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30 April 2018

# **Submission to Senate Economics References Committee Inquiry into the Indicators of, and Impact of, Regional Inequality in Australia**

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## Summary points

- Economic activity and total incomes are growing faster in most capital cities compared to the regions. The economies of Sydney, Melbourne and Adelaide have all grown substantially faster than regional economies in NSW, Victoria and South Australia.
- But differences in economic growth *per person* between capital cities and the regions are smaller. And income growth *per person* has not been obviously different between capitals and regions over the past decade.
- Most of the difference in total economic activity between capitals and regions results from different rates of population growth. Population has grown rapidly in capital cities over the past decade, while remote areas are losing population, or remain stagnant. Regional centres have drawn population from surrounding rural villages and towns, but in general are not growing as fast as capitals.
- The differences in population growth between capitals and regions reflect longer-term structural changes in the Australian economy. An increasing proportion of the workforce is employed in service industries, which cluster in urban areas. By contrast, the loss of agriculture and manufacturing is most keenly felt in regional and outer-suburban areas.
- Governments should not fight the “gravitational” pull of the cities and major regional centres. Past attempts at intervention have been expensive and done little to increase regional growth and productivity.
- Policy makers should assess regional development projects on a social-equity basis, rather than on whether they are likely to drive sustainable economic growth. This may then provoke an honest conversation about what level of service governments are prepared to fund in more remote areas, given the costs of servicing them.

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## 1 Introduction

Grattan Institute is an independent think-tank focused on Australian domestic public policy. We aim to improve policy outcomes by providing evidence-based analysis of Australia's most pressing problems.

We welcome the Senate Economics References Committee Inquiry into the Indicators of, and Impact of, Regional Inequality in Australia.

This submission focuses on the causes of inequality between cities and regions. Many people assume Australia's regions are getting a raw deal compared to the big cities. But a careful look at the data shows that the oft-repeated "tale of two Australias" is a more nuanced story.

Although people living in the city earn higher incomes, average income growth in the regions *per person* has kept pace with the cities. Other economic indicators do not appear to be materially different between cities and the rest of Australia.

What *is* different is that economic activity is concentrating in cities as more people settle in the capitals. Population shifts therefore

may be the source of the commonly held view that regional Australia has been left behind.

Grattan has published two reports and one working paper that address these issues:

- Wood et al., 2018. *A crisis of trust: The rise of protest politics in Australia*. <https://grattan.edu.au/report/a-crisis-of-trust/>
- Daley et al., 2017. *Regional patterns of Australia's economy and population* (working paper). <https://grattan.edu.au/report/regional-patterns-of-australias-economy-and-population/>
- Daley and Lancy, 2011. *Investing in regions: Making a difference*. <https://grattan.edu.au/report/investing-in-regions-making-a-difference/>

## 2 Economic indicators of regional inequality

Before diagnosing the cause of regional inequality in Australia, it is necessary to understand its nature.

City economies are steaming ahead – economic growth is much higher in our capitals than anywhere else in the country. City-dwellers also earn higher incomes on average than people in the regions.

But the regions are not obviously falling behind on other measures of economic well-being. Income growth *per person* is similar between the regions and the cities. Income inequality, wealth accumulation, and unemployment also do not seem to be noticeably different between cities and the rest.

### 2.1 City economies are steaming ahead

Economic output grew faster in most major cities compared to the regions over the past decade. The economies of Sydney, Melbourne and Adelaide have all grown substantially faster than regional areas in those states.<sup>1</sup> And total income earned by

<sup>1</sup> Western Australia and Queensland bucked this trend because of the mining boom. SGS Economics and Planning (2016). *Australian Cities Accounts 2015-16*. SGS Economics and Planning.

[https://www.sgssep.com.au/application/files/9914/8106/1313/GDP\\_by\\_major\\_capital\\_city\\_201516 - high\\_res.pdf](https://www.sgssep.com.au/application/files/9914/8106/1313/GDP_by_major_capital_city_201516 - high_res.pdf); and ABS (2017, State accounts).

*Australian National Accounts: National Income, Expenditure and Product*, Sep 2017. Cat. 5206.0. Australian Bureau of Statistics.

