



INTERIM SUBMISSION

**House of Representatives Standing Committee on Infrastructure,
Transport, Regional Development and Local Government**

**IMPACT OF THE GLOBAL FINANCIAL CRISIS ON
REGIONAL AUSTRALIA**

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EXECUTIVE SUMMARY

Parts of Regional Australia are characterised by heavy reliance on a narrow economic base and dependence on Local Governments to provide a wide range of services that are provided by the private sector or Federal / State Governments in other parts of Australia.

As the consequences of the global financial crisis flows through to a downturn in global economic activity this has and will continue to impact on sectors of the economy to varying extents. For regions heavily dependent on badly affected industries, the impact will be significant not only on those employed in those industries but throughout the broader community in the region.

In many Western Australian regions the mining and construction sectors are major employers that are expected to be particularly seriously affected by downturn in many commodity prices, and the inability of companies to finance new resource developments. The tourism industry, which is also critical to some regions, is also likely to suffer as a result of reduced business and recreational travel.

Local Governments are important in assisting regional Australia through the current economic downturn through their diverse roles in direct service delivery, employment, economic development and infrastructure provision. However, Local Governments do not have the capacity to offset the consequences of the closure or downsizing of major local employers in the short term.

In order to enhance the partnership opportunities between the Federal and State Governments in lessening the impact of the global economic crisis on regional Australia it is recommended that the Commonwealth:

1. Investigate the extent to which timing of targeted economic stimulus measures can be matched to the needs of different regions, bearing in mind that timing of the economic downturn is different in different regions of Australia;
 2. Work with regional and local communities that are particularly exposed to the downturn to identify and support strategies that ensure these regions emerge from the current downturn with stronger and more resilient economies;
 3. Ensure that the administrative processes associated with the Regional and Local Community Infrastructure Program (non-competitive and competitive components) deliver timely funds to Local Governments, enabling them to complete construction projects in a timely fashion;
 4. Provide an on-going commitment to funding the Regional and Local Community Infrastructure Program via a budget and out-years commitment in the May 2009 Federal Budget;
 5. Identify with the States appropriate strategies to assist them manage the concurrent rapid downturn in revenue from resource royalties, property transactions and GST transfers from the Commonwealth, to enable the States to continue to support critical infrastructure projects within the Australian regions;
 6. Ensure that Local Governments have access to funding for major, sustainable infrastructure projects if credit markets deteriorate to the extent that this becomes necessary;
 7. Evaluate the business case for public investment in tourism related infrastructure, particularly critical transport system infrastructure in cooperation with the industry and regional / local authorities;
 8. Ensure access to adequate, high quality telecommunications infrastructure is available in regional Australia; and
 9. Develop access to training and educational opportunities for those living in regional Australia.
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1. BACKGROUND

The Western Australian Local Government Association (WALGA) is the united voice of Local Government in Western Australia. The Association is an independent, membership-based group representing and supporting the work and interests of all 139 Local Governments in Western Australia, plus the Christmas Island and Cocos (Keeling) Island Councils.

The Association provides an essential voice for almost 1,400 elected members and over 12,000 employees of the Local Governments in Western Australia. The Association also provides professional advice and offers services that deliver financial benefits to Local Governments and the communities they serve.

This interim submission has been prepared in consultation with individual stakeholders within the sector. It will be considered by the WALGA Zone and State Councils at the next opportunity. Any amendments will be forwarded following the next State Council meeting in June 2009.

2. GLOBAL FINANCIAL CRISIS

The current crisis in the global economy and its financial markets had its origin in the years preceding 2007 which were characterised by relatively cheap credit (low risk premiums) and aggressive lending practices. Financial institutions and investors sought to achieve higher yields through high rates of leverage, leaving them exposed to adverse developments in the market.

Triggered by falling house prices and rising interest rates in the US, default rates, particularly on non-recourse sub-prime housing loans increased. The losses incurred by some investors in mortgage backed securities were too large for them to bear leading to their collapse. The widespread use of securitisation reduced transparency making it impossible for investors, institutions and authorities to understand the potential losses through-out the financial system. A lack of trust in counter-parties resulted in credit markets, particularly in the US and Europe, ceasing to function properly.

The failure of financial markets has limited the capacity of companies to borrow money to fund their investment programs and day to day operations. Linked with this, asset values have fallen markedly with negative impacts on households and companies leading to a shrinking of economic activity.

3. ECONOMIC STABILITY AND REGIONAL AUSTRALIA

Economic diversity and / or the dominance of stable industries in a region leads to greater economic stability and hence the ability to better weather the impacts of an economic downturn, such as that triggered by the current global financial crisis¹.

