Glenn Stevens: The United Kingdom and Australia – shared history, shared outlook

Remarks by Mr Glenn Stevens, Governor of the Reserve Bank of Australia, to the Australian British Chamber of Commerce, Sydney, 18 October 2013.

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It could have been the Dutch who started European settlement in Australia. In their journeys to the East Indies numerous Dutch traders saw the western and northern coastlines of the continent and some came ashore. But the conditions were not hospitable and, finding nothing in the way of commodities that they could exchange for value at home, they left.

Or it could have been the French: Jean-François de Galaup La Perouse arrived in Botany Bay only a few days after Arthur Phillip's fleet in 1788. Apparently the English and French mariners, despite the rivalry of their countries, enjoyed cordial relations for a brief interlude before La Perouse sailed off into the South Pacific, never to be seen by Europeans again (Dyer 2009).

But it was the English who came to start a colony. Eighteen years after James Cook landed at Botany Bay, the First Fleet anchored there in January 1788. After only a few days, finding the shallow, sandy bay too exposed and short on potable water, they sailed 20 kilometres or so north to Port Jackson, which they regarded as a superior location to found the settlement. Looking at Sydney Harbour today, it appears they made the right call.

The contrast with today's prosperity could not, however, have been more pronounced. In time the Great South Land would help to feed the world, but in 1788 the new arrivals couldn't feed themselves. Geoffrey Blainey's book *The Tyranny of Distance* records how the fledgling settlement nearly starved – and how, later in 1788, HMS *Sirius* was sent to a suitable supply station to bring back food and seed. That station was the Cape of Good Hope (now Cape Town, South Africa) – 11,000 kilometres away – a measure of the degree of isolation the First Fleeters must have felt. The return journey took about seven months, shorter than it would have been had Captain Hunter not ignored the advice of his superiors. After proceeding south from Sydney, he turned east, rather than west, so picking up a favourable wind for the outward journey. He sailed more miles, but in a shorter time.

And so began the inflow of people, capital, and know-how that ultimately resulted in the modern Australian nation. Today Australia is still a nation of immigrants, where almost one-quarter of our 23 million inhabitants were born somewhere else (ABS 2012). Just about every nationality is here and we face the "Asian Century" with the sense that – for the first time in our modern history – our geographical position is an economic advantage.

For a long time, the economic and financial relationship with the UK dominated, despite the distance. In colonial times, the UK was by far Australia's most prominent trading partner – in the 1880s the UK was the source of 70 per cent of Australia's imports and the destination for up to 80 per cent of exports (Vamplew 1987). By the turn of the 20th century still more than half of Australia's trade was with the UK. Though overall Australia accounted for less than 10 per cent of the UK's bilateral trade in the 19th and early 20th centuries, Australia was among the UK's largest sources of wheat imports and at times accounted for more than 50 per cent of the UK's wool imports (Mitchell and Deane 1962; Mitchell and Jones 1971).

The Australian Pound was linked to the pound sterling and the Australian banks kept reserve balances in sterling – "London funds". In time, Australia created its own central banking arrangements, and by the 1930s the Commonwealth Bank was serving as a basic central bank (though without, at that time, the same full central banking mandate and obligations that the RBA has today). Still, the links with Britain were strong. The decision *not* to devalue the Australian currency with sterling in 1967 was a departure from previous practice. When

Australia got into financial difficulties meeting its obligations in the late 1920s, Sir Otto Niemeyer was despatched from the Bank of England in 1930 to offer advice to the Australian Government. Niemeyer's diagnosis – that Australia had lived beyond its means, and should accept lower living standards in order to service its international debts – was not, shall we say, universally welcomed, but his influence lived on. The monthly statement of Commonwealth Government finances, which he devised, was still known as the "Niemeyer" statement until well into the 1980s, when I was a junior economist in the Reserve Bank.

So the links were strong. But of course the world was changing. Two world wars saw the UK's financial strength diminish and its weight in the global economy decline, as that of the United States rose. In the 1970s the UK also increasingly turned towards Europe, with EU-directed trade increasing strongly in the two decades after joining the EEC.[1] By then, Australian trade had long turned towards first the US, then Japan. Trade with the USA had been increasing steadily since the late 1940s and the USA replaced the UK as Australia's largest bilateral trading partner in the mid 1960s. Similarly, trade with Japan grew rapidly and overtook that with the UK by the 1970s (and began to rival that with the US as well) (Vamplew 1987; RBA 1996).

In the subsequent decades Australia's trade focus continued its shift towards Asia generally and, in the past decade especially, towards China in particular. Today nearly three-quarters of our trade is with the Asia Pacific, while half of the UK's trade is with Europe (ABS 2013b; ONS 2013).

