Speech

Strangers in Paradise

RESERVE BANK OF AUSTRALIA

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Deputy Governor

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Introduction

Picture if you can a thriving trading hub on the Australian coast. It uses imported capital equipment and processes, and temporary migrant labour, to extract and process an abundant natural resource for on-sale to China. The business brings wealth and prosperity to the local community. Over time, public debate emerges about whether rewards are being fairly divided between locals and foreigners, and how to manage ecological degradation.

A mine or refinery in present day Western Australia or Queensland? Could be. But what I have actually just described are the arrangements for trading in trepang – or sea cucumbers, a Chinese delicacy – that began around 1700 between the Yolŋu people of Arnhem Land and itinerant fishermen from Makassar on Sulawesi, part of modern-day Indonesia. By the mid-19th century, the Makassar fleet was supplying an amazing 900 tons of trepang to China every year.[1]

The existence of such a striking historical echo of today's debates is less surprising when one remembers that Australia is home to the oldest continuing culture on earth. For more than 65,000 years this continent has been cultivated by First Nations peoples. In that context, I want to acknowledge the Gadigal people of the Eora Nation as the traditional owners and custodians of the land on which we are meeting this evening and pay my respects to Elders, past and present.

I also want to welcome all of you to the A50 forum, an event initiated in 2016 to highlight the benefits of investing in Australia. There are many important issues to discuss in the current climate, and the organisers have put together a fantastic program tomorrow, involving government leaders, the regulatory community and the corporate and financial sectors, to do just that. With such a rich main course to come, I have no intention of competing. Instead, I offer merely a light starter to put tomorrow's discussions in context – reviewing the historical sources of economic growth in Australia, and the role played by foreign investment.

When economic conditions are as challenging as they are today, it can be easy to forget just how prosperous modern Australia is. Measures of relative affluence, such as GDP or wealth per head, regularly place the country in the top echelon globally.[2] Of course, the distribution of that prosperity is far from uniform – so it would be brave for a new and infatuated stranger to declare Australia an earthly paradise.[3] But coming as I do from a country whose GDP per head has been more or less static since the global financial crisis and lies between one-quarter and one-third lower than Australia's, I can tell you that cross-country gap feels very real.

How Australia got here is long-debated; this evening I want to discuss three important drivers:[4]

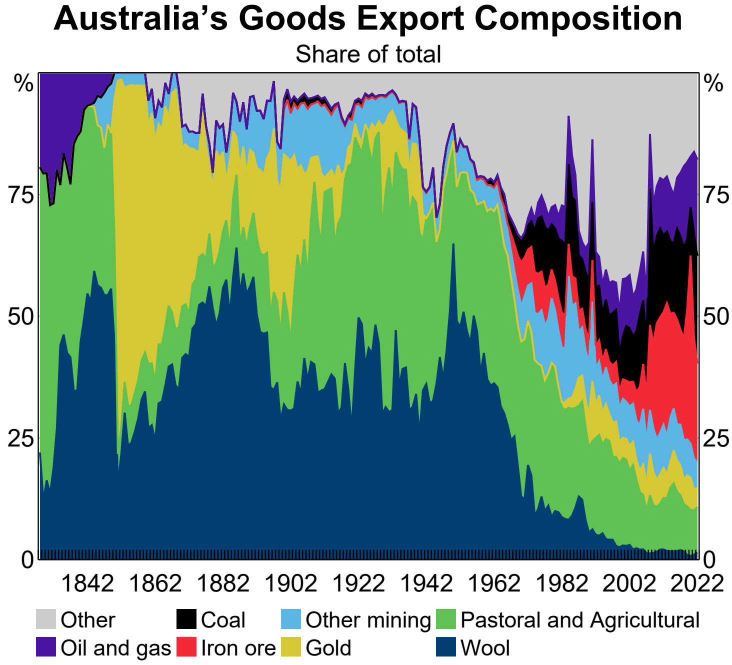
- Its unusually diverse range of resource endowments – below ground, above ground, and beyond the seas.
- Its strong but adaptable pro-growth institutions – supporting political, legal, macro and microeconomic and financial stability.
- Its longstanding welcoming environment for foreign investment.