Parts of Regional Australia are characterised by low levels of economic diversification, and heavy dependence of cyclical industries. This is particularly true in regional Western Australia where economies may be dependent on a very small range of commodities, and often a single industry or commodity.

¹ For example

J Wagner and S Deller 1993 A Measure of Economic Diversity: An Input-Output Approach. University of Wisconsin Extension.

Accessed at: <http://www.aae.wisc.edu/cced/937.pdf>

B Trendle 2004 Regional Economic Instability: The Role of Industrial Diversification and Spatial Spill-overs. Queensland Government Department of Employment and Training.

Accessed at: http://training.qld.gov.au/resources/business_employers/pdf/wp22_regional_economic_instability.pdf

The regions are clearly much less diverse than is the Australian economy as a whole and generally much more dependent on export markets.

4. WESTERN AUSTRALIA AND ITS REGIONS

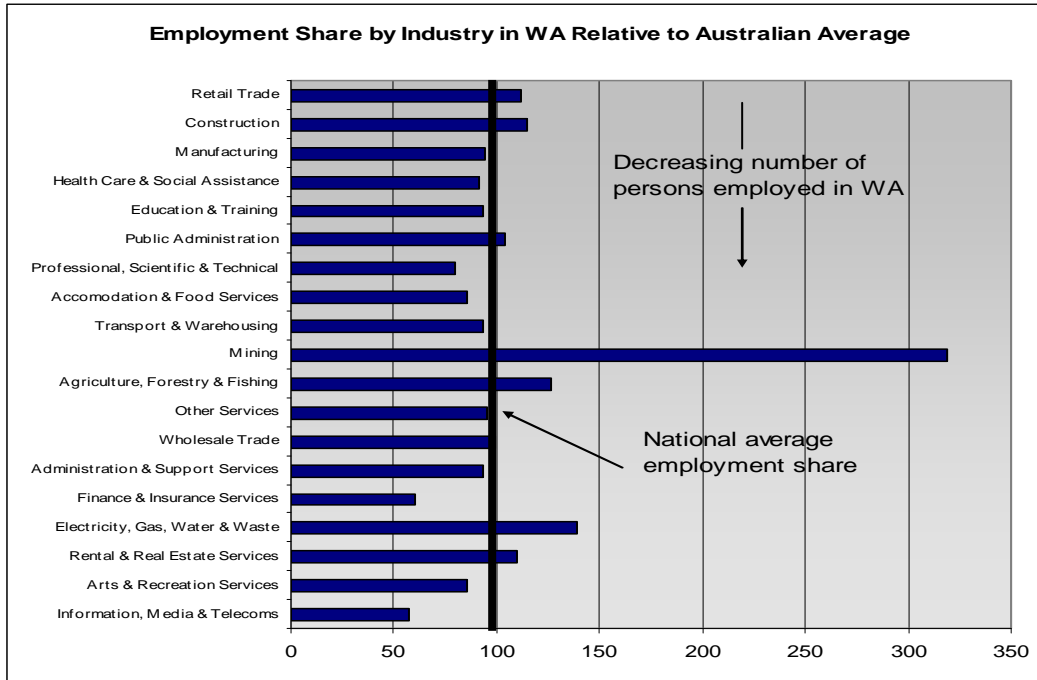


Figure 1: Ratio of employment share by industry in Western Australia relative to the Australian average for February 2009.

Source ABS Cat No 6291.0.55.003

Labour Force data is published by the Australian Bureau of Statistics at a State level, but not at smaller areas. However, even at State level the data illustrates the differences between parts of Australia.

Mining is clearly a much more important employer in Western Australia than Australia as a whole (Figure 1). When extended to regional areas, this difference would be even more marked. Although the mining industry is being strongly affected by the downturn in demand for key commodities, this is not spread across all sectors. The demand for gold remains strong, while demand for nickel and a range of other metals is extremely weak. This means that the impact of the current economic situation is often regionally quite specific.

Case Study – Shire of Ravensthorpe

- The Shire of Ravensthorpe had an estimated resident population of 2,249 in June 2007, growing at over 10% per annum, which made it the fastest growing local government area in WA in percentage terms in that year². The population is spread across the towns of Ravensthorpe, Hopetoun and surrounding farming districts, which along with mining and small scale tourism provides the economic base of the community.
- BHP-Billiton commenced construction of a \$2 billion nickel mining and processing operation near Hopetoun in 2005.
- Community infrastructure funded by Federal, State and Local Government including a new airport, roads, school, entertainment and recreation facilities were constructed.

