Lighting Up our Great Small Cities: Challenging Misconceptions

June 2017

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Independent and informed by both research and ongoing dialogue with the community, the Regional Australia Institute (RAI) develops policy and advocates for change to build a stronger economy and better quality of life in regional Australia – for the benefit of all Australians. The RAI was established with support from the Australian Government.

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Acknowledgements

The RAI acknowledges the following people and organisations who have contributed feedback and ideas during the development of this report:

This report can be referenced as

Pearson, L.J., Houghton, K., How, G. (2017) *Lighting Up our Great Small Cities: Challenging Misconceptions*, The Regional Australia Institute.

Contacts and Further Information

To discuss the research report please contact:

Dr Leonie Pearson
Leader, Great Small Cities Program
M: 0409 697 440
P: 02 6260 3733
E: leonie.pearson@regionalaustralia.org.au

Further information can be found on the program website:
www.regionalaustralia.org.au/home/challenging-misconceptions

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Executive Summary

Despite their size, Australia's great small cities' long-term growth rates have matched those in metropolitan cities. There are good prospects for this medium-term economic performance to continue.

However, recent economic outcomes have been less impressive, mirroring the general decline in Australia's economic growth and regional cities' significant exposure to the mining investment boom transition.

Unfortunately, Australia's Great Small Cities are widely misunderstood. Portrayed in our national economic discussion as perpetual laggards, struggling to transition to services based new industries, too small to matter, and with little future potential. Recent challenges have been confused with long-term trends.

The Regional Australia Institute's analysis reveals that Australia's 31 regional cities collectively expanded their economies at 3 per cent per year from 2001-2013. They share comparable economic performance with our major cities across the key measures of growth; Output, participation, and productivity.

While some regional cities are larger than others, it is not size that matters in understanding city economic performance.

Regional and Metro cities share economic performance

83%	98%	91%
Output growth rate of metro	Particpation rate of metro	Worker productivity of metro

Australia's economy, like other developed economies, is becoming service focused with the growth of jobs concentrating in new economy industries. Regional cities have also been making this transition and are already producing more output in new economy industries (finance, education, health and professional services) than old industries (agriculture, mining and manufacturing).

The RAI's projections of future regional city growth are positive. Regional cities have the potential to produce $375 billion in output in 2031, representing a 65 per cent increase from 2013 levels and a contribution of 15 per cent to the national economy.

Putting the output in today's terms, regional cities in 2031 will produce twice as much as all the new economy industries alone produce in today's metropolitan cities.

But important changes are taking place in growth trajectories as the contribution of mining and population driven high growth cities has moderated. There is clear upside potential available in low and average growth regional cities, but it will not come as easily as the growth fuelled by enormous resources projects during the mining investment boom.

Achieving sustained growth in regional cities will require a locally tailored policy approach. In contrast to our major cities where congestion and settlement patterns constrain performance, the goal in small cities should be to tune up the economic engine that drives growth. Across our diverse regional cities we need to nurture new industry specialisations, better enable local business growth, stimulate workforce attractiveness and build on existing lifestyle and affordability advantages as attractors for new private investment and city growth.

The RAI estimates that if good policy and increased investment can facilitate an increase of only 0.6 per cent annual compounding growth for the slow and steady regional cities, then an additional $3 billion can be added the national economy by 2031. Delivering a total output (GVA) of $378 billion from regional cities. In today's economic terms, this is equivalent to half of what the government is expected to spend in 2016/17 on the fuel tax credits scheme[i]. This comparison highlights that even low performing regional city economies are still growing strongly and require little stimulation to achieve average national growth.

The companion report to this one, ***Blueprint for Investing in Regional City Deals***, looks at how to lift economic performance in regional cities. The Blueprint addresses one issue – is a city ready for a City Deal? In addressing this, two questions emerge (i) Are city economic engines ready? and (ii) Are cities ready? Both components draw heavily from UK City Deal experiences and the underlying data provided in this report. The Blueprint provides guidance to local, state and federal government, as well as private businesses and community groups on which cities are ready to deal.

Regional City Myths

Regional cities have a new prominence in Australian economic policy. They have been included in the Australian Government Smart City Agenda and are an increasing focus for State urban and regional policy. City Deals are bringing three levels of government to the table to pursue city level growth strategies. But there is a need for better evidence to inform government and regional city leaders on the triggers for growth opportunities, as regional cities are still widely misunderstood.

With the Australian and State Governments focused on tight budgets and investment, policy implementation needs to be based on clear evidence.

However, regional cities in Australia are widely misunderstood.

The basics are accepted, they house 4.5 million people and have output that is important to the national economy, but the assumptions of slow growth and stagnant potential still surround them.

This report challenges four of the most commonly occurring misconceptions in regional city policy by shedding light on the recent performance of regional cities and expectations of how economic growth will change in the future. The RAI's work identifies that regional cities are key contributors to national jobs and economic output, and play a pivotal role in the economic growth of the regions they service.

All data for this report is available online at ***The Great Small Cities Data Tool*** - http://www.regionalaustralia.org.au/home/great-small-cities-data-tool/

This report is co-produced with a policy paper ***Blueprint for Investing in Regional City Deals: Are You Ready to Deal?*** that sets out how to get a regional city ready for a City Deal. The policy paper proposes a guide for understanding how to invest in regional cites, what criteria to consider, what questions to ask, and how to determine if a city is ready for a major intervention like a City Deal. The policy paper is a collaboration between the RAI and the UK Centre for Cities, drawing on the United Kingdom's experiences in delivery of City Deals over the past 6 years.