Australia's unusually diverse resource endowments

Many countries have resource endowments of some kind. What is different about Australia is it seems to have the full set! That diversity can be seen in the evolving shape of its exports over the past 200 years (Graph 1).[5] But it also applies to its as-yet untapped potential.

To see that more clearly, let's divide Australia's endowments into three.

Graph 1



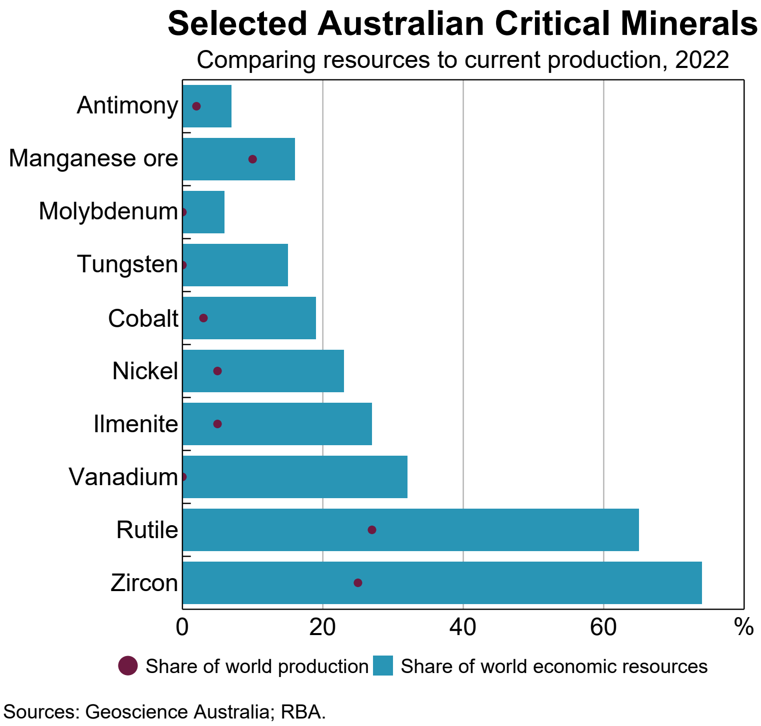
Sources: ABS; Owen (2023); Pinkstone and Meredith (1993); RBA; Vamplew (1987).

Below ground

It is sometimes said that Australia has long relied on 'old world' mining exports. But while it's true that more than half of today's goods exports consist of iron ore, gas and coal, that is not a longstanding feature of the economy. The only significant mining export in the 19th century was gold – and for much of the 20th century, mining played only a modest part in Australia's trade (Graph 1).

More importantly for the future, Australia has large shares of global reserves of many of the minerals critical to 'new world' technology and energy transition industries, with significant headroom to expand current production (Graph 2), given the right investment and demand conditions.

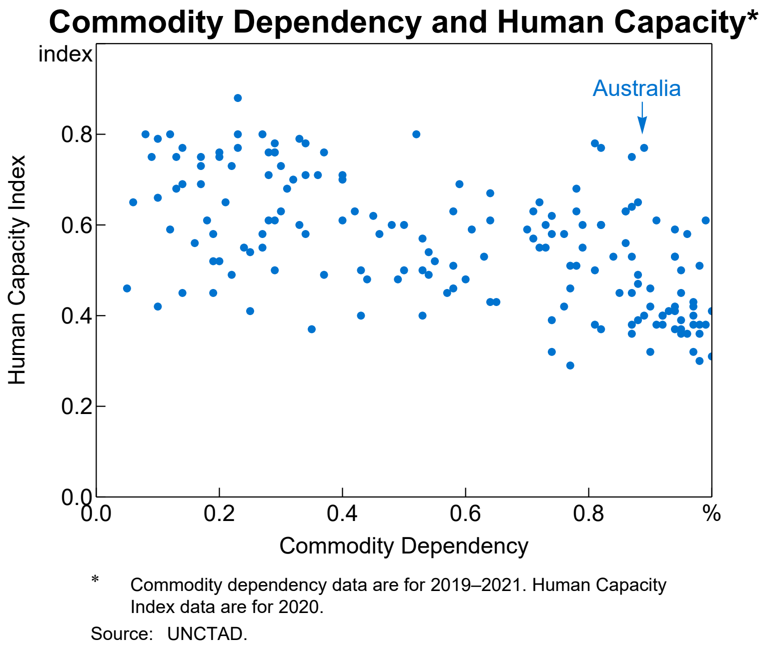
Graph 2



Above ground

For over 150 years, agriculture – particularly wool – dominated Australia's goods exports (Graph 1). While that dominance has now pivoted to mining, other 'above ground' resources have grown significantly. In particular, Australia's *human* capital ranks highly globally, bucking the trend of countries with significant commodity dependencies (Graph 3) and positioning the country well to take advantage of developments in the services and technology sectors. Indeed, nearly one-fifth of Australia's total exports consist of services – principally inbound tourism and education.