² Australian Bureau of Statistics 2008 Cat No 3218.0 Regional Population Growth, Australia.

- The mine was closed in January 2009 after just eight months operation, with the loss of 1,800 direct jobs (employees and contractors) and many indirect jobs in associated service industries.
- Closure was due, in part, to a major fall in the price of nickel resulting from falling demand for stainless steel as a result of the global financial crisis.
- With some support from the State Government, Ravensthorpe Shire and its community is now seeking ways to meet the on-going costs associated with the facilities established to support a much larger population and maximise the returns on these investments.
- Owners of businesses established to support the once rapidly growing community of Hopetoun have been particularly badly affected.

Direct employment in the mining industry clearly under-states the importance of the resource sector through the impact it has on other sectors, particularly construction, engineering services and transport.

Employment sectors such as construction and retail trade are over-represented in Western Australia compared with the National average. The degree to which these sectors are affected by the current global financial crisis will depend heavily on the success of the economic stimulus packages targeting household expenditure and public (Federal, State and Local) infrastructure investment.

While employment in the Finance and Insurances Services industry is expected to be badly affected by the global financial crisis, this sector is a reasonably small employer in Western Australia, and has a much lower share of employment than the national average.

Notwithstanding the direct impact on employment in the Finance and Insurance services industry, it would seem that there is some evidence that regions with a high reliance on resource exports (with a few exceptions such as gold) will be more severely impacted than average by the downturn in the global economy.

The Regional Economies of Western Australia are less dependent on financial markets but much more heavily dependent on commodity markets than Australia as a whole.

In this particular downturn, the cycle commenced with the collapse of financial markets and it is only as this moved into the real economy as consumer confidence fell that commodity markets have been impacted. Much of this is still to flow through. For example, it is widely anticipated and almost certain that contract prices for coal, iron ore and a range of other basic commodities will fall.

It is important that the Government considers the impact of timeliness in delivering economic stimulus to the regions. It is possible that measures will need to be tailored to suit different timing in different regions.

The States of Western Australia and Queensland grew particularly quickly during the period from 2004, driven by strong demand for resources. As the demand for these resources contracts, it would seem likely that the downturn in these States will be felt more severely than in Australia as a whole.

While public sector spending is normally relied upon to stimulate economic activity during a downturn, the lagged impact of Commonwealth Grants Commission decisions impacting on GST revenues to the States may significantly limit the ability of the States to cushion the downturn.

Recommendations

Investigate the extent to which timing of targeted economic stimulus measures can be matched to the needs of different regions, bearing in mind that timing of the economic down turn is different in different regions of Australia.

Work with regional and local communities that are particularly exposed to the downturn to identify and support strategies that ensure these regions emerge from the current downturn with stronger and more resilient economies.

5. LOCAL GOVERNMENT

Local Government in Australia is a large employer directly, particularly in regional areas and local government projects contribute significantly to indirect employment.

There are approximately 172,000 Local Government employees in Australia³, equating to around 10% of the total public sector workforce.

Local Governments across all regions of Australia have a well documented backlog of infrastructure renewal and re-investment needs. Investing in well planned and delivered infrastructure projects provides jobs within the local community as well as ensuring that the regions emerge from the current downturn stronger than before.

Non-dwelling construction contributed 10.4% of Gross State Product in Western Australia in the year ending June 2008⁴. This sector, which has high domestic multipliers through the economy, is expected to contract significantly as the opportunities for new business investment fall. Local Government projects are well placed to utilise these skill sets.

The Regional and Local Community Infrastructure Program announced in November 2008 is an excellent initiative in this area. However, in order to maximise its effectiveness in delivering both timely and valuable stimulus to the economy it is critical that funding commences to flow – particularly to enable a smooth flow of work such that excess demand for particular skills does not drive up costs and lower quality as was seen in some sectors during the boom period. Despite Local Governments being provided only weeks to complete submissions, the administrative processes have now extended over several months making the Government's commitment to on-ground work in the first quarter of 2009-10 progressively more difficult to achieve for some projects.

While the announcements made at the gathering of Local Government Mayors and Presidents in November 2008 and the second economic stimulus package in February 2009 have been strongly welcomed by Local Governments, given the lead time associated with larger projects it will be critical that the Government, through the 2009-10 Budget conveys its clear intentions with respect to sustained funding to address the backlog in local infrastructure renewal and the development of new community infrastructure.

