

LOCAL GOVERNMENT IN THE MACRO-ECONOMIC PICTURE

PRESENTATION TO THE
2017 LOCAL GOVERNMENT NSW FINANCE SUMMIT

CUSTOMS HOUSE, CIRCULAR QUAY, SYDNEY
11TH SEPTEMBER 2017

Infrastructure investment is ‘flavour of the month’ – globally and in Australia

“The case for increasing public investment is very strong almost everywhere in the world in light of the low long-term borrowing costs and substantial infrastructure deficiencies”

– International Monetary Fund, *Fiscal Monitor*, April 2017

“A more active use of fiscal and structural policies is needed to boost potential output and support aggregate demand, given waning benefits from monetary policy support ... Fiscal measures could include increased spending on hard, soft and remedial infrastructure investment and other measures that add to demand and enhance supply”

– Organization for Economic Co-operation and Development (OECD), *Economic Outlook*, June 2017

“We stress the importance of quality infrastructure investment, which aims to ensure economic efficiency in view of life-cycle cost, safety, resilience against natural disaster, job creation [and] capacity building ... while addressing social and environmental impacts and aligning with economic and development strategies ... Infrastructure connectivity is key to achieving sustainable development and shared prosperity”

– G20 Leaders’ communiqué, Hangzhou, China, 5th September 2016

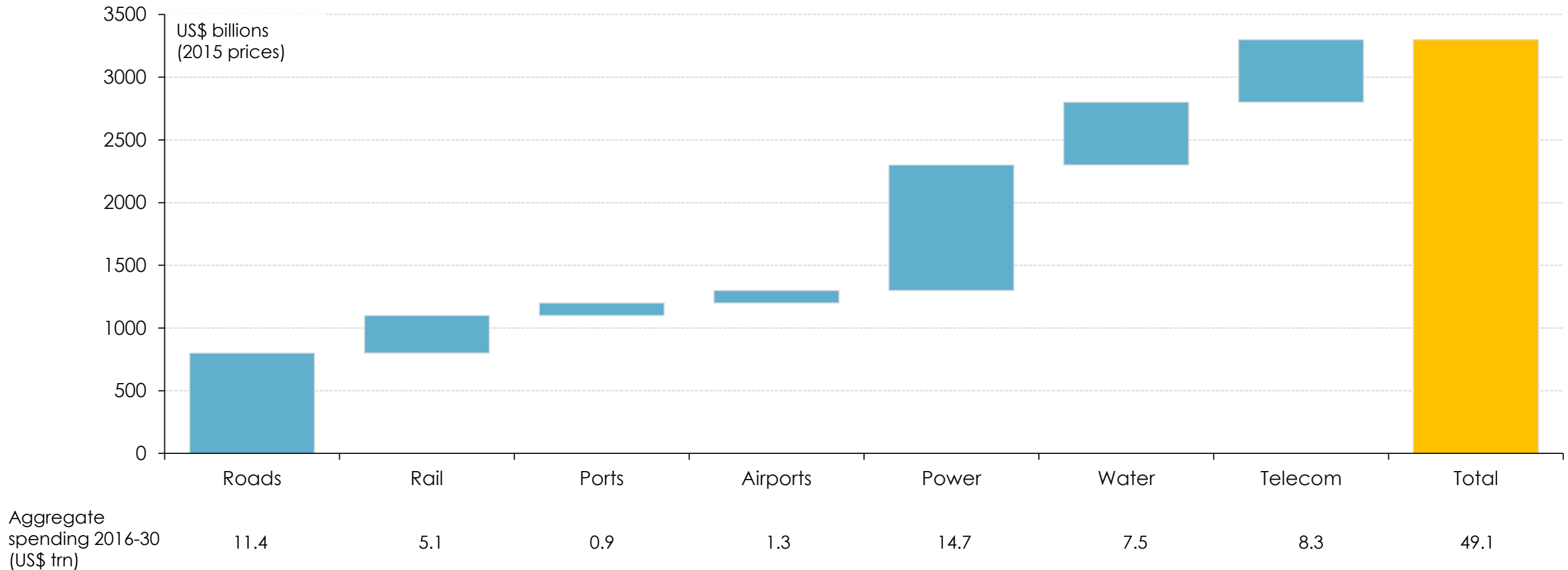
“Government spending on infrastructure, where this is backed by a strong business case ... can provide support for the economy and can help generate the productive assets that a prosperous economy needs”

– Philip Lowe, RBA Governor, Address to Committee for the Economic Development of Australia (CEDA), 15th November 2016

**Why is infrastructure spending
'flavour of the month'?**

The world needs to spend US\$3¼ trn a year on infrastructure to keep pace with economic growth – but is spending about \$350bn less than that

Global annual economic infrastructure investment required to keep pace with projected economic growth, 2016-2030

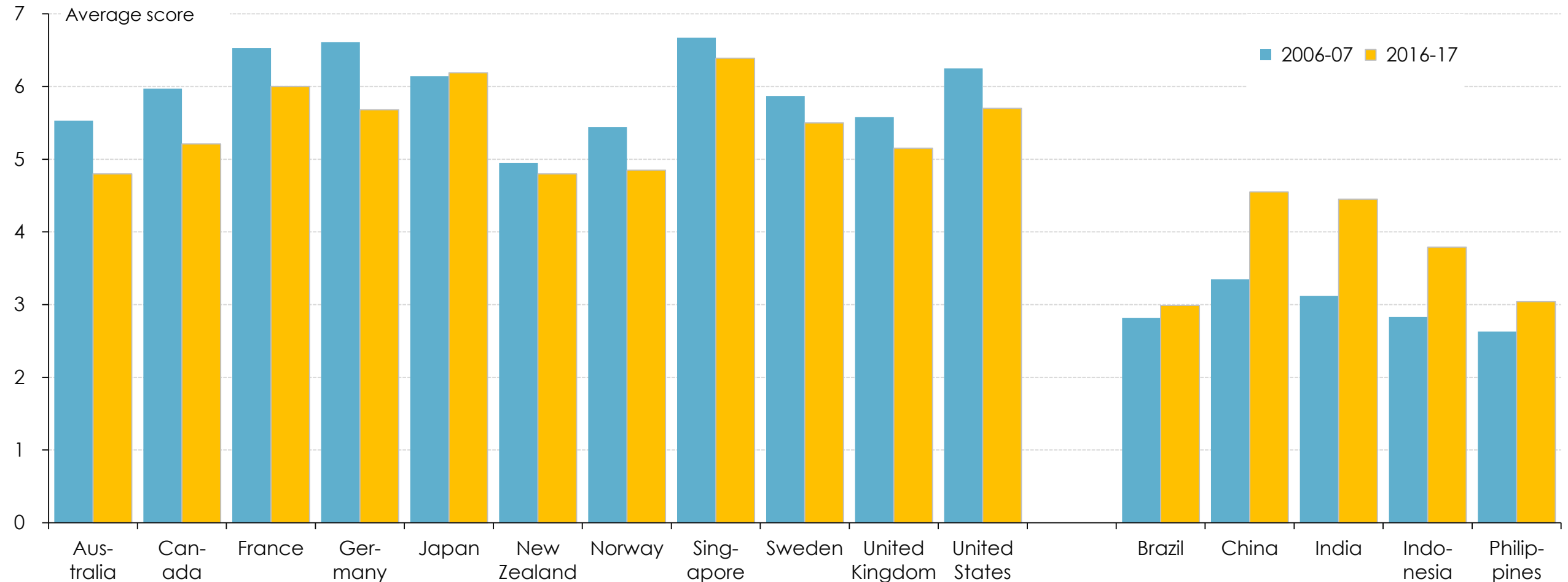


Note: Assumes global GDP growth averaging 3.3% pa between 2016 and 2030. Estimates of required infrastructure investment excludes infrastructure spending required to mitigate climate change and its effects, and to achieve the UN Sustainable Development Goals.

Source: McKinsey Global Institute, *Bridging Global Infrastructure Gaps*, June 2016.

The quality of infrastructure is perceived as deteriorating in most 'advanced' economies – whilst improving in many 'developing' countries

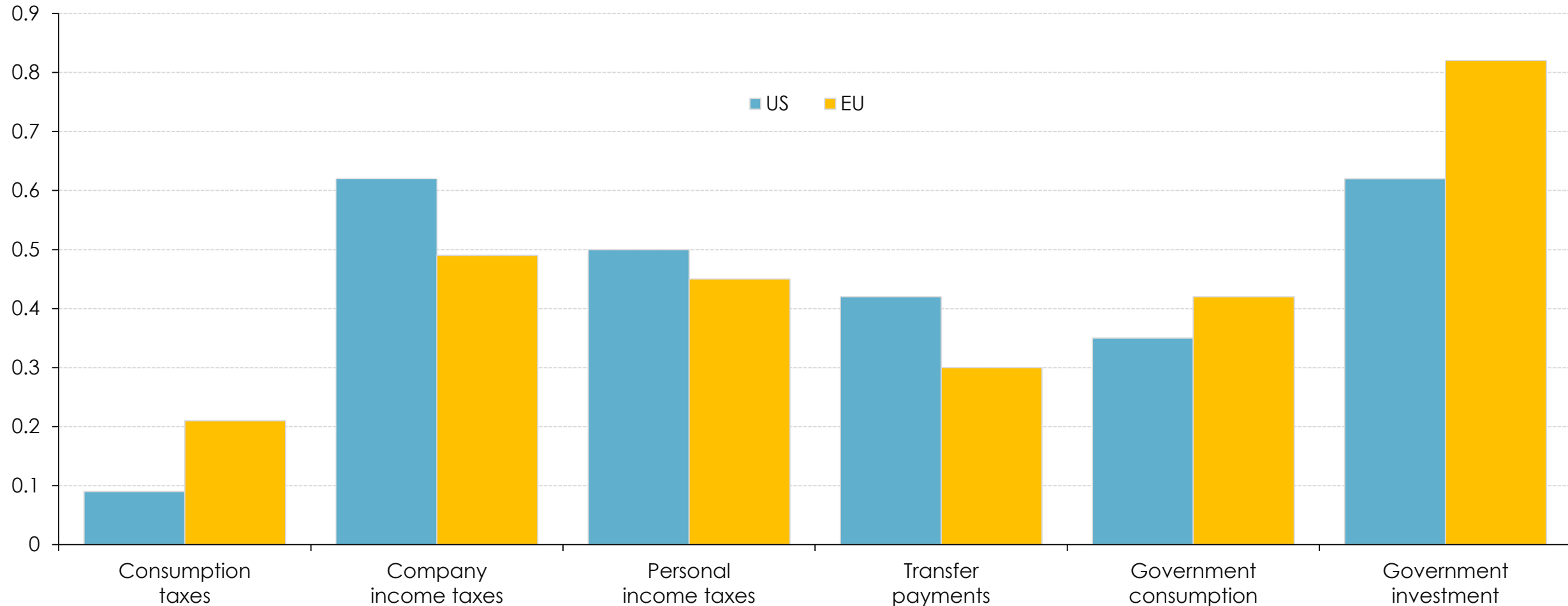
World Economic Forum Global Competitiveness Index assessment of quality of overall infrastructure, 2006-07 and 2016-17



Note: The World Economic Forum's Executive Opinion Survey is based on the responses of 13,877 executives in 135 economies. The infrastructure questions ask respondents to assess 'the general state of infrastructure' in their country from 1 ('extremely underdeveloped – the worst in the world') to 7 ('extensive and efficient – among the best in the world'). Source: World Economic Forum, *The Global Competitiveness Report 2016-17* and GCI database.

Infrastructure investment is (in principle) more effective in stimulating economic activity than other fiscal policy measures

Short-term 'multiplier effects' of alternative fiscal policy instruments in the US and EU

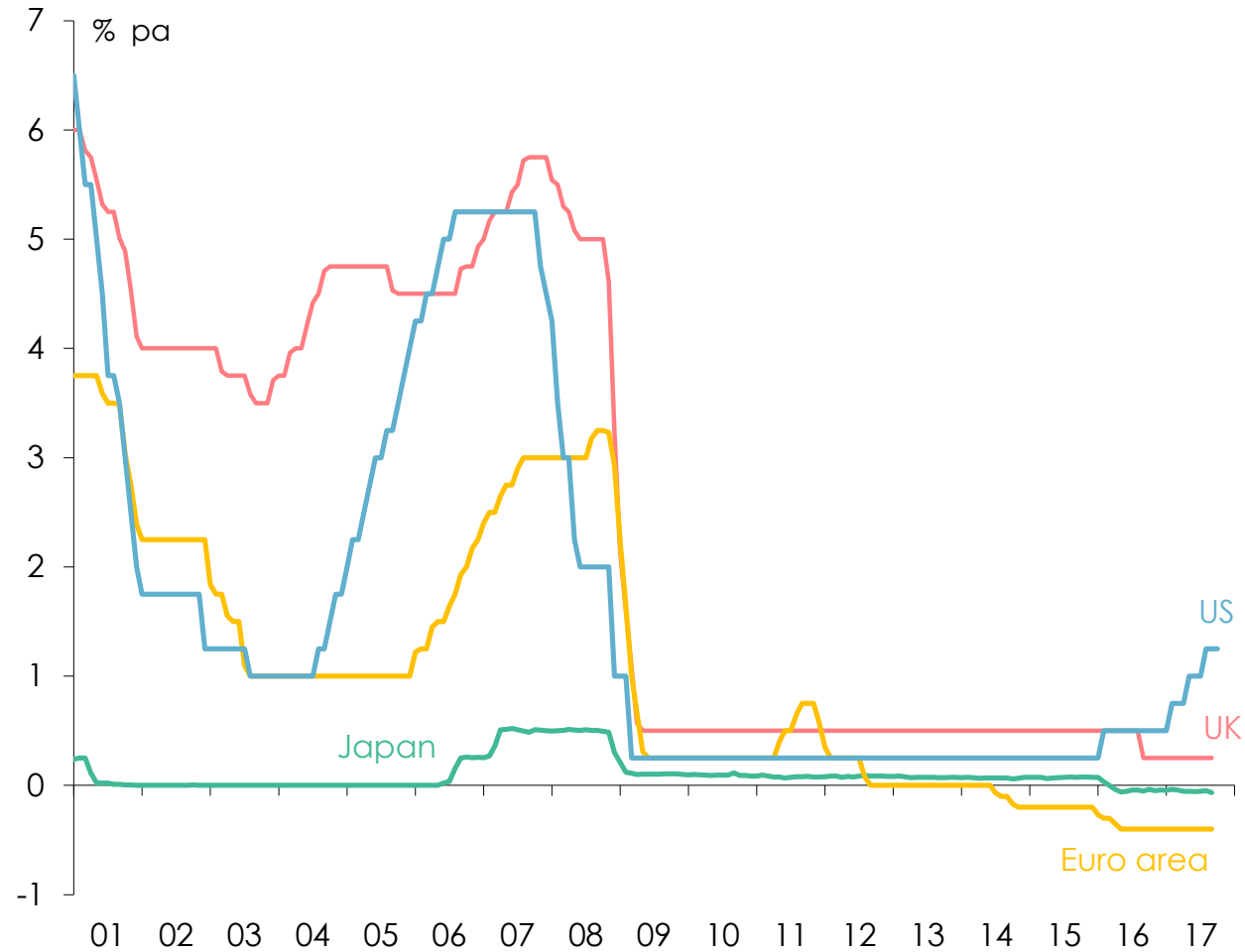


Note: Multipliers show the impact of a change in each instrument equivalent in magnitude to 1 pc point of GDP on the level of real GDP in one year's time, according to a range of DSGE (dynamic stochastic general equilibrium) macro-economic models.

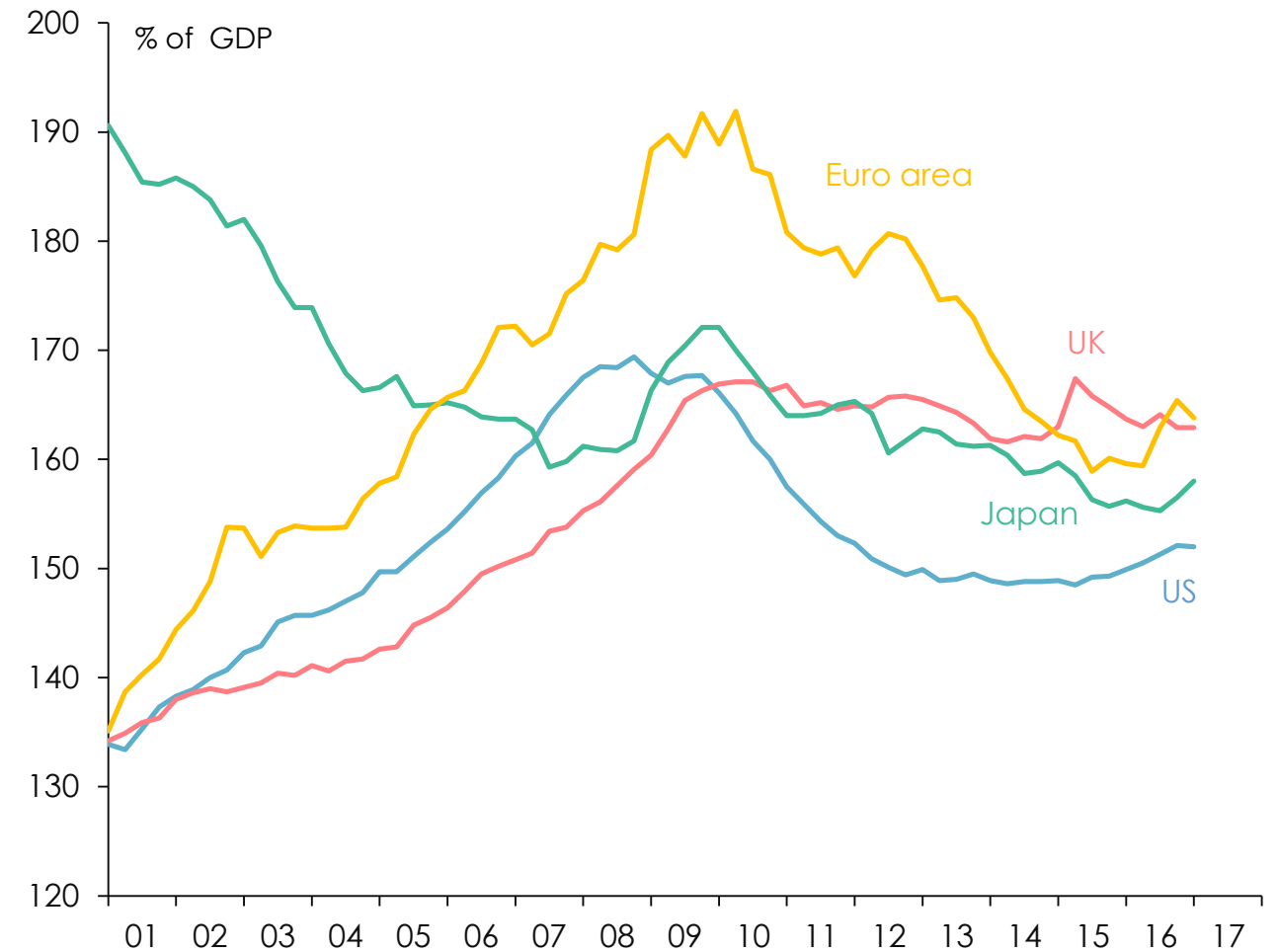
Source: Nicoletta Batini and others, *Fiscal Multipliers: Size, Determinants and Use in Macroeconomic Projections*, International Monetary Fund (IMF) Fiscal Affairs Department Technical Notes and Manuals no. 14/04, September 2014, Appendix II.

And infrastructure investment may be more effective when monetary policy has reached the limits of what it can do to stimulate growth

Central bank policy interest rates in major 'advanced' economies



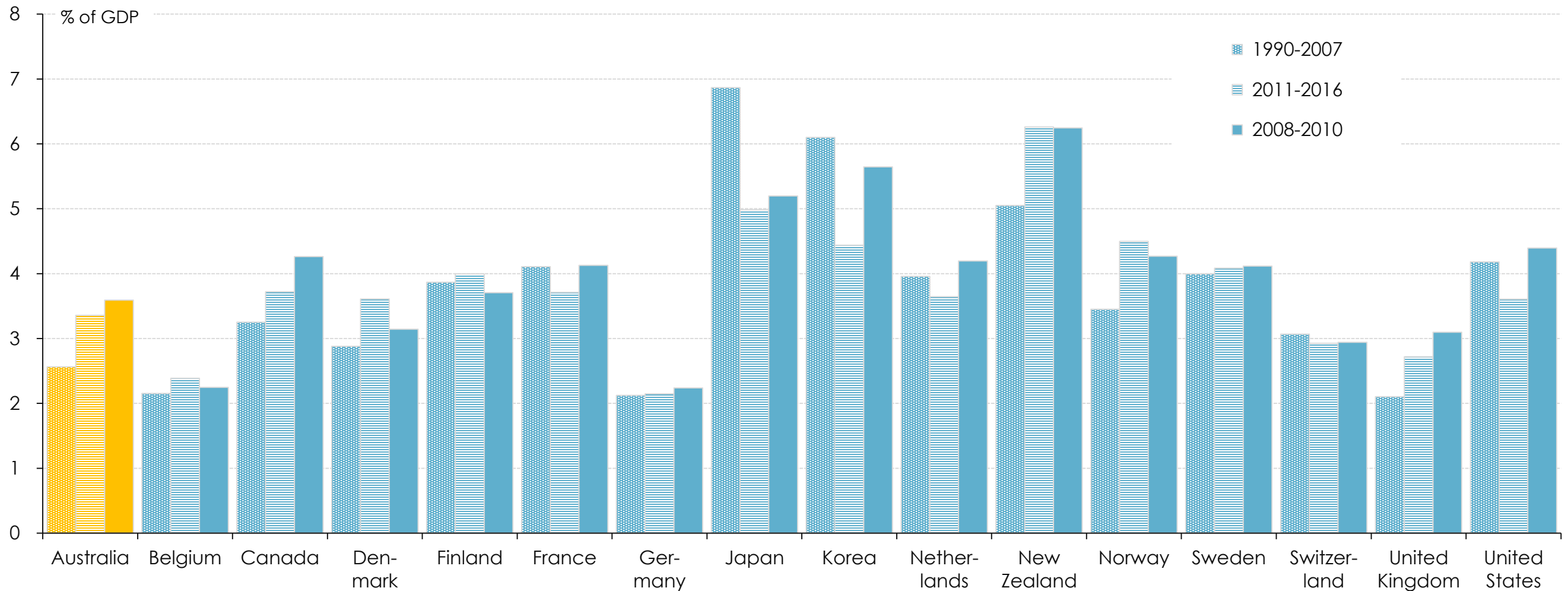
Private non-financial sector debt in major 'advanced' economies



Sources: US Federal Reserve; European Central Bank; Bank of Japan; Bank of England; Bank for International Settlements.

