MELBOURNE: A PARASITE CITY?

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Melbourne appears to be booming. Job growth is far more rapid than in Sydney. This article shows that Melbourne's economy is being driven by population growth and that most job growth is in the city-building and people-servicing industries. The city's apparent boom is obscuring its poor performance in exports to international markets. When export and imports are taken into account, the growth in per capita gross state product in Victoria is the slowest of all Australian states and territories since 2000–01. Melbourne is becoming increasingly dependent on external support.

The 2010 federal election produced a sharp divide in voting patterns. Victoria moved strongly to Labor (along with Tasmania) while Western Australia and Queensland (the mining states) swung equally decisively towards the Coalition.

One interpretation of this is that Victoria's recent robust economic performance had left Victorian voters happy with the incumbent federal government. In the year to August 2010, 32 per cent of job growth in Australia occurred in Victoria, yet as Table 1 below shows, only 25 per cent of Australia's population resides in Victoria. By contrast, just 22.5 per cent of job growth occurred in New South Wales (NSW), yet 32.5 per cent of Australia's population lives in NSW.

It is no wonder *The Australian's* George Megalogenis could describe Victoria as the 'Goldilocks economy'[1] or that prominent economist, Saul Eslake, was recently quoted as saying that Victoria is emerging as our strongest economy.[2] The advice from Megologenis is that 'Gillard should look to her home state of Victoria for inspiration'. He thinks that Victoria's economic performance is attributable to its recent leaders' willingness to take tough decisions on economic reform and the relative absence of corruption in the state.[3]

For some others, the election result has generated a distinctly sour interpretation of Victoria's circumstances. According to Michael Stutchbury (also from *The Australian*), the election result highlights the need to redouble structural change and reform in Australia. Stutchbury's concern is that Labor will indulge the regions and the states left behind by the mining boom, when it should be managing the economy to ensure that resources flow to where they will be most productively used—the mining states. 'This requires policy discipline and a flexible economy that allows the mining boom to draw workers and capital from the squeezed industries and regions'.[4]

This argument is an extension of the two-speed economy thesis. It has long been predicted that a mineral boom will drag capital and labour to the mining states where rates of return to capital and wages are high. This, plus a likely strengthening of the Australian dollar, will disadvantage growth in the non-mining states. Stutchbury is concerned that the Labor Party, dependent on voters in the disadvantaged states, including Victoria and Tasmania, will impede this process by subsidising the people and industries remaining in these states.

We are moving rapidly out of the realm of theory here because the Governor of the Reserve Bank has suggested that the rapid anticipated growth in mining investment and the inflationary forces thereby generated may prompt the bank to increase interest rates—which will, of course, impact on the second-speed components of the economy as well. Governor Stevens, however, questions the extent of the two-speed process on the grounds that mineral activity also boosts economic activity elsewhere in Australia. He cites the case of extra employment in the headquarters of mining companies located in Melbourne.[5]

There is an obvious conflict between the Megalogenis and Stutchbury perspectives. The mineral boom has been running through most of the last decade. How is it then that, despite this boom, Victoria can be dubbed a 'Goldilocks economy', with strong employment growth and a healthy state budget? In 2009–10, the state recorded a surplus of $644 million despite increasing expenditure on services by $5 billion or 12.5 per cent.[6] Perhaps Stevens is right: Victoria has shared in the fruits of the mineral boom.

To answer these questions requires a closer look at the Victorian economy. The state has done well in the creation of new jobs over the last decade by comparison with NSW. But, on other indicators explored below, including overseas trade and growth in per capita gross state product, Victoria has fallen below NSW and all other states. Perhaps Victoria's economic vigour is not due to the mining boom, but to factors distinctive to Victoria.

Victoria has experienced very rapid population growth relative to NSW. Could it be that population growth is driving Victoria's economy? Commentators are familiar with this idea when it comes to explaining the dynamism of the South East Queensland (SEQ) economy. It is obvious that economic activity deriving from accommodating and servicing the flood of people settling in that region is central to its rapid economic growth (at least until recently). The people-servicing aspect of the hypothesis derives from our previous work which shows that most employment growth in Australia is occurring in industries providing services to people where the demand for these services is closely related to population growth. These industries include the public health sector, education and community service industries and sections of the private sector professional services industries.[7]

We pursue the implications of this hypothesis after exploring the evidence available.