Graph 3



But one of Australia's most significant above ground resource endowments has no physical form at all: sunlight. Multiplying the intensity of the Australian sun (using the World Bank's Global Horizontal Irradiation metric) by its enormous landmass, Australia has the largest assessed theoretical potential solar capacity in the world – many thousands of times the country's domestic energy needs.[6] Estimates of realisable capacity, after allowing for the many practical constraints of real-world power generation, lie well below this theoretical maximum. But they still suggest there is very substantial further headroom available, compared to today's output.

Beyond the sea

Australia's geographical position, lying as it does a long way from some of its closest partners, is sometimes said to confer an economic disadvantage – the 'tyranny of distance'. But as Ian McLean pointed out, this is too simplistic. During the 19th and a good part of the 20th centuries, a combination of comparative advantage, rapidly improving transport technologies and 'colonial preference' meant that economic growth was supported by advantageous trading arrangements with the United Kingdom, despite it being as far away as it is possible to get! In recent decades, the focus of trade relations has pivoted decisively towards Asia. But Australia has also maintained a broader and deeper network of political and economic relationships, within and beyond the Asia-Pacific region, with which to navigate the shifting tides of economic opportunity.

Australia's strong but adaptable pro-growth institutions

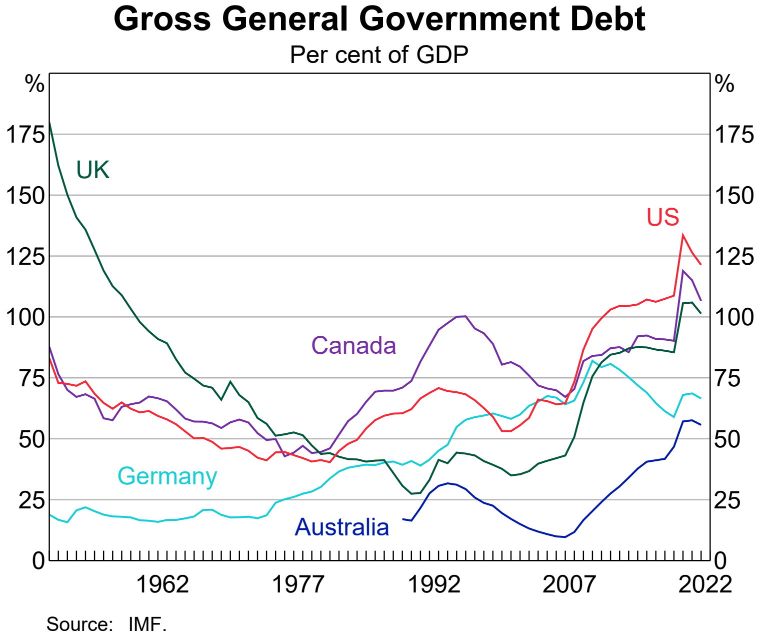
Strong resources alone are rarely sufficient to guarantee prosperity – indeed, the reverse is more often true, a phenomenon sometimes termed the 'resource curse'. Donald Horne's 1964 polemic *The Lucky Country* predicted Australia would eventually be cursed too.[7] But 60 years on, real GDP per head has more than tripled.[8] That's not just luck.

Endowments bring opportunity. But harnessing them for a country's greater good takes something more – and Australia's real secret sauce has been its strong but adaptable pro-growth institutions.[9]

Among Australia's greatest assets have been its **political institutions, its legal system and its civil service**. Australians may debate the merits of its political arrangements from time to time. But the country regularly scores in the top deciles of objective global measures of liberal democracy.[10] Through history, Australia has regularly had to make tough national economic decisions – on squatters' rights in the 19th century, on the appropriate balance between agriculture, extraction and manufacturing in the mid-20th century, or on the appropriate pace of de-regulation in the 1980s and 1990s. In each case, the debate may have been noisy, drawn out and non-linear – but assisted by Australia's top-flight legal and civil service, the outcomes have much more often been right than wrong.