<sup>2</sup> Daley et al. (2017, pp. 8-11).

<sup>3</sup> Daley et al. (2017, p. 8). Unless otherwise stated, this submission uses ATO data on taxable income by postcode rather than Census data, because it appears to be more robust, with more accurate information for those with high

people in city areas – the size of the pie – also grew faster in cities than in regional areas.<sup>2</sup>

### 2.2 Average incomes are higher in city postcodes, but so is income inequality

There is a gap in incomes between cities and regions. It is rare for postcodes less than ten kilometres from the city centre to have average taxable incomes of less than \$40,000, but this is common in postcodes 100kms or more from the city.<sup>3</sup>

Most regional areas in NSW, Victoria, Tasmania and southern Queensland have below-average incomes; this is rare for areas in the capitals of these states.<sup>4</sup>

Higher incomes may be contributing to greater income inequality in city suburbs. Income inequality is highest in postcodes close to a capital city centre, where inequality is also increasing more quickly.<sup>5</sup>

incomes and from regional areas. See Appendix A in Daley et al. 2017 for a description of our methodology.

<sup>4</sup> See <https://grattan.edu.au/report/regional-patterns-maps/> for an interactive map of average income by SA3, and Appendix A in Daley et al. (2017) for a description of our map methodology.

<sup>5</sup> Daley et al. (2017, p. 13). ATO data reports many regional areas as more unequal than analysis based on the Census. This may be because the ATO data has much more accurate information about high-income earners. See Biddle, N. and Francis, M. (2017), *What income inequality looks like across Australia*, The Conversation <https://theconversation.com/whatincome-inequality-looks-like-across-australia-80069> for an example of similar analysis using Census data.

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### 2.3 Income growth per person is similar across cities and regions

The income gap between city and regional Australia is not getting wider. Income growth *per person* has been similar across city and regional areas over recent years.

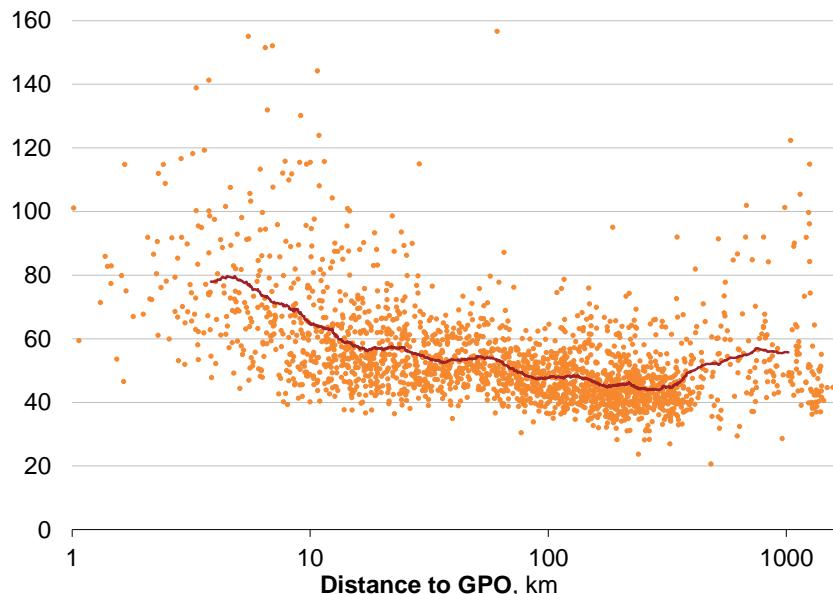
Some remote areas have experienced very strong income growth (Figure 2.2), mostly in mining areas in Western Australia and Queensland. But this is not just a mining-state phenomenon: average income growth rates have been similar between the city and regions in every state between 2003 and 2015.<sup>6</sup>

Differences in economic growth per person between the cities and the regions are also much smaller than the absolute gap.<sup>7</sup>

### 2.4 People in regional areas have been accumulating wealth at a similar rate to people in the cities

People in regional areas on average have also accumulated wealth at a similar rate to their city cousins. Net worth and housing values increased slightly more in remote and outer regional areas compared to city and inner regional areas.<sup>8</sup> This partly captures the strong growth in house prices in remote mining areas during the boom, as well as growth in prices in outer regional coastal towns. Growth in city prices has probably been more consistent than in the regions. And prices in some regional areas are now declining.<sup>9</sup>

**Figure 2.1: Average income is higher in inner-city postcodes**  
Average taxable income per tax filer, 2014-15, \$000s, by postcode



Sources: ATO (2017) Taxation Statistics 2014-15, Table 8; Grattan analysis

<sup>6</sup> See Appendix B in Daley et al. (2017).

