

IN THE LONG RUN

November 2009

Long term economic issues are again attracting attention after the distraction of upheavals in the financial sector over the past two years. Most Local Government *Plans for the Future* and associated long term financial plans consider a four to ten year period. Over this time frame Governments at all levels need to put in place strategies that respond to major forces which will have a much bigger impact over generations than the recent financial crisis. The challenge is to realistically plan for:

Population Aging and Growth

Lower birth rates in the 1960's and 1970's, accentuated by increasing life expectancy, have changed the age structure of the Australian population. The statistics are not new, but they are stark. The proportion of the population aged 65 and over has increased from 8% in 1969 to 13% today and is forecast to be over 22% by 2049.

This is now coupled with new population forecasts which indicate that the Australian population will be 25% higher by 2049 than previously anticipated as a consequence of higher net overseas migration and the increased fertility rate of Australian women. Western Australia is likely to see higher than average population growth rates as a result of resource-based employment opportunities.

All spheres of government have a role in ensuring that this profound population expansion and structure change is achieved without compromising the environmental, social and economic aspirations of the community. Where will these people live and how will existing cities cope with expansion? Where and how will the public infrastructure be provided? Will the footprints of our cities expand accordingly?

The State Government will need to provide updated population projections alongside recent planning documents such as *Directions 2031* and provide population projections for regional centres. The long term plans of Local Government need to demonstrate how development and re-development will set the direction for meeting the accommodation needs of a larger and demographically different population to that of today.

As a major employer, Local Governments will need to consider the sorts of work that needs to be done, and how this will be achieved. The aging population has resulted in a growing participation rate (number of people available for employment out of the total population) over the past 30 years. However, this has now peaked. How will Local Governments innovate in order to increase the employment participation rate, or will services be delivered in different, less labour intensive ways?

Climate Change

The consensus (although not unanimous) amongst the scientific community is that the south west part of Australia will become warmer and drier with more extreme weather events.

At the most fundamental level, adapting to these anticipated climatic changes and contributing to their mitigation is capital intensive. In some areas the financial impact may be acute, with large infrastructure investments required to protect or relocate public assets. Other places may have more time to adapt. Few can afford to assume that climate change impacts can wait ten years before needing to be considered.

Information and Communication Technology

There are good reasons to believe that we have only just begun to see what developments in the world of Information and Communication Technology (ICT) can deliver. We are now seeing a focus on "general purpose technology" which has a wide scope for improvement, potential for use in a variety of products and processes and strong complementarities with existing or potential new technologies. History indicates that the productivity gains from general purpose technologies take a long time to reach their full impact.

Most directly, ICT has profound implications for the way in which services can be provided to a rapidly growing, aging population. However, ICT may also facilitate a more sustainable pattern of population settlement, perhaps a key issue for regional centres with good water supplies.

"In the long run, we are all dead."

John Maynard Keynes (1883 – 1946) Economist

The provision of most Local Government services is long term and in many cases the services provided today are delivered by infrastructure built and paid for by our forefathers. Likewise we will leave a legacy for generations to come.

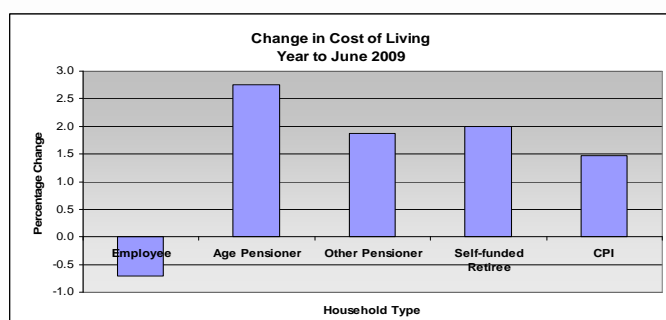
The renowned economist Keynes said, "In the long run we are all dead." However, between now and then there are lots of things to do that will make a difference to the type and quality of life for this and future generations.

