



Global Economic Downturn – Some Implications for Australian Local Governments



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Introduction

The global economic downturn will test the resilience of local economies. Declines in the economic capacity of individuals and businesses will reduce their capacity to weather further shocks. Local governments too, will be affected in different ways through possible income decline and higher service demand.

Local economies that lack a diverse industry base or skilled workforce are the most likely to be adversely affected by the economic downturn and may face long term adjustment pressures. The process of economic recovery and structural adjustment, however, will also bring opportunities for local economies. It will be a time for local governments to lead their communities toward economic growth and sustainability.

This paper examines the potential local economic impacts of the global downturn by analysing a range of economic data. In particular, it looks at the spatial distribution of aspects of wealth, debt and investment. These will be affected by changes in interest rates, housing prices and the stock market, and will in turn affect consumer spending and overall economic activity.

Characteristics of the global downturn

The succession of institutional collapses that followed the fall of Lehman Brothers in September 2008 was a major trigger of the financial crisis and resulting economic downturn. It heralded a period of unprecedented uncertainty in global financial markets and led to a tightening of credit and a collapse in business and consumer confidence. The result was massive falls in stock markets and pressure on housing values.

The economic downturn has moved from the financial to the household and industrial sectors and is washing through the Australian economy. House and share prices have fallen, and

unemployment rose to 5.7 per cent in May 2009. Across the world 29 of the 30 OECD countries – all except Australia – have entered into recession or have experienced negative growth since the onset of the global crisis and are experiencing the associated declines in employment, consumption, investment and trade.

Government response and other mitigating factors

In response to the initial financial crisis, the Australian Government stabilised the financial sector through the bank deposit guarantee. As the global economy contracts, the Government is delivering a \$42 billion Nation Building and Jobs Plan and a \$22 billion infrastructure package as part of the Budget to support jobs and invest in future long term economic growth. These measures, building community and large-scale infrastructure, follow the initial cash stimulus payments. The stimulus packages are expected to raise the level of GDP by 2¾ per cent in 2009-10 and 1½ per cent in 2010-11, supporting up to 210,000 jobs.

The Government is also stimulating infrastructure spending at the local level. The \$800 million Community Infrastructure Program, combined with increased Financial Assistance Grants and Roads to Recovery funding are boosting the spending capacity of local governments. These initiatives supplement existing economic stabilisers such as unemployment benefits and household savings which act to soften the impact on local demand.

In addition, the Government has brought forward the first quarter payment of almost \$480 million in Financial Assistance Grants to the 2008-09 financial year to help councils with cash flow.

Economic resilience and adjustment

The economic resilience of regions largely depends on the resilience of the industries that underpin them. Regions supported by more than one industry are less likely to be severely affected by shocks. Similarly, those with a skilled workforce are typically more resilient than those with fewer skills. The impact of the initial stages of the global recession on the wealth of individuals, businesses and councils will also be a factor.

Economic downturns are often the catalyst for structural change. Australia's long period of economic growth has provided a buffer for industries against economic shocks, however, the pressure for structural change is strengthened during difficult economic conditions. Many agricultural industries, for example, have undergone change resulting from prolonged drought, the relative strength of the currency and weak commodity prices for traditional industries such as wool and sugar. This creates both challenges and opportunities for local economies.

Impacts on Council budgets

Rates are property-based taxes and are not immediately affected by changes in economic growth like income or transaction-based taxes. Similarly local government can continue to charge for the essential services it delivers. Commonwealth funding is also stable and secure, delivered through the mechanisms listed above. Pressures on council revenues are likely to stem from an increase in ratepayer defaults, or in changes to funding from State/Territory Governments, whose GST and other revenues have fallen (Access Economics 2008).

Where it occurs, higher unemployment is likely to cause some increase in the demand for local government services (libraries, community centres etc), which may involve some additional costs to councils. On the other hand lower inflation may reduce some costs. Local government borrowing will be at lower interest rates, although investments may return less.