While enhancing the liveability of the regions is necessary to secure future growth and prosperity, it is not a sufficient condition. Securing jobs is also essential.

³ ABS Cat No 6248.0.55.002 Employment and Earnings, Public Sector, Australia 2007-08

⁴ Australian Bureau of Statistics Cat No 5220.0 Australian National Accounts: State Accounts, 2007-08

Local Governments in Western Australia derive approximately 80% of their total revenue (operating and capital) from their own sources, primarily property rates, user charges and fees⁵. In total, 11% of Local Government income in Western Australia is derived from Commonwealth Grants (capital and operating).

However, this average masks enormous variability in the dependence of individual Local Governments on Federal and State support in order to deliver services to their communities. For some remote jurisdictions as little as 6% of their total income is derived from their own sources, with heavy dependence of Federal and State Governments. For example, in 2006-07, 82% of the total income of the Ngaanyatjaraku Shire was derived from Commonwealth Government Grants (capital and operating). The median Local Government derives 21% of income from Commonwealth Grants and a significant number receive 30 – 40% of their income from the Commonwealth.

State Government Grants provide a further 8.3% of total local government income. Again the average masks significant variability between local government areas.

Local Governments in rural and remote Australia are often directly involved in providing a range of goods and services typically undertaken by the private sector in capital cities and regional centres. This includes the provision of land, capital and infrastructure for business and residential developments as well as capital and operating costs for services such as aged care, medical centres, commercial premises, cinemas and galleries.

While property rates are theoretically a tax on property values, which have risen strongly over the past five years, in practice Councils annually determine the rate in the dollar to be charged. One important factor in determining the level of rates is the after tax income of ratepayers (both residential and commercial / industrial). Thus while rates income will be a deliberative decision of Council, the decision will be impacted by the capacity of ratepayers to pay, which in some areas has been seriously reduced.

It is critical that transfers to Local Governments from other spheres of government are at least maintained through the financially difficult period ahead. To date, the Commonwealth has clearly signalled its commitment to local communities and engaging Local Government in the delivery of economic stimulus through the Regional and Local Community Infrastructure Program, continuation of the Roads to Recovery program and Financial Assistance Grants.

To date the Western Australian State Government has provided strong support to non-metropolitan Local Governments through the Country Local Government fund. However, the capacity to continue to do this, given that funding is based on income from royalties needs to be monitored and the Commonwealth consider supporting the State as required.

Recommendations

Ensure that the administrative processes associated with the Regional and Local Community Infrastructure Program (non-competitive and competitive components) deliver timely funds to Local Governments, enabling them to complete construction projects in a timely fashion.

Provide an on-going commitment to funding the Regional and Local Community Infrastructure Program via a budget and out-years commitment in the May 2009 Federal Budget.

Identify with the States appropriate strategies to assist them manage the concurrent rapid downturn in revenue from resource royalties, property transactions and GST transfers from the Commonwealth, to enable the States to continue to support critical infrastructure projects within the Australian regions.

⁵ WA Local Government Grants Commission Returns 2006-07

5.1 Demographics

The global financial crisis impacts directly on households through reduced household wealth as well as through employment and confidence in future employment prospects. Household net worth is estimated to have fallen by 10% over the course of 2008⁶ and will continue to decline in the early part of 2009.

The global financial crisis has impacted on different groups within the Australian community in different ways. To the extent that some regions have a much higher (or lower) proportion of certain demographic groups these regions will be differentially impacted and to differing extents.

The reduction in household wealth, as result of falling share market values, housing values superannuation portfolios etc leads to a reduction in household expenditure.

'Although estimates of the effect of wealth on consumption spending are subject to a high degree of uncertainty — some estimates suggest that a change in household wealth of one dollar results in a long—run change in consumption of around 4 cents — the fall in wealth that has occurred is sufficiently large to have a material effect on household spending over the coming period.'⁷

For groups such as self-funded retirees, the decline in household wealth is significant and will lead to a reduction in household spending with significant negative impact on local businesses and service providers. The impact of regular bills for utilities and rates is likely to result in hardship in some cases, and will be a factor in determining the level of property rates that are able to be levied in communities with high populations of self-funded retirees.

For illustration, the 2006 Census shows that 20.3% of the population of the City of Mandurah is aged over 65 years. While not all of these persons will be self-funded retirees, this contrasts with typical Perth metropolitan areas where significantly less than 10% of the population is aged over 65 years.

5.2 Financial Impacts

The Local Government sector in Western Australia in aggregate is a net creditor, although is reliant on continued access to finance for capital projects, equipment leases etc.