Hence many governments have increased their infrastructure investment spending since the financial crisis

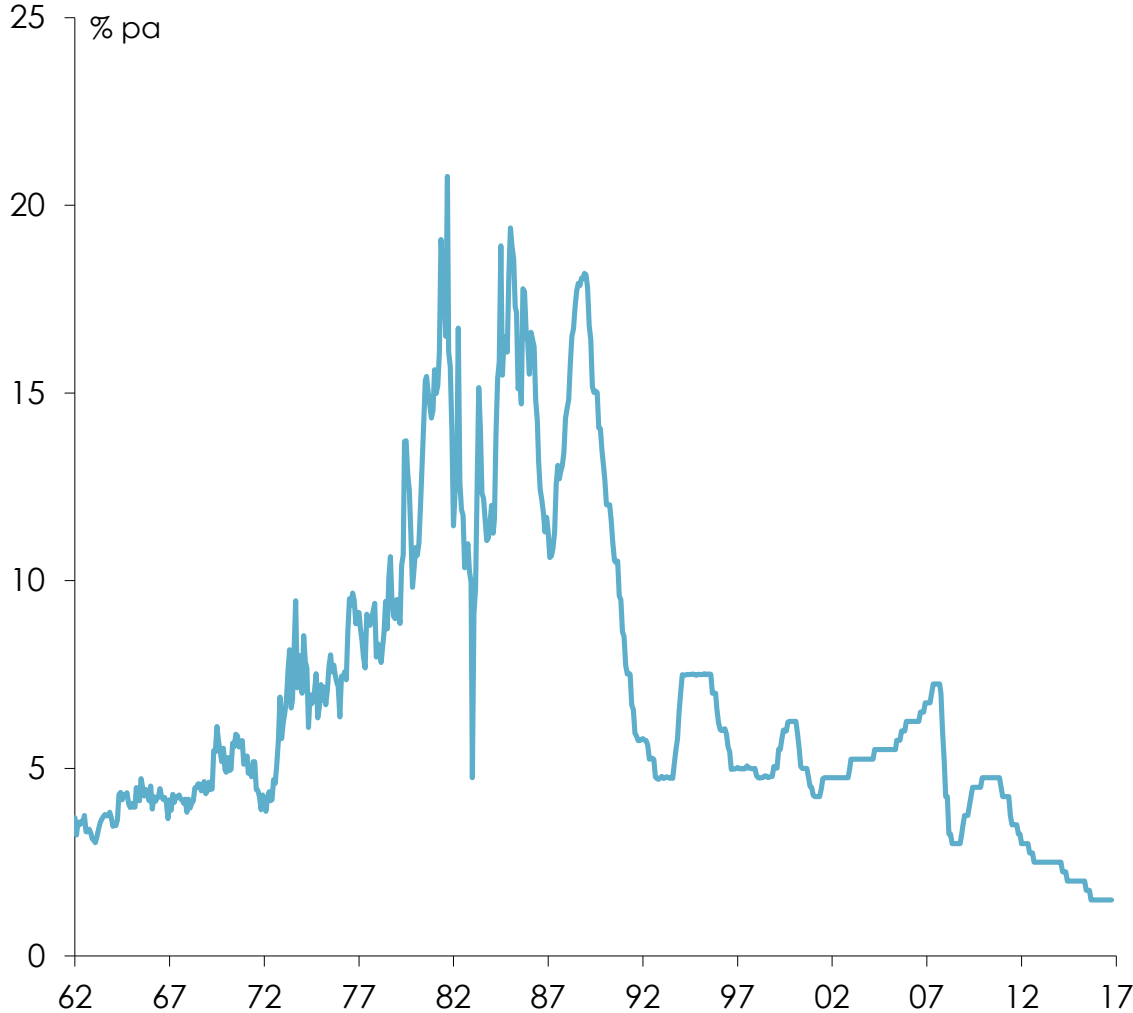
Government investment as a proportion of GDP, Australia and other OECD countries



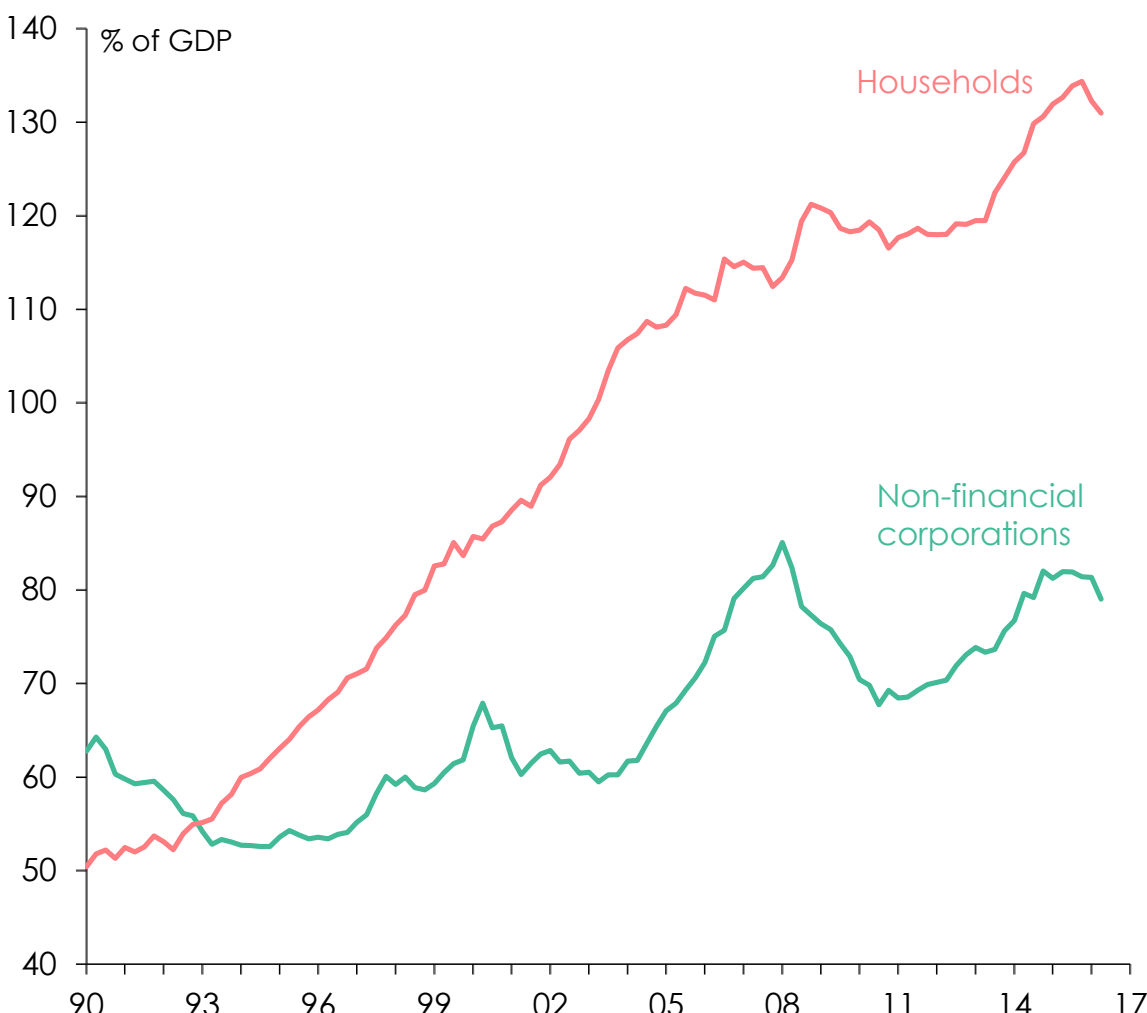
Source: OECD Economic Outlook 101, June 2017.

The RBA hasn't thought it necessary to push Australian interest rates to (or below) zero, but monetary policy may have reached its limits here too ...

RBA cash rate



Australian private sector debt



Sources: Reserve Bank of Australia; ABS Australian National Accounts: Finance and Wealth (5232.0), March quarter 2017.

... as both the previous and current Governors of the Reserve Bank have recognized

“The most powerful domestic expansionary impetus that comes from low interest rates surely comes when someone, somewhere, has both the balance sheet capacity and the willingness to take on more debt and spend. The problem now is that there is a limit to how much we can expect to achieve by relying on already indebted entities taking on more debt”

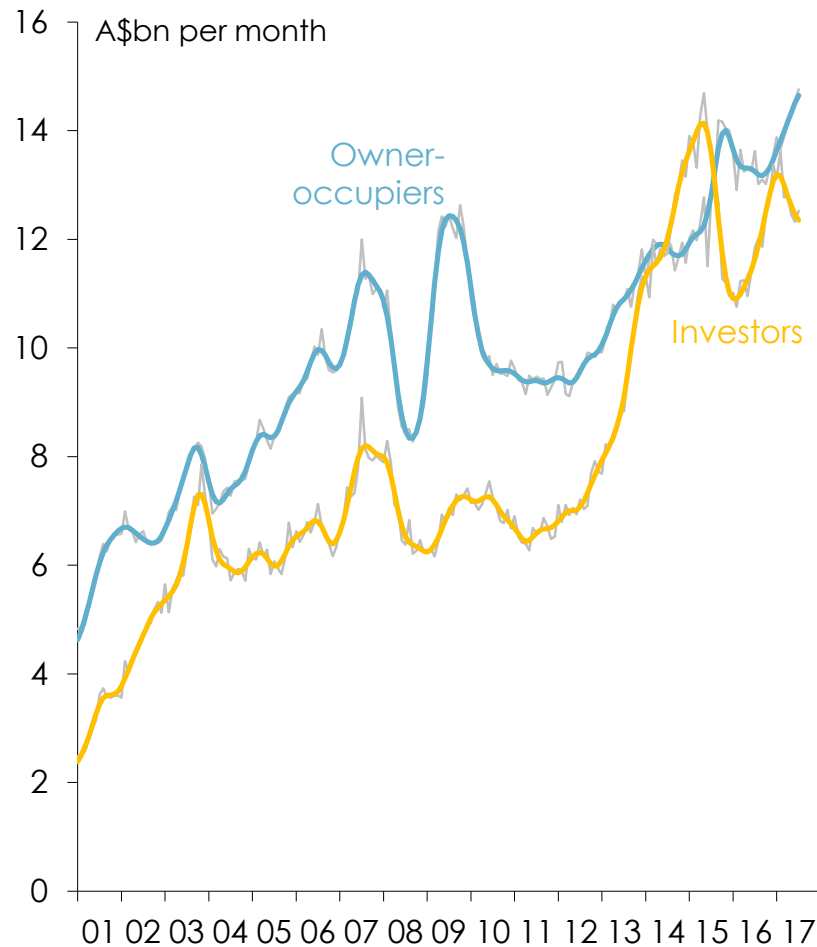
– (former) Reserve Bank Governor Glenn Stevens, “An Accounting”, 10th August 2016

“One of the ways in which monetary policy works is to make it easier for people to borrow and spend. But there is a balance to be struck. Too much borrowing today can create problems for tomorrow, because debt does have to be repaid. At the moment, most households with borrowings do seem to be coping pretty well. But the current high level of debt, combined with low nominal income growth, is affecting the appetite of households to spend, and we are seeing some evidence of this in the consumption figures. The balance that is required is to support spending in the economy today while avoiding creating fragilities in household balance sheets that could cause problems for the economy later on”

– RBA Governor Philip Lowe, Opening Statement to House of Representatives Standing Committee on Economics, 24th February 2017

Record low interest rates promoted a surge in property investment, riskier lending practices, and a further spike in property prices

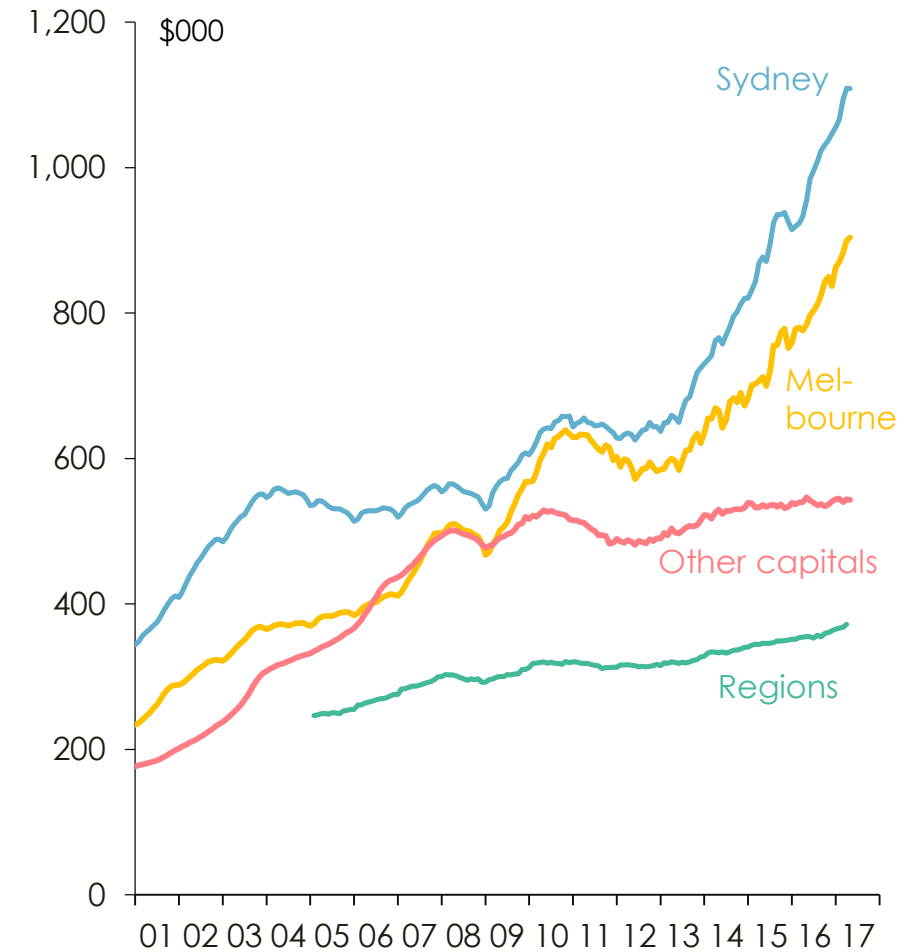
Housing finance commitments



Interest-only loans



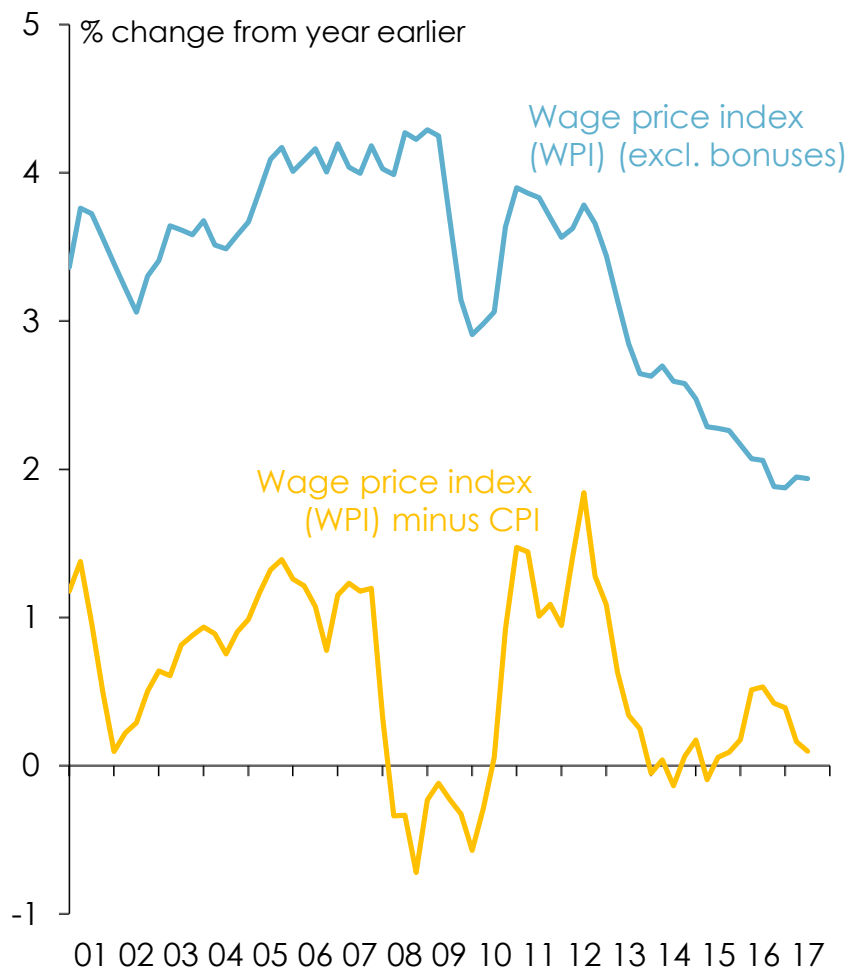
Residential property prices



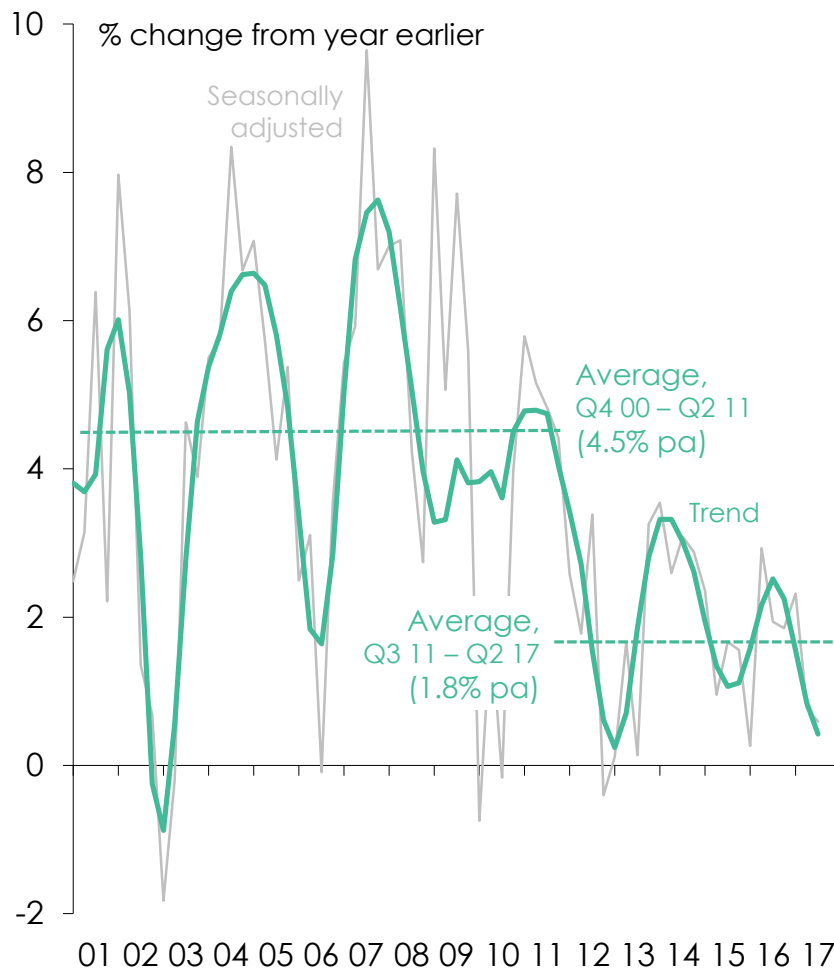
Sources: ABS, Housing Finance (5609.0); Australian Prudential Regulatory Authority, Quarterly Authorized Deposit-Taking Institution Property Exposures; CoreLogic.