<sup>7</sup> SGS Economics and Planning (2016) and ABS (2017, State accounts).

<sup>8</sup> Wood et al. (2018, p. 43).

<sup>9</sup> Lutton, E. (2017). The long-suffering Qld towns that could be the next property hotspots, Domain <https://www.domain.com.au/news/the-longsuffering-qld-towns-thatcould-be-the-next-property-hotspots-20170817-qxx820/>.

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But over 15 years the price of regional housing has increased (relative to incomes) in similar ways to the price of capital city housing.<sup>10</sup>

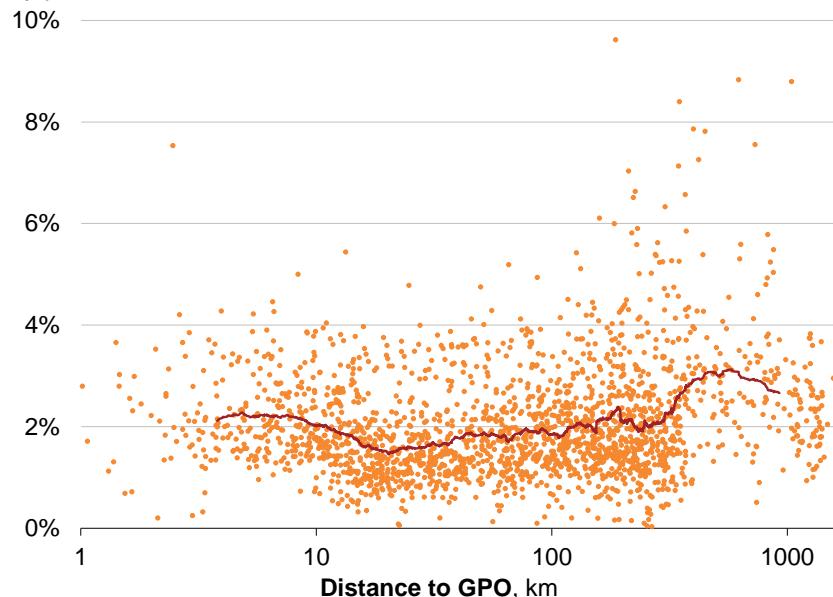
## 2.5 Unemployment is not obviously worse in the regions

Unemployment is not definitively worse in regional Australia. Some regional areas have low levels of unemployment – such as south-east NSW and western Victoria. Others, such as Far North Queensland and remote parts of the Northern Territory, have very high levels of unemployment.<sup>11</sup> Unemployment in the cities is similarly patchy.<sup>12</sup>

Unemployment did not get markedly better or worse in regions as opposed to cities between 2011 and 2016.<sup>13</sup>

**Figure 2.2: Income growth has been similar in cities and regions**

Annual growth in real taxable income per tax filer, 2003-04 to 2014-15, by postcode



Notes: The growth rate is calculated as the compound annual growth rate (CAGR) in income per tax filer 2003-04 to 2014-15. A small number of outliers have been excluded to make the chart more readable.

Sources: ATO (2017) Taxation Statistics 2014-15, Table 8; Grattan analysis

<sup>10</sup> Daley et al. (2018, Figure 2.4). *Housing affordability: re-imagining the Australian dream* <https://grattan.edu.au/report/housing-affordability-re-imagining-the-australian-dream/>.

<sup>11</sup> Daley et al. (2017, p. 16).

<sup>12</sup> See <https://grattan.edu.au/report/regional-patterns-maps/> for an interactive map of unemployment by SA2.

<sup>13</sup> Daley et al. (2017, p. 18).

