“Business as Usual is not Enough”

Lunchtime Address to the Asia-Pacific Financial Forum and Urban Infrastructure Network

ABAC3, 10 August 2015, Sofitel Melbourne, 12:40pm-1:00pm

The point I would like to make today is one I’ve made before.

In fact, it’s one I’ve been making since I took up the position of Secretary to the Treasury at the start of the year.

In essence, we need to do more to secure our future prosperity.

Global growth remains subdued and a number of major economies face long-term challenges.

This is not new.

It has been seven years since the collapse of Lehman Brothers and yet the global economy continues to struggle to regain rates of growth seen prior to the global financial crisis.

This is not to say there aren’t any bright spots.

The US economy is one of them.

The US labour market is strengthening and recent data suggest renewed momentum.

If these conditions remain in place, the US Federal Reserve has signalled that it will begin lifting interest rates in the second half of the year.

While risks in the euro area remain elevated, recent data suggest the euro area in general may have turned a corner.

Progress toward a further financial assistance package for Greece has reduced the risk of a Greek default and exit from the euro area in the short term. But there is a long way to go before the situation in Greece is resolved.

Even though economic conditions in other euro area economies have improved and financial exposures to Greece have been greatly reduced in recent years, the situation in Greece has generated some renewed focus on sovereign risk more broadly.

Borrowing costs for European peripheral governments briefly spiked recently, although very easy monetary conditions meant that the rise did not reach that of the euro crisis turmoil during 2011 and 2012.

Closer to home, we need to keep close watch on the prospects of the Asia-Pacific region more generally.

You might think this is an unusual statement to make, given that the region will remain the fastest-growing in the immediate-term at least.

But growth has started to slow in some of the major economies in the region. And there are different issues driving the change in many of these countries.

And in some countries, crucial reforms to address slowing growth have been stalled.

That is why we can't put all of our eggs in the 'Asia-Pacific basket'.

Although China will continue to drive growth in the region, we may possibly see slower growth and periodic bouts of volatility as China opens up its capital account.

And despite Japan having a strong March quarter growth outcome – an expansion of 1 per cent –we need to see a sustained pick-up in permanent wages for Japan to overcome deflation concerns.

And, beyond the short-term, demographics will continue to be a drag on Japanese growth.

Korea, too, faces significant challenges from its rapidly ageing population, with the working-age population expected to peak in 2016.

For Indonesia, low global commodity prices and delays in the infrastructure investment pipeline are weighing on growth.

Poor infrastructure, regulation and import restrictions are driving inflation up, constraining Bank Indonesia's ability to support growth through monetary policy.

Prioritisation and follow-through on key reforms is necessary, particularly those designed to improve the investment environment.

Malaysia, another major regional oil exporter, is also adjusting to lower commodity prices and a more difficult export environment generally.

Their introduction of a Goods and Services Tax in April this year will prove to be a valuable reform but it may affect short term growth.

Singapore – one of the world's most open and trade-exposed economies – is even more sensitive to shifts in global economic demand.

Facing an uncertain global outlook, ageing demographics and physical resource constraints, the country is in the process of re-engineering its growth model.

As well, growth in Thailand continues to disappoint, with export growth falling for six consecutive months.

Infrastructure spending has helped support growth during this time but there is no clear reform plan to drive growth over the medium term.

India may be an exception to this.

We expect India will become a more important driver of growth in the region, with its favourable demographics and ever-growing middle class.

India is on track to be the fastest growing major economy this year and is set to overtake China as the world's most populous country by 2030.

The consequences of this uncertain global outlook play out differently across regions and economies.

But to address this outlook, we must all undertake reforms to help lift global growth and build a solid foundation for future growth.

Australia is no exception.

We have been very fortunate that our abundant commodities have been in high demand by China since the early 2000s.

This helped us escape the worst effects of the global financial crisis and the subdued global recovery since.

The Australian economy is now entering its 25th consecutive year of growth.

This is the second longest continuous period of growth of any advanced economy in the world[1].

The March quarter National Accounts confirm there is increasingly solid and broad-based momentum in the Australian economy – the real economy grew by 0.9 per cent in the quarter, to be 2.3 per cent higher over the past year.

And the forecasts in the 2015-16 Budget show that Australia still has one of the better short-term economic outlooks among the world's developed economies.

But while growth in Australia may be stronger relative to that of many other advanced economies, it remains below its long-run average.

As mining investment falls away, commodity exports will continue to support growth.

But the economy is increasingly looking towards the non-mining sectors to fill the large gap left by this decline in mining investment.