Historically, the UK was a top destination for Australians travelling abroad – "falling towards England" as Clive James memorably described it. In 1950 around 30 per cent of Australian outbound tourists were destined for the UK and Ireland. That had fallen to 6 per cent by 2013. Australians' travel to the USA has remained fairly consistent since the 1970s at around 10 per cent. Travel to Asia increased dramatically with destinations in South-East Asia now accounting for more than 30 per cent of the total. The UK is, though, still a major source of tourism for Australia. Despite a decline since the GFC, UK citizens account for around 10 per cent of all arrivals in Australia, remaining close to the historical (post-1950) average of around 15 per cent. These days, China is the biggest source of Australia's inbound arrivals after New Zealand, and is usually the fastest growing. Interestingly, however, recent data show that in the year to August 2013, UK arrivals grew faster than arrivals from China (Vamplew 1987; ABS 2013c). Those picture postcards of sun and blue skies must be very appealing during the European winter!

It will take a good deal more time yet for these shifts in trading relationships to be mirrored in the accumulated stock of invested capital. The UK's foreign investment in Australia during the country's formative years was large, even for the UK. Between 1870 and 1913 about 8 per cent of Britain's total foreign investment went to Australia. As recently as the mid 1950s, the UK's investment in Australia dwarfed that from any other country, and was more than double the investment of our second largest investment partner, the USA (Vamplew 1987; RBA 1997; Ukhov and Goetzmann 2005). As at the end of 2012 the stock of foreign invested capital that came via the UK amounted to almost $500 billion, and it is still growing (it rose at an annual average compound rate of more than 6 per cent over the past 10 years) (ABS 2013a).[2] The stock of Chinese inbound investment has been growing at 20 per cent over the past decade, but is estimated at only 2 per cent of the combined total from the US and UK. Similarly, and perhaps more surprisingly, the stock of Australian investment abroad

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[1] IMF *Direction of Trade Statistics*.

[2] It should be noted that the country level data in ABS (2013a) are based on the country of residence of the creditor or the debtor. Since London is an international financial hub, for some transactions the ultimate owner or recipient may reside in another country.

remains concentrated in the UK and the US – though that is beginning to change now, with a bigger focus on Asia.

That accumulated inbound investment has helped Australia become a very affluent nation, augmenting our own national savings to a significant extent. According to Angus Maddison's data set, within 80 years of the founding of a penal colony on the shore of Sydney harbour, about a kilometre from our present location, Australia's real GDP per head matched the UK's (Maddison 2003). Today, Australia's real GDP per head of about $44,600, measured at purchasing power parity, is noticeably higher than the UK's ($36,900), though for the UK that comparison is adversely affected by the economic weakness in recent years.[3]

Such an outcome is perhaps not surprising given the endowment of land and natural resources that Australia has. Opening up of large areas of land for agriculture enabled Australia to enter powerfully the markets for grain and wool. Agriculture was a major source of wealth over most of our history (and many predict will play a big role in future). The gold rush of the mid-nineteenth century helped to propel the city of Melbourne in particular to globally significant size and affluence (though there were later excesses that led to a serious depression). The things the Dutch and others couldn't see under the ground when they surveyed the inhospitable northwest four centuries ago are the source of massive wealth today. About 1.5 million tonnes of iron ore, valued at about $150 million at current prices, leave those shores each day in ships about 250 times the size of Cook's *Endeavour*. A combination of those endowments with a willingness to accept international capital, including very prominently from the UK, has given Australians the opportunity to grow our economy quickly.

But it wasn't just money, land and minerals. There are other countries with resources and land that do not enjoy the same incomes. And there are nations with very little in the way of resources or land that is wealthy. It was other things about the British heritage that were of higher value.

It turns out that the English language is just about everyone's second language, which means even with our broad accent, we can communicate with educated people virtually everywhere and engage in commerce in most places. The common law and parliamentary democracy provide a foundation for the sorts of property rights and governance processes that are widely and rightly regarded as fundamental to building a prosperous modern economy. That property rights could become so well established in a society in which the "immigrants" of 1788 had no such rights is, perhaps, an ironical outcome. And we are still coming to terms with the property rights of those descended from the inhabitants who were here before 1788.

But the point is that this heritage, so important for enterprise, is something we have in common with the UK. One has to observe as well that Britain traded with and invested in her former colonies, however imperfectly, rather than simply extracting the rents. The fact that so many prominent English-speaking former colonies are counted among the rich of the advanced world today is perhaps not entirely a coincidence (Grier 1997; Acemoglu, Johnson and Robinson 2001 and 2005).[4]

In my own field of central banking, we have a good deal in common. The Bank of England and the Reserve Bank of Australia conduct monetary policy using the approach of a medium-term target for consumer price inflation, endorsed by government, with operational

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[3] World Bank, *World Development Indicators*, September 2013; figures are for 2012.

[4] Acemoglu *et al* (2001) assert that "settler colonies" (such as Australia, Canada, USA and New Zealand) have had better economic outcomes compared to colonies set up for resource extraction (giving the example of the Belgian Congo). Recent literature identifies that economic, trade and education policies, as well as the institutions set up by Britain and other colonial powers have been important to economic performance today (see Grier (1997) and Acemoglu *et al* (2005) as examples).

independence for the central bank, and a flexible exchange rate. We are not alone in this – there are quite a few countries that follow a version of this approach these days – but the Bank of England and the RBA were, after the central banks of Canada and New Zealand, fairly early adopters of the approach. There is a very practical level of cooperation between the two institutions, exemplified by staff exchanges as well as contact at the highest levels. I well remember a phone call from Mervyn King on the morning of 15 September 2008, to ask how our markets were absorbing the news of the Lehman failure that had been announced just after trading started. (The answer was: reasonably calmly, initially, but that subsequently changed.)