Sluggish wages growth has meant weak growth in household incomes and depressed levels of consumer confidence

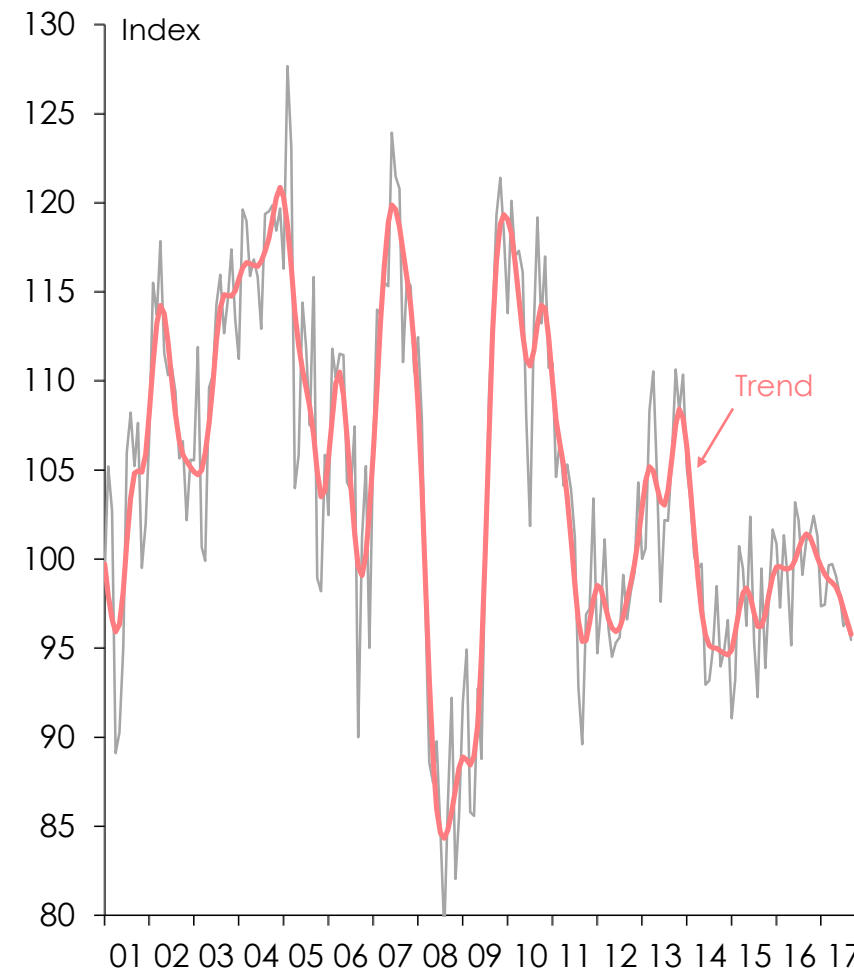
Nominal and real wages



Real household disposable income



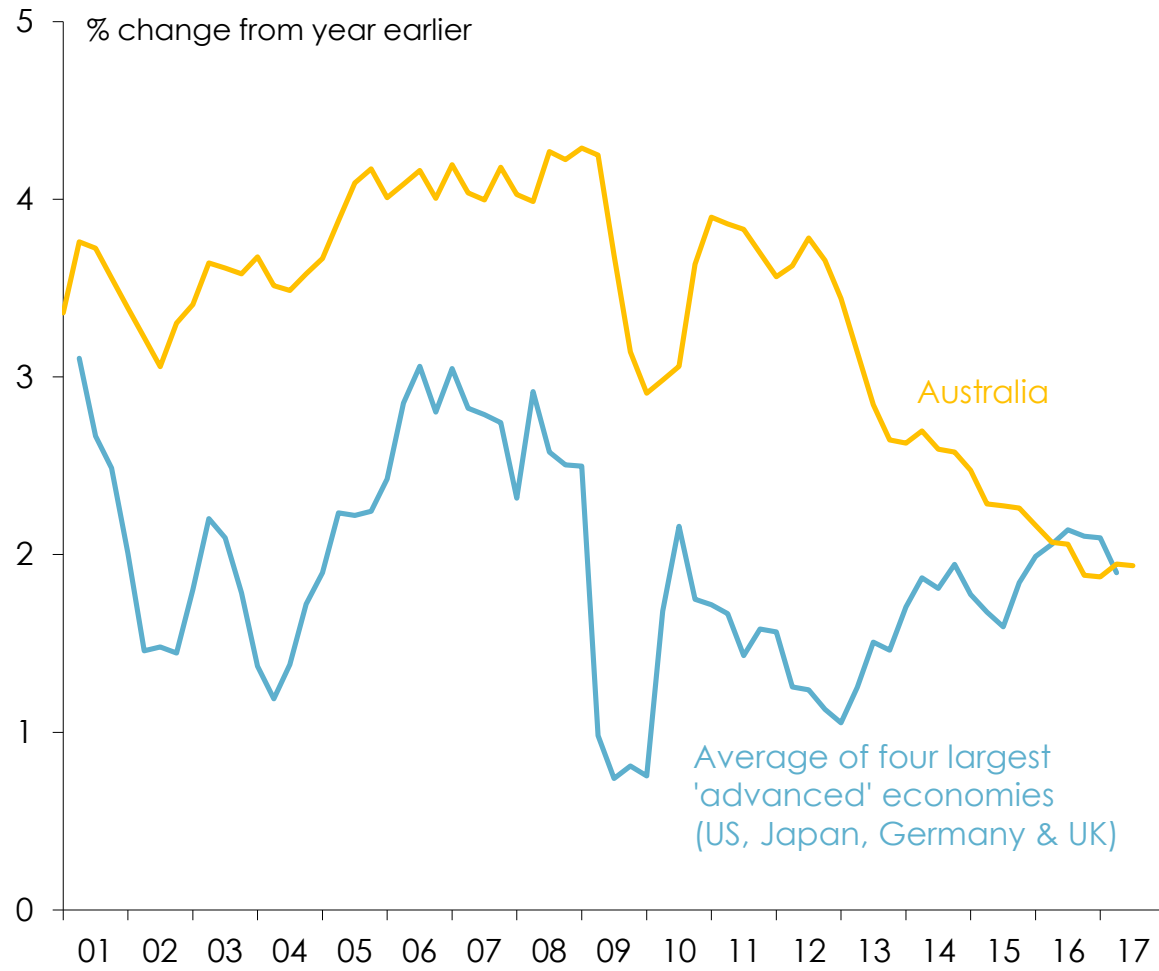
Consumer confidence



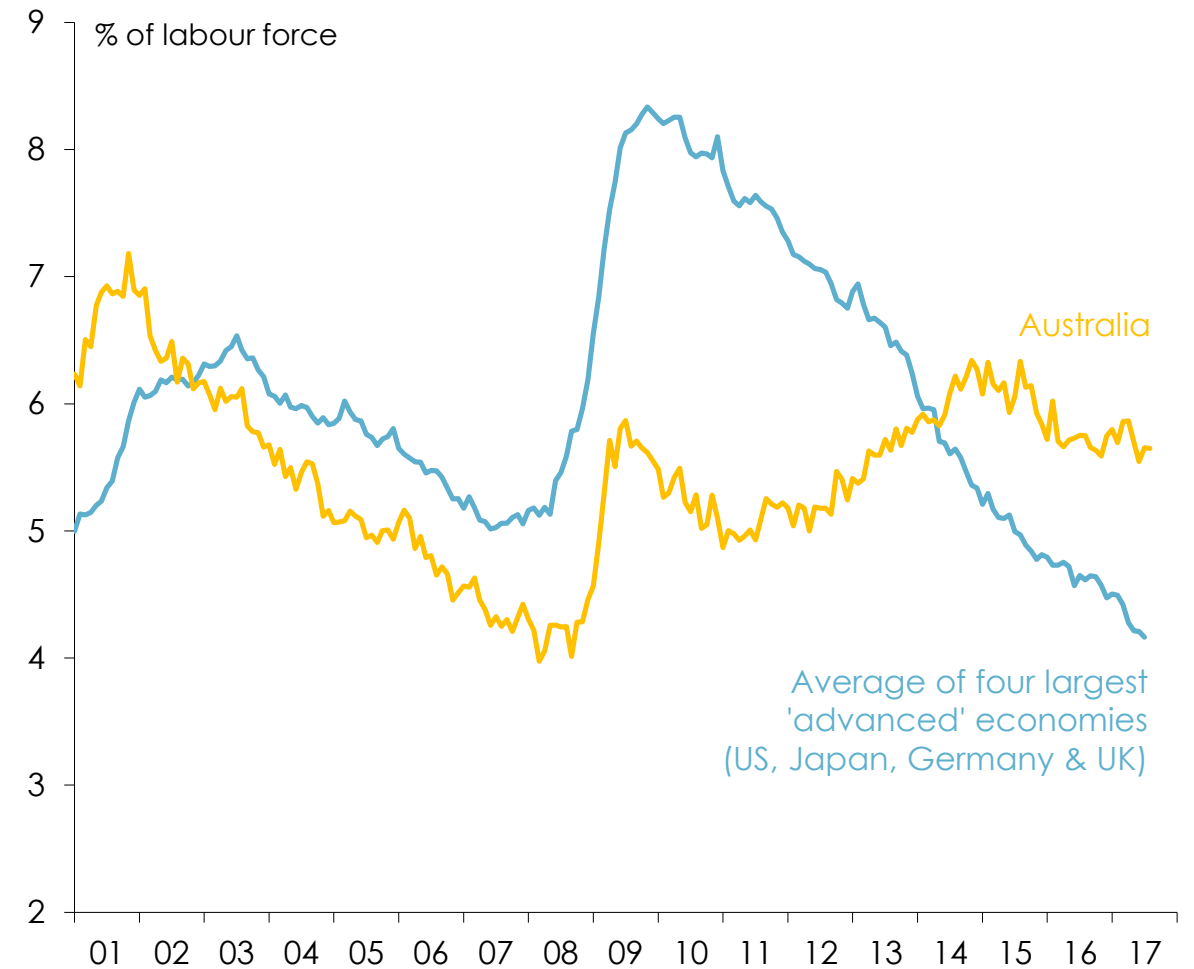
Sources: ABS, Wage Price Index (6345.0) and Australian National Accounts: National Income, Expenditure and Product (5206.0); Westpac and Melbourne Institute of Applied Economic & Social Research.

Weak wages growth has been common among 'advanced' economies, especially following periods of high unemployment

Wages growth – Australia vs four largest 'advanced' economies



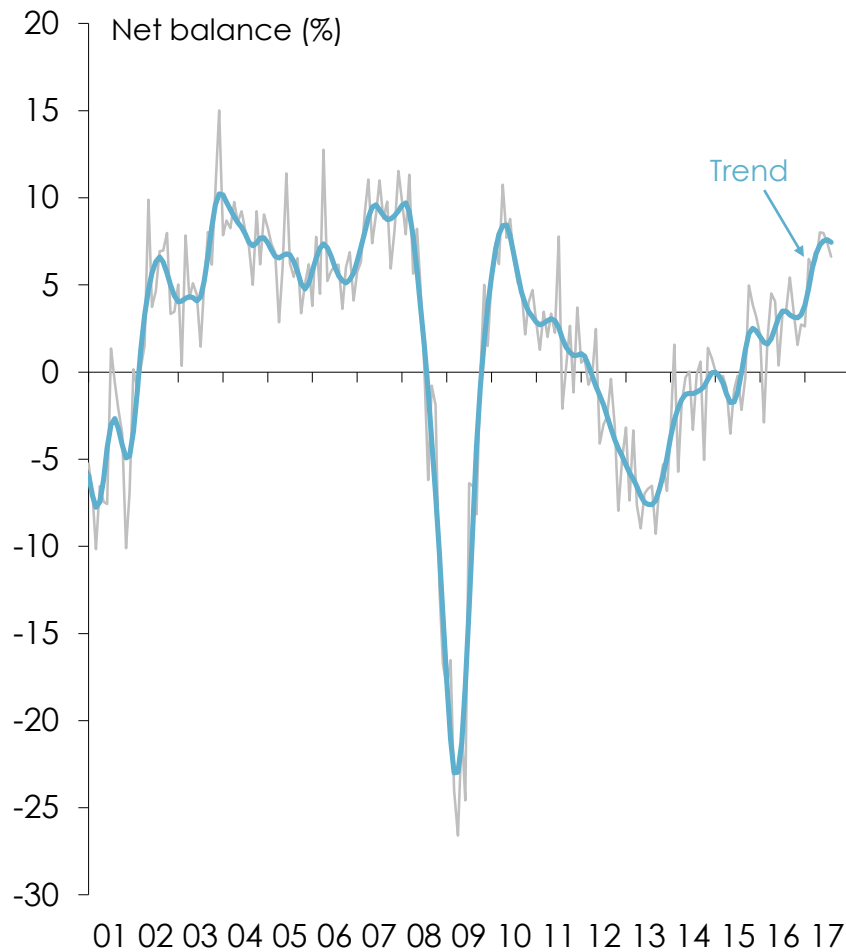
Unemployment – Australia vs four largest 'advanced' economies



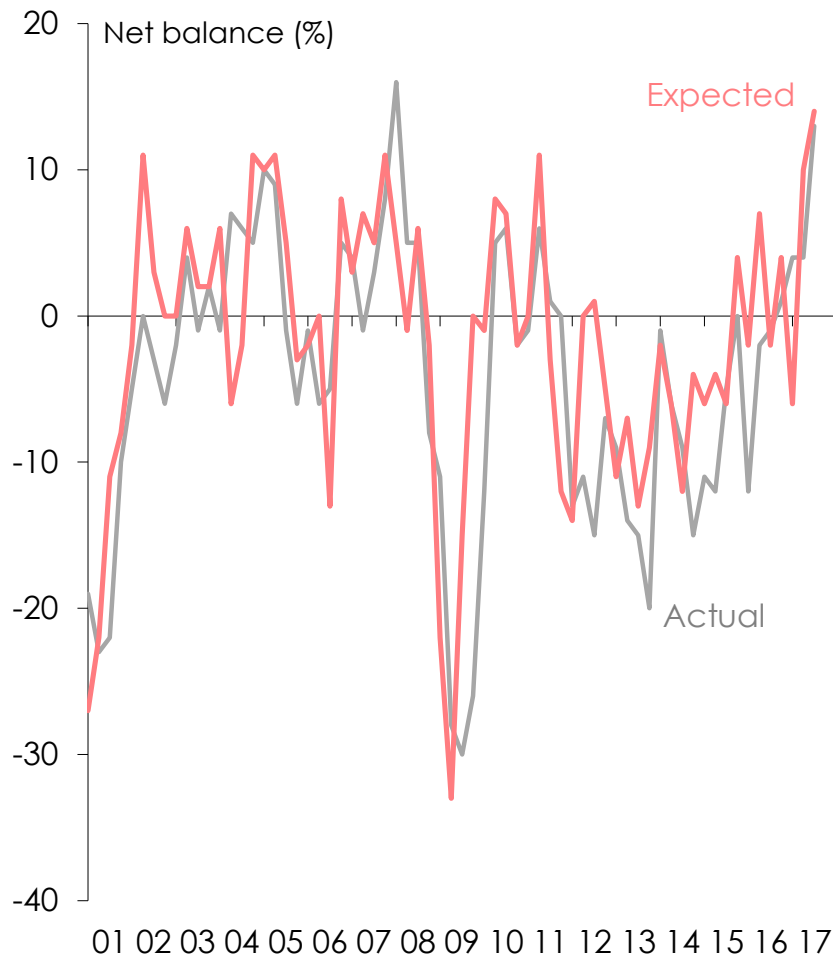
Sources: US Bureau of Labor Statistics; Japan Ministry of Health, Labour & Welfare; Deutsche Bundesbank; UK Office for National Statistics; Australian Bureau of Statistics.

Employment growth seems likely to pick up, which should eventually be reflected in stronger wages growth

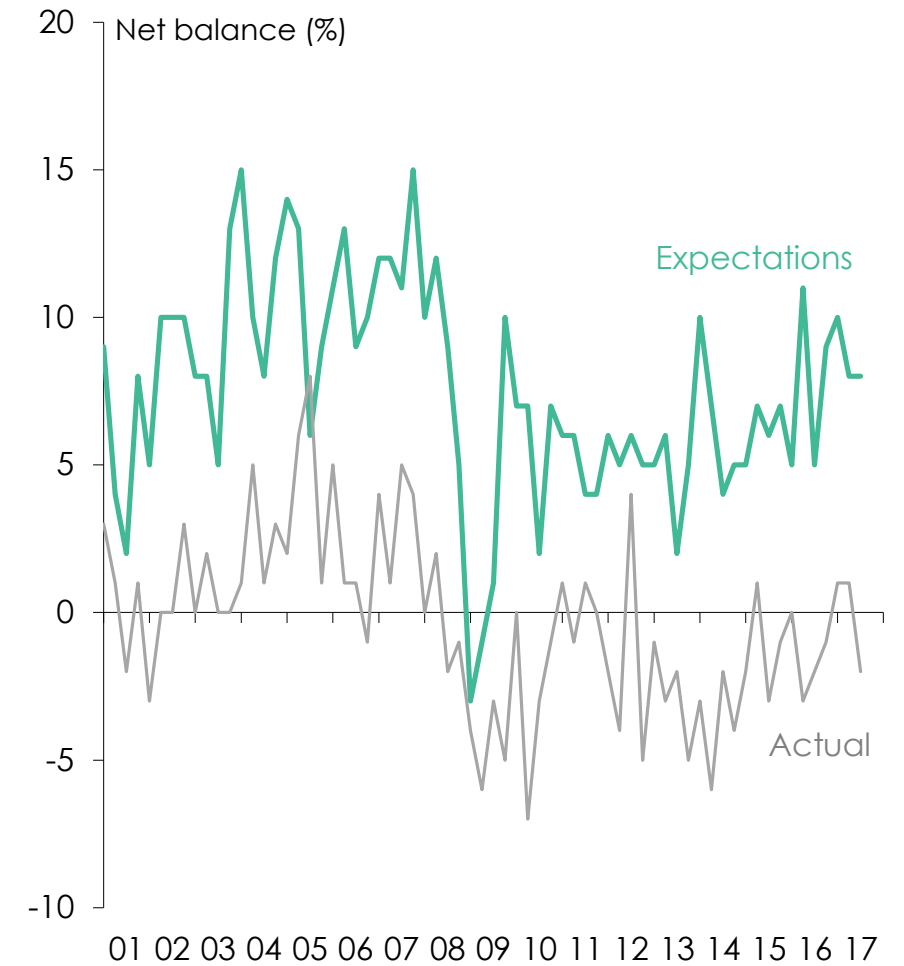
NAB survey of employer hiring intentions



Westpac-ACCI survey – employee numbers



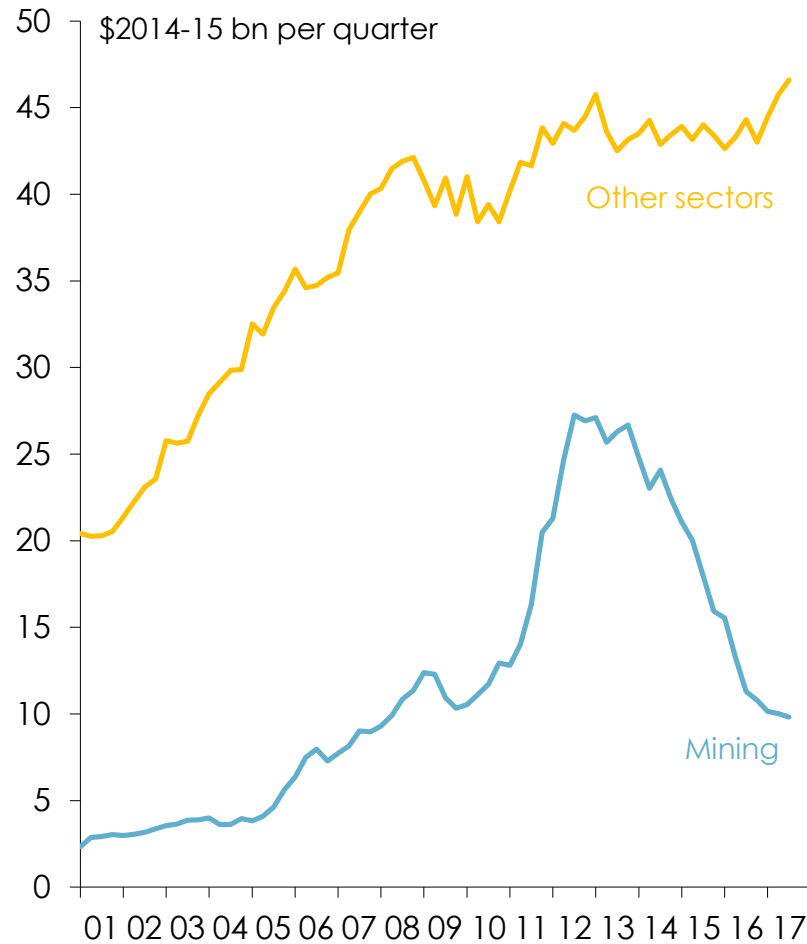
Sensis SME survey – size of workforce



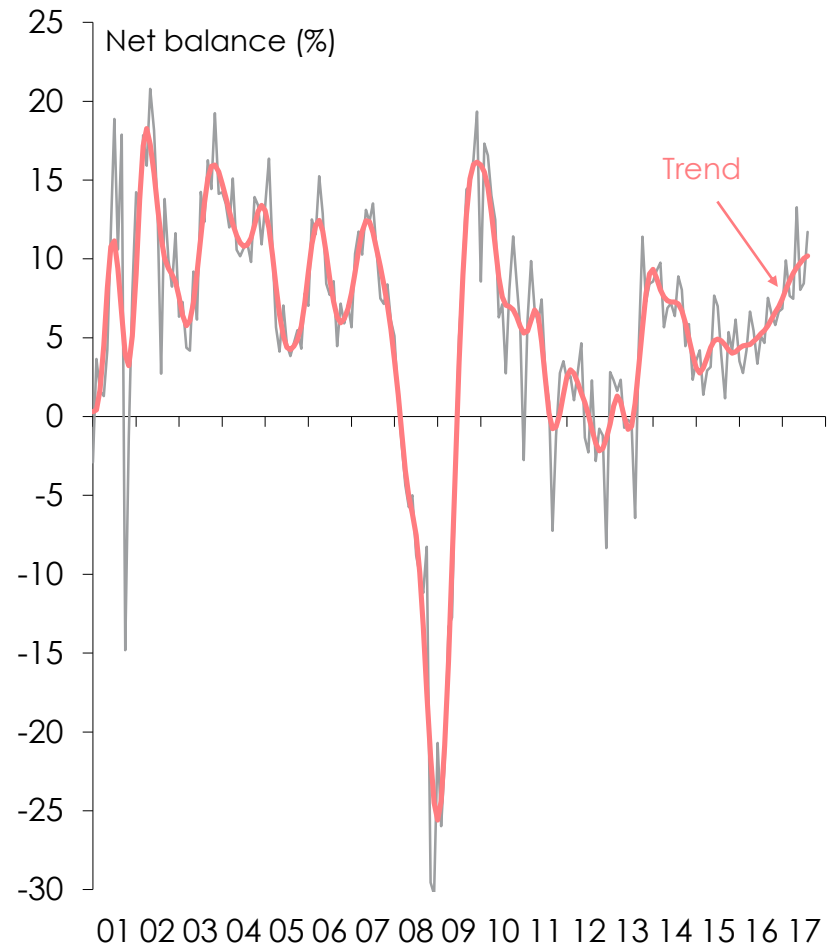
Sources: National Australia Bank; Westpac and Australian Chamber of Commerce & Industry; Sensis.