THE VICTORIAN RESPONSE TO THE TWO-SPEED ECONOMY PREDICAMENT

Victorian political leaders have been well aware of the potential dangers of a two-speed economy. Indeed, in 2006, the Victorian Department of Treasury and Finance published a discussion paper on the subject which concluded that the Victorian economy is vulnerable to competition from northern and western Australia for capital and people.[8] As we have argued in an earlier publication on the two-speed economy issue, Victoria is especially vulnerable because of its residual reservoir of manufacturing industries which evolved in the protectionist post-World War II era.[9] The capacity of these industries to export and to compete against imports falls as the dollar rises in value, especially given the low-tariff regime now in place. Remarkably, since coming to power in 1999, the two Labor premiers, Steve Bracks and then John Brumby, have not sought to restore a protectionist regime (with the exception of huge handouts to the car industry). Quite to the contrary, they have embraced the challenges of an open international marketplace and the associated need for continued economic reform, so as to encourage the most efficient use of resources. As stated in a 2005 paper summarising the Victorian Government's proposals for continued economic reform:

> Australia must continue to expand its influence in sectors where it has global opportunities. These sectors, which include

> the traditional strengths of resources and agriculture... and, increasingly, emerging manufacturing and service industries are likely to help drive Australia's future prosperity.[10]

The Victorian Labor government thinks the state's most promising future lies in participating in the new innovative economy, through which it can build on Victoria's intellectual capital. To this end, it has sought to make Melbourne an exciting location for new enterprise, including the international student industry, by promoting the capacity of the city's educational and research institutions and by enhancing its cultural and physical attractions so as to entice smart, globally-mobile people to locate in the city. The attraction of international events like the Grand Prix is part of this strategy.

Is the Victorian government succeeding? Perhaps the city is attracting talented people and new industries. Alternatively, perhaps the city's apparent economic dynamism has more to do with city-building and people-servicing activities.

We start by analysing the scale of population growth, city-building and employment growth in Melbourne and Sydney. The differences between the two cities on these indicators are sharp and apparently to Melbourne's advantage.

VICTORIA'S POPULATION GROWTH

Victoria's population growth is extraordinary given that the mining boom might have been expected to attract people to the mining states. Yet, Victoria's share has not changed since 2001. Some 24.8 per cent of Australia's population lived in Victoria in 2009 compared with 24.7 per cent in 2001. Melbourne dominated the Victorian scene, with 82 per cent of the net growth in the state's residents locating in Melbourne. By 2009, some 18.1 per cent of all Australian residents were living in Melbourne, compared with 17.8 per cent in 2001. It was a different story in NSW. The state's population grew by just 8.5 per cent over the period 2001 to 2009, compared with 13.3 per cent in Victoria. Sydney also increased its share of the NSW population over this period. However, whereas Melbourne grew by 15.1 per cent, Sydney grew by just 9.1 per cent.

Melbourne has been growing strongly throughout the past decade. As Table 1 shows, Melbourne grew at around 50,000 a year between 2001 and 2006, which was well above 20,000–30,000 per annum figure for Sydney at the same time. The main reason for Melbourne's more rapid overall population growth than Sydney was that there was very little net loss from interstate migration, including to Western Australia. By contrast, Sydney has been losing some 15,000–20,000 residents each year through interstate migration, though not to mining areas. The primary destination has been South East Queensland.

There was an acceleration of population growth after 2006 in both cities. The main reason was a sharp increase in net overseas migration (NOM). NOM to Australia jumped in the second half of the past decade, from 156,780 in 2005 to 315,690 in 2008. Table 2, which is drawn from unpublished data prepared by the Australian Bureau of Statistics (ABS) for the Centre for Population and Urban Research, indicates the state share of this NOM.[11] As is evident, at 106.8 per cent, Victoria's growth in NOM over the three years exceeded the growth for Australia as a whole (101.4 per cent). But, NSW too received a major boost with an increase of 89.8 per cent over the same period. Almost all of the migrants arriving in NSW and Victoria during this time domiciled in Sydney and Melbourne respectively.

The consequence was a further increment in the annual growth in Melbourne and Sydney to around 90,000 and 80,000 a year, respectively. This has led to delusions of endless growth on this scale within

Table 1: Population growth in Australia by state and capital city, 2001 to 2009

	2001	2003	2005	2007	2009	Change 2001 to 2009	Change as per cent of 2001	State share of total change
New South Wales	6,575,217	6,672,577	6,756,457	6,904,942	7,134,421	559,204	8.5	22.0
Victoria	**4,804,726**	**4,923,485**	**5,048,602**	**5,221,310**	**5,443,228**	**638,502**	**13.3**	**25.1**
Queensland	3,628,946	3,809,214	3,994,858	4,195,981	4,425,103	796,157	21.9	31.3
South Australia	1,511,728	1,531,278	1,552,514	1,585,794	1,623,590	111,862	7.4	4.4
Western Australia	1,901,159	1,953,070	2,017,088	2,112,967	2,245,057	343,898	18.1	13.5
Tasmania	471,795	477,646	486,327	493,204	503,292	31,497	6.7	1.2
Northern Territory	197,768	200,046	206,373	214,804	225,938	28,170	14.2	1.1
ACT	319,317	325,661	330,164	341,054	352,189	32,872	10.3	1.3
Australia	**19,410,656**	**19,892,977**	**20,392,383**	**21,070,056**	**21,952,818**	**2,542,162**	**13.1**	**100.0**
Capital city statistical divisions								
Sydney	4,128,272	4,190,874	4,245,045	4,344,675	4,504,469	376,197	9.1	
Melbourne	**3,471,625**	**3,577,411**	**3,680,609**	**3,817,806**	**3,995,537**	**523,912**	**15.1**	
Brisbane	1,663,120	1,744,111	1,822,074	1,902,235	2,004,262	341,142	20.5	
Adelaide	1,107,986	1,121,742	1,134,513	1,159,131	1,187,466	79,480	7.2	
Perth	1,393,002	1,435,907	1,485,823	1,559,178	1,658,992	265,990	19.1	
Greater Hobart	197,282	199,853	203,467	207,330	212,019	14,737	7.5	
Darwin	106,842	107,440	111,258	117,333	124,760	17,918	16.8	
Canberra	318,939	325,340	329,865	340,766	351,868	32,929	10.3	