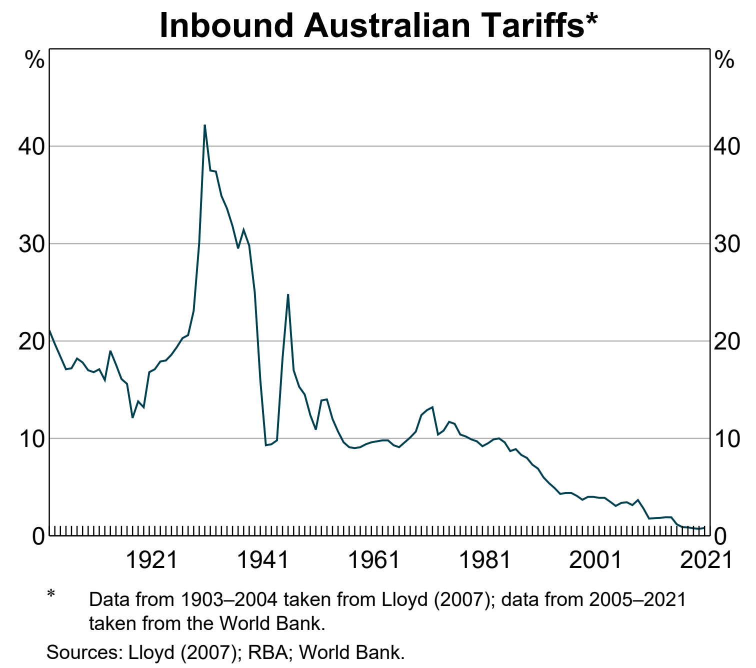
Australia's **macroeconomic framework** has also been a clear strength over the past 40 years. Resource-rich countries can suffer significant economic volatility when the prices for their key outputs adjust – and Australia has certainly had its fair share of this over its longer history. But today it has powerful shock-absorbers in place to reduce that buffeting. First, unlike most commodity-exporters,[11] Australia has a fully flexible exchange rate. Second, the RBA has independent authority for setting monetary policy to achieve a flexible inflation target that gives appropriate weight to employment outcomes – similar to that in the United States. And third, gross public debt lies well below that of many other developed countries – not least, it has to be said, my own country of origin (Graph 4)!

Graph 4



On the **microeconomic** side, the reforms of recent decades[12] have left Australia with internationally open and transparent product markets,[13] low tariffs (Graph 5) and a relatively open capital account.

Graph 5



And finally, **financial stability** is overseen by a comprehensive set of regulators. The major banks are liquid and strongly capitalised, there is a well-developed capital markets infrastructure and domestic non-banks are increasingly interested in coming in alongside overseas investors in onshore projects as part of joint ventures.

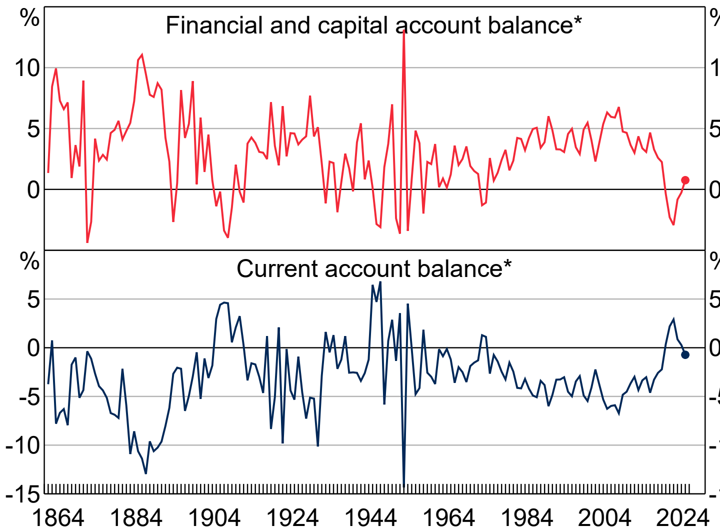
Australia’s welcoming environment for foreign investment

When Walter Wriston, Citibank’s CEO from 1967 to 1984, said ‘capital goes where it is welcome, and it stays where it is well treated’, he could have been describing Australia. And that matters – because other than a brief period around the turn of the 20th century, and another around the Second World War, Australia has run a persistent current account deficit (i.e. drawn on overseas financing to help fund onshore investment) for most of the past 160 years (Graph 6).