### 3 Population shifts drive regional inequality

Population shifts are driving a wedge between city and regional Australia. Economic activity has become more concentrated in urban areas as people increasingly choose to live in cities.

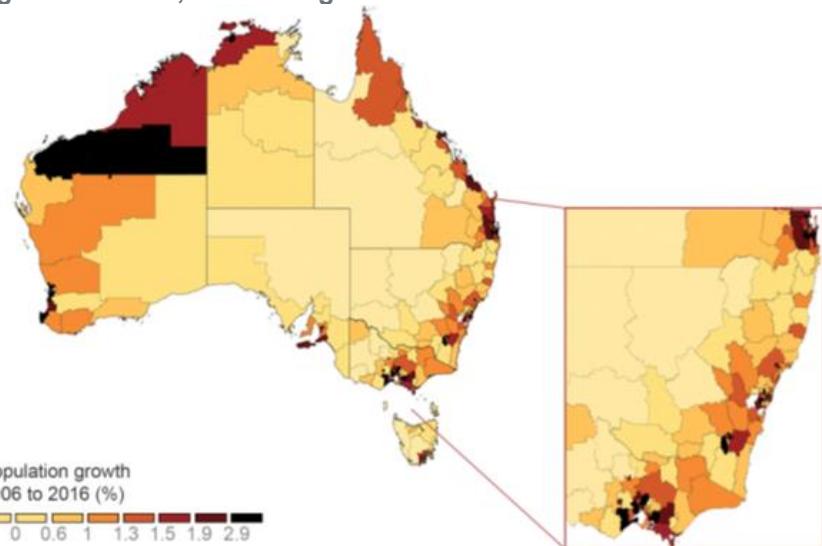
#### 3.1 Australia is highly urbanised, and becoming more so

Australia is a highly urbanised country: the most densely populated parts of the country house 80 per cent of the population but occupy less than 1 per cent of the land mass.<sup>14</sup>

And urbanisation is increasing. Population in the capital cities – particularly the inner cities and the city fringes – grew more than 1.5 per cent a year on average between 2006 and 2016.<sup>15</sup> In contrast, populations of suburbs more than 100 km from a major city barely increased.<sup>16</sup> Even this hides a regional dynamic: major regional centres grew, while many of the surrounding regions and smaller towns lost population.<sup>17</sup>

The growth of city populations relative to the rest has the effect of concentrating economic activity in urban areas. Relative levels of population growth explain why city economies have been growing faster than regional economies, while incomes and economic growth *per person* have been similar in cities and regions.

Figure 3.1: Population growth is highest in the capitals, some regional centres, and mining areas



Source: ABS (2017), *Census of Population and Housing, Time Series profiles 2006-2016*.

<sup>14</sup> Daley et al. (2017, p. 20).

<sup>15</sup> Grattan analysis of ABS (2017). *Regional Population Growth, Australia, 2016*. Cat. 3218.0. Australian Bureau of Statistics; see also Daley et al. (2017).

<sup>16</sup> Daley et al. (2017, p. 20).

<sup>17</sup> Daley et al. (2017, p. 23); PC (2017).

## 4 Implications of regional inequality

Policy makers should work with, not against, the forces shifting Australia's economic geography. Governments can't push economic water uphill. But they can smooth the transition by ensuring our regions have access to good-quality services and that our cities are flexible enough to cope with growing numbers of people and activity.

### 4.1 Population shifts reflect structural changes in Australia's economy

Differences in population growth between cities and regions reflect longer-term structural changes in the Australian economy.

As in other developed economies, an increasing proportion of Australia's workforce is employed in service industries. Over 50 years, employment in services has risen from 5-in-10 workers to 8-in-10 workers.<sup>18</sup>

Services jobs, particularly in professional services, tend to cluster in cities and their centres. This is because there are big benefits to 'agglomeration' – being close to lots of other service firms. These services jobs attract people both from overseas and within Australia who are younger and more educated than the general population. So it is not surprising that cities have a higher

<sup>18</sup> Withers, G., Endres, T. and Perry, L. (1985). *Australian Historical Statistics: Labour Statistics, Source Papers in Economic History*, Source Paper No. [https://www.rse.anu.edu.au/media/118715/SP07\\_001\\_Contents.pdf](https://www.rse.anu.edu.au/media/118715/SP07_001_Contents.pdf); ABS (2017). *Labour Force, Australia, Detailed, Quarterly*, May 2017. Cat. 6291.0.55.003.

