Transitioning Regional Economies –

Productivity Commission Initial Report

31 JULY 2017

AUSTRALIAN LOCAL GOVERNMENT ASSOCIATION

Productivity Commission study into Transitioning Regional Economies

The Australian Local Government Association (ALGA) welcomes the opportunity to make a submission to the Productivity Commission's (the Commission) Study into the transition of regional economies.

ALGA is the voice of local government in Australia, representing 537 councils across the nation. ALGA's President represents local government as a member of the Council of Australian Governments (COAG) and several other ministerial councils. In structure, ALGA is a federation of state and territory local government associations.

ALGA has worked constructively with successive Australian Government Ministers on matters relating to regional development. It was a member of the former Regional Development Ministerial Council and contributes to policy debate through its annual Regional Cooperation and Development Forum. ALGA also commissions the State of the Regions (SOR) Annual Report, which has made a valuable contribution to public policy.

ALGA has an equally long history of working with the Commonwealth Department of Infrastructure and Regional Development on regional issues and is active in the areas of transport, infrastructure, planning, the environment, community development, emergency management and settlement and indigenous affairs. ALGA has specifically identified the need to strengthen regions and cities as part of its key objectives in its Strategic Plan (2017-2020).

This submission has been prepared in consultation with ALGA's members, and should be read in conjunction with any separate submissions received from state and territory associations as well as individual councils.

Introduction

ALGA welcomed the Productivity Commission's comprehensive initial report that was released in April 2017. Whilst ALGA agrees in principle with many of the Commission's initial findings and overall commentary, it is not without qualification in parts.

ALGA would like to take this opportunity to acknowledge its support for this independent investigation. ALGA will continue to advocate the necessity for the Australian Government to provide greater leadership and policy support when it comes to matters relating to national regional policy and regional development interventions.

ALGA concurs with the Commission's observation that "by its nature, the geography of our economic transition will not be consistent across the country and

that the combination of forces driving the transition will unavoidably create friction points in specific regional areas and localities across the country".

ALGA also acknowledges that the task given to the Commission by the Commonwealth Treasurer in December 2016 is difficult one. ALGA has had extensive experience through commissioning of successive State of the Regions (SOR) Reports on both identifying regions and collecting relevant and useful metrics. We have come to the conclusion that developing a single metric for assessing a region's adaptive capacity would be highly challenging and not without qualifications. Having said this, collecting local and regional data based on geography is desirable and making it available for policy makers, and the community on a regular basis is fully supported.

Understanding the intricacies of economic policy from a geographic perspective is something that successive Commonwealth Governments have struggled with. It is true that some regions have less capacity than others to respond to changes in economic conditions, due to myriad of reasons that are not always responsive to the intervention mechanisms available to governments. Equally true is the importance of local and regional leadership, the ability of a locality to build strong networks based on trust and experience, and for public policies to appreciate the value of taking a geographic or place based perspective.

This submission seeks to provide a broader local government context to the discussion, and highlight challenges that arise accordingly. From a public intervention perspective, it is critical that all levels of government work together to ensure the policy environment adequately supports the necessary levers that in turn will drive the much-needed development activity and diversification of Australia's economy. Addressing the growing inequity between Australia's diverse regions is one of the greatest challenges facing all levels of Australian government today.

Local Government

Local government in Australia is a dynamic and extremely diverse sector, consisting of some 537 councils. The unique characteristic of local government is its geographic spread and the critical role council's plays is fostering local economic development and community wellbeing through leadership, infrastructure investment, strategic planning, regulatory assessment, compliance and delivery of a range of services.

In aggregate, local government has an annual expenditure of more than $34 billion, which represents around 3.5 per cent of the national GDP (2014-15). In employment terms, local government accounts for almost 10 per cent of the total public-sector workforce, at 187,000 employees. More importantly, this sphere of government provides a range of essential services and infrastructure that serve as

the foundation for local and regional communities, and are critical in fostering economic activity and community wellbeing.