Source: Australian Bureau of Statistics (ABS), *Regional Population Growth: Estimated Residential Population*, Catalogue no. 3218.0

the Victorian state government and the Victorian business community. Both have visions of Melbourne overtaking Sydney in population size. Property investors seem to believe that demand for housing will forever exceed supply and that they need not worry about any downturn. All this has helped feed Melbourne's city-building boom.

Is Victoria attracting the talented people that the Brumby government hopes will energise the innovative economy? There may well be some high-flyers among the very large number of migrants arriving to Sydney and Melbourne. But, in recent years, most are being drawn from just one source, international students. Table 2 shows that, in the case of Victoria, 64 per cent of the growth in NOM between 2005 and 2008 was due to the increased numbers of overseas students and that, in the case of NSW, it was 60.4 per cent. Other temporary visa holders, including those on 457 visas (not shown in Table 2) also contributed to the growth in NOM. There was only modest growth in the number of migrants arriving with permanent entry visas deriving from the skilled migration program. However, both Sydney and Melbourne remain attractive destinations for Asian migrants because of family and ethnic ties to the large Asian ethnic communities in these two cities. As long as jobs are plentiful in the two cities these attractions will ensure that they continue to receive at least half of Australia's migrant intake.

DWELLING APPROVALS

The best direct indicator of city-building (defined to include housing, shopping centres, public facilities and the required infrastructure to support the additional population) is dwelling construction. To describe this we use dwelling approvals data. Table 3 provides these data (for both houses and units) for Melbourne and Sydney and Victoria and NSW for the period 2003–04 to 2009–10.

Table 2: Total net overseas migration (NOM) to Australia, New South Wales, Victoria and Western Australia plus growth in NOM due to overseas students, between 2005 and 2008

	Total NOM				Overseas student component of NOM				Overseas student share of increase in NOM
	2005	2008	Change 2005 to 2008	Per cent change	2005	2008	Change 2005 to 2008	Per cent change	
Australia	156,780	315,690	158,910	101.4	42,800	121,690	78,890	184.3	49.6
NSW	50,690	96,190	45,500	89.8	16,610	44,070	27,460	165.3	60.4
Victoria	40,200	83,150	42,950	106.8	13,880	41,370	27,490	198.1	64.0
Western Australia	22,750	48,240	25,490	112.0	3,040	10,020	6,980	229.6	27.4

Source: Australian Bureau of Statistics (ABS), customised database held by CPUR.

As might be expected, given that Melbourne's population has grown by a greater number than in Sydney, the pace of growth of dwelling approvals in Melbourne has exceeded that of Sydney. In the 1990s, there were more dwelling approvals in Sydney than Melbourne. Since that time, the pattern has reversed. By 2009–10, 24.5 per cent of all dwelling approvals within Australia were in Melbourne, yet only 18.2 per cent of Australia's population was resident in Melbourne.

We acknowledge that, notwithstanding the importance of population growth in producing this striking contrast, other factors are involved. In the case of Sydney, the low level of dwelling approvals undoubtedly reflects the costs of new housing. New houses and land on Sydney's suburban frontier, in particular, have been priced well above the means of most first-home buyers. This is not the case in Melbourne. The explanation is partly to do with geography. There are limits to the expansion of the suburban frontier in Sydney because of the constraints of the Nepean-Hawkesbury river system and the Blue Mountains. In Melbourne, there is no serious geographical barrier to the outward spread of the city to the south-east and north-west.

The respective state government policies on urban expansion are also important. The NSW government has taken a tough line on releasing new suburban land and has imposed steep up-front infrastructure loadings on developers. By contrast, the Victorian government has been anxious to maintain Melbourne's comparative advantage in the price of dwellings relative to NSW and Queensland, precisely because it puts a high priority on the health of the building industry and, in turn, on Melbourne's continued rapid population growth. Reflecting this policy, infrastructure charges in Melbourne are a small fraction of those in Sydney and well below those payable in South East Queensland. Despite the existence of an urban growth boundary, the Victorian government continues to release whatever suburban frontier land is needed to maintain a high level of outer-suburban development.