A number of Councils have suffered losses due to exposure to poor quality investment vehicles. These losses are impacting on council budgets and reducing capacity to access investment funds. Loss of value in superannuation schemes may also impact on local government finances – particularly those who have employees in defined benefit schemes. The Commonwealth's decision to bring forward payment of almost \$480 million in Financial Assistance Grants to the 2008-09 financial year will help councils with cash flow.

Economic growth and employment

Analysis of industry employment patterns (BTRE 2003) suggests there will be a regional dimension to the impact of the downturn. The early disruption to the financial sector meant that regions with high employment in financial and business services or high levels of investment in stocks and shares bore the initial impacts. This is consistent with the 1990s recession (BTRE 2005) where impacts in Sydney were first felt in the northern and eastern suburbs, but then progressively spread to the more industrial western suburbs. Similar patterns were observed in other capitals. Across the nation, coastal areas were slower to move into negative growth and came out more rapidly, while a number of inland regions moved in different ways as the result of locally important factors such as drought, commodity prices and weather events. The more remote areas of Queensland and Western Australia were slowest to recover.

Unemployment lags behind changes in economic growth, with the extent of unemployment growth and the timing varying from state to state. In the 1990s, Victoria, with its high dependence on manufacturing, was particularly affected with the lowest unemployment rate going into the recession translating to the highest peak (>12%) of any state. While individual regions had different unemployment patterns, this did not reflect a distinct metropolitan-country divide.

Primary commodity prices

Regions that are particularly dependent on primary commodity production can be vulnerable to changes in the fortunes of those commodities. Regions with associated processing industries can also be affected. One of the key determinants of economic resilience is diversity in industry. Those areas which are heavily reliant on a particular industry or commodity may be greatly impacted if that industry experiences a shock (BTRE 2003).

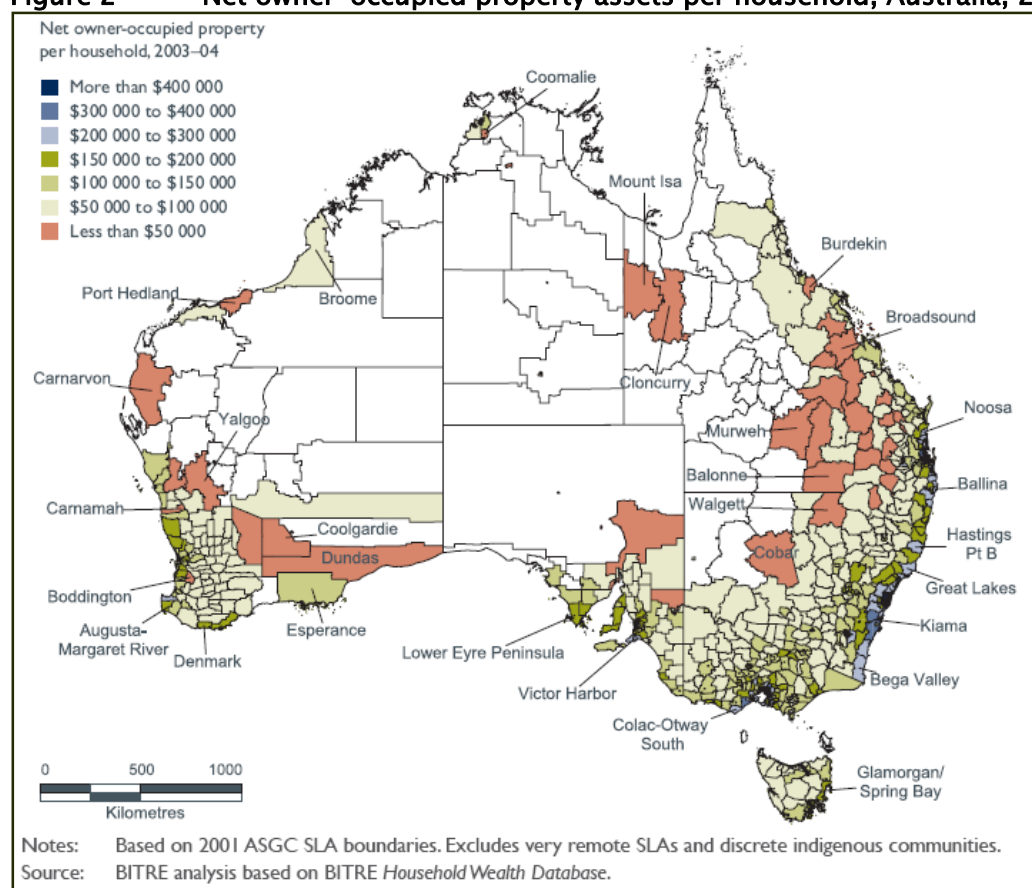
ABARE (2009) projections suggest that in the short term, the export values of commodities such as dairy, wool and some mineral resources will fall. Areas with proportionally high employment in dairy cattle farming are concentrated in Victoria, such as Corangamite, Campaspe, South Gippsland – East, Moyne and Colac-Otway – North. The Western Australian wheat belt dominates the list of regions with proportionately high employment in grain, sheep or beef cattle farming. Coal mining areas are predominantly in Queensland, NSW and Victoria, while many regions with very high proportions of those employed in mining overall are in WA, such as Ashburton and the Pilbara, and isolated regions in other states (such as Roxby Downs, Mount Isa and Nhulunbuy).