In the ensuing five years, Australia and the UK have both faced the challenges arising from the global financial crisis (GFC). For various reasons the UK has had a harder time of it, with bigger problems in its banking system, which is also bigger relative to its economy, and a higher exposure to a troubled Europe, in contrast to our exposure to a resilient Asia. Hence, while Australia has experienced growth, albeit slower than average, in the years following the GFC, the UK suffered a painful and rather protracted recession. It seems of late though that there are more signs of expansion in the UK economy, which will no doubt be very much welcomed by citizens and policymakers alike.

The UK still warrants the label "major economy". Its GDP is still among the top 10 in the world. Perhaps more significantly London remains easily the world's pre-eminent international financial centre. New York, being in the US, boasts bigger domestic markets of course, but London services the world. In the councils of global governance the UK holds an important position – in bodies like the IMF, the BIS, the UN and others, it holds its own seat and acts with influence. Australia, with a third the UK's population and about half its absolute GDP, as the eighteenth largest economy,[5] and with a correspondingly more modest stature on international bodies, cannot see itself in quite the same way. We have well-developed financial markets and there are plans to develop more as a regional financial centre, but realistically Sydney will never rival London.

Nonetheless we have our contribution to make, and our UK partners have always been welcoming in hearing it. And this has to be because there is so much in common today, in the modern world. The ties that bind are not just history. They extend beyond a fascination and affection among Australians for the royal family – strong though that is – or the long-contested rivalry between "old enemies" for one of the world's smallest sporting trophies.

There is a real sense in which the UK and Australia share an outlook, at a very basic level, on how an economy should be organised and governed. They share a perspective on the role – and the limits – of markets in setting prices and allocating resources. They share a commitment to a world economy in which trade is free and capital, in general, is free to move. We have had some differences of nuance in recent years about matters financial, reflecting mainly our differing experiences of the crisis, but in the broad the perspective of the role of the financial services sector in facilitating the real economy is very much shared. The business communities of the two countries have strong links, evidence for which is your attendance here today. I'm sure that this association will continue to strengthen and mature over the years ahead, even though the two countries are at opposite ends of the globe.

Perhaps the most important thing the two countries have in common is the strong belief that societies prosper when policies are debated in an open way, when evidence, reason and judgement can be brought to bear on decisions, and where accountability and evaluation are key attributes of the process.

[5] IMF *World Economic Outlook*, October 2013; figure is for 2012.

That set of commonly held values will be important for us over the year ahead, as Australia assumes the chair of the G20. What issues will be on the agenda? And how can the business communities of the two countries contribute?

The full agenda is of course for the Australian Government to determine, in consultation with other G20 member governments. It will certainly have a strong focus on growth, and on the role of the private sector in driving growth, including its role in infrastructure investment. So I expect there will be significant call for engagement of the business communities of Australia and the UK, and other member economies, over the year ahead. I will make just two points here.

First, in the area of financial regulation, there is a major agenda for reform, on which very good progress has been made, but on which there is still much work to do. In my view, having developed a very substantial pipeline of work since 2008, our energies need now to be devoted to careful and systematic implementation of the already agreed reforms. That is not to preclude new regulatory initiatives, which are still being put forward. But the implementation task arising from the pipeline of reforms already agreed, either in detail or at a conceptual level, is very large indeed. Of these, the most important ones are the Basel III package, the reforms for OTC derivatives trading and clearing, establishing appropriate oversight of "shadow banking", and work to address the problem of "too big to fail", including cross-border resolution of systemically important financial institutions.

This by no means exhausts the list of work streams, but these are the key ones. Each is individually very demanding for regulators and industry players alike. Taken together, they are, in a word, daunting. We need to avoid reform fatigue, and to sustain our support to those doing the hard grind of devising the new rules and making them work. To do that, we need, in my opinion, to contain the growth in the regulatory agenda, and to respond only to the most important calls for further major work streams, at least for the next little while.

Let me be clear this is NOT a call for current reform efforts to stop, or to be watered down. It is about ensuring we focus our finite energies and resources on the most important problems, and getting industry to do the same.

The second point is that the business community, both in the UK and Australia, and generally under the auspices of the "B20", can contribute to meaningful progress towards the G20's broader goals. That contribution will be most constructive if it can avoid being dominated by particular national or industry interests, if it can adopt a genuinely global perspective, if it can have realistic aspirations and if it can understand the constraints under which policymakers operate. A contribution like that will be key to achieving the G20's goals: an open world economy, characterised by strong, sustainable and balanced growth. I hope that Australian and UK business leaders, along with their peers from around the other G20 countries, will seize that opportunity and that responsibility.

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