<sup>19</sup> Daley et al. (2017).

<sup>20</sup> Daley and Lancy (2011).

proportion of young people, immigrants and people with a tertiary education than regional areas.<sup>19</sup>

### 4.2 Governments should not try to fight the "gravitational" pull of the cities and major regional centres

Policy makers should not try to reallocate activity to slower-growing areas. Past attempts at intervention have been expensive and done little to increase regional growth and productivity.<sup>20</sup>

A 2011 Grattan Institute report showed Australian governments planned to spend more than \$2 billion a year on explicit programs to promote regional growth. The report found that many regional development programs – such as local job-attraction schemes, regional universities, small roads and major infrastructure – did not materially accelerate growth in slow-growing regions.<sup>21</sup>

### 4.3 Extra spending on infrastructure and services should be based on need

Ideally, extra funding to increase the level of services and infrastructure in an area should be tied to population growth, as this is a good proxy for the level of capital expenditure required to keep up with community needs.<sup>22</sup>

<sup>21</sup> Daley and Lancy (2011).

<sup>22</sup> Static populations may need some extra capital funding in addition to regular funding for maintenance and recurrent services if the age structure of the population changes, or to keep up with community expectations. See Daley and Lancy (2011, p. 42).

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Fast-growing regional centres should get help to accommodate new arrivals. But smaller and slower-growing parts of rural and regional Australia should not be left without services such as schools, hospitals, transport and other community facilities.

Spending per person on services already tends to be significantly higher in regional areas. The costs of providing services – particularly health, education and policing – are higher with more dispersed populations, so governments spend more to ensure that service quality in regional areas doesn't fall too far behind service quality in cities (Figure 4.1).

This additional spending per person may well be justified given a desire to promote national unity, partly by delivering roughly comparable levels of government services to as much of the Australian community as possible. But even if the numbers suggest otherwise, many people in regional areas believe that they do not get a "fair share" of Australia's resources.<sup>23</sup> If governments do not address this perception, they run the risk of exacerbating growing cultural divides between cities and regions.<sup>24</sup>

But policy makers should recognise that many regional development programs are in fact subsidies that can only be justified on social equity grounds rather than because they are likely to drive sustainable economic growth. This may then provoke an honest conversation about what level of service governments are prepared to fund in more remote areas, given the costs of servicing them. At times, government spending does not appear to be well targeted – for instance, transport spending

was not even remotely linked to growth in the economy or population in the past 15 years (Figure 4.2).

### 4.4 Understanding the nature of the regional-city divide is key

The idea that regional areas have been "left behind" by big cities is widespread, and politically potent.<sup>25</sup> Although there is some truth to the sentiment, it's important to recognise the nuance behind the concern.

Firstly, the aggregate trends in economic growth don't capture the significant population shifts that are occurring within regional Australia and between cities and the rest. For instance, even though total incomes have grown fastest in cities, average income *per person* has kept pace in the regions.

Secondly, the division between regional and city Australia conceals significant variation between regions and within cities – as is the case for unemployment rates, which are very high in some regional areas but low in others.

Policy makers should therefore focus on identifying the differing needs of city and regional communities. And they should recognise that regional inequity is driven primarily by population shifts which reflect large structural shifts to Australia's economic geography.

It is not possible to push economic water uphill, but there are things governments can do to ease the transition.

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<sup>23</sup> Brett (2011). *Fair Share: Country and city in Australia*. Quarterly Essay No. 42.

