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THE TROPICAL SOUTH WEST PACIFIC - ECONOMIC OPPORTUNITIES & CHALLENGES

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ADDRESS TO THE
PNG GAS DEVELOPMENTS CONFERENCE, CAIRNS

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Tropical Australia, Papua New Guinea, Papua Indonesia, and adjacent island states including the Solomon Islands, Vanuatu, East Timor are geographic neighbours that share in common, a significant section of the globe.

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Historically, they have also shared a number of attributes that have affected their previous levels of development.

The whole area lies in the tropics. Well known US economist and one time US Ambassador to India commented in the early 1960's:

".....if one marks off a belt of a couple of thousand miles in width encircling the earth at the equator, one finds within it "no" developed countries. The industry such as there is, is extractive - tributary to the economies further North or South. The agriculture, excepting a substantial amount of plantation agriculture, is also primitive. Everywhere the standard of living is low and the span of human life is short. Surely all this is not an accident."

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While, on any measure in the island areas, all of the tropical South West Pacific exhibited the low incomes characteristic of the tropical lag, the situation in tropical Australia was not so obvious. In a unified Australian common market, where population and workers could move freely, incomes were high. (Workers and families would leave rather than accept lower wages.) The great industries that led to the initial development of southern Australia – wheat and sheep, did not thrive in a tropical environment.

A major set back occurred when tick-borne Redwater Fever swept through the cattle herds pushed into the area.

The foundation of most closer settlement, the sugar industry, was effectively subsidised through to the 1970's. Most of the area remained a vast wilderness given over to only sparse cattle grazing.

In an area covering 40% of Australia's land mass and having over 60% of its water run off, its population was less than 400,000, about 4% of Australia's total. In an Australian 'common market' where only high income outcomes can survive, the underdevelopment in tropical Australia has been characterised not by lack of high incomes but by lack of population.

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As a consequence of the tropical lag, the whole South West Pacific area suffered a further problem - lack of accumulated investment in physical infrastructure throughout the island areas and in tropical Australia, especially in the higher rainfall far North.

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While the limited population of tropical Australia had high levels of investment in 'human and social' capital through high levels of education, health and law, and order services, this was not the case in island areas.

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History and geography have left the area highly fragmented - culturally, politically and economically with six different jurisdictions involved - Indonesia in Papua Barat and Papua Indonesia, Timor Leste, Papua New Guinea, Federated States of Micronesia, Solomon Islands, Vanuatu and Australia.

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But what was and still needs to be realised is that the area is not poor in natural resources.

This slide shows a satellite derived measure of the rate at which carbon is absorbed from the atmosphere, a map of underlying plant growth potential. Levels in the island areas are extremely high.

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These maps compare the Cairns/Peninsula region with southern India and Victoria.

With 26% of Australia's water run off, value of agricultural production is only about 3% of Australia's total and with equivalent plant growth potential, only about a quarter of that of Victoria.

The agricultural potential of Papua New Guinea, and the islands' area is immense.

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There was no underlying lack of marine resources. There was no lack of mineral resources.

Importantly, these days there is no lack of underlying natural tourism resources.

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Four major underlying factors have been leading to the development of this previously under developed resource base throughout the whole area.

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The first has been a growing global economy reaching out for previously marginal resources.

Growing markets in southern Australia and New Zealand have played a role, but importantly, the area is relatively close to the rapidly growing economies of Asia, first Japan, Korea, Taiwan, Singapore and Malaysia and more recently a rapidly rising demand from the massive populations of China and India and potentially Indonesia, and the other South East Asian countries – a level and scale of rapid industrialisation is taking place not seen since the late 1800's and early 1900's when massive industrialisation took place in Europe and North America, a phase that had major consequences for the tropical South West Pacific at that time.

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The second major factor has been developments in transport and communication technology that have broken down former cost barriers to remoteness from major markets.

The development of bulk carriers has revolutionised the prospects for mining export over long distances of minerals like coal, bauxite and of course natural gas. Road transport development has enabled the Cairns region to realise its potential to grow tropical fruit more cheaply for markets in southern Australia and revolutionised long distance transport of cattle.

Aircraft development has not only revolutionised the prospects for tourism through the advent of large wide bodied jets, but, advances in short take off large air freight carriers and small aircraft including helicopters has been extremely important in opening up economic potential in Papua New Guinea.

Computers, wireless and satellite technology has of course made the world a 'global village'. The advent of mobile telephones is currently revolutionising communication in the island areas.