We have a very diverse and productive agricultural sector which could help fill some of this short fall.

The consumption needs of the growing middle class in our region and around the world offer an immense opportunity to Australia's agricultural producers.

[1] The longest was the Netherlands from the December quarter of 1981 to the March quarter of 2008.

This transition will be supported by easy credit and a lower exchange rate.

Taking a longer view, the Intergenerational Report reminds us that we also face headwinds from an ageing population, a challenging fiscal repair task and ever increasing expectations around social expenditure — including health in particular.

What I want to touch on today are areas for private sector engagement to encourage the types of investment that will help to maintain the growth in income we have come to expect over the past two decades.

An important area of private sector interest and involvement is getting the right policy settings around the planning, selection and provision of infrastructure projects.

Infrastructure is of critical importance to the productivity of businesses – whether those businesses rely on ports, airports, roads, railways, reliable energy supply or telecommunications.

The provision and maintenance of infrastructure already places a large call on the Australian Government's Budget.

As a percentage of GDP, government expenditure on infrastructure has been higher in the past five years than at any other point in the preceding twenty years[2].

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[2] Infrastructure Australia, *National Infrastructure Audit* (April 2015) – Available online: http://infrastructureaustralia.gov.au/policy-publications/publications/australian-infrastructure-audit.aspx

But with demands on other areas of government expenditure growing, the governments must look for new ways to meet our infrastructure needs over the long term.

Ensuring there is a strong and consistent pipeline of well-planned, quality projects available to potential investors is crucial to securing greater investment in infrastructure.

The Productivity Commission's 2014 report into the public provision of infrastructure found that there is no shortage of private sector financing available to be deployed to infrastructure projects.

We in Treasury hear the same feedback.

Indeed, feedback provided to Treasury during 2013 and 2014 from infrastructure financiers was consistently that there is no shortage of financing available for quality projects.

That was my experience at UBS too.

The strong market for brownfield infrastructure assets sold by State Governments in recent years shows that investors are willing to pay for established infrastructure that has demonstrated ability to achieve commercial returns.

We're making some progress in this area.

In 2014, Infrastructure Australia was reformed to improve infrastructure project planning, selection and delivery.

It is currently devising a 15-year infrastructure plan based on national and state priorities.

Once completed, the plan will be revised every five years.

Infrastructure Australia will also conduct evidence-based audits of Australia's infrastructure assets every five years to identify and address any gaps.

The inaugural audit was completed in May this year.

The $4.2 billion Asset Recycling Initiative is giving the private sector the opportunity to invest in existing assets, while freeing up capital on State and Territory government balance sheets.

The initiative provides incentive payments to State and Territory governments if they sell existing assets and reinvest the sale proceeds to fund additional productive infrastructure.

States and Territories receive 15 per cent of the price of the asset sold if all the sale proceeds are allocated to new infrastructure investment.

Agreements with the Australian Capital Territory and New South Wales have been signed.

Additional States are expected to come forward shortly.

And, as well, Treasury with the States and Northern Territory will be managing the Government's $5 billion Northern Australia Infrastructure Facility – the NAIF –to help establish projects and increase the productive capacity of northern Australia.

The NAIF is intended to support large-scale infrastructure with the potential to have a transformative impact on northern Australia.

It will support the construction of new infrastructure or upgrades to existing infrastructure like ports, airports and rail – things that provide a foundation for economic activity.

Projects supported by the NAIF must generate a revenue stream – this is a loan facility not a grant program. And the Commonwealth expects to be repaid.

There will also need to be private sector involvement and participation in some form by the relevant States or the Northern Territory.

While loan terms and conditions will be negotiated on a case-by-case basis, we will be looking to lend on the minimum terms necessary to get a worthwhile project across the line to financial close.

We have been accepting expressions of interest for the NAIF since 1 July 2015 and will soon be consulting on eligibility criteria to assist potential applicants.

Treasury will draw on professional investment expertise to scrutinise rigorously all potential investments and for that reason I plan to run the facility from our Sydney Office.

Further abroad, as I'm sure this audience is aware, there is a clear need for additional investment in economic infrastructure in the Asia-Pacific region.

The Asian Development Bank estimated in 2010 that developing Asian economies will need to invest $US8 trillion in infrastructure between 2010 and 2020 to maintain current levels of economic growth[3].

While this figure is now somewhat outdated, it does give you a sense of the enormity of the task facing the region.

China's massive infrastructure program aside, not much has been done in the region to address this deficit.

Perhaps this is why international forums have taken to the issue of infrastructure financing and development with alacrity.