Similarly it seems likely that business investment has 'bottomed out' and will pick up over the next year

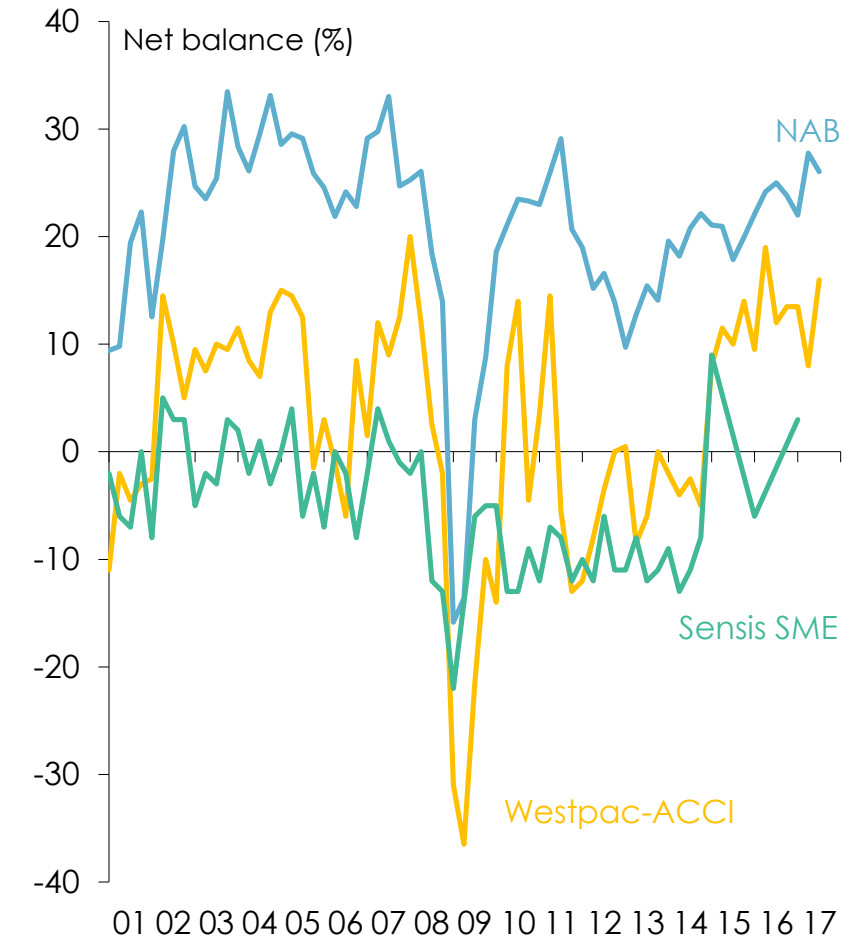
Business investment – mining vs other sectors



Business confidence



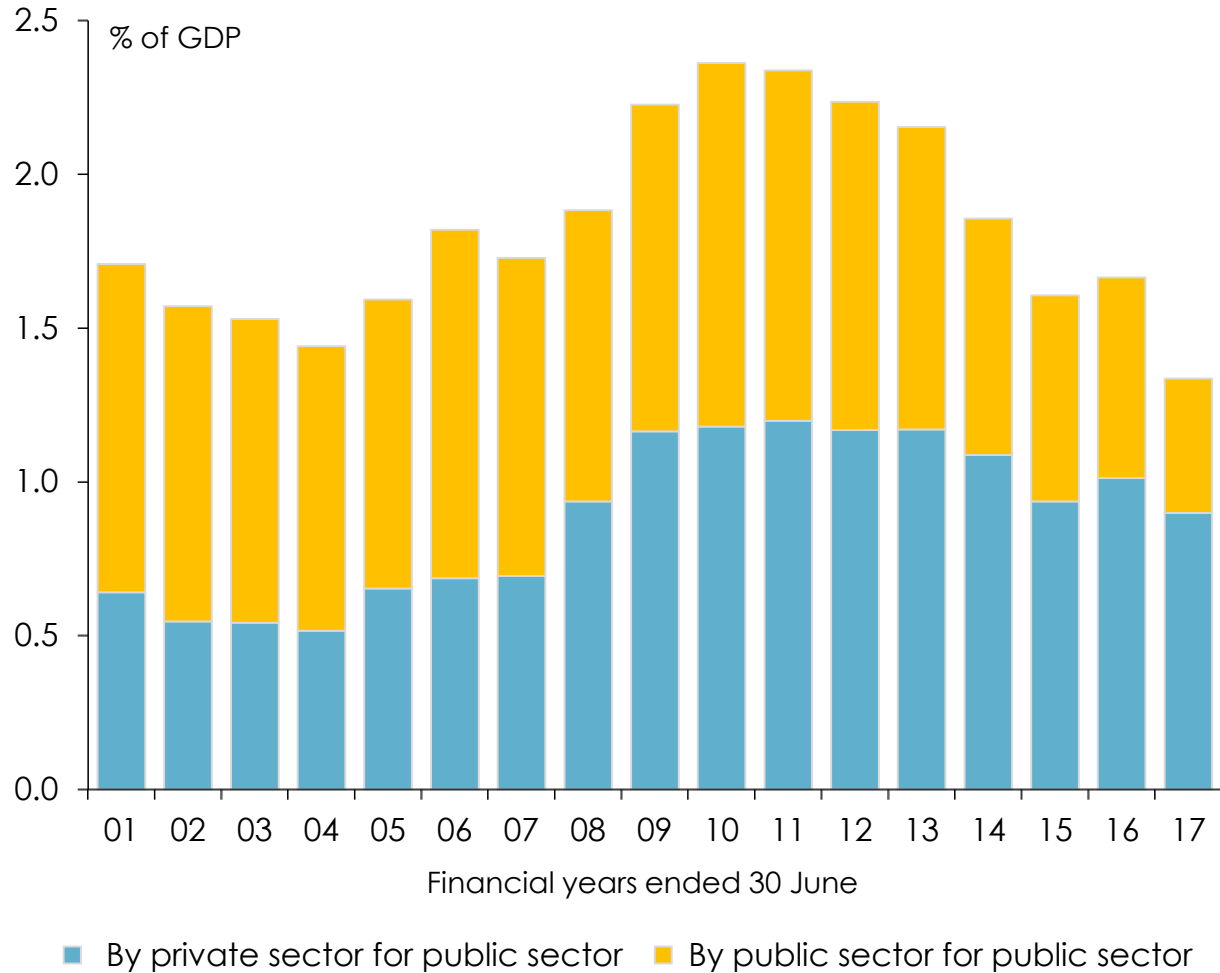
Business survey capital expenditure expectations



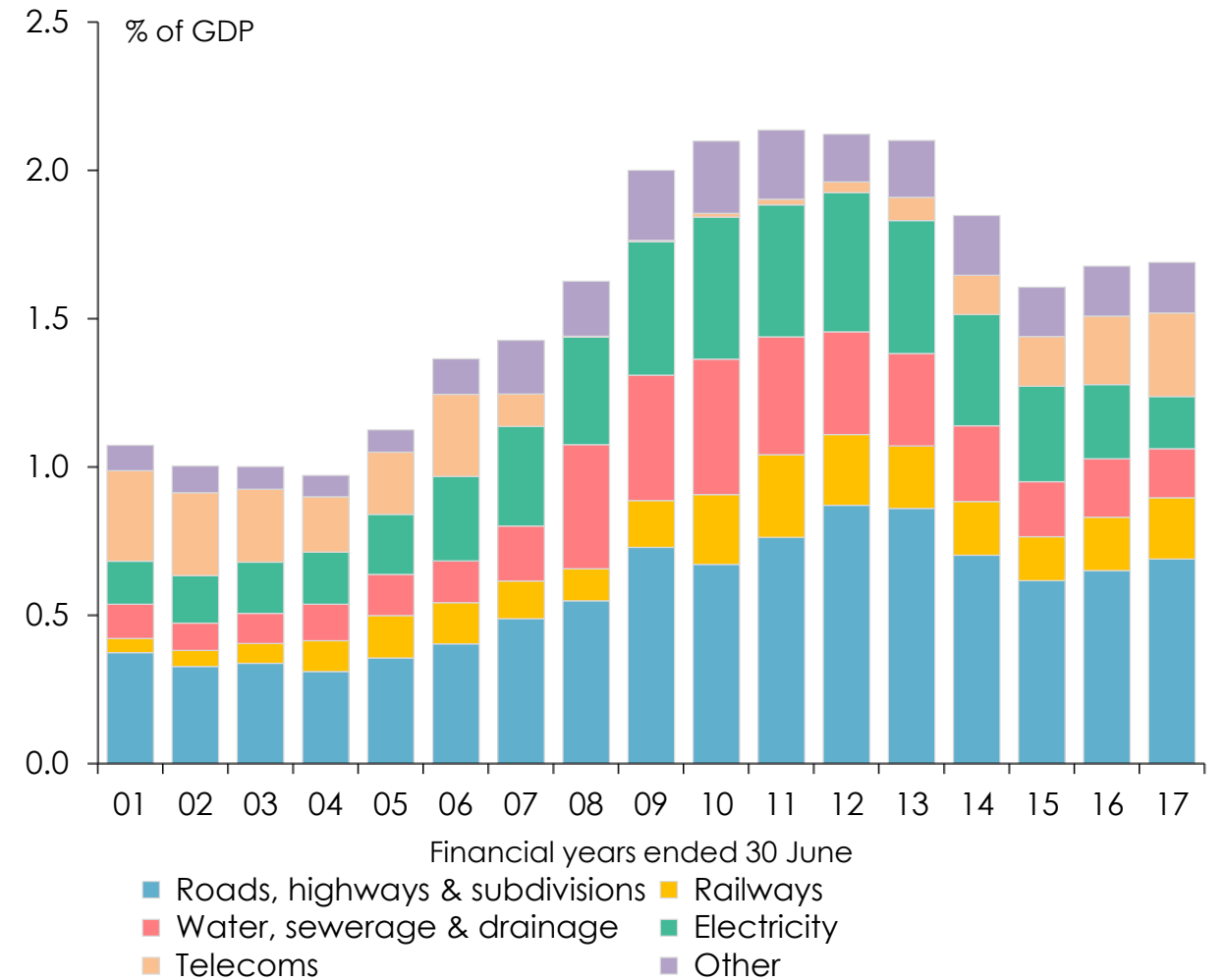
Sources: National Australia Bank; Westpac and Australian Chamber of Commerce & Industry; Sensis.

Infrastructure spending by Australian governments has declined (as a proportion of GDP) over the past five years ...

Engineering construction work done for the public sector, by sector, as pc of GDP



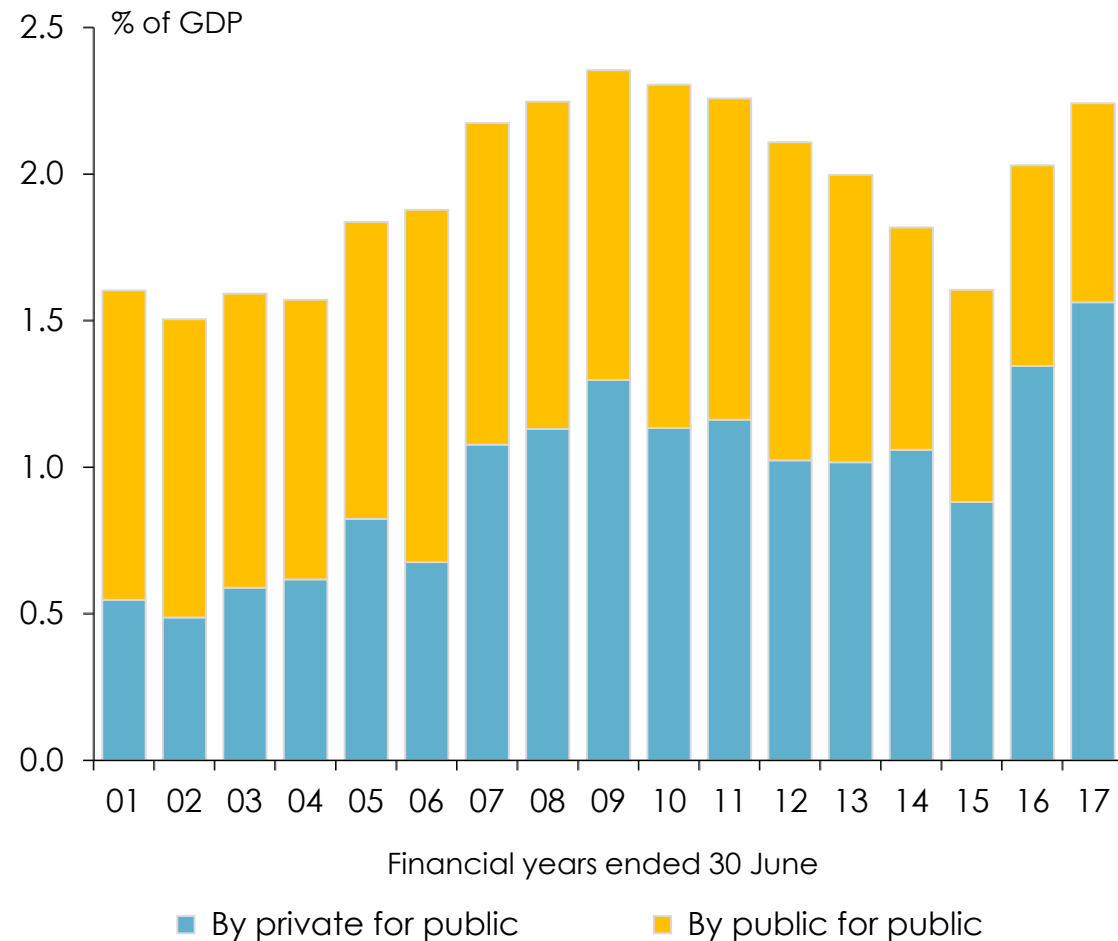
Engineering construction work done for the public sector, by type, as pc of GDP



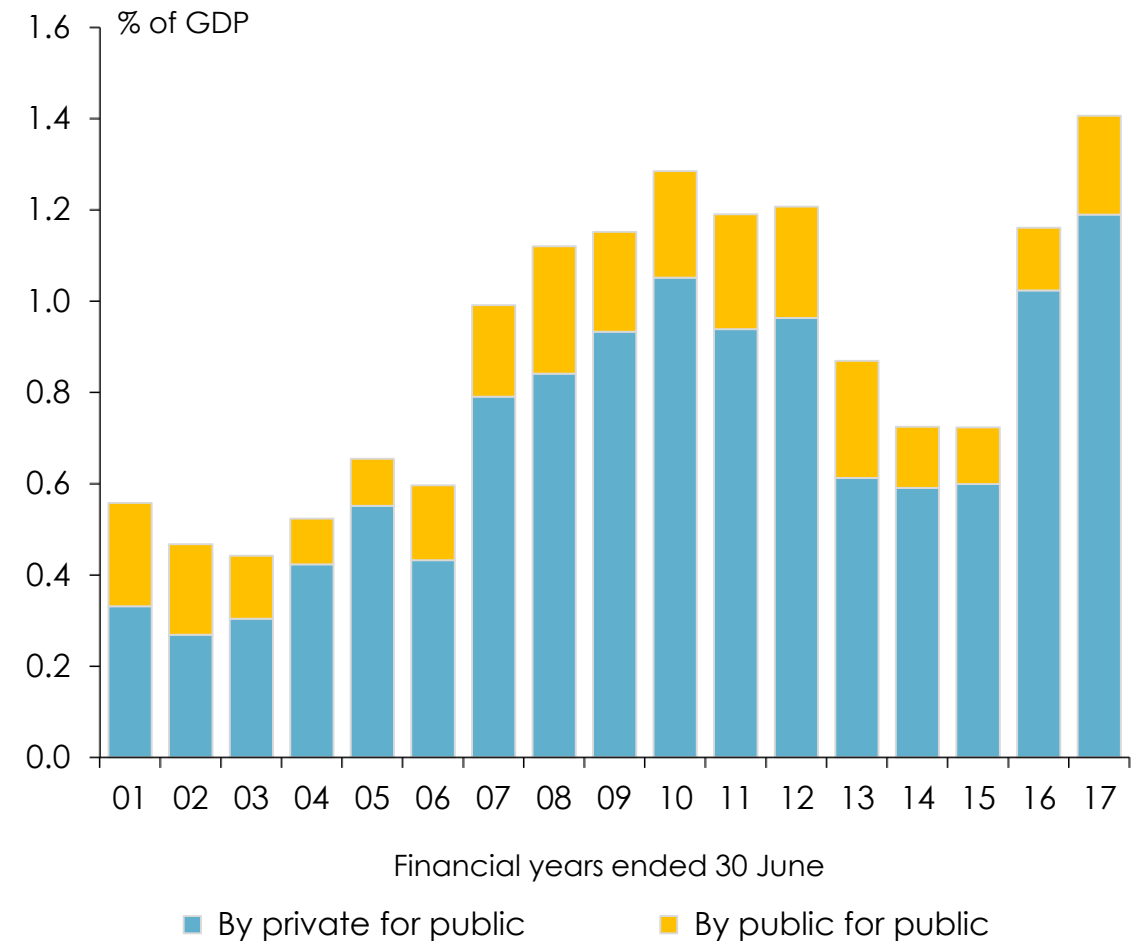
Note: Estimates of work done by type for 2016-17 are based on data for the first three quarters of the financial year.
 Sources: ABS, *Engineering Construction Activity* (8762.0), March quarter 2017 and *Construction Work Done, Preliminary* (8755.0), June quarter 2017.

... although it seems likely to increase again over the next few years ...

Engineering construction commencements for the public sector



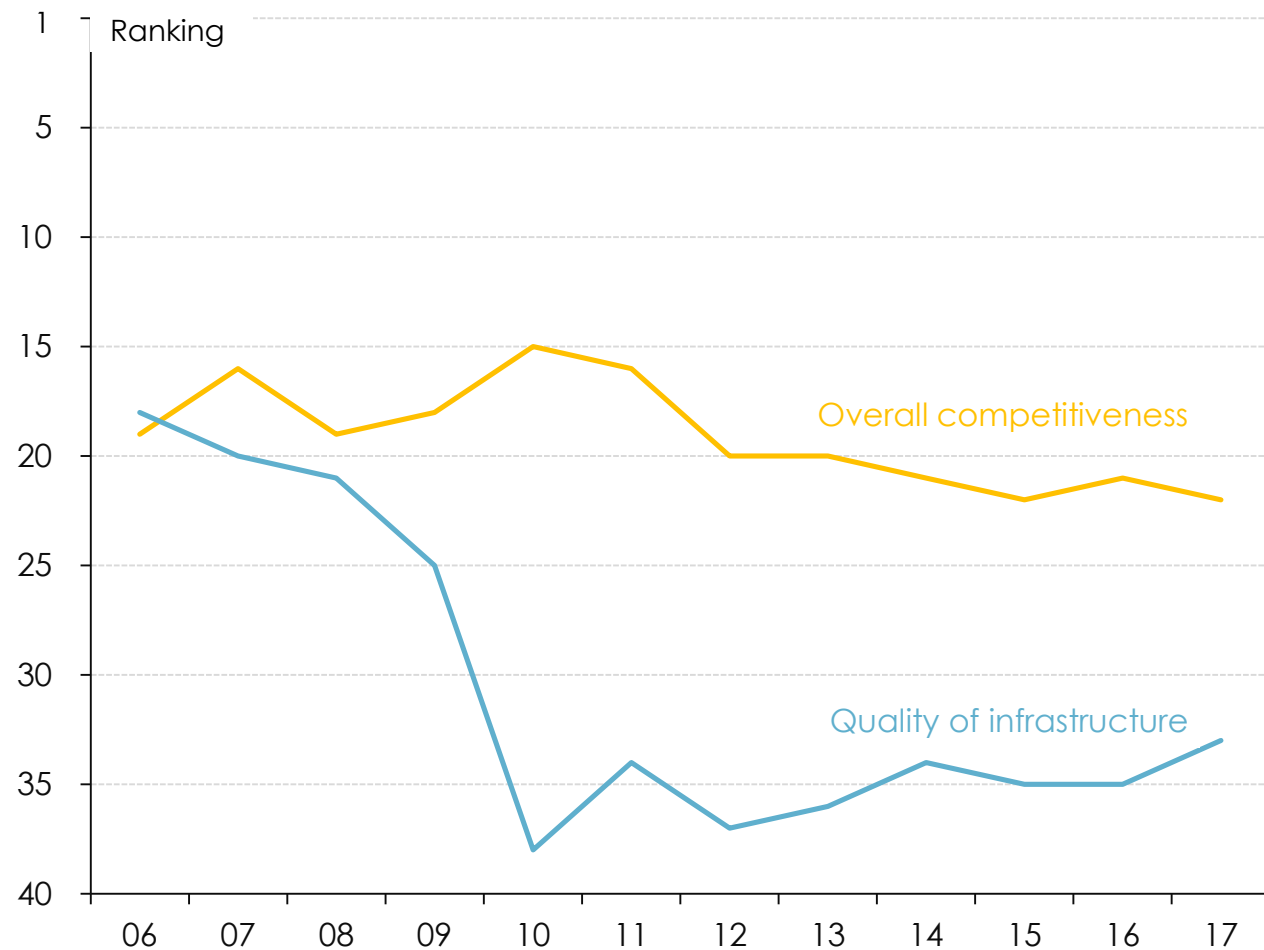
Engineering construction work for the public sector yet to be done



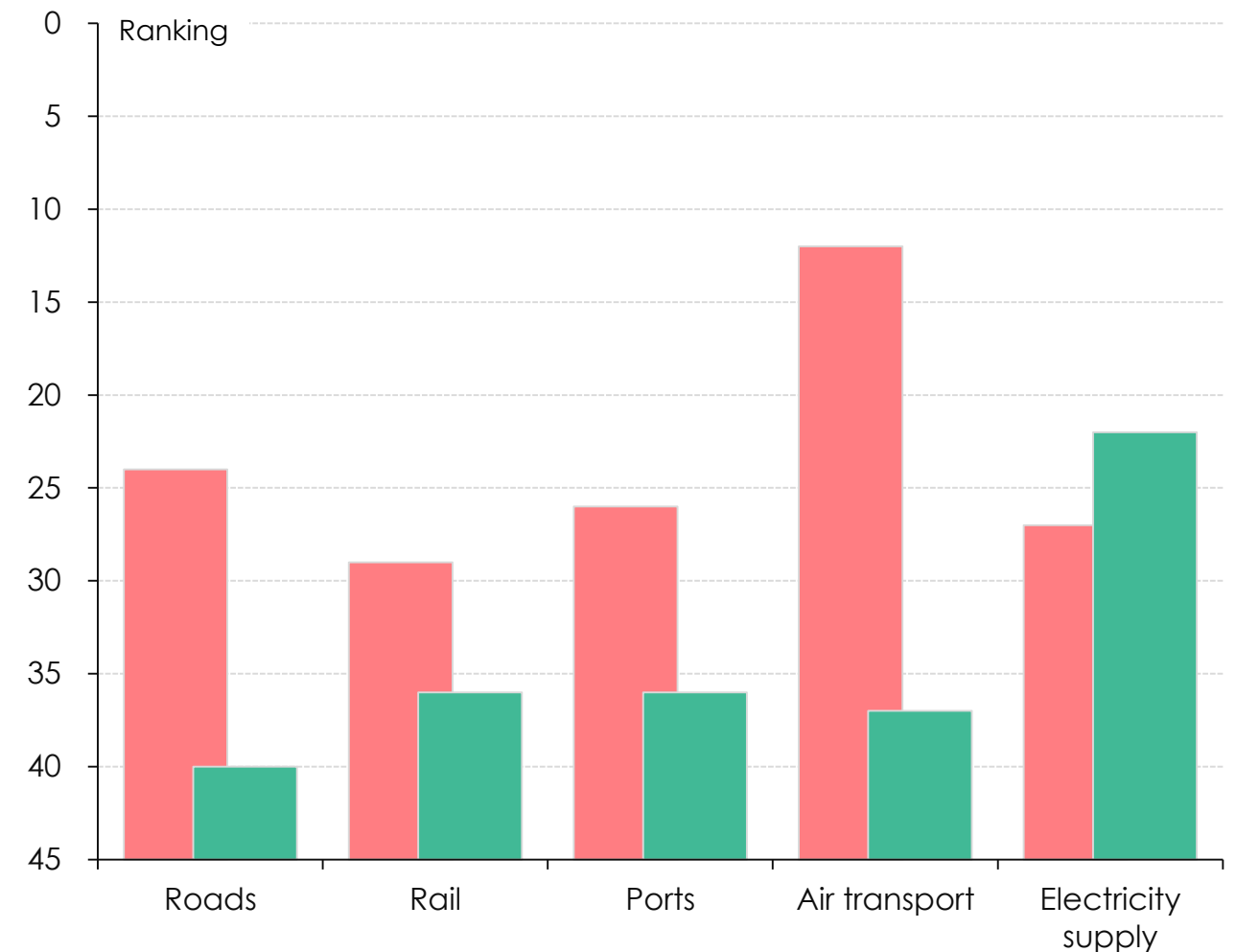
Note: Estimates of commencements and work yet to be done for 2016-17 are as at 31 March 2017
Sources: ABS, *Engineering Construction Activity* (8762.0), March quarter 2017.