This background helps explain the continuing boom in dwelling approvals in Melbourne over the last couple of years, and why such approvals have exceeded the number for all of Queensland. Population growth and dwelling construction are interconnected phenomena. Just as relatively low housing costs have contributed

Table 3: Building approvals by selected capital city and states, 2003–04 to 2009–10

	Melbourne	Sydney	Victoria	NSW	QLD	Australia	Melbourne share of Australia	Sydney share of Australia
2003–04	33,373	29,653	46,415	49,499	45,233	184,476	18.1	16.1
2004–05	30,225	22,234	42,547	39,943	39,316	163,627	18.5	13.6
2005–06	25,368	17,966	36,529	34,160	38,033	152,214	16.7	11.8
2006–07	27,289	17,453	37,942	31,402	41,516	153,415	17.8	11.4
2007–08	32,397	18,375	42,908	31,302	45,052	162,732	19.9	11.3
2008–09	31,881	14,013	41,762	23,934	28,954	133,088	24.0	10.5
2009–10	41,324	19,588	55,916	33,056	32,588	168,400	24.5	11.6

Source: ABS, *Building Approvals*, Catalogue no. 8731.0, July 2010

Table 4: Change in employed persons by industry (numbers and per cent) and share of change, Australia, Melbourne and Sydney, 2000 to 2009

	Melbourne			Sydney			Australia		
	Change 2000 to 2009 ('000)	Per cent change	Share of change per cent	Change 2000 to 2009 ('000)	Per cent change	Share of change per cent	Change 2000 to 2009 ('000)	Per cent change	Share of change per cent
Agriculture, forestry and fishing	-2.6	-15.5	-0.7	2.8	27.3	1.1	-67.7	-14.9	-3.4
Mining	3.8	79.1	1.1	2.6	61.0	1.0	85.1	95.7	4.3
Manufacturing	-45.9	-16.7	-13.1	-22.4	-9.6	-9.1	-34.3	-3.1	-1.7
Electricity, gas, water and waste services	8.3	76.2	2.4	6.9	40.5	2.8	65.4	80.3	3.3
Construction	56.2	50.2	16.0	19.4	11.6	7.9	291.9	42.1	14.8
Wholesale	16.1	20.9	4.6	-5.2	-4.8	-2.1	33.5	8.6	1.7
Retail	35.1	19.6	10.0	28.7	14.4	11.7	198.3	19.7	10.1
Accommodation and food	33.1	33.5	9.4	22.7	17.4	9.3	98.9	15.8	5.0
Transport, postal and warehousing	26.6	30.2	7.6	17.0	14.5	6.9	139.6	30.1	7.1
Information media and telecommunications	6.1	11.6	1.7	-2.9	-3.9	-1.2	5.1	2.3	0.3
Financial and insurance services	15.2	19.6	4.3	13.9	10.9	5.7	60.7	17.8	3.1
Rental, hiring and realestate services	7.4	31.0	2.1	8.8	25.3	3.6	44.3	31.2	2.2
Professional scientific and technical services	44.8	32.5	12.7	43.7	24.6	17.9	198.1	33.5	10.1
Administrative and support services	-2.3	-3.1	-0.6	-10.2	-11.6	-4.2	22.8	6.8	1.2
Public administration and safety	15.6	20.9	4.5	28.3	31.7	11.6	188.0	38.6	9.5
Education and training	42.3	37.1	12.0	25.4	19.7	10.4	175.6	27.7	8.9
Health and social assistance	61.7	42.2	17.6	53.8	30.5	21.9	351.3	41.8	17.8
Arts and recreation services	16.2	50.9	4.6	8.3	26.5	3.4	65.1	45.3	3.3
Other services	13.5	19.0	3.9	3.4	4.0	1.4	48.1	12.1	2.4
Grand Total	351.2	21.1	100.0	245.0	12.3	100.0	1969.7	21.8	100.0

Source: ABS, Labour Force Survey 2000 to 2009 (unpublished data) to Melbourne's population boom by attracting or keeping prospective home owners, so Queensland's recent decline in the net number of interstate residents moving to the state reflects the parallel increase in housing costs in south-east Queensland.[12]

EMPLOYMENT GROWTH

For this section we draw on a customised ABS Labour Force Survey dataset for the period 2000 to 2009, which provides information by occupation and industry by capital city and rest of state. Comparisons over this period are difficult given the changes in occupation and industry definitions introduced by the ABS during this period. The dataset was defined according to the most recent occupational and industry definitions. Thus, the information below is comparable over the years 2000 to 2009. The industry data is relatively fine-grained or three-digit level. The detailed industry numbers cited in the text come from this source.

Table 4 shows a comparison of employment by industry for Melbourne and Sydney over the period 2000 to 2009 at the broadest or one-digit level of classification. The figures for Australia as a whole are also provided. The contrast between Melbourne and Sydney is remarkable. Employment grew by 21.1 per cent in Melbourne—almost the same as for Australia as a whole—but by only 12.3 per cent for Sydney. State comparisons (not shown in the table) tell a similar story, with job growth over the period in Victoria being 20.4 per cent and 13.5 per cent for NSW.