ALGA wishes to take this opportunity to remind the Commission that in its report *Assessing Local Government Revenue Raising Capacity (2008)*, it was able to identify numerous examples of the considerable variation across Australia's councils whether by revenue, expenditure or population. Given the fact that local government in Australia is characterised by a high degree of diversity in terms of its functions, characteristics and revenue sources, it should not be surprising that the capacity of councils to strengthen the ability of regions to transition will vary.

ALGA was pleased to see in the Initial report that the Commission acknowledges the challenges of defining regions and appreciates that there is considerable variability in the productivity of Australian regions. Given this, ALGA has long argued that the challenges of dealing with transitioning economies from a regional perspective needs to reflect these local and regional characteristics. A single policy approach does not work in all circumstances.

Among the key benefits and strengths of local government are:

- Wide and established networks of political governance and public administration;
- Strong links and accountability to the communities it represents;
- Practical service orientation and sound organisational skills which make it capable of innovative, timely and flexible responses;
- Strong links between local government and local businesses and industries that facilitate and foster opportunities for valuable 'bottom up' approaches to regional development;
- Its skill as a place manager; and
- Its role as a local and regional information collector and provider, to support both Commonwealth and State/Territory regional policy development, implementation, monitoring and evaluation.

<u>State of the Regions</u>

The transitioning of Australian regions and economies is nothing new. It has a long history in Australia. Given the importance of regions, local economic development and local government, ALGA has commissioned the National Institute of Economic and Industry Research (National Economics) over the past two decades to prepare a comprehensive State of the Regions (SOR) report. The report, produced and launched annually at the Regional Cooperation and Development Forum, divides Australia into 65 regions and analyses how each region is performing on several metrics. The report also investigates the likely consequences of current and future economic circumstances and trends for each region and contains a wealth of interesting analysis.

For the best part of two decades the State of the Regions reports have made the case for greater Commonwealth (and state) interest in regional economies, including a willingness to direct investment funds to regional development. For many years the arguments for central funding of locally-directed economic development strategies made little headway in the face of a view that free-market policy was delivering prosperity and economic growth.

In this year's report - Pillars of Regional Growth (2017-18), the regions have been grouped into six types (zones) with slight changes to how these regions are now described. The regional typologies used are:

- Core metropolitan;
- Commuter suburbs;
- Mining-based;
- Agriculture-based;
- Lifestyle; and
- Independent cities.

Each of these regions have similar characteristics but with their own unique attributes and challenges. While it is possible, for each type of region in the SOR classification, to have one or more archetypal attributes, there are many regions which exhibit mixed characteristics and are accordingly difficult to classify. Defining regions is as subjective as defining what a region represents.

ALGA would encourage and recommend that the Commission review the 2011-12 SOR report titled, Beyond the Mining Boom. This report examined the regional effects of the mining boom which took off in 2005. The report produced a balanced analysis of both the benefits and costs associated with the mining boom and the effect the mining boom was having on other industries, as well as the potential regional implications when the boom finished.

National Economics put forward arguments that Australia's mining boom may have cost Australia more than it delivered in the form of economic benefits. The impact on the foreign exchange rates, the down turn in the tourism sector and export markets were significant. It is also fair to argue that with the fly in fly out labour market, regional communities also experienced considerable stress and disruption. Lessons from Norway were included as a best practice international case study in highlighting how governments can better direct international investment in sustainably building the domestic economy and wellbeing of Australian communities more broadly.

Transitioning Regional Economies

In this year's SOR report – Levers of Regional Growth (2017-18), National Economics acknowledged that "there is much to applaud in the Productivity Commission's recent commendation of regional planning; planning which focuses on each region's relative strengths as locally perceived". This commendation was based on two key foundations. The first being that, contrary to recent free market fashion, the Commission concedes in their Initial Report that there is a role for regional planning. That is, acknowledging that it is not wise to leave economic development solely to market forces. Secondly, the Commission not only accepts but emphasises the importance of local knowledge and leadership in the preparation and implementation of economic development strategies, particularly at the local and regional levels.