... as it needs to, given that Australia's infrastructure ranks poorly, and detracts from our international competitiveness ...

Australia's overall competitiveness and 'infrastructure quality' rankings



Perceived quality ranking of Australian infrastructure, 2007 and 2017



Note: The quality of infrastructure rankings are based on responses to the World Economic Forum Executive Opinion Survey. The overall competitiveness rankings are derived from a combination of 114 indicators including both 'hard' statistics and results from the Executive Opinion Survey.

Source: World Economic Forum, *The Global Competitiveness Report*, 2016-17 and previous years.

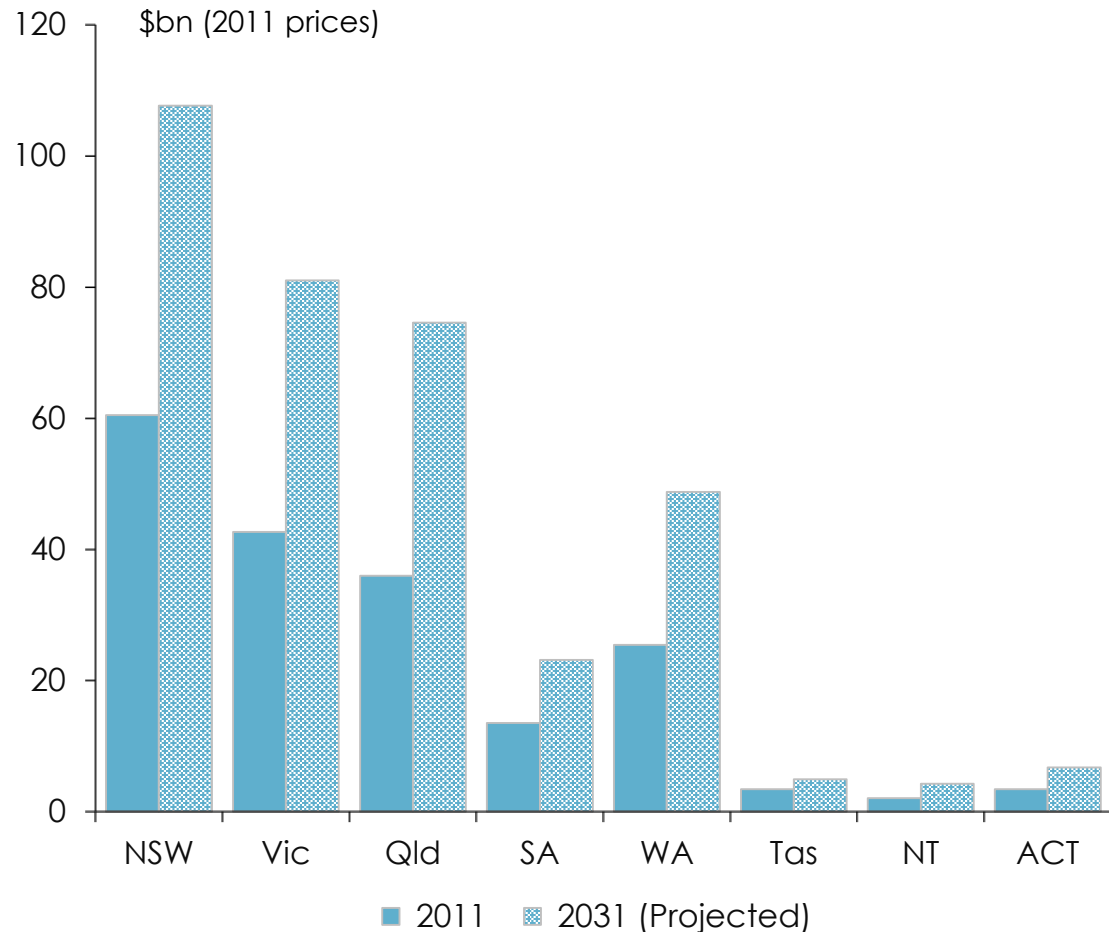
... and that the demands on Australia's infrastructure are likely to continue to grow

Key findings of Infrastructure Australia's National Infrastructure Audit 2015

- ❑ **Australia's population is growing faster than that of any other 'advanced' economy with more than 10mn people, and is expected to exceed 30mn by 2031 (up from 24.6mn today)**
 - more than 70% of this growth is expected to occur in Sydney, Melbourne, Brisbane and Perth
- ❑ **'Demand' for infrastructure services is expected to grow by 3.6% pa through to 2031**
 - ½ pc point per annum faster than the projected growth rate of the Australian economy
- ❑ **In the absence of additional capacity and/or 'demand management', the cost of congestion in capital cities is expected to increase by 290%, to over \$53bn, by 2031 (from \$13.7bn in 2011)**
- ❑ **The national land freight task is expected to have grown by 80% by 2031 compared with 2011 levels, while traffic through some ports is projected to "significantly exceed current capacity by 2031"**
- ❑ **Demand for airport infrastructure is projected to have doubled from 2011 levels by 2031**
- ❑ **Although demand for water infrastructure is projected to grow "significantly slower than GDP", water quality in parts of regional Australia "does not meet relevant standards"**
- ❑ **Climate change "is likely to have considerable impacts on infrastructure assets"**
- ❑ **"There are grounds for concern that Australia's infrastructure networks and the systems under which they are managed are not meeting" Australians' expectations that "their infrastructure networks support a high quality, first world standard of living" and "to improve their quality of life in the future"**

NSW accounts for just under 30% of the projected increase in national infrastructure demand – a little less than its current population share

Projected growth in infrastructure demand, 2011-2031, by State and Territory

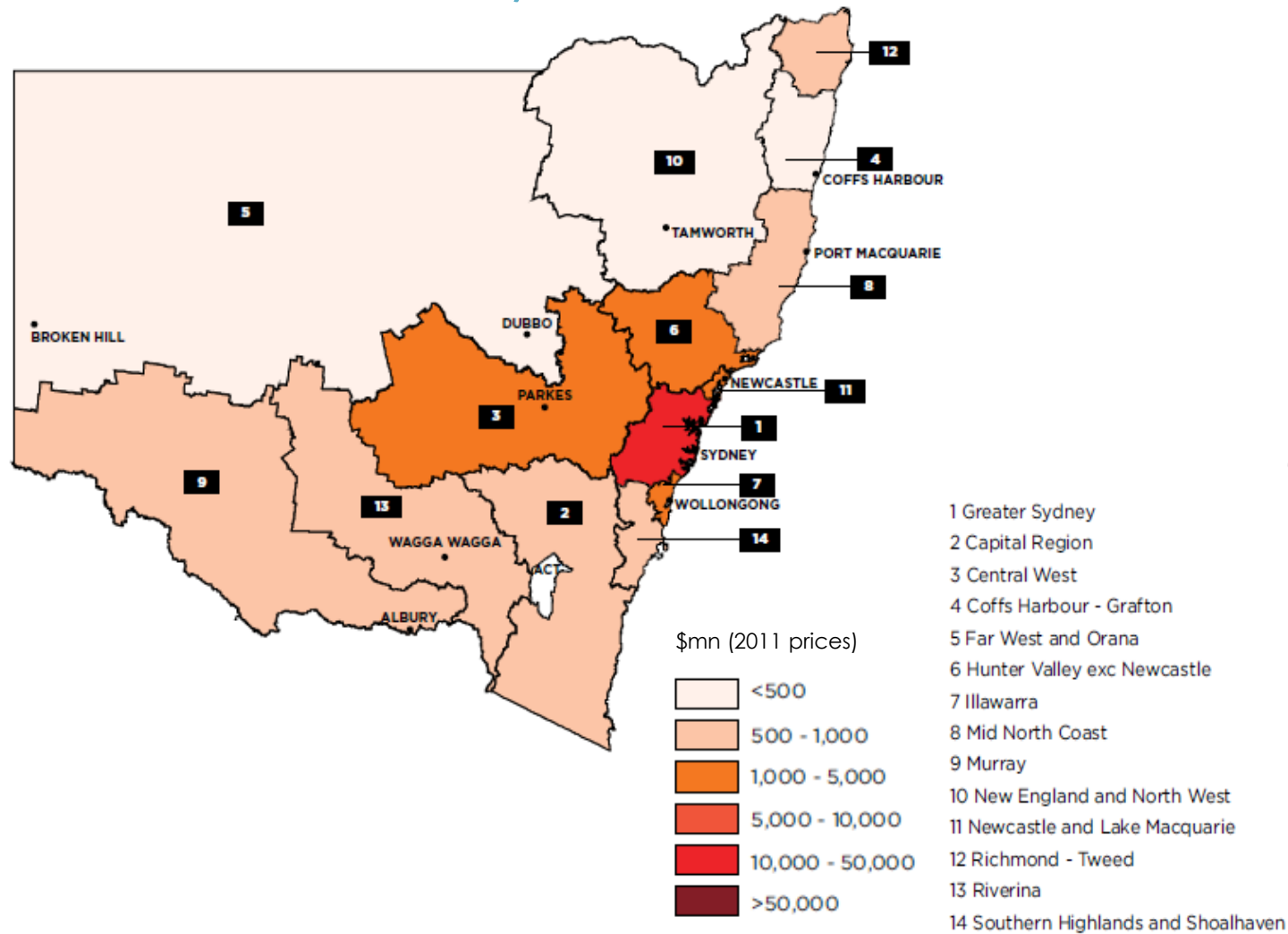


Direct economic contribution of infrastructure

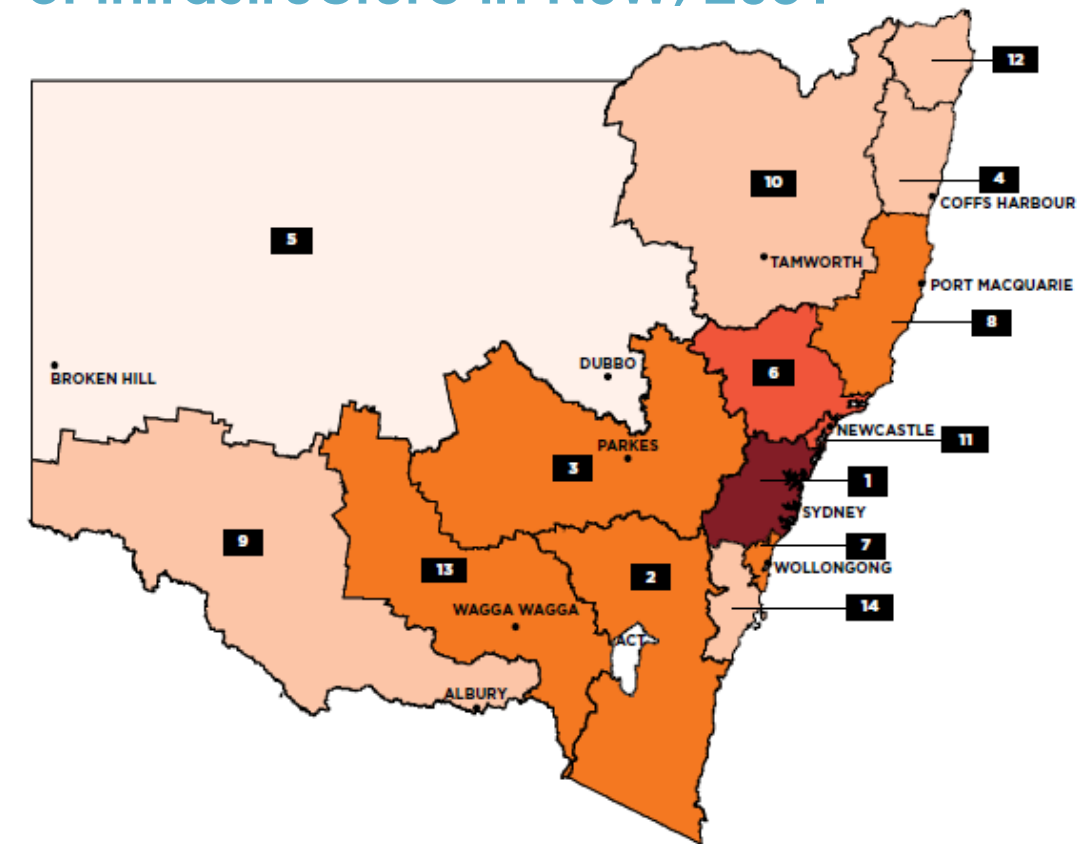
	Pc of national total, 2011	Projected pc change, 2011-2031	Pc of national total projected change
NSW	32.3	78.0	28.8
Vic	22.8	89.9	23.4
Qld	19.2	107.1	23.5
SA	7.2	71.2	5.9
WA	13.6	91.6	14.2
Tas	1.8	44.5	0.9
NT	1.1	107.6	1.3
ACT	1.8	95.6	2.0
Total	100.0	87.7	100.0

Much of the growth in NSW infrastructure will be in Greater Sydney, but also in the Hunter, Newcastle, Illawarra and Central West regions

Direct economic contribution of infrastructure in NSW, 2011



Projected direct economic contribution of infrastructure in NSW, 2031



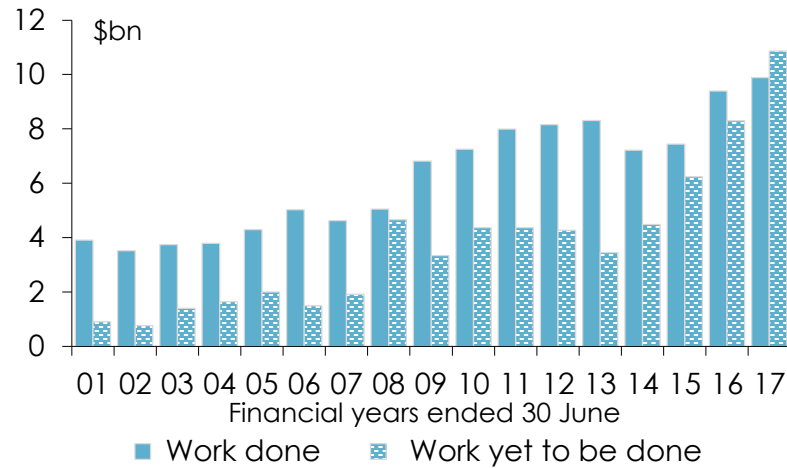
Note: The quality of infrastructure rankings are based on responses to the World Economic Forum Executive Opinion Survey. The overall competitiveness rankings are derived from a combination of 114 indicators including both 'hard' statistics and results from the Executive Opinion Survey.

Source: World Economic Forum, *The Global Competitiveness Report*, 2016-17 and previous years.

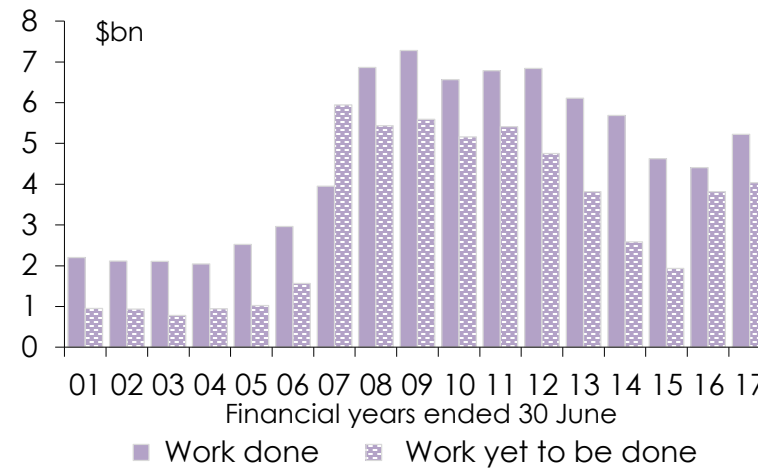
38% of the infrastructure construction work being done, and 45% of the work to be done, is in New South Wales

Engineering construction work done, and yet to be done, for the public sector, by State

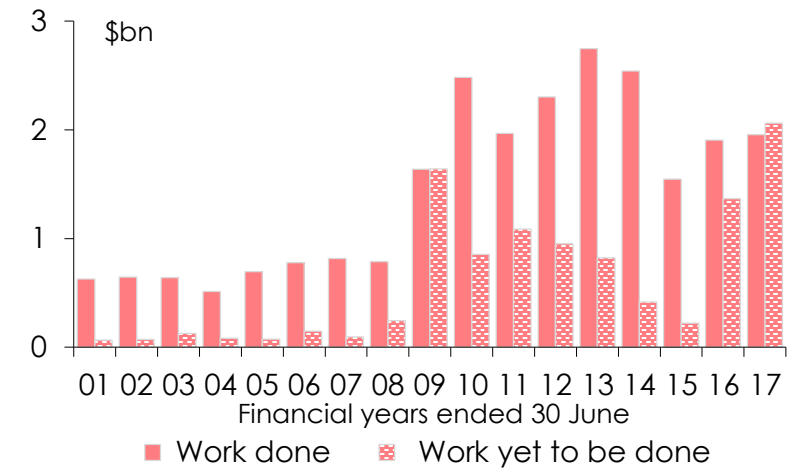
New South Wales



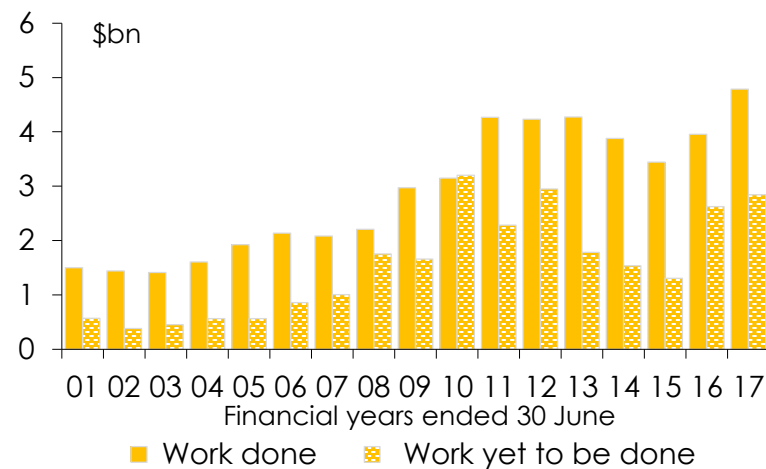
Queensland



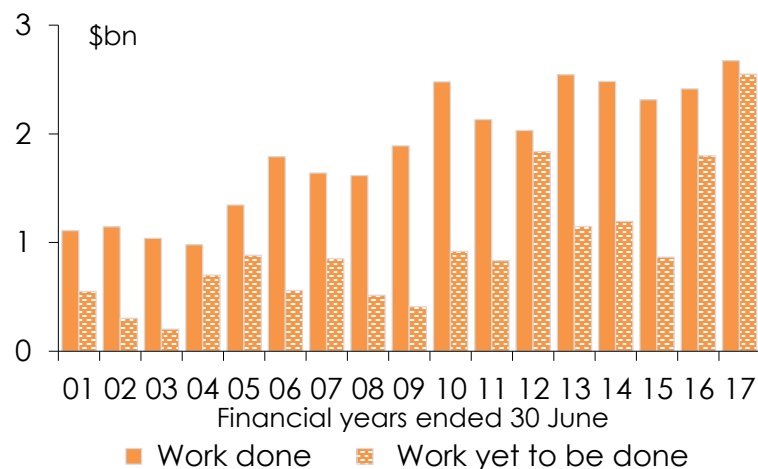
South Australia



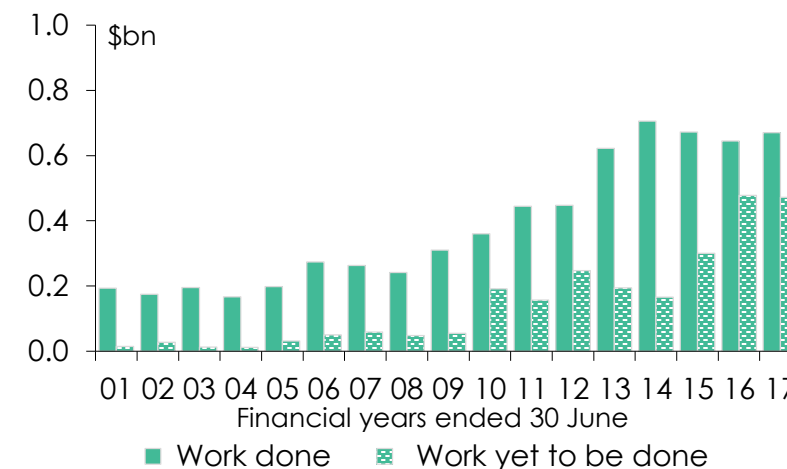
Victoria



Western Australia



Tasmania

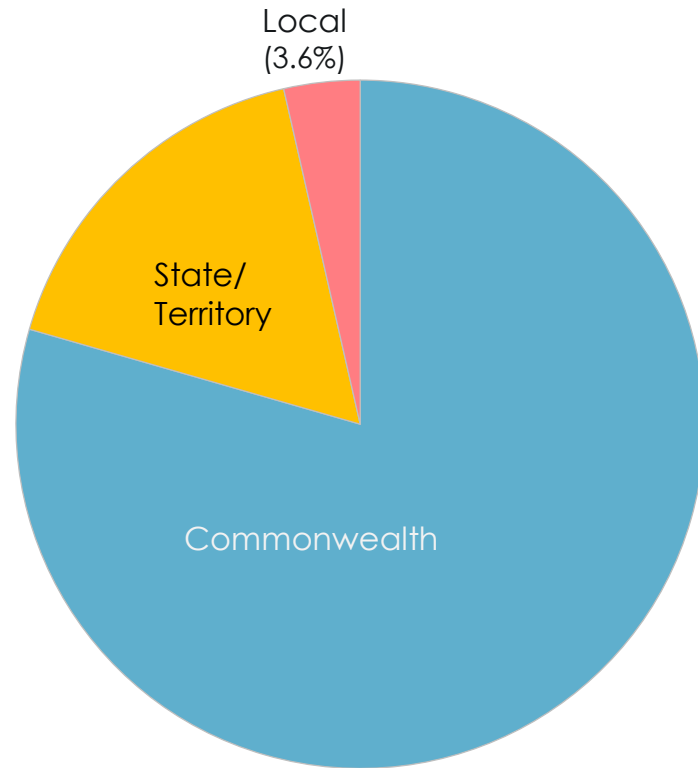


Note: Estimates of work done in 2016-17 are for the first three quarters, at an annual rate, while the estimate of work yet to be done is as at 31 March 2017. Figures exclude work on electricity assets and pipelines given the differences in public vs private ownership of these assets across States and Territories. Sources: ABS, *Engineering Construction Activity* (8762.0), March quarter 2017.