Basically, the table shows that the metropolitan economy of Melbourne has scaled up relative to Sydney. With a few notable exceptions, the numbers employed in each industry grouping in Melbourne grew at a considerably faster rate than for their counterparts in Sydney. The most rapid growth for Melbourne occurred within the industries directly engaged in accommodating the city's burgeoning population and in the provision of health, education, retail and other people services.

There is no indication of especially rapid growth in employment in industries whose product entered the global market place, except for education and training where, as detailed below, there has been an expansion in the international student industry. On the other hand, employment in manufacturing in Melbourne contracted by 45,900 between 2000 and 2009. This translates into a decline of 16.7 per cent over these years. Manufacturing employment also fell in Sydney, though by 9.6 per cent, and in Australia as a whole, by just 3.1 per cent. A major casualty was the automobile and parts manufacturing industry. This occurred despite the heavy investment of capital in the automobile industry by the Victorian Labor government. Employment in the automobile and parts manufacturing industry in Melbourne was 26,000 in 2000. It subsequently peaked at 33,500 in 2003, but fell to 22,500 in 2009.

There was some expansion in employment in the pharmaceutical industry in Melbourne. However, this bright spot is offset by declines in employment across most of the advanced manufacturing sectors, like computing and electronic equipment, electrical equipment and specialist machinery and equipment manufacturing. By contrast, employment has expanded in the food industry, especially in the manufacture of bakery products. By 2009, there were 13,500 employed in bakery product manufacturing (up by 2,800 on 2001). By 2009, employment in this industry exceeded all other manufacturing categories except motor vehicle parts manufacturing. Unlike most other manufacturing industries, the bakery industry is largely insulated from external competition and is thus in a strong position to benefit from Melbourne's population expansion.

One would expect a close link between population growth, city-building and the construction industry. This is evident. Employment in the industry in Melbourne increased by 50.2 per cent compared with just 11.6 per cent in Sydney.

The strong growth in retail employment in Melbourne relative to Sydney implies a link between people-servicing and population growth. Elsewhere, the pattern of adjustment to a larger population is more muted, but still evident as with the rapid growth in employment in education and training, and health and social assistance. These two industries contributed 29.6 per cent to the growth of employment in Melbourne between 2000 and 2009.

Employment in the education and training industry in Melbourne increased by 37.1 per cent, which is well above the 27.7 per cent level for Australia. Though it is not possible to identify employment in the international student industry in the data, there is no doubt that it has grown sharply as overseas student enrolments in Melbourne have escalated. In this case, the industry has had a double impact. It has contributed to Melbourne's sharp surge in population and to growth in employment servicing the extra residents.

The financial and insurance and professional scientific and technical services industries are of special interest as indicators of the international competitiveness of the two cities. Table 4 shows that employment growth in the finance and insurance industry has been modest in both cities. On the other hand, the rate of employment growth in the professional, scientific and technical services industry, which includes legal and accounting services, was well above the overall rate of employment growth for each city.

In the case of Melbourne, the standout performer within this industry sector was legal and accounting services, where employment increased from 38,749 in 2000 to 56,991 in 2009 (or by 46.8 per cent). Perhaps this sector benefited from the minerals boom as suggested by Governor Stevens. As Table 4 shows, employment in mining also increased sharply in Melbourne, mainly in the oil and gas extraction and exploration industries. This implies some spinoff from the interstate minerals industry. However, this increase in employment was off a tiny base and thus contributed very little to the massive overall employment growth in Melbourne during the period 2000 to 2009.

Some of the data in Table 4 defy the connection with people-servicing, particularly the sharp increase in employment in public administration and safety in Sydney relative to Melbourne. In both cities, most of this increase was in state and local government administration. Other things being equal, the lower rate of population growth in Sydney should have required fewer extra public servants, not more.

INTERNATIONAL TRADE

On the evidence so far, Melbourne is a 'Goldilocks economy'. However, whether it is sustainable is another matter. If the city's booming economic activity is just about city-building and people-servicing, it may not be sustainable. If, on the other hand, there is parallel growth in exports to interstate and overseas markets then the outlook is more positive.

In order to explore this issue, we use information drawn from the state accounts prepared as part of the Australian National Accounts by the ABS. These accounts provide estimates of economic activity by state over the period 2000–01 to 2008–09. Unfortunately, there is no city-based information. Because of this gap, the analysis switches to the state level. Our focus is on the expenditure-based estimates. State final demand is defined as the final consumption expenditure of governments and households in each state as well as public and private capital expenditure. This estimate is shown on the first line in Table 5, which compares state final demand for Victoria and NSW

Table 5: Gross state product in Victoria, NSW and Australia, 2000-01 to 2008-09, at current prices, A$ billion

	Victoria			New South Wales			Australia		
	2000–01	2008–09	Per cent increase	2000–01	2008–09	Per cent increase	2000–01	2008–09	Per cent increase
State final demand	178.1	300.8	68.9	246.1	390.0	58.5	705.9	1270.0	79.9
Gross state product	185.8	291.6	56.9	238.3	402.3	68.8	708.9	1253.1	76.8
Gross state product per capita ($)	38,944	54,361	39.6	36,518	57,138	56.4	36,787	57,903	57.4

Sources: ABS, *Australian National Accounts State Accounts, 2008–09*, Catalogue no. 5220.0

and for Australia as a whole. On this indicator, Victoria is doing well with overall growth of 68.9 per cent between 2000–01 and 2008–09 compared with 58.8 per cent for NSW.