Wealth

Consumption increases as wealth increases. Wealth also provides economic security in tough times, and protection against financial stress and poverty. Declines in household wealth (both real and perceived) cause a reduction in consumption. Several key characteristics of the global downturn – namely the decline in house prices, the fall in the stock market and the fall in interest rates – impact upon household wealth, which in turn impacts on consumer spending.

Property assets are the largest component of household wealth in Australia, mostly owner-occupied dwellings. Net owner-occupied property values are highest in capital cities (particularly Sydney), while regional areas with high values tend to be coastal and within a three hour drive of a capital (see Figure 2). Amongst the capital cities, in the year to the March quarter 2009, the price index for established houses rose in Darwin by 10.8 per cent, rose slightly in Hobart (0.6 per cent), and fell in the other capitals, most notably in Perth (by 10.1 per cent), Sydney (by 7.3 per cent), Melbourne (by 6.7 per cent) and Brisbane (by 6.3 per cent). There was a decrease of 6.7 per cent for the capital cities overall (ABS 2009b).

Figure 2 Net owner-occupied property assets per household, Australia, 2003-04



Investments and superannuation

The fall in the stock market has decreased the value of superannuation, which (after property) is the second largest component of household wealth. Regions experiencing the greatest

impact are likely to be those with high reliance of superannuation assets in their wealth portfolio and a high proportion of residents in the pre-retirement age group, as the impact on superannuation affects individual retirement decisions.

Interest rates

The positive effect of low interest rates on debt repayments needs to be considered in conjunction with the increased risk of unemployment. Households with high debt-to-asset ratios suffer a lack of resilience to losing an income stream, and are more exposed by the current uncertainty of the labour market. Areas with high debt-to-asset ratios tend to be outer suburbs or commuter zones of capital and provincial cities, and include Palmerston NT, Melton VIC, Thuringowa QLD, Roxby Downs SA, Kalgoorlie-Boulder WA and Mount Isa QLD.

The areas with high asset ownership and high proportions of interest earnings per taxpayer are negatively affected by low interest rates. They tend to be within the wealthy suburbs of Sydney and Perth, areas of the Gold and Sunshine Coasts, and some agricultural areas such as Beverley (WA) (BITRE 2009).

Conclusion

Local economies will face different challenges as the global economic downturn impacts on Australia. The resilience of households and businesses is being tested. Local governments also face difficulties in the form of less secure income and increased demand on services. As the Commonwealth's infrastructure spending flows to local economies, their ability to withstand the negative effects of the global downturn and adjust quickly when it has passed, will continue to improve.

Local governments should continue to focus on long term strategies to maintain their own financial sustainability. This will put them in the best position to foster diverse and dynamic economic growth as local economies emerge from the downturn.

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