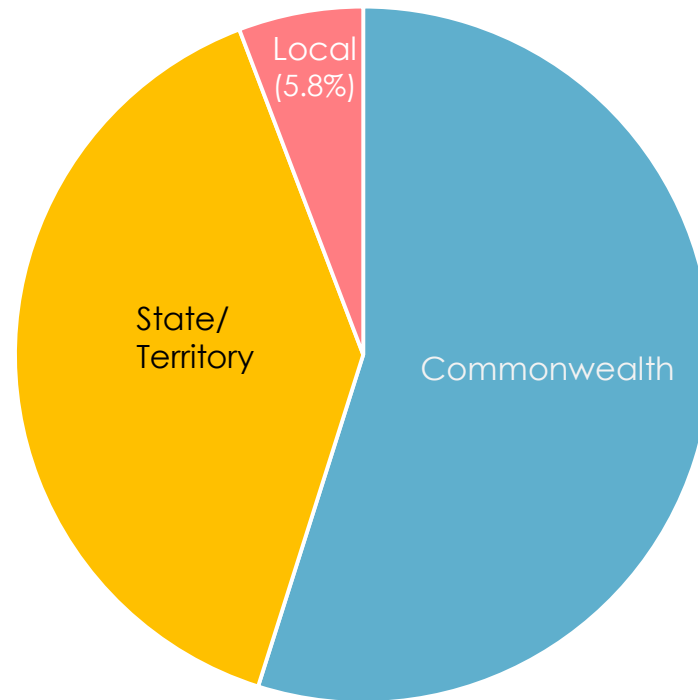
**And what's the relevance of all this to
local government?**

Local government accounts for a very small share of total public sector taxation revenue, recurrent spending and employment ...

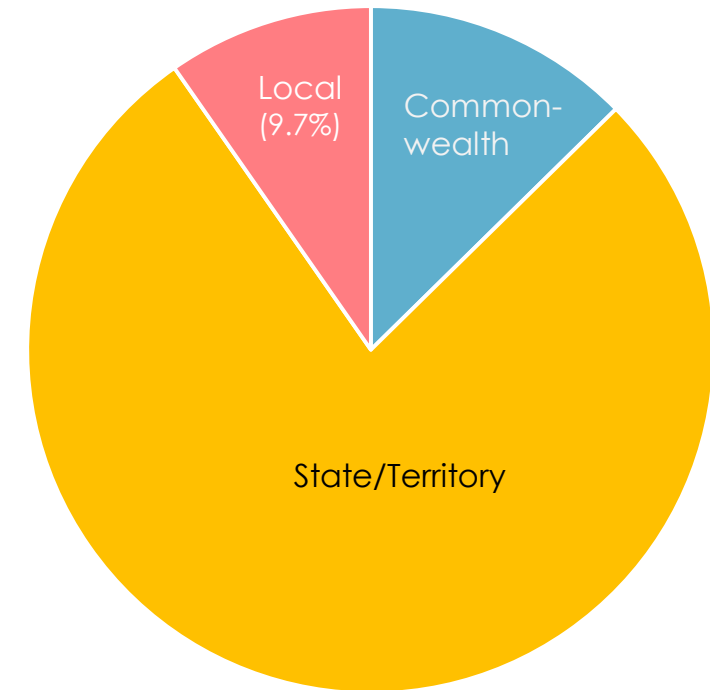
Shares of taxation revenue, 2015-16



Share of own-purpose 'operating expenses', 2015-16



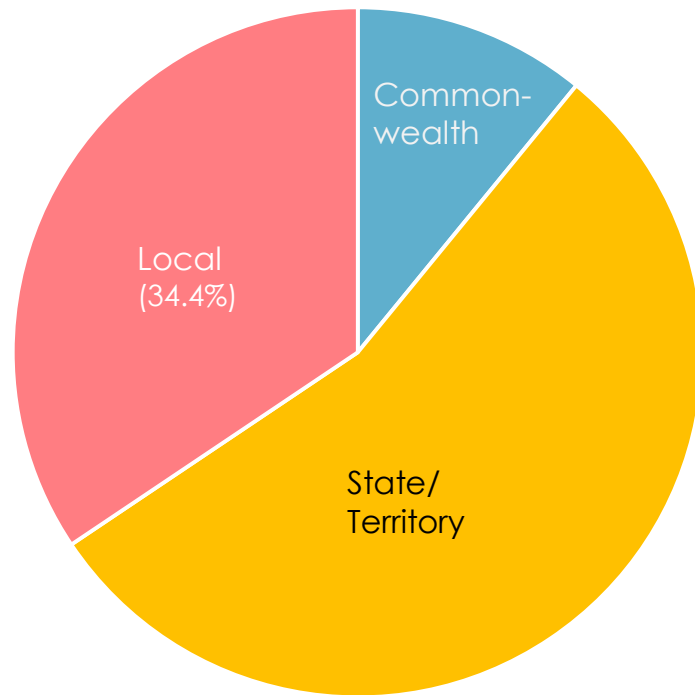
Share of employment, 2015-16



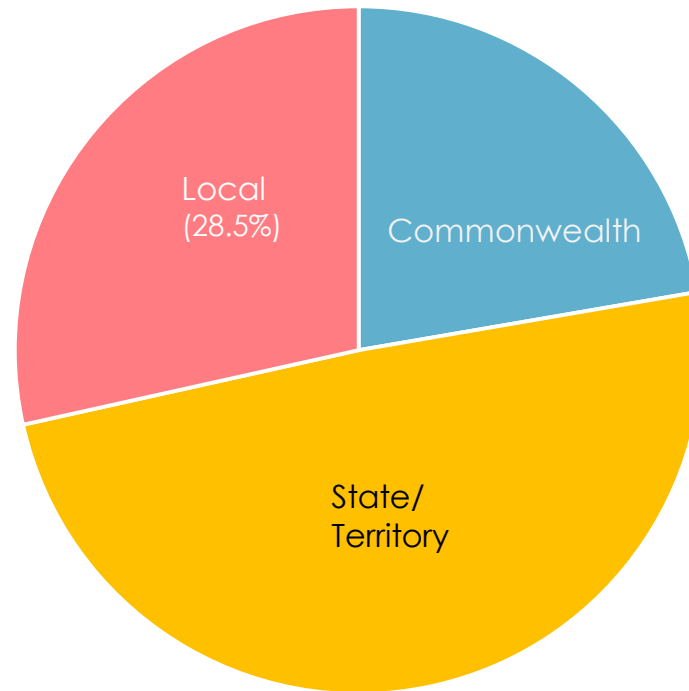
Source: Australian Bureau of Statistics, *Government Finance Statistics* (5512.0), 2015-16; *Employment and Earnings, Public Sector* (6248.0.55.002), 2015-16.

... but for a much larger share of total public sector assets, capital expenditures and user charges

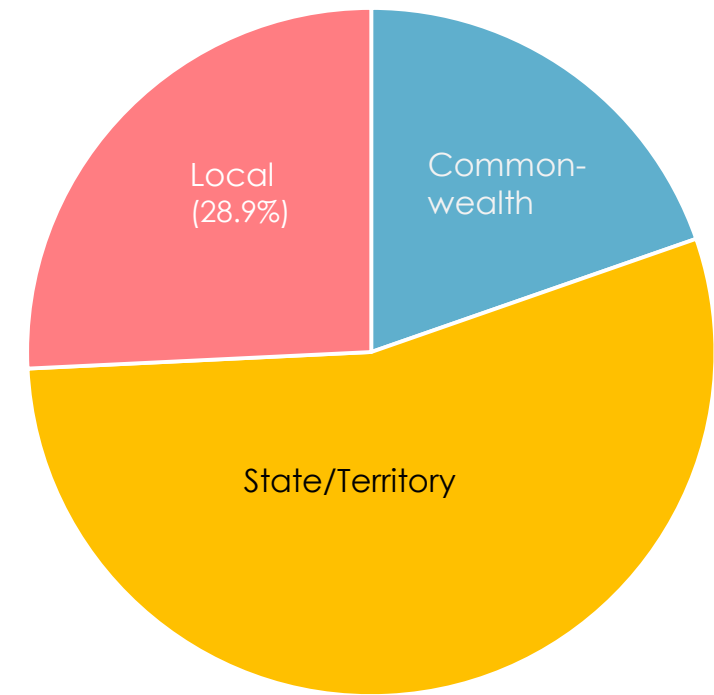
Shares of land and fixed assets owned, June 2016



Share of gross fixed capital formation spending, 2015-16



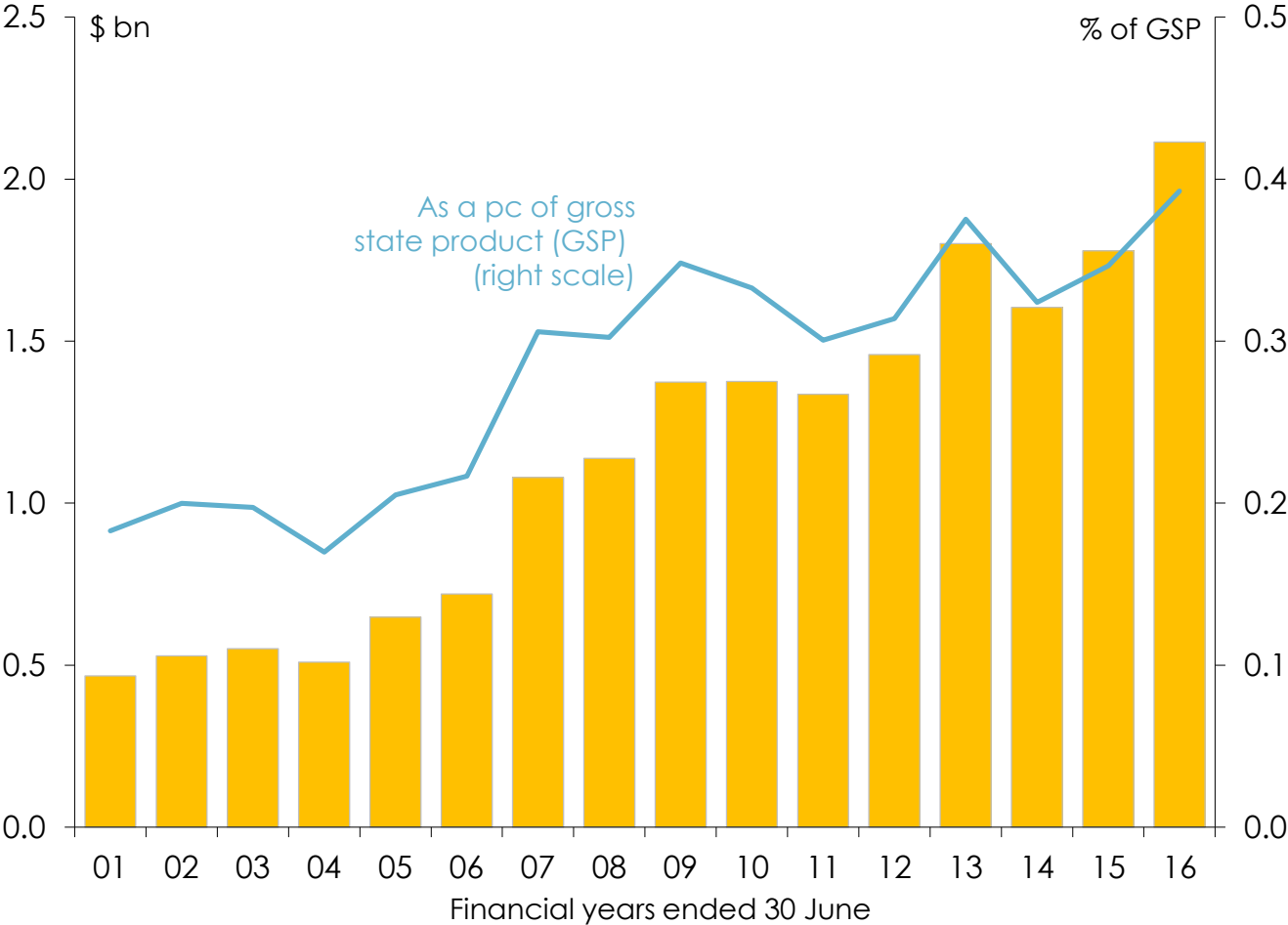
Share of revenue from user charges, 2015-16



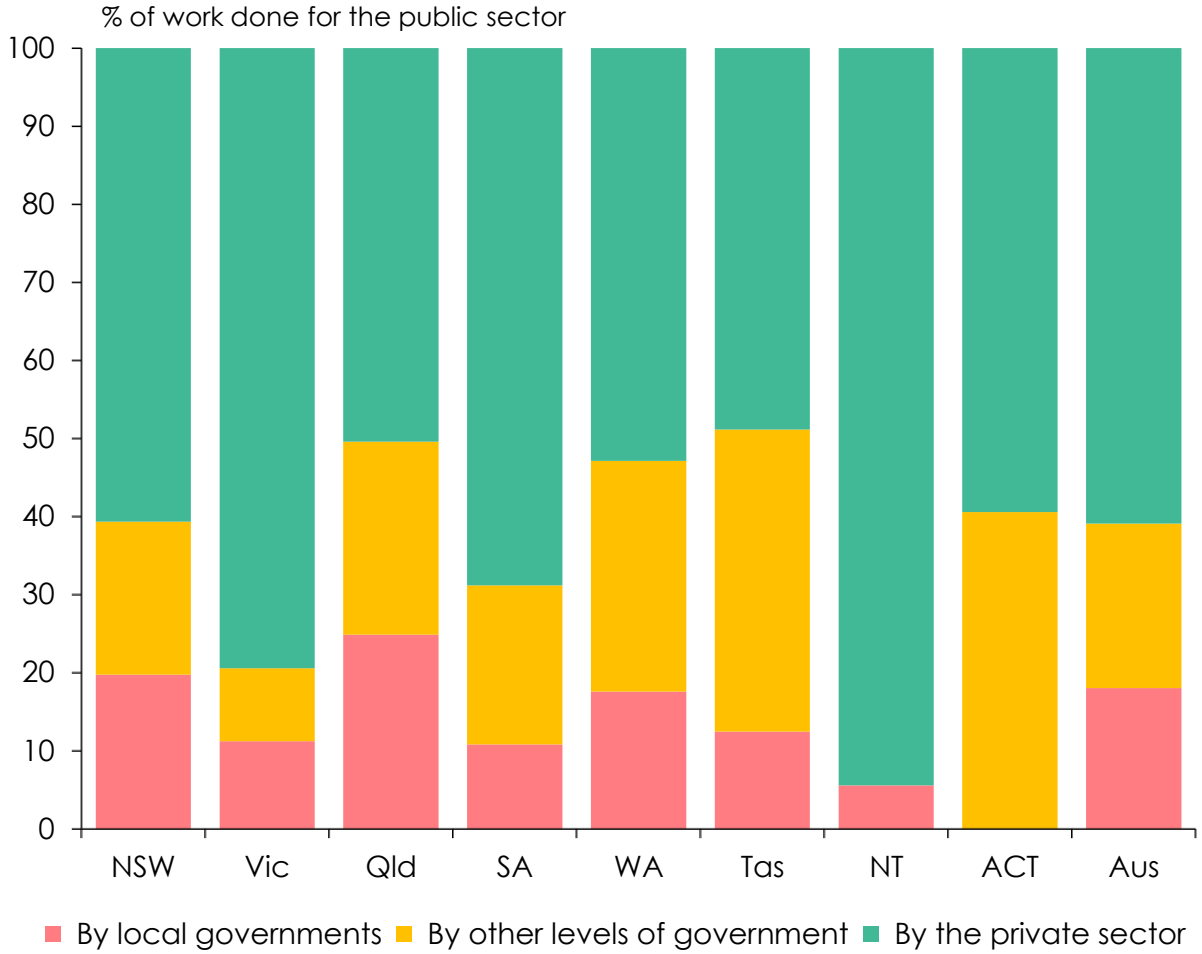
Source: Australian Bureau of Statistics, *Government Finance Statistics* (5512.0), 2015-16.

Local governments have a larger role in infrastructure spending in NSW than in most other States

Engineering construction (EC) work done by local governments in NSW



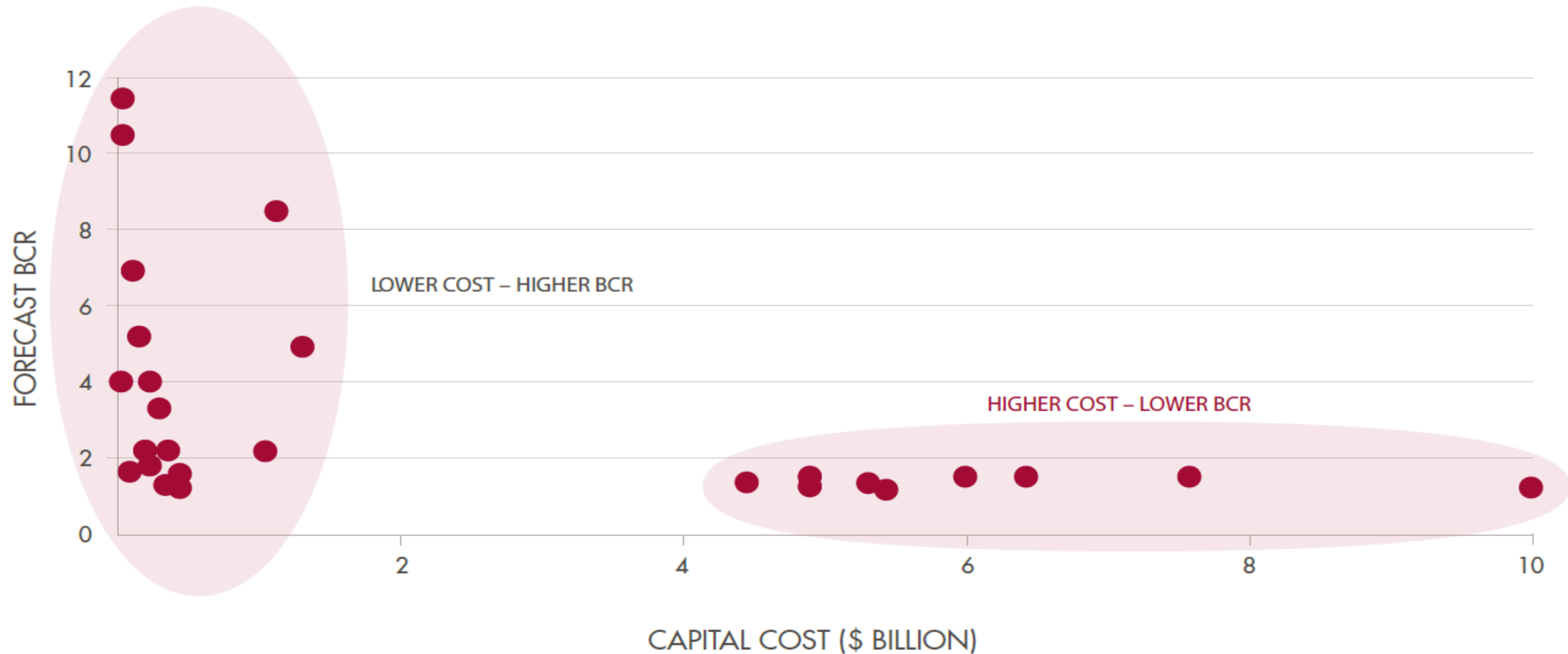
EC work done by local governments as a pc of total for the public sector, 2015-16



Source: Australian Bureau of Statistics, *Engineering Construction Activity (8762.0)*, March quarter 2017.

Local government projects are often relatively small, but smaller projects often deliver relatively high productivity benefits

Capital cost of infrastructure projects vs benefit-cost ratios (BCRs)



Source: Infrastructure Australia, *Australian Infrastructure Plan: Priorities and reforms for our nation's future*, February 2016, p. 25.