As National Economics argue, "If regional economic planning is to be authoritative and effective, it requires government auspices, not only to ensure that different voices are heard and balanced in a democratic way, but to provide the impetus to ensure implementation. In Australia authority is shared between federal, state and local government, and there is a strong case that the authority of each, should be shared in the preparation and implementation of regional plans".

ALGA has consistently argued that each level of government is able to bring complementary strengths to the process of planning and assisting regions to become more productive, sustainable and resilient. National Economics describe the potential roles to be played by the various levels of government as follows:

- The Commonwealth, primarily because it has charge of Australia's overall economic strategy as a nation which trades internationally, and also because it administers the national finances (both revenue raising and the broad outlines of expenditure) and is responsible for the regulation of the finance sector. In coming to the table, the Commonwealth should also acknowledge its weaknesses, which primarily have to do with lack of local knowledge and enthusiasm for one-size-fits-all strategies. ALGA would also add that there has also largely been an inability to move away from a silo based approach to policy;
- The states and territories, primarily because they are responsible for strategy at the mega-regional level but also because they administer the major public services and much infrastructure provision. The states and territories also have weaknesses, most commonly identified as their silo tendencies; their concentration on the efficient but uncoordinated delivery of particular services and bias towards capital cities at the expense of a more integrated regional focus; and
- Local governments, primarily because of their local knowledge and ability to see the regional scene as a whole, but also because of their local administrative capacity, networks and planning powers.

Whilst the concept of transition implies a sequence by which a region which is at first operating normally, experiences a disruption, followed by a transition to a new normality, finding metrics to measure the adaptive capacity or potential is fraught with difficulty. ALGA was not surprised to see the Commission admit that "*from (their) examination of economic growth over time, it might be possible to identify regions that have experienced a significant disruptive event...*" However, that in "*in practice, operationalising this concept has proved challenging with the time series data available and the level of regional disaggregation possible. It has been difficult to observe events at a regional level that are out of the ordinary... The analysis of employment data suggests that regions are constantly experiencing ups and downs.*" (pp7-8)

Concerning the concept of adaptability, the Commission must be commended in its attempt to construct a 'single economic metric of relative adaptive capacity'. Ideally, the Commission task to construct this metric would have been made easier had there been a considerable example of regions which have responded resiliently to disruptive events. However, given the inability to identify such events, the time frames involved, it was not surprising that the Commission retreated to simply listing local population attributes which it believed would be associated with adaptive capacity. However, ALGA is not convinced by the Commission's draft index of adaptability, that is based heavily on the assumption that regions with high-status residential populations have succeeded and therefore must be adaptive.

When it comes to factors that shape adaptive capacity, there would appear to be a number of factors that play a critical role and many of these were identified by the Commission in its Initial Report. These being: people- related attributes such as educational achievement, employment rates, skill levels, personal incomes and community cohesion; the degree of remoteness and accessibility to infrastructure and services; natural endowments and industry diversity. These correspond closely with what National Economics referred to as the main pillars of regional productivity growth in the 2017-18 SOR report. The four main pillars include: the skills base, non-dwelling capital (infrastructure), knowledge -creation capacity and supply chain strength. Equally relevant is the fact that having the right factors only indicates that the potential is there to make a difference. As National Economics argue, "it is very well to have potential, but various (other) factors can prevent the realisation of potential".

Given that 'significant disruptive events' cannot be identified while 'adaptive capacity' is essentially associated with a regions socio-economic status, the Commission does not seem to have advanced very far in its discussion of the best way to allocate funds for regional development or how best to utilise the potential adaptive capacity factors that were identified.

Nevertheless, it is pleasing that the Commission also decided to introduce a set of principles when it came to commenting on what changes may be necessary

when it comes to a preferred government approach in dealing with transitioning regional economies. The Commission believes *"that place-based policies are likely to be more effective than subsidy-based policies, though the latter remains (sic) a significant part of government policy. Guided by this way of thinking, strategies to support regional transition and development should:*

- *take a coordinated, strategic approach led by the regional community;*
- *build on a region's relative strengths (comparative advantage);*
- *invest in the capacity of people in regional communities and the region's connections with other regions and markets; and*
- *promote sustainability, so that projects and programs are viable without long-term government financial support.*" (p121)

Local government would strongly support such principles, whatever the socio-economic status of the residents of a region. In particular, the principle that a coordinated, strategic approach should be led by the local community provides a central role for local government and highlights the need for capable local councils and local/regional associations of councils.