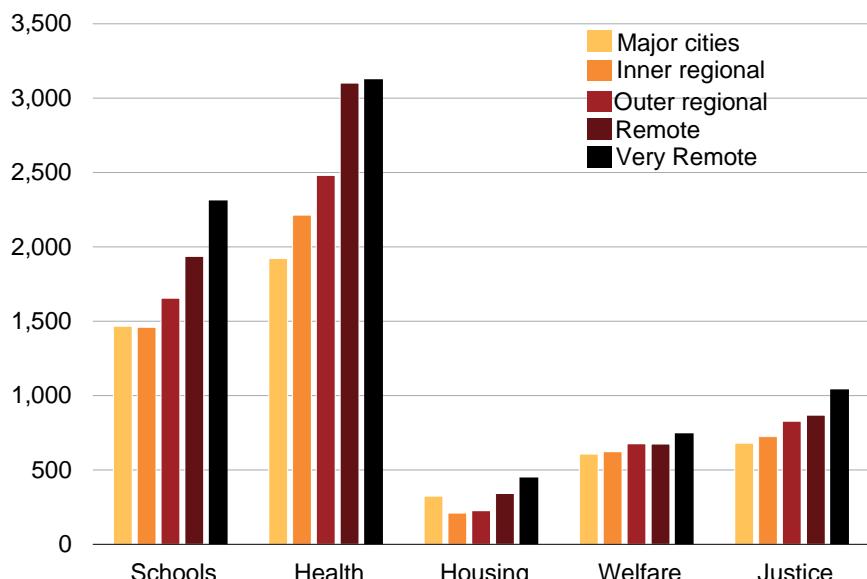
<sup>24</sup> Wood et al. (2018, pp. 61-5).

<sup>25</sup> Wood et al. (2018).

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**Figure 4.1: Costs of providing many government services are higher in the regions**

Average per capita spend by state governments by category and location 2013-14, \$



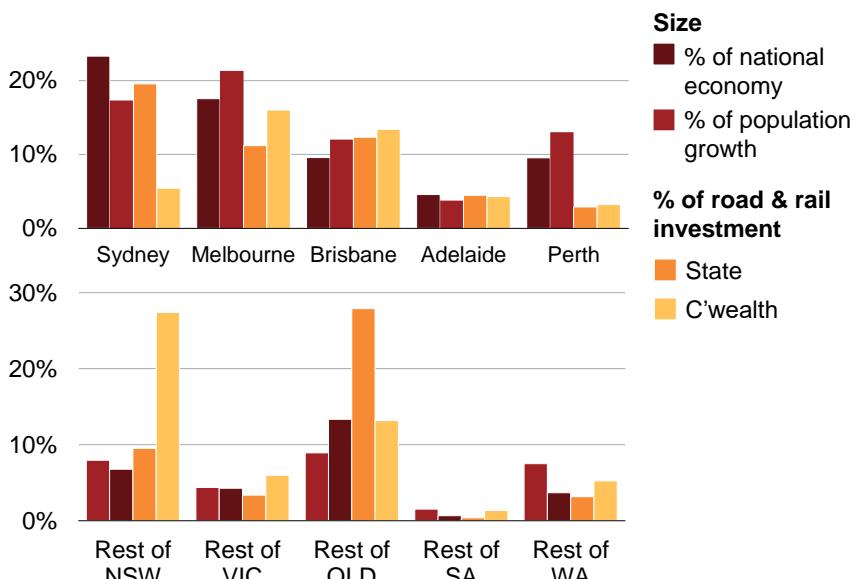
Notes: Differences are those attributed by the CGC to remoteness rather than socio-demographic composition. For example, the impact of larger Indigenous populations in remote areas has been excluded from this impact. Chart excludes post-secondary education and services to communities because these categories account for relatively low amounts of state government spending. There is very little variation between spending in most regions in these categories.

Source: Commonwealth Grants Commission (2015), Report on Sharing GST Relativities 2015 Review, p.84.

[https://cgc.gov.au/index.php?option=com\\_content&view=article&id=219&Itemid=318](https://cgc.gov.au/index.php?option=com_content&view=article&id=219&Itemid=318)

**Figure 4.2: Government transport spending has not targeted growth in economy or population**

Size and transport infrastructure spending; % of Australian total



Notes: Percentage size of national economy is for 2014-15; percentage of population growth is for 2004-14; percent of road and rail investment is for 2006-2015.

Source: Terrill et al. (2016). Roads to Riches: better transport investment, Grattan Institute. <https://grattan.edu.au/report/roads-to-riches/>

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