Graph 6

Australia’s Balance of Payments

Per cent of GDP



* Dots represents March quarter 2024 observations.

Sources: ABS; Butlin (1962); Foster (1996); RBA; Vamplew (1987).

In the early days, that financing sometimes came from rather unconventional sources.

Just north of where we are sitting tonight lies the cove originally known as Melia-Wool, but later renamed after the businessman Robert Campbell. Campbell built the warehouses you can still see through the window, to hold the wares of 19th century trade: from sugar and wool to whale oil, sealskins – and Peruvian guano.[14] He also ran the Sydney branch of the New South Wales Savings Bank, known colloquially as ‘Campbell’s Bank’. Newly arrived convicts were first encouraged, and then from 1822 compelled, to deposit any assets they brought with them in the Savings Bank until ‘their condition was improved by their good behaviour’.[15]

Though many of these deposits were pitifully small, some amounted to real money.[16] For example, one Thomas Bolton deposited 42 pounds, 18 shillings and 4 pence – roughly the annual salary of a well-to-do London builder of the time. This money was used to fund local development. A Savings Bank document from 1824 shows a 100-acre parcel of land near present-day Petersham passing hands for £100. Today – 200 years on – that land would be worth at least $2 *billion*: a striking illustration of the scale of change in the Australian economy over that period.[17]

Persistent current account deficits can sometimes drive a sense of national angst that you are living beyond your means, risking a sudden drying up in credit or an unaffordable rise in funding costs. Australia found itself in a particularly challenging situation between the World Wars, when a combination of weak growth, over-borrowing in sterling, and the British determination to stick to the Gold Standard caused the public debt burden to balloon dangerously. In August 1930, Sir Otto Niemeyer – a Bank of England official, I regret to say – delivered a pretty obnoxious speech to the Melbourne Conference of Commonwealth and State Leaders in which he warned Australia that ‘cold facts must be faced’, and that it had two years ‘to get its house in order’ before key debt tranches matured.[18] His intervention was so profound it caused a split in the Labor Party.[19]

Over the decades that followed, however, governments around the world came increasingly to the view that persistent overseas borrowing *could* in fact be sustained so long as it reflected the funding of profitable onshore investment, or so-called 'consumption smoothing' (e.g. by young households, expecting their lifetime incomes to rise). That view – dubbed the 'Pitchford thesis' in Australia in the 1980s – shaped a raft of policy reforms, including floating the exchange rate and reducing or eliminating a wide range of capital controls.[20] External financing switched increasingly from the public to the private sector.

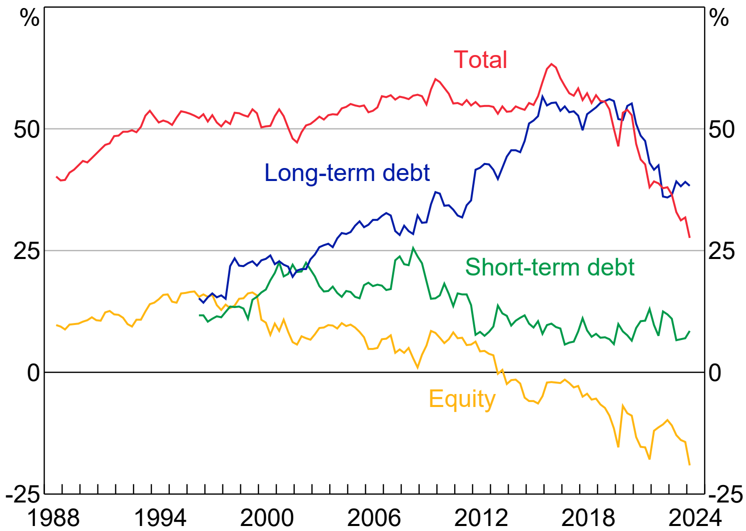
Of course, questions about external sustainability can still arise. After the 2016 Brexit referendum, for example, the then Bank of England Governor Mark Carney described the United Kingdom's current account deficit as relying on the 'kindness of strangers' – Blanche DuBois' memorable last line in 'A Streetcar Named Desire'.[21]