National Economics raises a number of further interesting and valid questions. They argue for instance, that there appears to be two relevant concepts missing from the Commission's discussion. The first missing concept is that of uncertainty. This concept is present in the Initial report – it is inherent in the idea of a disruptive event and pervasive in the observation that regional economies are constantly being buffeted by such events – but it is not named. It is instead smoothed over in the idea of a steady equilibrium growth path and no more than tenuously present in the idea of transition between equilibrium and equilibrium. The consequences of the pervasive uncertainty of regional economic growth include the following:

- Some investment proposals will inevitably fail. Though much can be done by investment assessment and scenario planning, the failures cannot be predicted in advance;
- The market deals with uncertainty by various financial devices, notably equity investment and venture capitalism. These should be matched against the level of uncertainty;
- Uncertainties can be reduced by sharing. Risks can be pooled through insurance but this is not technically possible as an approach to uncertainty; and
- There is no rule against governments shouldering risks and uncertainties – indeed, when one considers such areas as defense planning, they are a fundamental fact of public life.

The second missing concept according to National Economics is that of the economic base. They note that interestingly this concept is mentioned briefly where the Commission attempts to define economic resilience (p 46) but does

not otherwise re-enter into the discussion of how to build stronger capacity in regions. If a country, or a region, has a sound economic base, markets can be relied on to build on the economic base and provide those local services which are suited to business provision and taxes.

Whilst ALGA appreciates the potential value of developing metrics, it believes that the Commission is on the right track in its recommendation that regional economic development should build on each region's relative strengths and requires investment in the capacity of people in regional communities and the region's connections with other regions and markets.

Commonwealth policy initiatives and/or specific regional programs need to be adequately funded and integrated, if positive and sustainable outcomes are to be realised in Australia's diverse regions. This submission also acknowledges that there needs to be a recognition that local government plays in encouraging sustainable economic development and employment.

Role played by local government in encouraging economic development and employment

All of Australia's councils contribute significantly to the economic and social growth of their regions by focusing their efforts in three key strategic areas. These areas are:

1.creating and maintaining the investment environment – ensuring the availability of appropriate physical and social infrastructure, striving to deliver a quality public domain, ensuring sufficient housing and employment lands provision and lobbying on behalf of local and regional communities for sufficient community services such as schools, hospitals, police and emergency services;
2. facilitating new local investment – actively promoting business development through strategic planning, working with business associations/main street organisations, running economic facilitation services; and
3. attracting external investment through the creation of new business and capital – working with regional bodies and developers to attract, grow and create new businesses.

In broad terms, actions geared to creating and maintaining the investment environment in regional communities are considered to be of prime importance to a majority of local councils. If these actions are successfully implemented, investment is likely to flow both within, and outside the region. For the numerous rural, regional and remote communities, local government is often the only institutional presence and one of the key drivers of economic activity.

Any future regional development program or Federal or State policy initiatives designed to assist regional communities and sustainably assist economies to transition from major setbacks be they domestic, international or the

consequences of a natural disaster, must recognise the leadership, policy and implementation role played by local governments.

Creating and maintaining the regional investment environment

Creating and maintaining the investment environment is a prerequisite for sustainable economic growth and development. Governments have a responsibility for advancing economic growth, including local government. However, the Australian Government (and state and territory governments) must recognise the limitations, including resource constraints, faced by many local governments and the need to work in partnership with councils to ensure local and regional economic opportunities are maximised.

Infrastructure, both 'hard' and 'soft', underpins economic activity and is fundamental to an efficient and effective national economy. In this context, 'hard' infrastructure includes roads, water, sewerage, energy/utilities, and telecommunication networks. 'Soft' infrastructure accounts for items such as education, upskilling, health, community and recreation services and programs.