COST OF LIVING

Previous issues of *Economic Briefing* have discussed limitations of the Consumer Price Index (CPI) in reflecting movements in the costs of providing Local Government services. Less well known is the fact that the CPI does not provide a good measure to the question implicitly asked by ratepayers (and employees); "by how much would my after tax income need to change to allow my household to purchase the same quantity of goods and services as before?"

The Analytical Living Cost Indexes are designed to answer this question for different types of households. This data indicates that the average Australian household where the principal source of income is from wages and salaries would need 0.7% less income in June 2009 to purchase the same products and services compared with a year earlier. At the other extreme, households where the age pension is the principal source of income would require 2.8% more income to purchase the same quantity of goods and services as a year ago. The reasons for these differences are that different household types have different expenditure mixes.

Employee households typically spend a higher proportion of their income on financial services and housing which both had large cost decreases for the year to June 2009. Conversely age pensioner households spend a much higher proportion of their income on food, which had a large increase in the same period. Self-funded retiree households spend a relatively higher proportion of their income on health, which recorded large price increase for the year to June 2009.



Analytical Living Cost Indexes for Selected Australian Household Types
Source: ABS Cat No 6463.0

Recent data on Average Weekly Earnings and the Wage Price Index indicates that there remains upward pressure on wage costs, regardless of movements in the CPI or the cost of living, a reality that needs to be reflected in budgets and plans.

FEDERAL GOVERNMENT – MID YEAR BUDGET REVIEW

There are significant changes in outlook between the Federal Budget in May and the mid-year review published in early November. Underlying the changes is the view that the Australian economy has avoided a recession, and that the world economy is recovering more quickly than previously anticipated.

Consequently unemployment, while still rising, is not expected to rise as high as previously projected, and wage costs are expected to increase more strongly by 2010/11.

Headline inflation rates are also expected to be significantly higher in both 2009/10 and 2010/11 than forecast earlier this year.

Better than expected economic performance means that Federal Government tax revenues will be higher and expenditure lower. Consequently net debt is now forecast to peak at \$153 billion in June 2014, some \$50 billion less than forecast back in May. However, interest rates on bonds are

		2008/09	2009/10	2010/11	2011/12	2012/13
Headline Inflation (% Change)	Review	1.50	2.25	2.25	2.25	2.25
	May Budget	1.75	1.75	1.50		
Wage Price Index (% Change)	Review	3.8	3.25	3.5		
	May Budget	4.25	3.25	3.25		
Real GDP Growth (%)	Review	0.6	1.5	2.75	4.0	4.0
	May Budget	0	-0.5	2.25		
Unemployment (%)	Review	5.8	6.75	6.50	6.0	5.75
	May Budget	6.0	8.25	8.50		

Notes: Unemployment is rate in the June quarter.

expected to be higher and therefore the cost of this debt is not changed markedly.

The Western Australian Government is expected to benefit, with the revised forecasts of an additional \$81 million in GST revenue in 2009/10. However, the level of GST revenue to the State remains below that anticipated a year earlier in the 2008/09 Budget.

There have been many changes to the quantum and timing of Federal Government initiatives, some as a result of conscious policy decisions, and others as a result of unexpected cost increases particularly the estimated \$1.7 billion increase in costs of the schools building scheme. Particularly affecting Local Governments is the reduction in planned expenditure on social housing, home insulation and the clean energy initiative.

LOCAL GOVERNMENT COST INDEX

The Consumer Price Index (CPI) increased 0.8% in the three months between June and September, largely as a result of increases in utility prices (electricity, gas, water and sewerage). The increase in the CPI compared with the corresponding period last year was just 1.2% as a result of deflation in the preceding December and March quarters.

Although house construction prices increased 0.3% in the September quarter, Other Residential and Non-residential Building prices recorded decreases of 1.4% and 1.3% respectively. Road and Bridge construction costs also recorded a decrease of 0.7% in the quarter and are now 1.6% lower than the same quarter last year.

The Local Government Cost Index fell by 1.3% over the year to September 2009.

The ABS is no longer providing a General Construction Cost Index, which has been used in the calculation of the Local Government Cost Index. Consequently the methodology to determine this index will need to change from the December quarter of this year.

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