Australia's experience in recent decades has been more positive, for at least three reasons. First, Australia has generated substantial onshore investment opportunities, particularly during the 'mining boom' of the noughties. Second, borrowing has been structured in ways that make it relatively resilient to shocks, being denominated predominantly in (or hedged back to) local currency (reducing exposure to exchange rate adjustments), and issued at increasingly longer maturities (reducing rollover risk).[22] But, third, Australia has been through an unusual period since 2019 of running current account surpluses – *exporting* rather than importing capital in net terms, helping to halve the country's net overseas liabilities (Graph 7).

Graph 7

Net Foreign Liability Position

Per cent of GDP

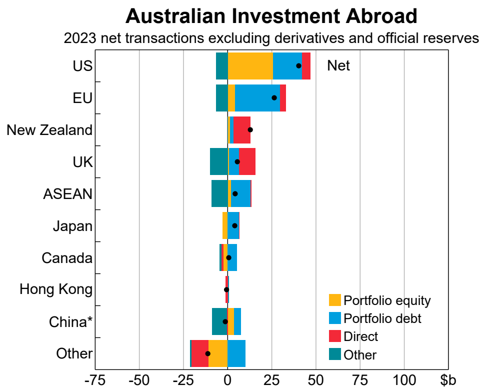


Sources: ABS; RBA.

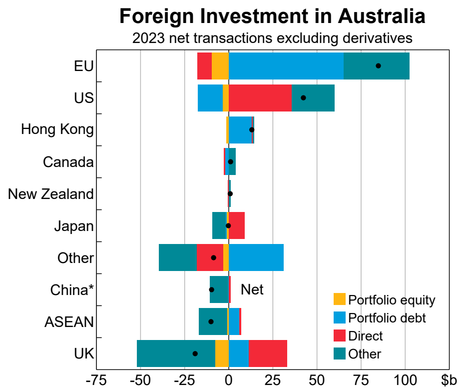
These surpluses reflected a number of underlying causes. Part of it was a classic excess of national saving over investment – with savings boosted by the sharp rise in the terms of trade, the structural increase in super fund balances and precautionary accumulation during Covid; and investment growth normalising somewhat after the highs of the mining boom. Australia's net investment income also rose for a period as a result of changes in relative asset prices. And capital flows were affected by mergers and acquisitions.[23]

It is unclear whether such surpluses will persist. The most recent data suggest they may not.[24] But even if they do, that does not mean Australia's need for inward foreign investment is a thing of the past. And that is because a substantial slice of national savings is placed in overseas assets, in order to diversify risk and return (Graph 8, left hand panel). The super funds alone hold nearly half their portfolio offshore.[25]

Graph 8
Inward and Outward Investment



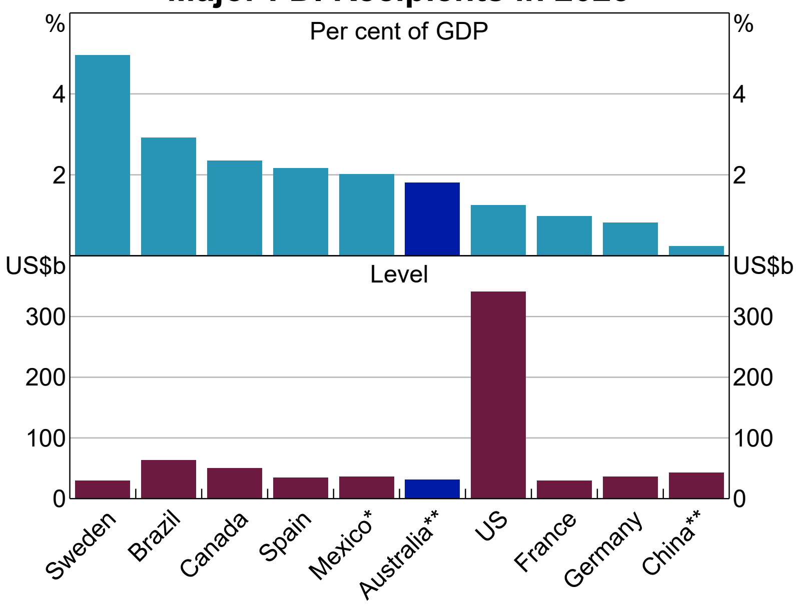
* Includes mainland China only.
Sources: ABS; RBA.