Many 'soft infrastructure' services are increasingly being delivered by local and regional governments, and the demand for them has only increased since the effects of the global financial crisis (GFC). Local governments need to be supported to facilitate and coordinate delivery of such infrastructure, as well as to ensure that their own 'hard' and 'soft' infrastructure is maintained and developed to reflect best practice standards, and resilient against future climate variability.

It should not be forgotten that local governments have a long history of participating in regional-based programs, and are active participants in regional-based organisations and committees. Over the past twenty years in particular, councils have played important roles in local economic development initiatives, tourism development, main street retail programs and a variety of regional economic development organisations. Local governments continue to contribute where they can to the national regional policy agenda through Regional Development Australia.

Local and Regional Community Infrastructure

It is now generally well understood that the range of functions undertaken by local government in Australia has expanded beyond simply administering a local property taxation system and delivering physical infrastructure like roads and services such as waste management.

Today it is increasingly common to find councils involved in the delivery of a range of social, cultural, environmental and economic services. This expansion of services and facilities being delivered by local government has arisen through a combination of internal strategic assessment, community expectations, State and

Commonwealth Government inducements, and as a result of the withdrawal of such services by other levels of government, that is commonly referred to by most local governments as 'cost shifting'.

ALGA commissioned PricewaterhouseCoopers (PwC) in 2006 to specifically investigate the financial sustainability of local government in the context of these 'cost shifting' pressures. PwC found that many councils are often forced to spend scarce resources attempting to address service and infrastructure gaps that are largely state responsibilities, with the result that some existing community infrastructure in local communities has not been adequately maintained.

Whilst the PwC report is now over a decade old, cost shifting remains a real and serious concern to local governments as they seek to ensure that communities are in the best position to adapt and transition their local and regional economies. Previous cost shifting onto local government means that local and regional communities have been disadvantaged as a result of councils needing to defer capital expenditure including replacement and renewal of their local community infrastructure.

Local government currently owns and manages significant local community infrastructure assets, many of which were constructed in the 1960s and 1970s and have now reached, or are close to reaching, the end of their economic and structural life. As a result of the PwC report, ALGA has consistently called for the Australian Government to establish a Local Community Infrastructure Renewal Fund (the Fund). ALGA envisages that such a Fund would support local and regional councils in delivering more timely and quality renewal works across a range of essential community infrastructure assets. Essential community infrastructure assets are those which enhance social inclusion and overall wellbeing of local communities. Examples of infrastructure that could be renewed under such a Fund included community centres, aged care services, libraries, health clinics, and sport and recreation facilities such as swimming pools, children playgrounds and walking/cycling paths. All of these types of community infrastructure help bring communities closer together, enhance feelings of wellbeing and social inclusion, attract and retain residents, boost physical activity levels, and produce communities that are actively engaged and well connected. Well delivered, located and maintained infrastructure is a critical component of ensuring strong, resilient and sustainable economies.

Accordingly, ALGA has stated the business case for the Fund to be around $300 million per annum over at least four years, in order for the Australian Government to make a real impact in this area. ALGA previously also advocated that such a Fund should be modelled on the administration arrangements used in the very successful Roads to Recovery Program funded by the Commonwealth.

Under Roads to Recovery arrangements, each council is guaranteed a share of the total available funding and is advised of its allocation in advance, for the full life

of the Program. The simple administrative procedures allow a council to decide which works they will undertake (from approved categories of work) and report details of the work to the Australian Government for information. Money is paid directly from the Australian Government to each council, and much of the administration is via the Internet.

Workforce Capability

Australia's regions have differing workforce capabilities. It will be important that regions have access to skilled labour, as the skills and knowledge of a workforce are critical to ongoing and future production and service delivery, and meeting the challenges arising from technology and international trade and investment. Many of Australia's key export sectors are found in Australia's diverse regions and are heavily reliant on the contribution of educated, skilled and innovative people.

