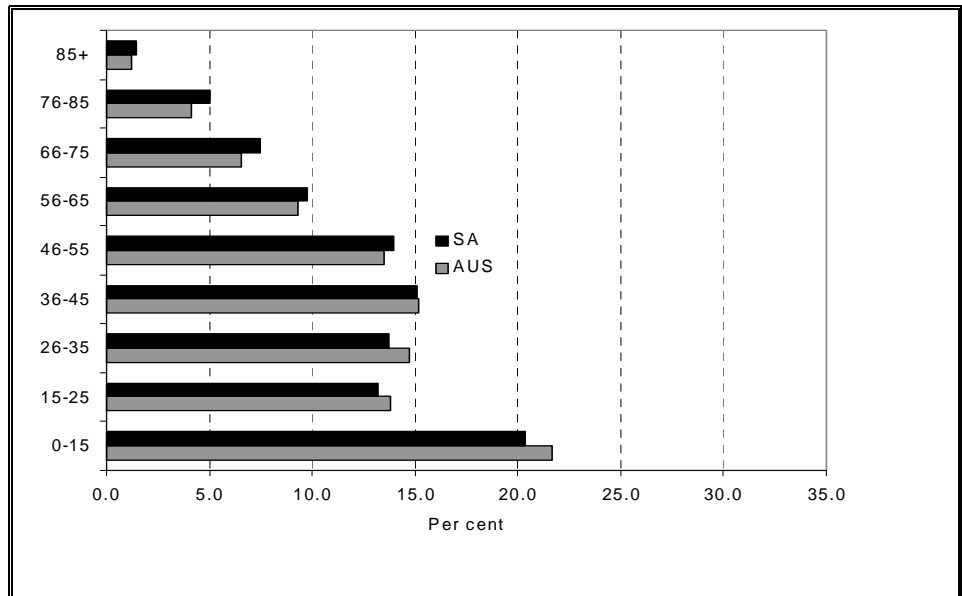
(even with significant structural reforms to superannuation) can be expected to put pressure on Commonwealth and State budgets.

Figure 28
Age Profile of the Population in 1971
South Australia and Australia



Source: ABS, AusStats, Population trends and estimates: Population by Age and Sex, Australian States and Territories, (3201.0).

Figure 29
Age Profile of the Population in 2002
South Australia and Australia

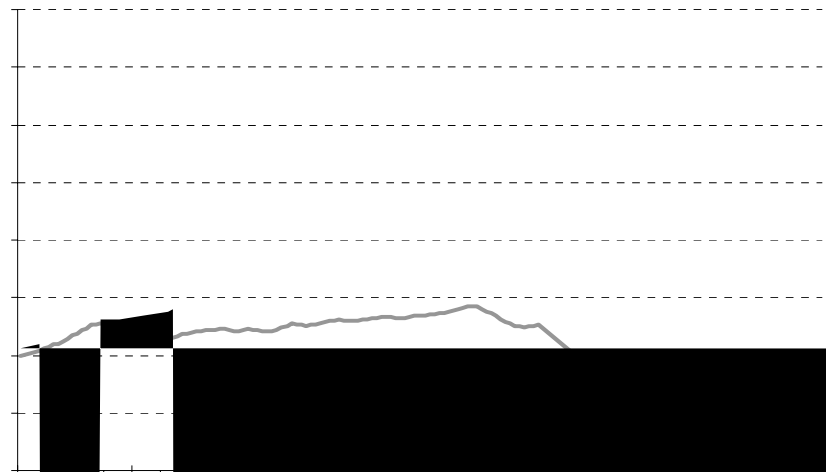


Source: ABS, AusStats, Population trends and estimates: Population by Age and Sex, Australian States and Territories, (3201.0).

*More people have left South
Australia for other States*

South Australia during 2003 suggests a brighter outlook for the labour market in the near-term.