* Includes mainland China only.
Sources: ABS; RBA.

With a substantial pipeline of investment projects waiting to be financed, that leaves many opportunities for inward investment. Consistent with that, public and private Australian debt remains in strong demand right around the world (Graph 8, right hand panel). And Australia remains one of the top recipients of inward foreign direct investment (FDI) globally, when expressed as a share of GDP (Graph 9).

Graph 9
Major FDI Recipients in 2023



* Data excludes resident special purpose entities.
** Asset/liability basis.
Sources: IMF; OECD; RBA.

Conclusion

Let me conclude.

No one has yet identified a single golden source of national prosperity. But Australia has come pretty close. Three key things have helped it navigate massive changes in the global economic and financial system, generating wealth for its people and ensuring it remains an attractive location for investment in equal measure:

- Its unusually diverse range of resource endowments – below ground, in both 'old world' and 'new world' minerals; above ground, in human capital, agriculture and solar capacity; and beyond the seas, in its geographical position.
- Its strong but adaptable pro-growth institutions – political, legal, macro and microeconomic, and financial stability.
- Its longstanding welcoming environment for foreign investment.

Of course, these things are not sufficient to guarantee prosperity in the future: as a small open economy, Australia relies on the continued functioning of global institutions. And it relies on making the right policy calls. Tomorrow's sessions are all about how to do that in the current climate. I wish you well in those discussions.

Endnotes

[*] I am grateful to Michele Bullock, Natasha Cassidy, Iris Chan, Jon Cheshire, Stephen Cupper, Anthony Dickman, Paula Drew, Jacqui Dwyer, Sarah Gallagher, Nick Harvey, Sarah Hunter, Claire Johnson, Brad Jones, Christopher Kent, Marion Kohler, Jeremy Lawson, Virginia MacDonald, John Murphy, Anna Park, Shivali Raj, Tom Rosewall, Carl Schwartz, Callum Shaw, Penny Smith, Harry Stinson, Katie Sun, Beth Tasker, Tom Williams and Jess Young from the RBA, and a range of others outside the Bank, for their assistance with, or comments on, these remarks.

[1] National Museum of Australia (2022), 'Trade with the Makasar'. Parke E (2021), 'New Study Reveals History of Aboriginal Trade with Foreign Visitors before British Settlement', *ABC News*, 18 July, describes a similar discovery further to the west, and includes a tremendous description of the overseas fishermen as 'sail-in, sail-out' (SISO) workers, by Alistair Paterson, Chair of Archaeology at the University of Western Australia. After 1901, the newly formed Australian Government banned Makassar trepangers, with the aim of protecting Australia's territorial integrity and encourage a local trepang industry.

[2] See, for instance, WorldBank Data (2024), 'GDP per capita (current US$)'; IMF (2024), 'World Economic Outlook Database', April; UBS (2023), 'Global Wealth Report 2023'.

[3] We can be confident that William Morris was not explicitly describing Australia in his epic poem 'The Earthly Paradise.' But it does bear at least a family resemblance: a land 'across the western sea' but 'a little to the southward steer', where gardens are 'ever blossoming', 'no Greenland winter waits', no 'year-long night', 'but spice-trees set waving by the western wind, and gentle folk who know no guile at least, and many a bright-winged bird and soft-skinned beast'.

[4] This entire speech, and most of whatever understanding I have on this topic draws heavily from McLean IW (2012), *Why Australia Prospered: The Shifting Sources of Economic Growth*, Princeton University Press. I wholeheartedly recommend this book to anyone seeking insight into either the history of Australia's economy, or its future.

[5] I am grateful to Ashley Owen of Owen Analytics for this chart. Somewhat similar analysis is also presented in Gillitzer C and J Kearns (2005), 'Long-term Patterns in Australia's Terms of Trade', RBA Research Discussion Paper No 2005-01.

[6] See ESMAP (2020), *Global Photovoltaic Power Potential by Country*, Washington, DC: World Bank; Australian Government, 'Australian Energy Statistics'. Available at <https://www.energy.gov.au/energy-data/australian-energy-statistics>. The World Bank study only covers solar radiation between 60°N and 45°S parallels – so it is theoretically possible (if unlikely) that countries with large landmasses outside this region (such as Russia) have a higher capacity.