Big or small, infrastructure projects have to be paid for – what are the options for local government?

❑ Higher rates

- limited scope in NSW given long-standing rate-pegging, and state-mandated exemptions and concessions
- problematic for councils outside of major urban areas
- unfair to make current generations pay full cost of infrastructure that will benefit future generations as well

❑ User charges

- have considerable merit in principle on 'fairness' grounds, and (if intelligently structured) as a way of encouraging more rational use of both existing and new infrastructure
- were supported by 2009 Henry Review
- technology is opening up new ways of charging users of infrastructure (eg roads)

❑ New ways of tapping into increases in property values associated with infrastructure projects

- 'value capture' could contribute 10-30% of direct infrastructure costs within a defined area
- used overseas (eg London Crossrail) and in Australia (eg Sydney Harbour Bridge, Melbourne City Loop)
- supported by Productivity Commission, Business Council of Australia, the RBA and Infrastructure Australia
- but would require change in state government policy

❑ Grants from other levels of government

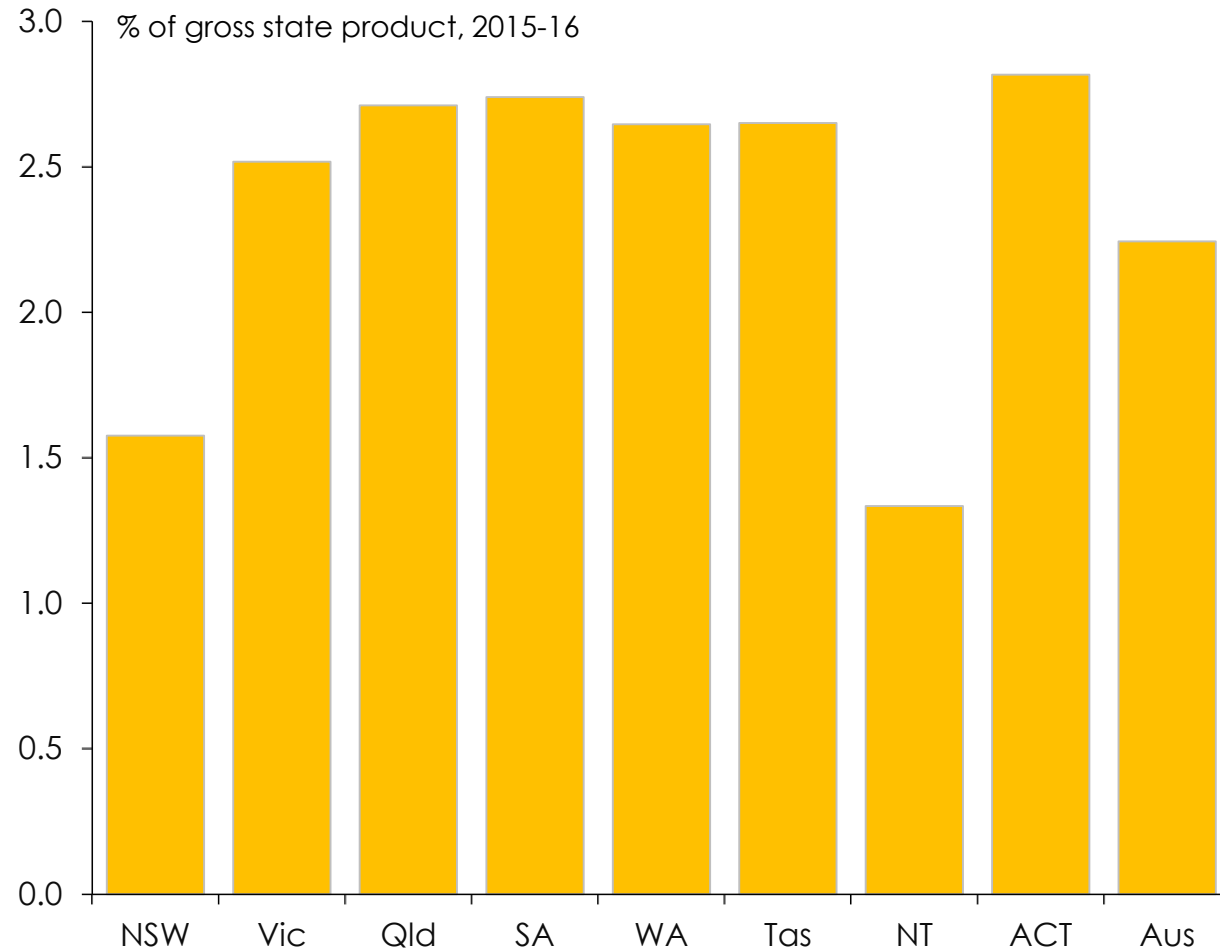
- difficult given budgetary constraints facing Commonwealth government

❑ Increased borrowing

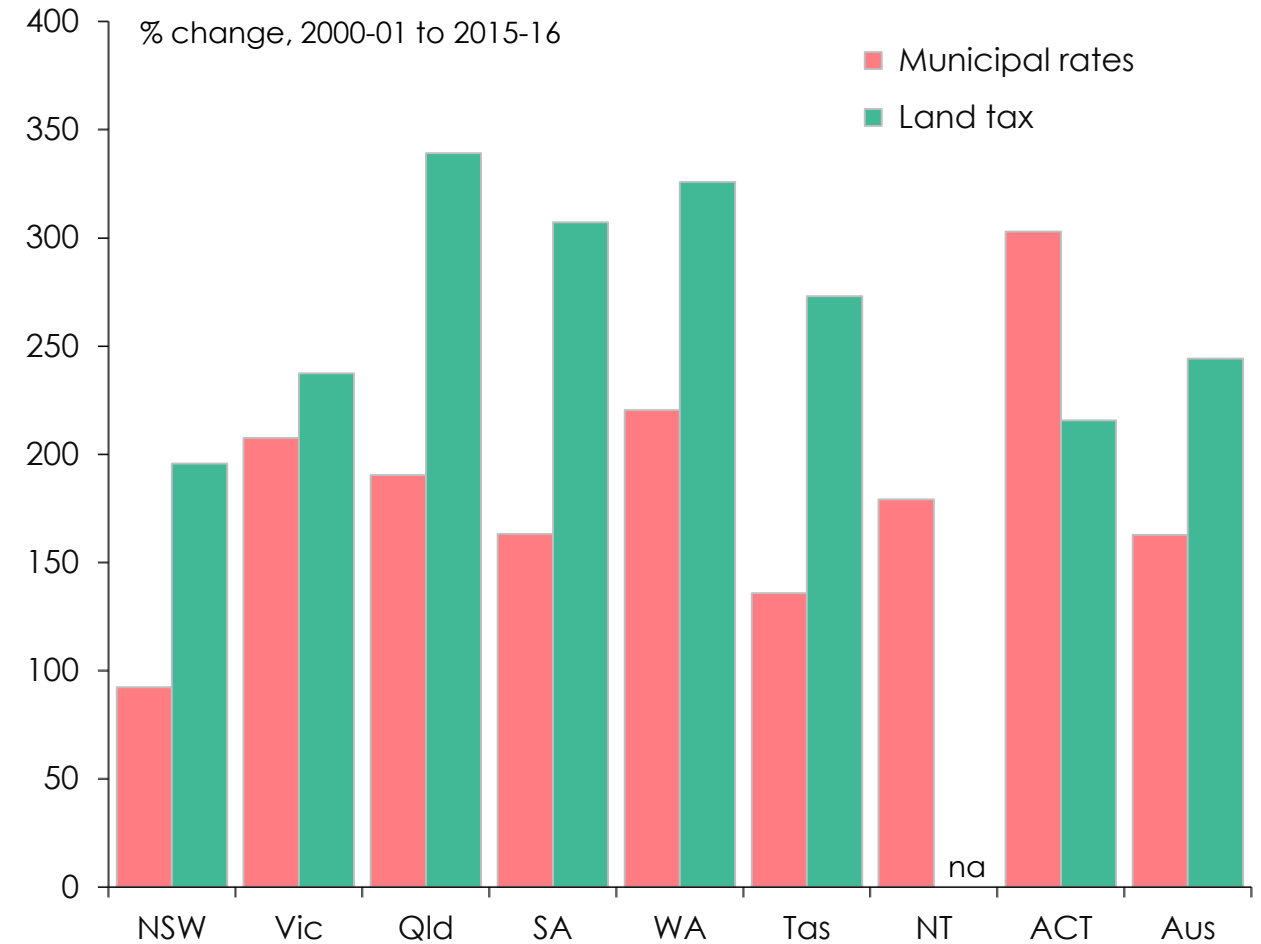
- prudent borrowing is a fair way of making future generations meet part of the cost of providing infrastructure from which they will benefit
- many local governments have scope to take on more debt

There is a stronger case for raising local government rates in NSW than in any other State

Local government rates as a pc of gross state product, 2015-16



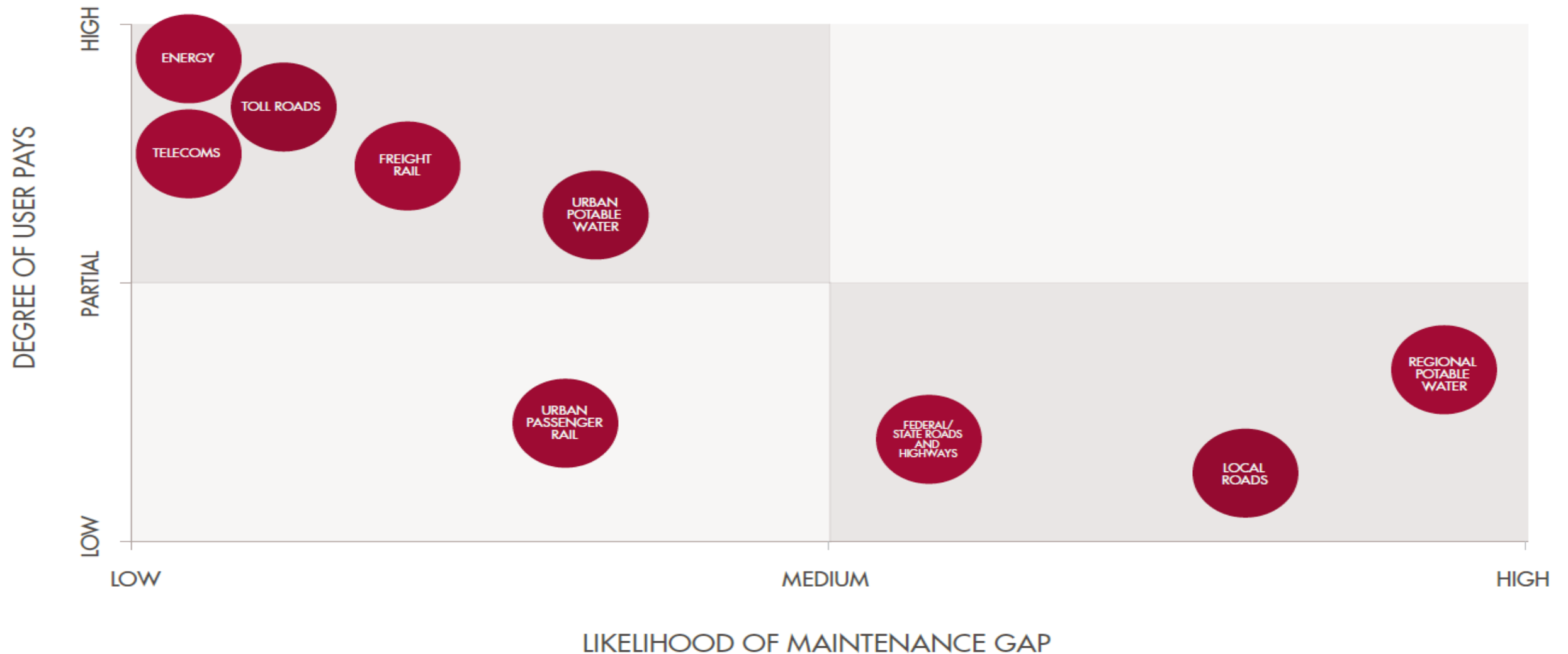
Increases in local government rates and state land tax, 2000-01 to 2015-16



Note: There is no land tax in the Northern Territory; while in the ACT, municipal rates are levied by the Territory Government.
Source: Australian Bureau of Statistics, *Taxation Revenue (5506.0)*, 2009-10 through 2015-16, and *State Accounts (5220.0)*, 2015-16.

'User pays' leads to better infrastructure maintenance outcomes

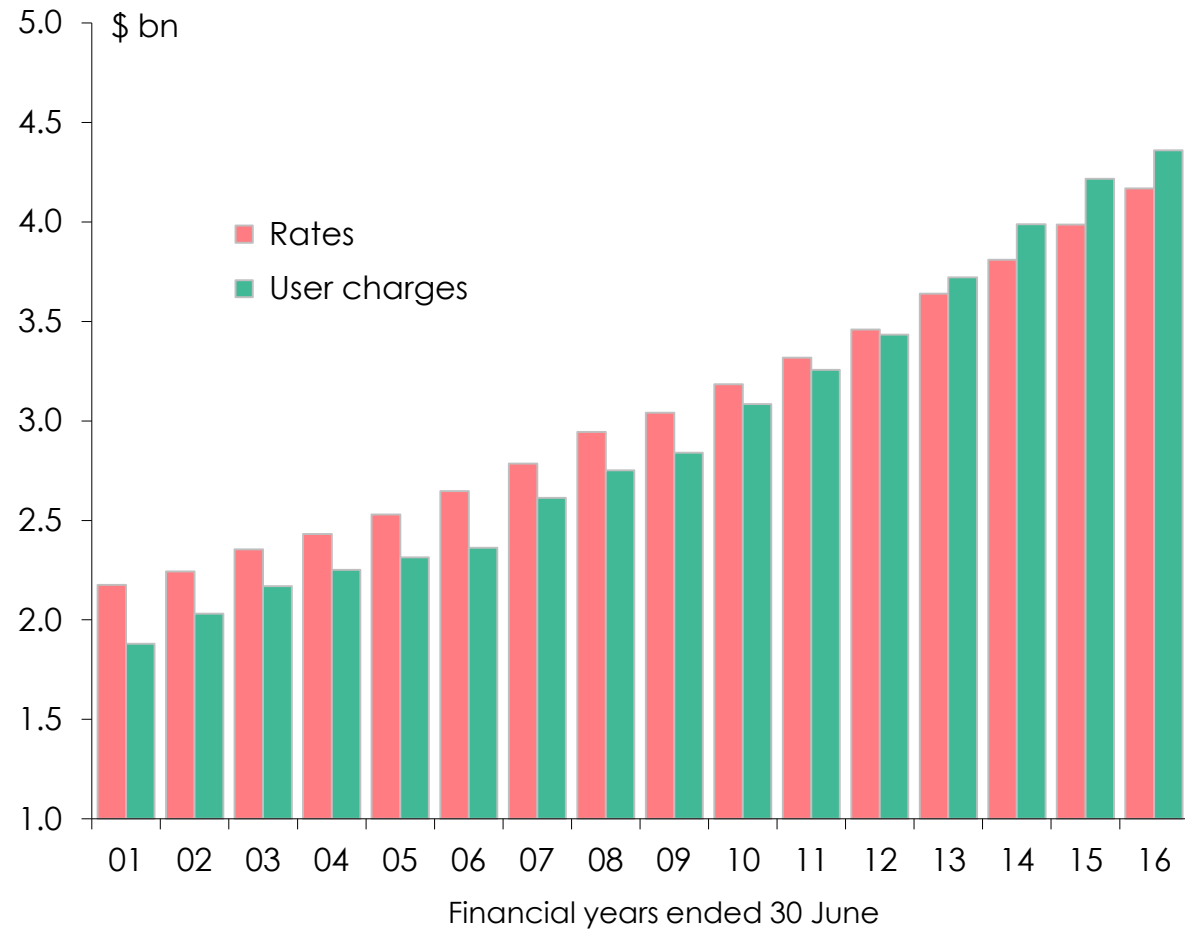
Comparison of user pays and maintenance across infrastructure sectors



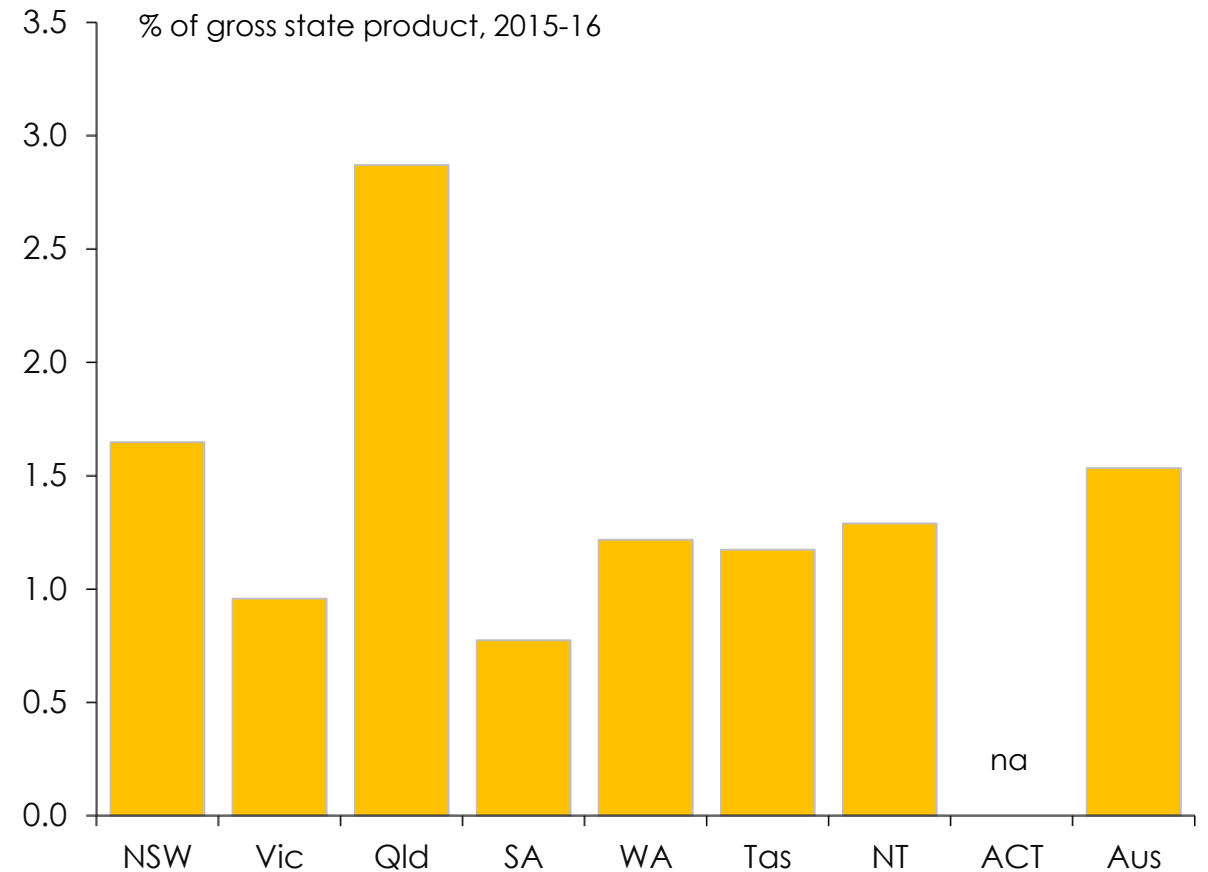
Source: Infrastructure Australia, *Australian Infrastructure Plan: Priorities and reforms for our nation's future*, February 2016, p. 83.