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[3] Bhattacharyay, B.N. (2010). Estimating demand for infrastructure in energy, transport, telecommunications, water and sanitation in Asia and the Pacific 2010-2020.Working Paper Series, No. 248. Tokyo: Asian Development Bank Institute

It was certainly a focus under Australia's G20 presidency, with the *Global Infrastructure Initiative* and the *Global Infrastructure Hub* developed and initiated under our chairmanship.

The Global Infrastructure Hub will work with Governments – both G20 and non-G20 – the private sector and international organisations to address data gaps, lower barriers to investment, increase the availability of investment-ready projects, help match potential investors with projects and improve policy delivery.

But it is through better engagement with the private sector that the Hub will really make a difference to the infrastructure investment environment.

Since its announcement in November 2014, we have made considerable progress in establishing the Hub in Sydney.

I chaired the first meeting of the Hub's Board in April 2015, and I will be travelling to Ankara to chair the second Board meeting in early-September.

Chris Heathcote's commencement as CEO in mid-June, following an international search, was another major milestone for the Hub.

Relocating from London, Chris brings extensive experience at senior levels in both the private and public sector overseas and in Australia.

The Hub's mandate is to drive growth by accelerating the flow of infrastructure projects to market.

Chris and his team will do this by creating a best practice database which will enable procurement authorities to access successful examples of financing and costing of new projects.

The Hub will work closely with the public and private sectors to ensure that the best practice solutions it espouses are both pragmatic and effective.

The Hub will not follow individual projects, nor shall it provide direct investments.

Chris' first priority is to draft a business plan which will take into account broad-ranging stakeholder consultation.

This will be approved by the Hub's Board in Ankara and then put to G20 Finance Ministers for their endorsement in early September.

But the need for private sector involvement in productive investment goes beyond infrastructure.

There is an important role for the private sector to play in continuing efforts to reduce barriers to trade in the region.

As we learned from the Great Depression, succumbing to protectionist impulses, no matter how popular these impulses are, can be catastrophic for growth.

In the absence of any meaningful progress in brokering a new multilateral deal at the World Trade Organisation, governments have instead pursued their own arrangements.

To this end, the Australian Government has recently concluded free trade agreements with three of Australia's top five trading partners – China, Japan and Korea.

And it doesn't stop there.

Negotiations for a trade agreement with India have now commenced, and hopefully, the negotiations for the Trans-Pacific Partnership Agreement will still be successful at some time in the future.

We've also just heard during the previous session about one of the Government's lesser known but highly relevant trade initiatives – the Asia Region Funds Passport.

The Passport is expected to provide investors with a wider choice of investment products issued by fund managers from across the region, which will improve investors' ability to diversify their portfolio and reduce concentration risk.

Improved competition may also lead to lower fees for investors.

Specific to Australia, I understand my colleague Rupert Jolley spoke earlier in the day about the role the Passport could play in turning Australia into a regional financial centre.

With the middle class set to exceed 3 billion people by 2030 in the Asia-Pacific region,[4] the Australian funds management industry is ideally placed to service their demand for sophisticated financial services given our reputation for having a sound, stable and well-regulated financial market.

Treasury is the chair of the Asia Region Funds Passport Working Group which consists of officials from Korea, Singapore, New Zealand, Korea, Thailand and the Philippines.

Expanding the Passport's membership remains a priority.

Finance Ministers of economies that are willing and able to join the Passport are expected to issue a Statement of Understanding at a side event at the APEC Finance Ministers' Meeting in September this year.

Securities regulators will then sign a Memorandum of Understanding which will contain the rules and operational arrangements.

I have spoken in recent speeches about the need for widespread reform across the board.

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4 Sourced from the Assistant Treasurer's op ed 'Asian economies hungry for enhanced solutions', Australian Financial Review, 10 June 2015

What I want to impress on you today is the pivotal role the private sector can play in pursuing reform.

To be frank, governments can only provide the right conditions for business to flourish.

It is up to business – big and small – to help drive the policy agenda and begin investing when conditions are right.

The private sector will need to put itself at the centre of policy debates to ensure we do not rest on our laurels – and we must all recognise that reform cannot always proceed with no losers.

APEC is remarkable in that it was one of the first regional economic bodies to give the private sector a voice, with the APEC Business Advisory Council initiated in 1995.

Through ABAC the private sector has an opportunity – and an obligation – to make its voice heard and help governments understand the challenges that business faces in the region.

The private sector must be prepared to advocate for reforms which are in the national interest, even if they don't align directly with immediate interests.

Your efforts in this forum to date have been appreciated and I look forward to your continued involvement.