[7] Horne D (2008), *The Lucky Country*, Penguin eBooks.

[8] Our World in Data, 'GDP per capita, 1820 to 2022'. Available at <https://ourworldindata.org/grapher/gdp-per-capita-maddison?tab=chart&country=~AUS>.

[9] The importance of institutions in breaking the resource curse is explored in Mehlum H, K Moene and R Torvik (2006), 'Institutions and the Resource Curse', *The Economic Journal*, 116(508), pp 1–20.

[10] Australia for example is in the top 10 per cent of countries as measured by the V-Dem Institute's Liberal Democracy Index (the UK is in the next decile down). See V-Dem Institute (2024), 'Democracy Report 2024: Democracy Winning and Losing at the Ballot'.

[11] See, for instance, Al-Sadiq AJ, P Bejar and I Ötker (2021), 'Commodity Shocks and Exchange Rate Regimes: Implications for the Caribbean Commodity Exporters', IMF Working Paper No 2021/104.

[12] Kent C and J Simon (2007), 'Productivity Growth: The Effect of Market Regulations', RBA Research Discussion Paper No 2007-04.

[13] See, for instance, OECD, 'Indicators of Product Market Regulation'. Available at <https://www.oecd.org/economy/reform/indicators-of-product-market-regulation/>.

[14] Austral Archaeology Pty Ltd (2015), 'Campbell's Stores, Campbell's Cove Sydney, New South Wales: Aboriginal and Historical Archaeological Assessment, Statement of Heritage Impact and Research Design', Report prepared for Altus Page Kirkland.

[15] RBA Museum, 'Hidden History of Banking'.

[16] RBA Unreserved, 'Series Guide: Savings Bank of New South Wales'.

[17] The records of the New South Wales Savings Bank found their way into the RBA's archives through a series of mergers – with the Savings Bank of New South Wales in 1832, the Government Savings Bank of New South Wales in 1914, and the original government-owned Commonwealth Bank in 1931 – from which the RBA emerged as a separate institution.

[18] RBA Unreserved, 'Research Guide: Sir Otto Niemeyer, GBE, KCB'; Dwyer J and V MacDonald (2021), 'From the Archives: The London Letters', RBA *Bulletin*, March 2021; Millmow A (2004), 'Niemeyer, Scullin and the Australian Economists', *Australian Economic History Review*, 44(2), pp 142–160.

[19] Labor History (undated), 'The Scullin Years – The Lang Plan and the Party Split, 1931–1931'. Available at <https://laborhistory.org.au/category/the-scullin-years/the-lang-plan-and-the-party-split/>.

[20] For a comprehensive overview of thinking in this area, see Belkar R, L Cockerell and C Kent (2007), 'Current Account Deficits: The Australian Debate', RBA Research Discussion Paper No 2007-02; Debelle G (2011), 'In Defence of Current Account Deficits', Address at ADBI/UniSA Workshop on Growth and Integration in Asia, Adelaide, 8 July. The thesis itself is set out in Pitchford JD (1989), 'A Sceptical View of Australia's Current Account and Debt Problem', *Australian Economic Review*, 22(2), pp 5–14.

[21] Mark Carney (2017), 'A Fine Balance', Speech at Mansion House Bankers and Merchants Breakfast, London, 20 June.

[22] These trends are covered in detail in Debelle G (2019), 'A Balance of Payments', Address to the Economic Society of Australia, Canberra, 27 August. The latest data from the periodic Survey of Foreign Currency Exposure are described in Atkin T and J Harris (2023), 'Foreign Currency Exposure and Hedging in Australia', RBA *Bulletin*, March.

[23] For a comprehensive discussion of these developments, see Smith P, 'The Extraordinary Decline in Australia's Net Foreign Liabilities', Speech to CFA Societies 2023 Australian Investment Conference, Sydney, 18 October.

[24] Australian Bureau of Statistics (2024), 'Balance of Payments and International Investment Position, Australia, March 2024'.

[25] See, for instance, NAB (2023), 'Super Funds Continue to Increase Allocation to International Assets: NAB Report', NAB News, 27 November.