The positive picture changes when the impact of trade between states and overseas trade is taken into account. This adjustment is necessary to obtain estimates for gross state product, since the latter only includes goods and services produced within the state. Exports are added to state final demand and imports are subtracted. The result is shown in line two of Table 5 showing gross state product. For both states, net interstate trade adds to gross state product, though more for NSW than for Victoria. The opposite is the case for international trade, as both states showed large deficits on international trade, which substantially exceed their gains from interstate trade (see Table 6). As Table 6 below shows, Victoria's deficit on international trade has expanded particularly rapidly.

Much depends on the reliability of these state-based trade estimates. The ABS has indicated that the data for its estimates of interstate trade are less robust than for international trade. The Department of Foreign Affairs and Trade, whose description of the main items of this trade by state for 2004–05 to 2008–09 that we rely on below, warns that 'caution needs to be exercised in interpreting these statistics'.[13] This is primarily because, with Victoria and NSW being national distribution centres for imports, some of these imports may be incorrectly classified by the Customs authorities as the final destination when in fact they are sent to other states. Thus, the data may overstate the level of imports to these two states.

However, exports may be overstated where products of other states are finally exported from Victoria or NSW. As an example, the Department says that, 'it would be possible for some goods originating from

Tasmania and exported from the Victorian Port of Melbourne to be inadvertently recorded in Customs' documentation as being exported from Victoria, rather than Tasmania'.[14] Since we draw attention to Victoria's poor export performance it is comforting to know that if anything the ABS data for Victoria are likely to overstate the export figures reported in the state accounts.

The impact of Victoria's foreign trade deficit

It is because of Victoria's relatively high international deficit that the state falls behind NSW on the gross state product measure (line two of Table 5). Over the period 2000–01 to 2008–09, gross state product in NSW grew by 68.8 per cent compared to 56.9 per cent for Victoria.

When population size is taken into account, NSW performs even better. Gross state product per capita (line three of Table 5) grew substantially faster in NSW than in Victoria between 2000–01 and 2008–09 (by 56.4 per cent compared with 39.6 per cent in Victoria).

Table 6 details the international trade data for the years 2000–01 and 2008–09 for Victoria, NSW and Australia. The table shows that total exports grew by just 14.6 per cent in Victoria compared with 54 per cent for NSW. Both states had a strong appetite for imports with the result that both showed a net deficit of around $35 billion by 2008–09. The key difference is that the size of Victoria's deficit, which increased from $15.3 billion to $35.7 billion, grew at a much faster rate of 133.7 per cent than was the case for NSW, where the deficit grew by 45.7 per cent.

A major reason for the difference between the two states was that the value of goods exported from Victoria actually declined during the period. All the state's export growth occurred among services. This in turn, was largely attributable to education-related travel, which includes the fees and

Table 6: International trade, Victoria, New South Wales and Australia at current prices (A$ billions)

	2000–2001 Goods	2000–2001 Services	2000–2001 Total	2008–2009 Goods	2008–2009 Services	2008–2009 Total	per cent increase in total goods and services
Victoria							
Exports	23.7	6.4	30.1	21.7	12.8	34.5	14.6
Imports	36.5	8.9	45.4	56.8	13.4	70.2	54.5
Net			-15.3			-35.7	133.3
NSW							
Exports	25.4	16.8	42.2	43.3	21.7	65.0	54.0
Imports	52.5	15.1	67.6	80.5	22.0	102.0	50.1
Net			-25.4			-37.0	45.7
Australia							
Exports	119.5	35.7	155.2	230.5	53.3	283.8	82.8
Imports	118.3	34.0	152.3	218.4	56.9	275.3	80.8
Net			2.9			8.5	193.1

Source: ABS, *Australian National Accounts State Accounts, 2008–09*, Catalogue no. 5220.0

expenses paid by overseas students who attend Australian-based courses in schools, English colleges, vocational education and training (VET) colleges, and universities. The ABS estimates that this expenditure in Victoria grew from $1.3 billion in 2000–01 to $5.4 billion in 2008–09.[15] This means that almost all of the total growth in exports of goods and services from Victoria between 2000–01 and 2008–09 of $4.4 billion (see Table 6) was attributable to this one industry. The export of financial, intellectual property, telecommunication and other business services (including legal, accounting, architectural and engineering services) amounted to $2.7 billion or just half that of education-related travel services.

There is no sign of any upsurge in the export of elaborately transformed manufactures (ETMs) or other high value-added industries from Victoria. The export of ETMs was $7.2 billion in 2004–05 and $7.7 billion in 2008–09.