The Commonwealth, in partnership with the State and Territories must ensure that the increasing global competition does not diminish the capacity or quality of Australian education and training bodies, in cities, towns or regions.

Innovation

It is widely accepted that innovation through investment in research and development and technology allows new products, employment opportunities and economic sectors to develop. ALGA believes that the Australian Government can play a critical role in securing jobs and ensuring that Australia is able to better adjust to negative impacts by ensuring that it does not reduce or hinder investment in, and incentives for, ongoing innovation.

Structural reforms and appropriate funding support from the Australian Government can assist innovation growth. Australia's taxation policy, the commitment to the rollout of a world class National Broadband Network, and support for research and scientific institutions such as CSIRO and the public institutions such as the Bureau of Meteorology , the Australian Bureau of Statistics, Geoscience Australia or think tanks/initiatives like the Regional Australia Institute and the Australian Urban Research Infrastructure Network, are all critical to ensuring that regional innovation activity can be boosted in Australia's medium to long-term interests.

The Leadership role of the Commonwealth

Regions experiencing economic pressures following the mining boom or any other significant event, will require some level of external assistance. This assistance will never be uniform across the country and as such, needs to be flexible enough to allow the regions themselves to work out how best to undertake given initiatives. Whilst the interventions in regions may vary depending on the region's existing capabilities, it is critical that governments at all levels can be flexible enough to

assist, whilst at the same time being supported through the consistent leadership at all levels, especially at the level of the Australian Government.

ALGA would note that intergovernmental funding, especially general-purpose grants from the Australian Government, plays a fundamental role in assisting local government to deliver services and infrastructure and that it is critical that general purpose funding continues to be available to local councils in all regions. However, there are significant concerns that the amount of general purpose funding, called Financial Assistance Grants, is generally inadequate, and also insufficient to achieve one of its main aims – horizontal fiscal equalisation. (That is, the capacity of local government to deliver services and infrastructure to the same standard).

The Productivity Commission has previously agreed that there is a case to review the provision of Australian Government general purpose grants to local government. However, such a review is still outstanding.

Conclusion

ALGA acknowledges that there are no simple solutions when it comes to developing regional development programs or meeting the substantial challenges facing Australia's regions as a consequence of international trade, external shocks or the transitioning impacts of technology, or changing tastes and fashions. Regional development relies on multiple ingredients and the active participation and co-ordination of multiple stakeholders, especially governments.

From ALGA's perspective, the four key findings made in the Initial report are the following:

1. Caution is required if making policy decisions based on rankings of regions using the estimated metric of relative adaptive capacity. There is unavoidable uncertainty about its estimated value for each region, and actual adaption to any specific disruption would be affected by factors beyond the metric;
2. There is no 'one size fits all' approach that will promote successful adaptation in all regions;
3. The factors shaping adaptive capacity include: people-related factors (educational achievement, employment rates, skills levels, personal incomes and community cohesion, accessibility to infrastructure and services, natural endowments and industry diversity; and
4. Strategies for successful adaptation and development are those that focus on supporting people in regional communities to adjust to changing economic circumstances. Strategies work best when they are; identified and led by the local community, in partnership with all levels of government; aligned with the region's strengths; supported by targeted investment in developing the capability of the people in the local community to deal with transition, adaptation, and securing an economic future; and designed with

clear objectives and measurable performance indicators and rigorous evaluation.

In relation to the role of local government, the Commonwealth must ensure that any interventions support the everyday roles played by local government. Local government needs to be consulted by other levels of government about possible measures so that it can continue to work with regional communities and deliver local/regional solutions to local/regional issues.

It is imperative, given the budgetary pressures that will be faced by all levels of government, that future programs and initiatives are designed to assist regional Australia to enhance resilience and produce real and sustainable benefits to communities. Short-term, quick fix solutions should not be adopted at the expense of desirable long-term transformational change. This is why ALGA continues to advocate for substantial and ongoing national investment in local and regional community infrastructure.

Should you require further information in relation to matters raised in this submission, or access to any of the State of the Regions reports, please contact Mr John Pritchard on (02) 61229414.

Yours sincerely

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