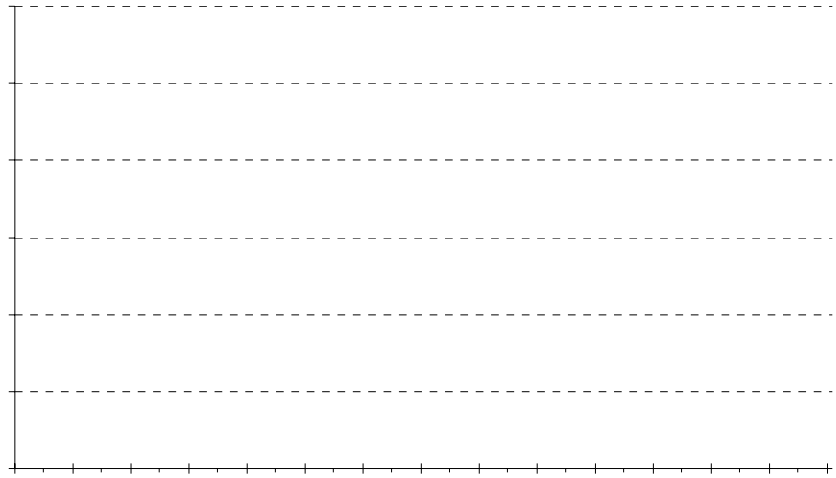
Figure 33
Index of Labour Force Growth
South Australia and Australia – January 1990 to October 2003
(Seasonally Adjusted Series, Moving Annual Average)
Index: January 1990 = 100



... as was employment growth ...

... which was dominated by rising part-time employment

Figure 36
Unemployment Rates
Australia and South Australia – January 1990 to October 2003
(Original Series, Moving Annual Average)



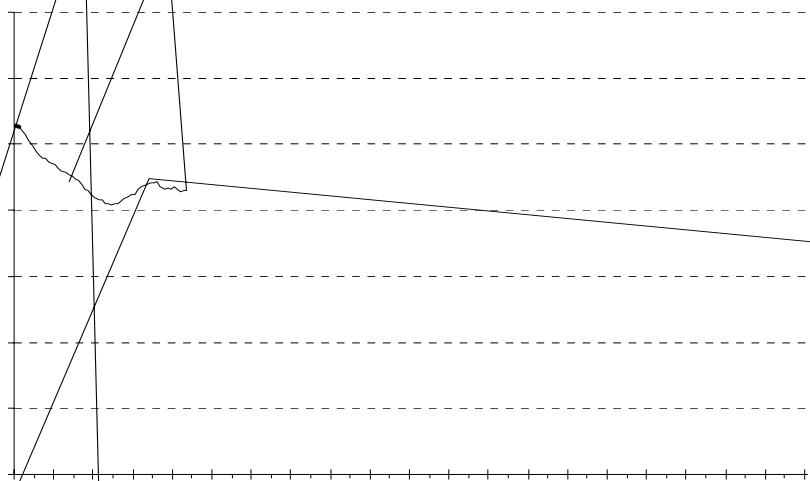
The unemployment rate has declined since 1993.

Male unemployment is persistently higher than female unemployment.

Labour force participation in South Australia has trended down reflecting slow population growth and the differences in industry structure between the State and national economies.

unemployment. Short-term changes in participation tend to be influenced by economic growth. However, economic growth itself is influenced by, *inter alia*, relative factor endowments and their impact on industry structure and population movements. For these reasons, as described earlier, the State has grown more slowly than the national economy which at least partly explains the divergence between the labour force participation rates for South Australia and Australia illustrated in Figure 38.

Figure 37
Unemployment Rate by Gender
South Australia – January 1990 to October 2003
(Original Series, Moving Annual Average) 0.02.0



Economic and population policies in conjunction are required to improve the economic outlook for South Australia and hence labour market outcomes.

South Australia is now faced with the challenges of an ageing population with its consequences on the labour force and employment. Slow population growth has always been both a cause and effect of a poorly performing economy. Strong and sustainable economic growth can stimulate population growth and vice versa. Hence, economic and population policies used hand in hand should improve the economic outlook for South Australia and lead to more positive outcomes for the State's labour market.

End Notes

- ¹ The Centre examines employment changes in manufacturing in the period 1990-