The impacts of the rapid changes in the finance industry will impact on regional local governments. However, the consequences will be quite specific and to a large extent depend on the previous financial strategies of Council. Those with large cash reserves will expect significant reductions in interest earnings. Although interest earnings equate to around 3% of total income across all Local Governments, for some Local Governments more than 10% of income is derived from interest.

Those most negatively affected will be Councils who have fixed interest borrowings and variable interest deposits, where net interest costs will increase.

Employee costs are the largest single expenditure item for Local Governments. These costs have escalated strongly over the past five years. Although wages are still growing quite strongly in Western Australia through 2008, it is widely anticipated that the rate of increase will ease in 2009 and 2010. Furthermore the shortage of skilled staff that has constrained Local Government activities is anticipated to ease over the next two years.

⁶ Financial Stability Review March 2009 Reserve Bank Australia p 48

⁷ Reserve Bank of Australia 2008 *Statement on Monetary Policy*, 5 November, at www.rba.gov.au/PublicationsAndResearch/StatementsOnMonetaryPolicy/Statements/statement_on_monetary_1108.pdf p 66

Recommendation

Ensure that Local Governments have access to funding for major, sustainable infrastructure projects if credit markets deteriorate to the extent that this becomes necessary.

6. INDUSTRIES

A number of key industries are strongly affected by the global financial crisis have an important interface with Local Governments.

6.1 Land Development and Housing

Very low levels of housing affordability across many parts of regional Australia occurred during the 2004 – 2008 period. While falling interest rates and prices are now addressing this issue in part, there remains strong demand for housing, particularly in the rental sector. The Commonwealth is encouraged to continue to work with the Local Government sector on initiatives to improve housing affordability and provide access to social, including indigenous housing. The downturn in other construction activities provides a window of opportunity to deliver long lasting benefits in this area.

6.2 Tourism

Tourism while both a significant employer and significant contributor to Gross State Product in Western Australia, is relatively more important in regional areas⁸. The serious downturn in real (or perceived) net wealth, consumer and business confidence is likely to have a negative impact on tourism expenditure⁹.

Where there is a sound case for public investment, such as in improving and extending critical transport system infrastructure which is critical in Western Australia, then Government can and should get involved. Public sector investment in community infrastructure can have both countercyclical and longer term merits in the current environment and that anticipated in the immediate future, provided the total return justifies the use of taxpayer funds.

Many Local Governments in tourist regions have well developed plans for tourism infrastructure upgrades that can be accelerated with appropriate funding support. It is interesting to note that 15 – 20% of the Regional and Local Community Infrastructure Program projects approved for funding in WA in March 2009 were targeted primarily at improved tourism infrastructure. A range of other projects including walkways, cycle paths and public toilets also have benefits for the tourism sector.

This period is the time to ensure that the infrastructure is in place to capitalise on emerging opportunities as the world economic growth recovers.

Recommendation

Evaluate the business case for public investment in tourism related infrastructure, particularly critical transport system infrastructure in cooperation with the industry and regional / local authorities.

⁸ Tourism Satellite Account 2006-07 Published by Tourism WA. Accessed at: http://www.tourism.wa.gov.au/Research_and_Statistics/Documents/Tourism%20Satellite%20Accounts%202006-07%20-%20Western%20Australia%20Factsheet.pdf

⁹ Geoff Carmody and Associates 2008 Tourism Prospects as Wall Street Crunches Main Street. Accessed at: <http://www.tourism.wa.gov.au/SiteCollectionDocuments/Economic%20Crisis%20Report.pdf>

7. STATE OF THE REGIONS

The Australian Local Government Association has commissioned and published eleven annual *State of the Regions*¹⁰ reports that provide analysis of trends between Australian regions, describe the current regional economic status and provide policy recommendations for improving Australian regional performance.

Among the very strong messages from the 2008-09 report is that regions with high productivity have high household incomes and low unemployment levels.¹¹ Regions with comparatively lower household income and higher unemployment rates typically have poorer access to high quality telecommunications infrastructure, which severely reduces business and educational opportunities.

This provides two areas of important and related direction for public investment. There is a need to ensure access to adequate, high quality telecommunications infrastructure in regional Australia and access to training and educational opportunities for those living in regional areas.

Recommendations

Ensure access to adequate, high quality telecommunications infrastructure is available in regional Australia.

Develop access to training and educational opportunities for those living in regional Australia.

¹⁰ National Economics 2008 State of the Regions Report 2008-09. Australian Local Government Association.

¹¹ Ibid