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However, it is important to realise that improvements resulting in falling transport and communication costs can have a 'dark side' resulting in the loss of local manufacturing that was protected by transport costs (in the Cairns area loss of a regional brewery and brick works in the 1990's), and hollowing out of some services by computers and improved communications. These factors mean that if you don't go forward, you'll go backwards.

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The next major factor has been the development of technology more suited to the area, ie. to the tropics.

This is not only evident in higher yielding agricultural crop varieties and the introduction of tick and heat resistant Brahman into tropical Australia's cattle herds. Development of fast passenger catamarans, semi-submersible reef viewers and rainforest viewing cableways have been important to the development of tourism in the Cairns region. The advent of air conditioning, superior insecticides and detergents have revolutionised living and working in the tropics.

Fundamental to advances in the tropical areas has been to bring health threats like malaria, hookworm and the like under control. Current work taking place in Cairns is offering the prospect of a major advance in controlling dengue fever of importance throughout the tropical world.

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The last factor has been "success breeds success".

In the case of tropical Australia, as population and infrastructure has developed and in the case of the island areas, as higher incomes are achieved, higher order services in local manufacturing, education, health, sporting and cultural facilities can be supported, making the area a more comfortable and civilized place in which to live.

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Against the background of these underlying factors, the tropical Australia region had the opportunity to progress strongly.

Over the intervening period, the progress in tropical Australia is illustrated by the growth of Cairns, the furthest north and most tropical of Queensland's regional cities.

Based on growing outside earnings from mining, fishery, agricultural and tourism development, supplemented by earnings from aviation and marine services, education, defence and surveillance, Cairns has increased its population almost ten-fold since 1976, passing seven other regional cities with an average annual growth of about 3% per annum.

The story of Townsville, Darwin and Mackay, exhibit a similar picture of growth.

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Across the Coral Sea, as Papua New Guinea progressed from colony to nation, Port Moresby and Lae have expanded just as dramatically, as Papua New Guinea has expanded its earnings from agricultural, timber, fishery and mineral exports.

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Dutch New Guinea has changed to Irian Jaya and more recently the provinces of Papua Barat and Papua Indonesia with the giant Freeport Mine at Tembagapura recording output of \$5 billion per annum and the Tangguh gas project built to produce an output of 7.6 million tonnes per annum.

After a tumultuous period, Portuguese colony of Timor Leste has become a separate state.

The Solomon Islands, Vanuatu and the Federated States of Micronesia have become independent states.

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Today, leading population in the region is that of Papua New Guinea followed by Papua Indonesia, Tropical Australia, the Solomons, Timore Leste, Vanuatu and Federated States of Micronesia.

Population growth is strong throughout - in the island areas due to high birth rates and decreasing mortality rates, and - in Tropical Australia due to inward migration.

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This diagram shows relative areas of Papua New Guinea and the Cairns based Far North Queensland/Peninsula region compared with the British Isles and California.

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In Tropical Australia, realities of areas and distances lead to a series of discrete regional economies, each with its own regional hub city with a typical capital city relationship to the area serviced.

Regional population in Tropical Australia is distributed over five main regions based on the regional cities of Darwin, Cairns, Townsville, Mackay and Rockhampton, with that based on Cairns now the largest.

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Realities of geography, mountain barriers and islands lead to a series of major regions in Papua New Guinea, the largest in population being the Highlands, the next the Momase (Marobe Madang and Sepik), with Lae the largest city in that region.

Then comes Port Moresby and the southern region.

Finally, there is the island area in the north east with Rabaul/Kokopo the largest centre.

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The following Gross Domestic Product figures and per capita GDP figures illustrate the challenges facing the island areas in the provision of basic services like education, health and law and order.

Tropical Australia represents about 58% of the total for the area.

Papua New Guinea, with a Gross Domestic Product about \$Aust10 billion has a population to service of 7 million. The Cairns/Far North Queensland region has a Gross Domestic Product of about \$12 bn, ie. roughly about the same size, to service a population of less than 300,000.

The impact of Freeport and the Tangguh projects on GDP in Papua Indonesia and Barat is obvious. The very low levels per capita for the Solomons stands out.

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The very different structure of the economies of the islands and Tropical Australia is illustrated by ratio of trade to GDP. While in Papua New Guinea, the ratio is over 80%, the Cairns region has a ratio of about 50% of outside earnings to GDP and Australia 18%.