Table 7 shows the top 10 goods and services imported to and exported from the Victorian economy in 2008–09. The categories used in the table do not necessarily match the categories used above. However they are useful as a guide to Victoria's trade position. Relatively low-value added agricultural products still figure strongly among exports. In the case of personal travel (excluding education-related travel), passenger motor vehicles and passenger transportation, imports to Victoria greatly exceed exports.

The story is completely different for NSW. Goods exports have increased sharply in value, mainly because of the recent escalation in the value of coal exports. The export of services has also grown, though from a much higher base than in Victoria. In NSW, the export of financial, intellectual property, telecommunication and other business services (including legal, accounting, architectural and engineering services) was $7.0 billion in 2008–09, which is 2.8 times higher than the respective $2.7 billion figure cited above for Victoria.

Education-related travel is big in NSW too, with total exports reaching $6.4 billion in 2008–09. But, according to the Department of Foreign Affairs and Trade analysis, this represented a somewhat lower 29.5 per cent of total exports of services than the 42.6 per cent in Victoria.[16]

Table 7: Victoria's major exports and imports in goods and services, 2008–09

Major exports 2008–09:	A$m	Major imports 2008–09:	A$m
Education-related travel	5,408	Personal travel (excl. education)	4,404
Personal travel (excl. education)	2,065	Crude petroleum	3,679
Passenger motor vehicles	1,667	Passenger motor vehicles	3,559
Aluminium	1,523	Freight transportation	2,684
Milk and cream	1,360	Refined petroleum	1,602
Medicaments (incl. veterinary)	985	Passenger transportation (agency fees, etc.)	1,334
Meat (excl. beef)	742	Vehicle parts and accessories	1,341
Beef	734	Prams, toys, games and sporting goods	1,248
Passenger transportation (agency fees, etc.)	697	Telecom equipment and parts	1,217
Cheese and curd	617	Goods vehicles	1,172
Other	17,286	Other	47,473
Total	33,084	Total	69,713

Source: Department of Trade and Foreign Affairs, *Australia's Trade by State and Territory 2008–09*

Implications for Melbourne

The Victorian Government is basking in the approval of national commentators about its strong economy and budget position. By contrast, the NSW Government has been in the firing line as a relative laggard. A good example is David Uren and Imre Salusinszky's recent piece in *The Australian* entitled 'Premier state left in the shade'.[17]

On our account, this comparison is misleading. Victoria's buoyant level of economic activity depends on the continuation of rapid population growth and the impetus this gives to the city-building and people-servicing industries. The boom is built on unstable foundations. It is occurring despite the state's poor competitive record in the international marketplace. It is not Victorians' fault that the state does not possess an abundance of the iron ore, black coal or other mineral commodities now in demand overseas. In this sense, the state is already a victim of the second-speed economy syndrome. It is falling behind on the gross state product indicator when this is measured in current prices, which reflect the recent mineral export price boom.

This shows up starkly in a comparison of per capita gross state product between the states and territories. As Table 8 indicates, Victoria has experienced the lowest rate of growth over the period 2000–01 to 2008–09 on this indicator—even lower than South Australia and well below NSW.

On other measures, Victoria does much better. When the per capita gross state product indicator is expressed in chain volume terms (which estimate state product in volume terms, thus removing the price factor), Victoria does well. On this measure, per capita gross state product in Victoria over the period 2000–01 to 2008–09 increases by 15.4 per cent, slightly higher than for Australia as a whole (14.5 per cent) and well above NSW (6.3 per cent).[18] There is lots of economic activity in Victoria, as might be expected in an economy dominated by city-building and people-servicing. But, this activity has not been in areas that have led to any increase in exports of goods (in chain volume terms) or indeed to any significant export items which have benefited from the mineral commodity price boom. There has been an increase in volume terms in the export of services, but again this increase is almost entirely due to the education-related travel industry.

The state's deteriorating international economic position (in current prices) has not yet led to any significant relative decline in the household income of Victorians, such

Table 8: Per capita gross state product (in current prices A$) by state, 2000–2001 to 2008–2009

State	2000–2001	2008–2009	Increase 2000–01 to 2008–09 per cent
NSW	36,518	57,138	56.5
Victoria	38,944	54,361	39.6
Queensland	33,718	56,075	66.3
South Australia	33,793	48,999	44.9
Western Australia	39,713	77,108	94.1
Tasmania	28,915	46,326	60.2
Northern Territory	48,749	77,444	58.8
ACT	47,029	74,658	58.7
Australia	36,787	57,903	57.4

Source: *Australian National Accounts, State Accounts*, Catalogue no. 5220.0, ABS 2008–09 (Reissue) as might alarm voters or commentators. This is partly because the state's housing and infrastructure boom is being largely financed by the big banks via overseas borrowings, thus delivering a major external boost in funds to the state economy (and high household debt levels). Likewise, Victoria is a major beneficiary of Commonwealth funds, since these are largely based on per capita payments. But, is this situation sustainable? There are serious risks in this approach.