Further extension of user charges by NSW local governments could be politically challenging unless very well 'sold'

Local government rates and user charges in NSW



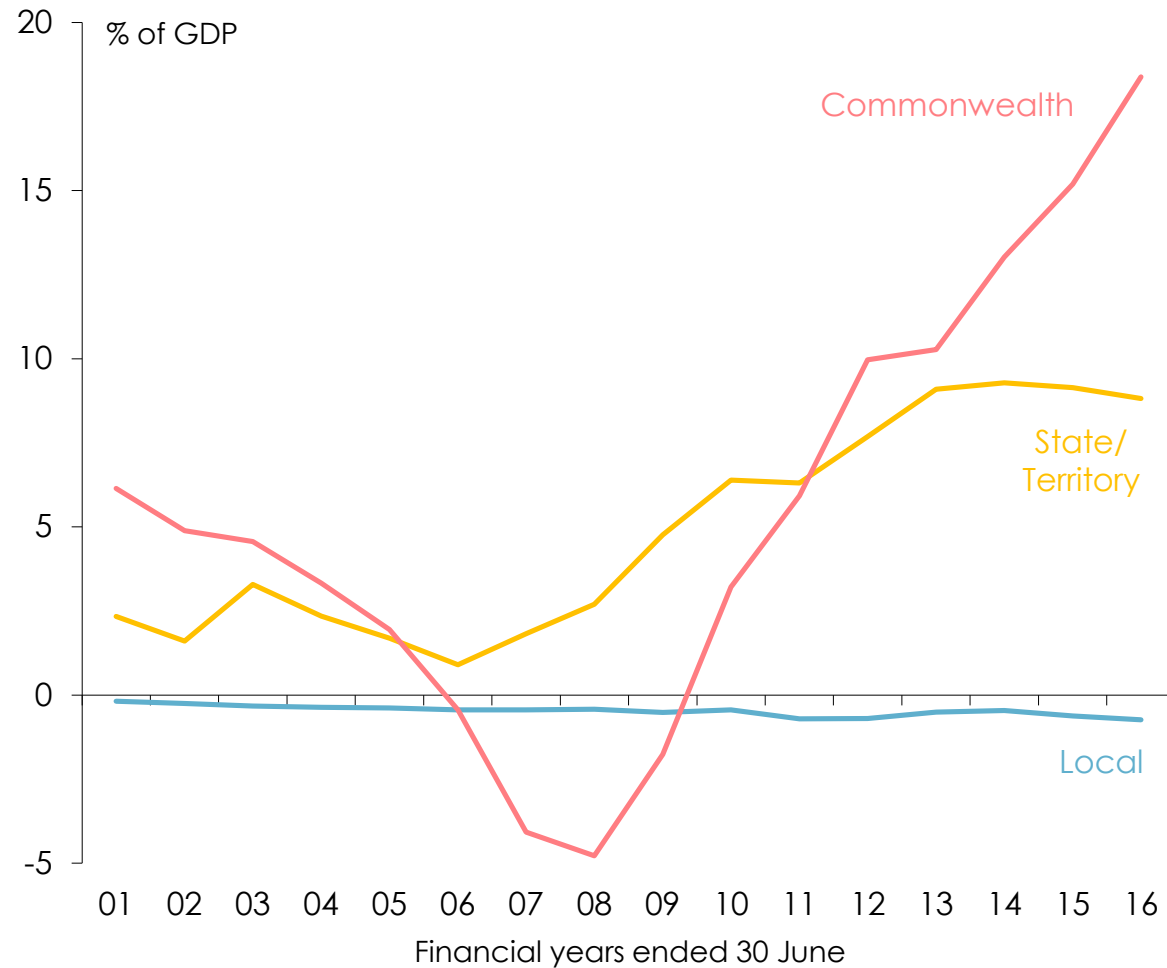
Local government user charges as a pc of gross state product, 2015-16



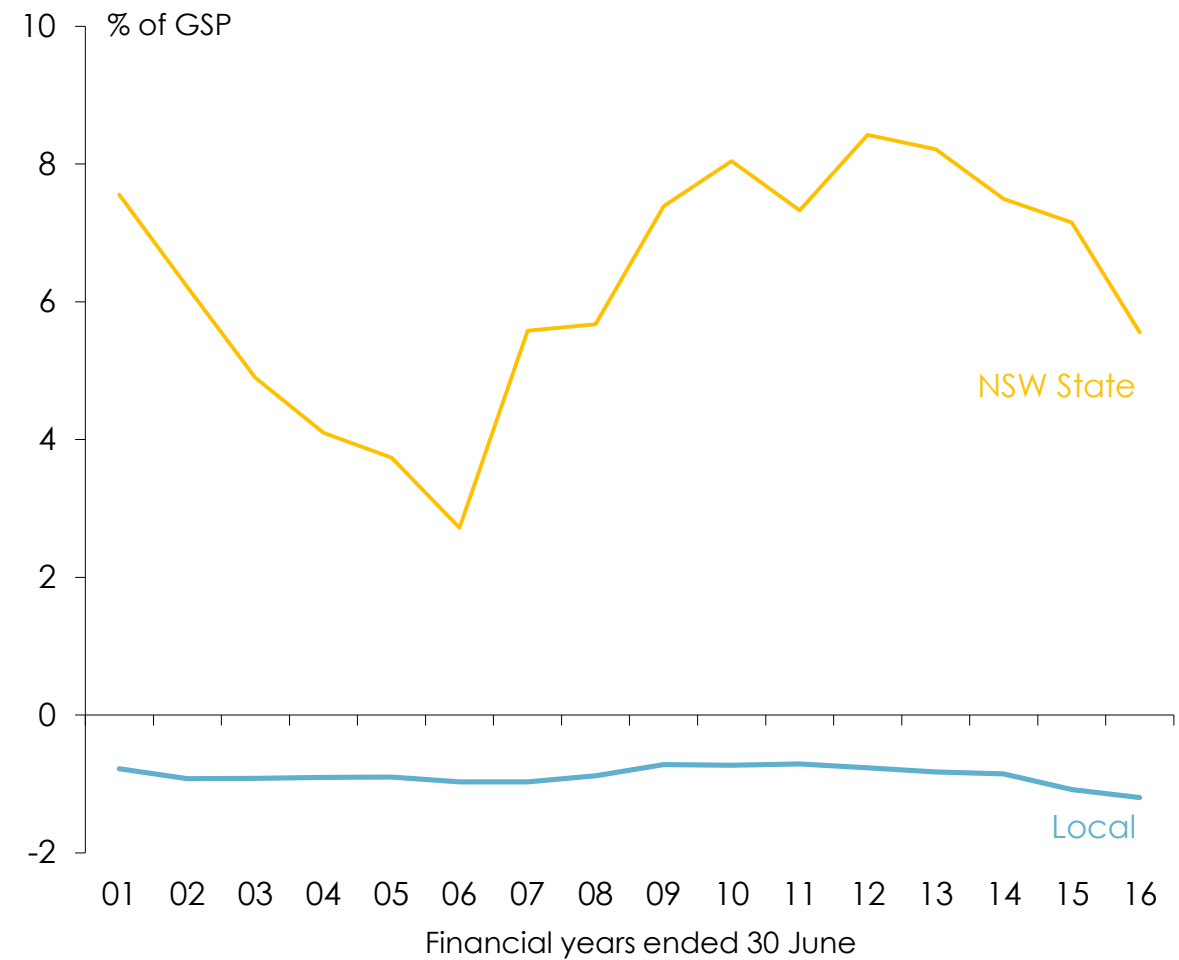
Source: Australian Bureau of Statistics, *Government Finance Statistics* (5512.0), 2011-12 through 2015-16, and *State Accounts* (5220.0), 2015-16.

It's surprising how little debt local government (as a whole) has, given the size of their asset holdings

Net debt by level of government, Australia



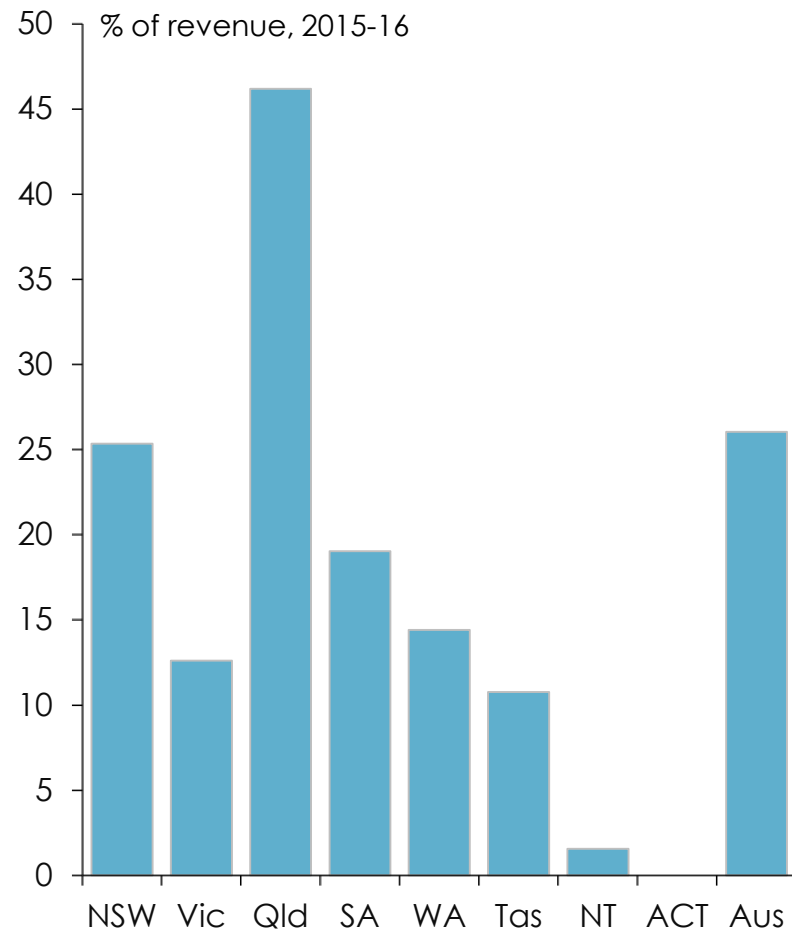
Net debt by level of government, NSW



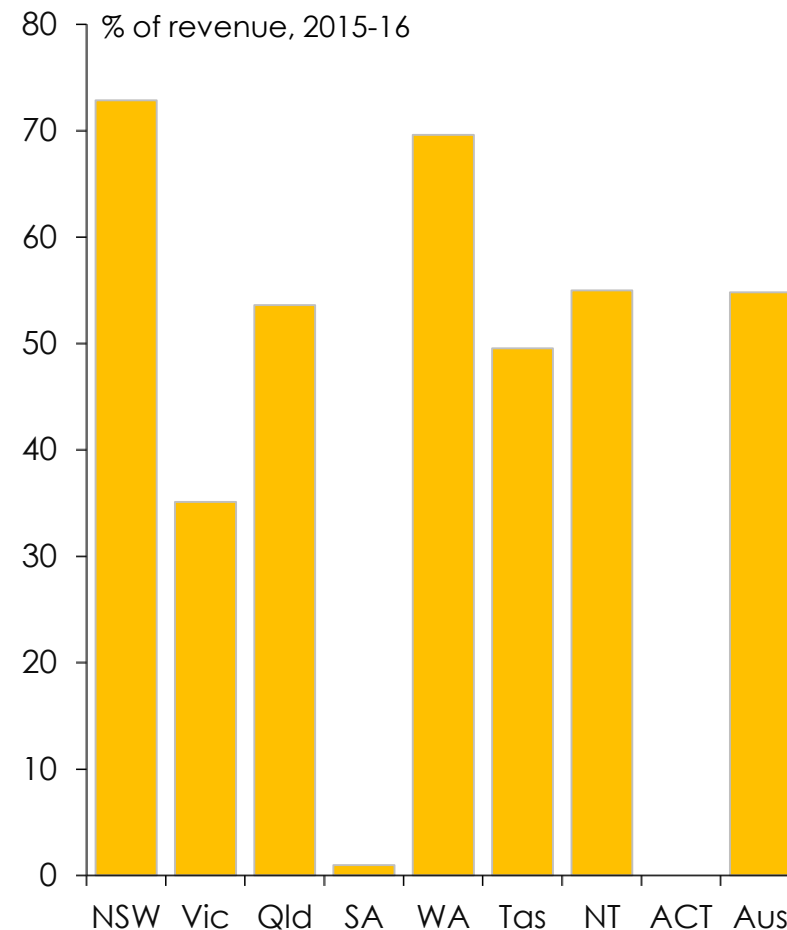
Note: Figures for Commonwealth and State/Territory net debt include non-financial public enterprises.
Source: Australian Bureau of Statistics, *Government Finance Statistics* (5512.0), 2011-12 through 2015-16, and *State Accounts* (5220.0), 2015-16.

Local governments in NSW have (in aggregate) a lot of financial assets, and (at least on the surface) would seem to be able to carry more debt

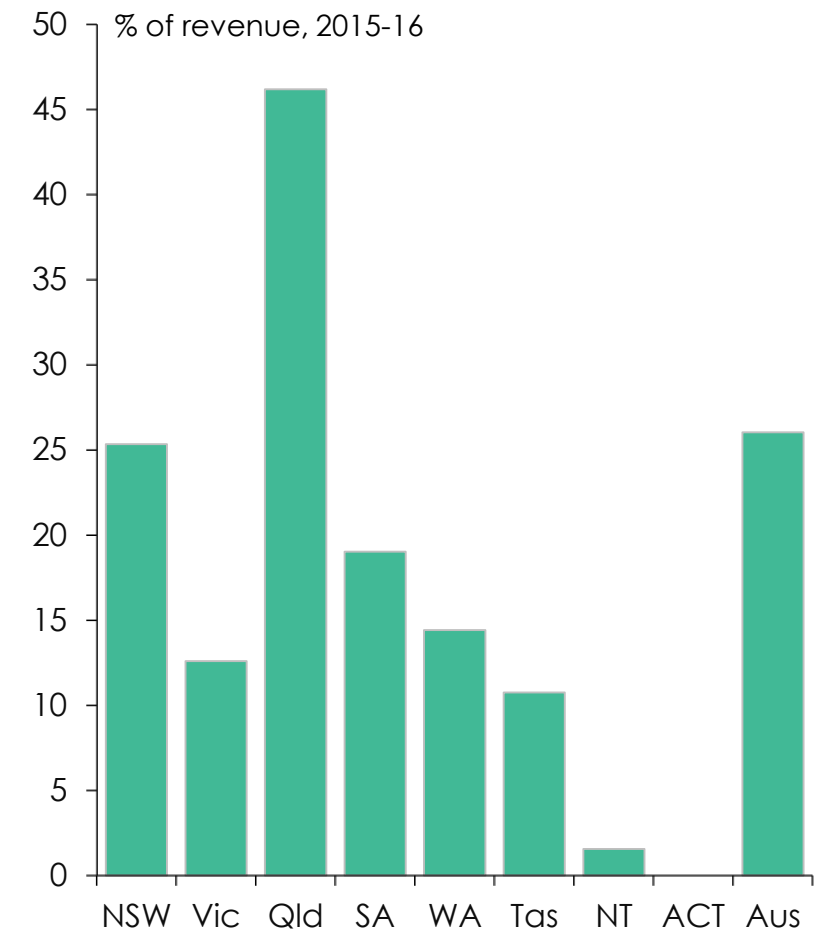
Local government gross borrowings, 2015-16



Local government financial assets, 2015-16



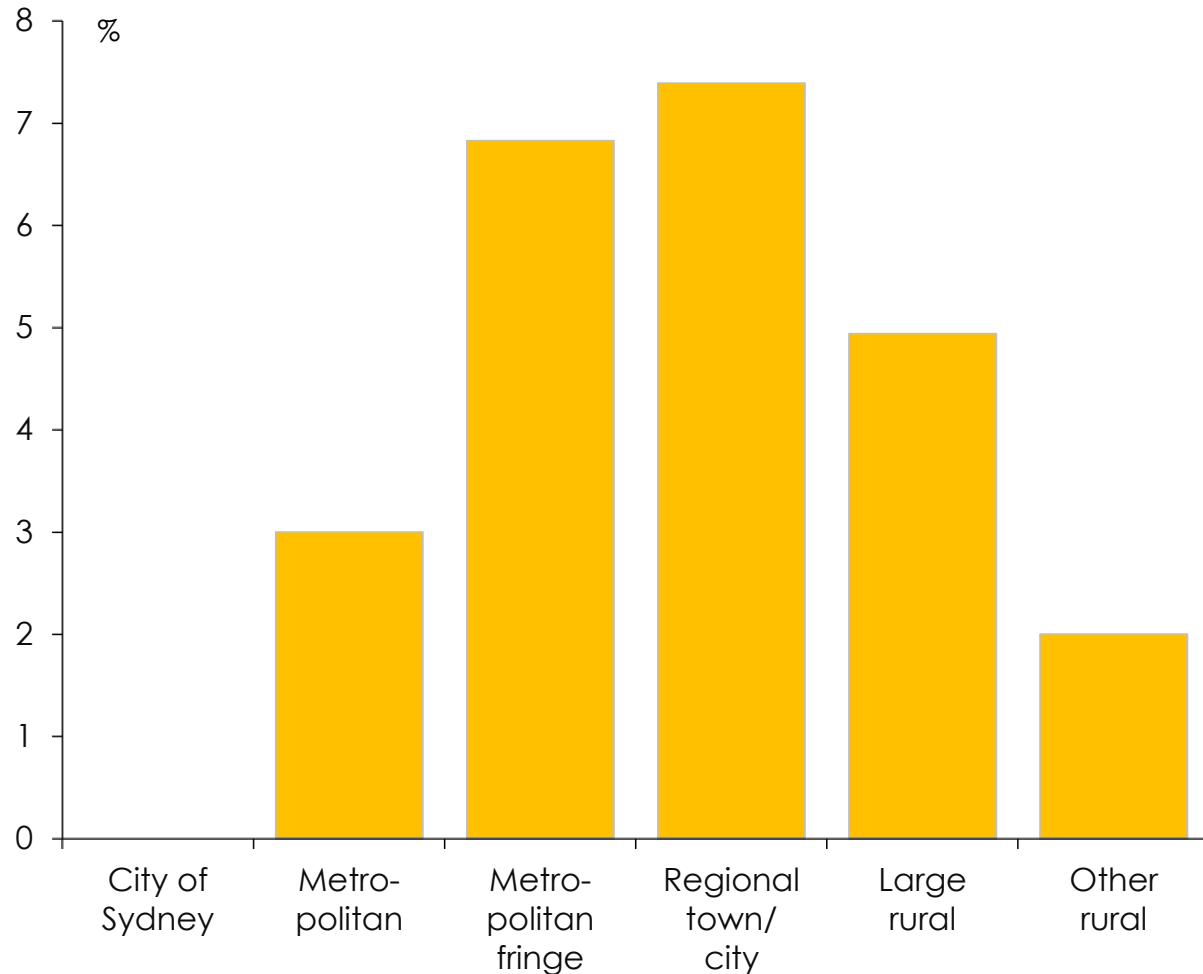
Local government net debt, 2015-16



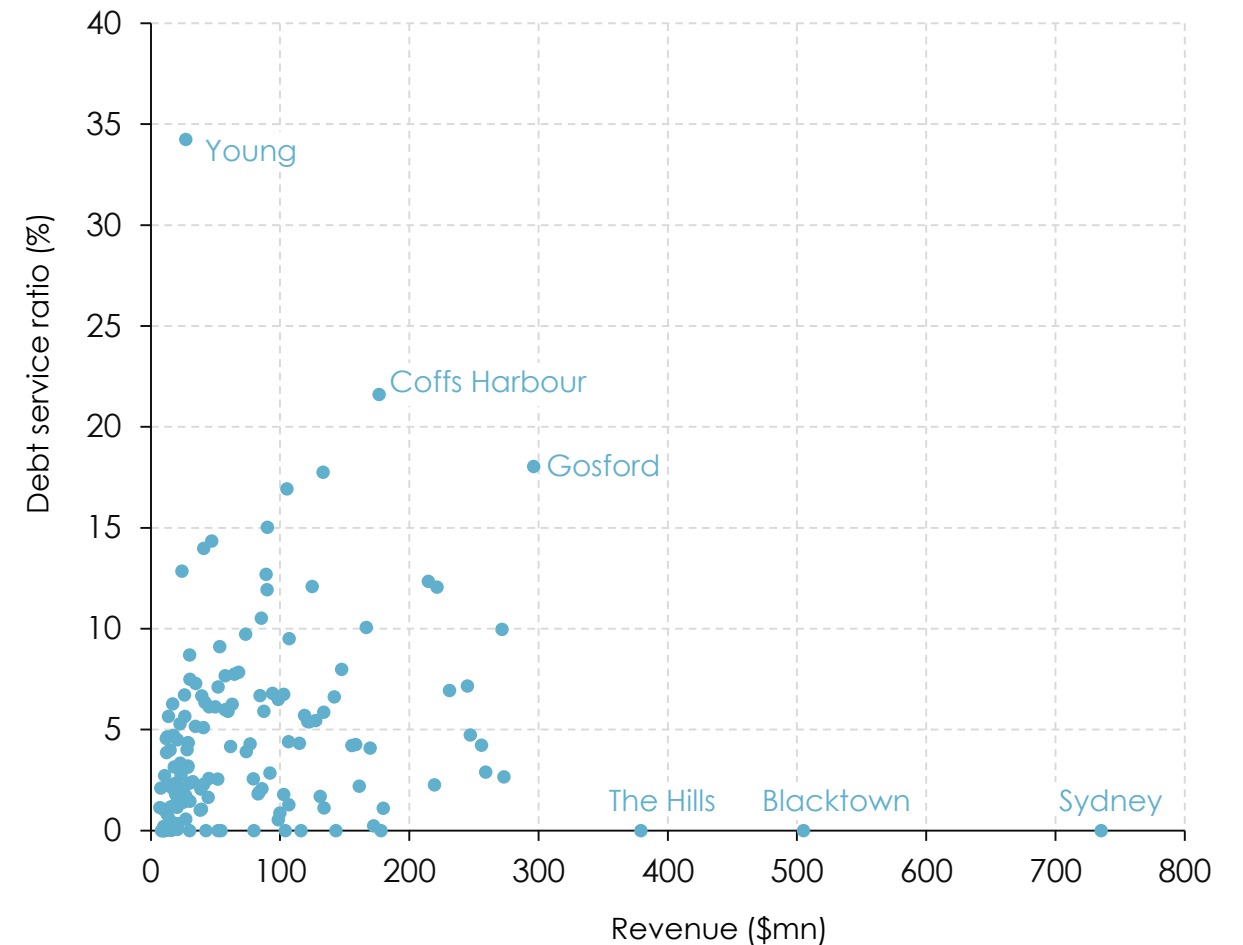
Source: Australian Bureau of Statistics, *Government Finance Statistics (5512.0)*, 2011-12 through 2015-16.

However in practice councils vary considerably in their capacity to borrow more

NSW councils, debt service ratio by OLG group, 2014-15



NSW councils, debt service ratio vs revenue, 2014-15



Note: Figures for OLG groups are averages for each council in the group weighted by revenue from continuing operations.
Source: NSW Office of Local Government, *Comparative Information on New South Wales Local Government Councils 1994/95 to 2014/15*.

The importance of good project selection and governance

Infrastructure investment is only a ‘Good Thing’ if projects are rigorously selected and subject to appropriate governance

“Poor governance is a major reason why infrastructure projects often fail to meet their timeframe, budget and service delivery objectives”

– OECD, *Getting Infrastructure Right: The Ten Key Governance Challenges and Policy Options*, March 2017, p. 2

“All government spending, whether for day-to-day operations (recurrent) or capital, should be closely scrutinised for its quality. This requires a strong commitment to rigorous project assessment and program evaluation to determine which spending generates the strongest public benefits”

– Australian Government, 2017-18 Budget Paper No. 1, *Budget Strategy and Outlook*, May 2017, p. 4-5

“There are many examples in Australia of poor project selection leading to highly inefficient outcomes. In such cases investment in public infrastructure is a drain on the economy and tends to lower productivity and crowd out more efficient projects”

– Productivity Commission, *Public Infrastructure*, Inquiry Report No 71, May 2014, p. 75

“Strong governance is critical to make sure money is spent wisely in this area. There is no substitute for rigorous and transparent cost-benefit analysis ... Building public confidence in the governance process not only helps ensure that the most pressing projects are selected, but also helps build public confidence that the money is being spent wisely”

– Then Deputy RBA Governor Philip Lowe, ‘Productivity and Infrastructure’, 26th November 2013

“Australia needs key infrastructure investments but there is a lack of rigor in identifying and assessing them ... There is unacceptable secrecy surrounding many projects; secrecy which undermines democratic accountability, erodes community trust and leaves everyone open to being misled and blindsided”

– John Menadue (former Secretary PM&C, Qantas CEO), *Pearls & Irritations*, 8th September 2017