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Differences in economic structure are illustrated by industry grouping that illustrates the relatively low level of development of service industry structure in Papua New Guinea compared with typical structure of a region in Tropical Australia's, the Cairns/Far North region.. The big difference is the percentage accounted for by health and education.

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However, while there has been progress over the decades, the basic fundamentals remain the same.

Tropical Australia's population, while increasing strongly, remains only 6% of Australia's total. The island states are still way down the developmental scale in terms of per capita incomes.

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Inter-connections between the areas have improved with air and shipping links from Darwin to Timor Leste, air and shipping links from Cairns to Freeport's mine in Papua Indonesia, strong air links between Cairns and Port Moresby with corporate links to other centres and shipping services from Townville to Port Moresby and Lae.

There are air links between Port Moresby and the Solomon Islands.

However, by and large, passenger and freight volumes involved in these inter-linkages remain small compared to the links between the island areas and southern Australia and Asia.

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Looking forward, if experiences with Japan are to be a guide, the massive industrialisation of China and India will go through phases:

- 1) A massive increases in demand for minerals and energy. This is happening now - the reason we are here today.
- 2) A massive increase in demand for basic agricultural products. This is getting underway – currently sugar in Queensland and products like timber and oil palm in Papua New Guinea.
- 3) As incomes rise, this can be expected to be a rise in demand for higher protein foodstuffs of beef, fish, fruits and the like.,
- 4) And, as incomes rise, a demand for tourism, an industry where the customer comes to the product and where high levels of infrastructure, health and security are important.

The first early steps are currently taking place with direct air services being established between Cairns and Shanghai.

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Clearly, for the foreseeable future, the main spring of progress of economic development of the Tropical South West Pacific area will depend on recognising a paradox of northern development and indeed of all the area's economy – that the economies of the region are too dependent on resource based industries like mining, agriculture, timber, fisheries and tourism, not because they haven't tried to develop more advanced and sophisticated manufacturing and service industries, but because they have failed to develop sufficient resource based industries upon which to base a larger and more sophisticated service structure.

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Foundations of the economic progress of the tropical South West Pacific area will continue to be its ability to develop its wider resource based potential in mining and energy, agriculture, fishing and tourism.

In the short term, mining and energy will lead the way, but this must lay the foundation for outside earnings from agriculture, fisheries, and tourism as opportunities progress.

Anything the mining and energy developments can do to help lay foundations for progress in these fields will be important., Certainly the expertise developed in these fields in tropical Australia could provide a nearby source to assist in this.

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However, if the area is to progress from being a quarry, a farm, a recreation area for others, and develop higher order manufacturing and services, the opportunity needs to be taken in the island area, with aid and assistance where possible from the outside world to invest in its human capital in the form of education, health and the provision of sound and stable government and law and order services.

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Research we carried out last year indicated that in Papua New Guinea, it was estimated that half a million children aged 6 – 12 years were not attending schools.

Drop out rates were high, literacy and numeracy skills were low.

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There were major deficiencies in health service provision with high incidence of some diseases including a strong spread of HIV/AIDS.

Anything the mining and energy developments can do to assist in these fields will be important. Again the expertise developed nearby in tropical Australia represents a potential resource.

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Throughout the area, the opportunity must be taken to invest in hard infrastructure of transport, energy and communications. The road system in Papua New Guinea is a major draw back.

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Finally, there is a need to keep fragmentation barriers down, and to integrate the area's markets if higher level manufacturing and service industries are to be achieved.

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In the short run however, for both Tropical Australia and Papua New Guinea, the major issue is dealing with the pressures brought about by high mineral and energy prices and major investment taking place in new capacity without damage to other sectors of the economy.

In Cairns, we have been made very conscious of the short term damage that has taken place to tourism income due to a high level of the dollar. Fortunately, expanding mining and agricultural income and service industry earnings have helped cushion the effects.

The inflation level in Papua New Guinea as measured, is running at a high level, with impacts on the cost structure of all sectors of the economy.

Against this background, for export industries to remain competitive, a depreciation of the currency would need to take place.

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But, the PNG kina has been appreciating strongly over the past twelve months, both against the Australian dollar and the US dollar.

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The other potential economic management threat comes from the fact that gas projects involve a very large initial construction investment, but relatively low on-going employment.

Unless other projects follow through, there is a risk of a major 'let down' period when construction is completed.

The history of Gladstone is a good example.

However, I am sure that PNG Monetary Authorities and the Government's economic advisers are all aware of these factors and working to control impacts.

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