The national context

Australia has a huge net external debt which, as the Commonwealth Treasury acknowledges, is largely in the form of short-term debt intermediated through the banking system.[19] The Treasury, in its briefing to the incoming Gillard government, raised this as a matter of some urgency. The Treasury also admits that there are serious infrastructure backlogs as states struggle to accommodate their rapidly increasing populations.[20] Melbourne is a major culprit on both grounds. Its booming dwelling construction and city-building is dependent on overseas borrowing through the big banks. On the infrastructure front, Victoria's road and public transport networks are chronically congested and in need of massive new investment. The Victorian government is desperately entreating the Commonwealth for infrastructure assistance. A Labor government, heavily dependent on Victorian electoral support, may be tempted to respond positively. This is precisely the concern of the Treasury and of commentators like Stutchbury who want to see resources flow to the mining-industry states.

This issue is gathering a political edge as the mining states contemplate their new role in subsidising the eastern states. In the case of the goods and services tax (GST) distribution, after the latest Commonwealth Grants Commission 2009 update, Western Australia (WA) and Queensland will receive 0.78 and 0.91 in the dollar, respectively, for every dollar of the national GST collection. Victoria is not yet a net beneficiary, though its allocation has increased from 0.87 in 2000–01 to 0.91 after the 2009 update. By contrast, WA received 0.98 and Queensland 1.02 back in 2000–01.[21] However, Victoria is on track to become a net beneficiary from the GST pool (with South Australia and Tasmania) because, as the mining boom proceeds, the mining states' capacity to raise revenue for their respective states increases. This capacity is the main factor underpinning the Commonwealth Grants Commission determination of the GST redistribution. When Victoria does become a net beneficiary it is likely that the complaints from the mining states, which are already evident, will escalate, and that they will start asking questions. They will want to know why they are helping to support a state like Victoria which contributes so little to the national export effort, but requires increasing levels of Commonwealth support to maintain its burgeoning people-servicing economy. For example, the Premier of Western Australia, Colin Barnett, recently stated: 'I know we have a greater advantage through natural resources, but some of the lagging states need to lift their game'.[22]

There will also surely be questions about the justification for current overseas migration policy. This is ostensibly being maintained at a very high level because of shortages of skills in the minerals industry. In reality, however, most migrants end up in Sydney and Melbourne. Very few migrants work in the mining industry either directly or indirectly (as in construction of mining related projects).[23] The main impact of current immigration is the impetus it is giving to capital city building in the eastern states and thus in generating demands for scarce capital and skills which compete with the needs of the minerals industry. The tiny net movement of Australian residents to Western Australia over recent years is a good indicator of this process;[24] because population growth is boosting demand for labour in the East, workers have very little incentive to move to the West.

Economic sustainability in Victoria

At present, there seems to be little awareness or acknowledgement of Victoria's lack of progress in creating a high value-added economy with industries able to compete successfully in the global marketplace. For example, in a message accompanying the announcement of the 2010 Governor of Victoria Export Awards in October, the Victorian Minister for Industry and Trade, Jacinta Allan, stated that 'Victorian exports of goods and services have gone from strength to strength'.[25] The boom associated with city-building and people-servicing has shrouded the state's economic decline, relative to other states.

There is no guarantee that the economic impetus gained from city-building and people-servicing will continue at its recent pace. The housing industry is vulnerable should interest rates increase. It may also lose some of the impetus from migration. Whether the Commonwealth government acts to reduce the immigration program or not, the recent decisions to decouple immigration selection from the onshore education of overseas students has reduced the attraction of overseas study in Australia. Education providers for international students face a contraction in enrolments because a qualification earned here will no longer provide a sure pathway to a permanent residence visa. The industry will have to consolidate around courses which can provide a qualification that will be of value in the student's home country.

These impacts are already evident. The number of student visas issued offshore decreased from 227,924 in 2008–09 to 158,240 in 2009–10, or by 30.6 per cent. It is likely that this decline has contributed to the (provisional) fall in NOM at the national level to 241,000 in the year to March 2010 (from 313,414 in 2008–09). If so, Victoria will be affected given that most of Victoria's recent growth in NOM has derived from international students.

THE WAY FORWARD

The Victorian government's stated commitment to fostering a genuinely innovative economy is the right way forward. But, the state government has been distracted in implementing this vision by its preoccupation with accommodating a rapidly-growing population. Its attention is focused on trying to patch up an overloaded public transport and roadway system. Vast amounts of capital are being lavished on this and other infrastructure needs.

The record we have traced suggests that the city-building effort has done little to strengthen the state's competitive capacity. The money being directed to this effort would be better spent on deepening the state's skill base and in contributing to the establishment of long-term, internationally-competitive industries.

Maybe it is only fair that Victorians receive some of the mineral boom cake from Western Australia and Queensland. But this claim should not obscure the need for a fundamental realignment of Melbourne's economy from dependence on population growth.

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