Together, these two companion reports provide advice to policy makers and leaders at local, state and federal government levels, community institutions and private investors. They continue the work of the RAI's Great Small Cities Program to provide knowledge, networks and ideas for effective investment and policy development.

Great Small Cities

The Regional Australia Institute (RAI) Great Small Cities Program provides clear knowledge as a basis for policy development and regional city investment.

The RAI's work focuses firstly on the 31 major regional cities that have populations above 50,000, excluding Canberra and the big five metropolitan cities of Sydney, Melbourne, Brisbane, Perth and Adelaide.

Australia's 31 major regional cities range in size from 61,000 in Tamworth to 673,000 in Gold Coast-Tweed. Figure 1 maps Australia's network of regional cities with current population estimates.

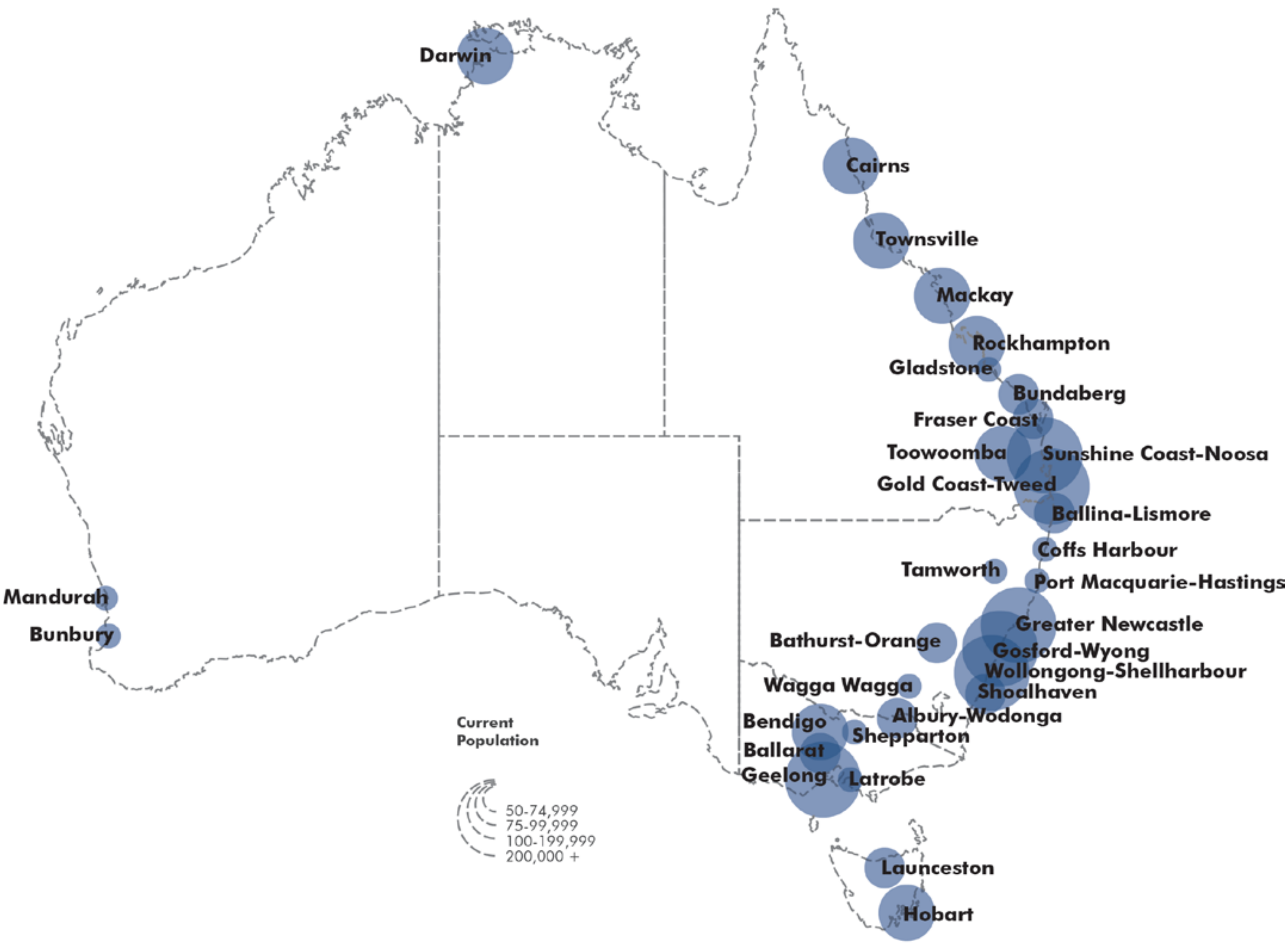

Figure 1. Map of 31 regional cities by population size and growth projections

Each city has a unique history, endowment of natural resources and political setting, resulting in varied identities and personalities. These were highlighted in the RAI's earlier report ***Deal or No Deal?: Bringing Small Cities into the National Policy Agenda.***

Myth 1: Slow or Declining Growth

While regional cities are often characterised as having slow or negative growth, as a group their medium-term economic performance has been comparable to the economy as a whole. In fact, prior to 2007 regional city growth outpaced the growth rates of Australia's largest cities. While growth has been good over the medium-term, more recent performance has been less impressive. Restoring the overall performance of the group is arguably the central challenge for policy makers at the national, state and local levels.

Australia engages in a mostly negative public discussion about regional economies. Media coverage and government activity tends to focus on the economic challenges of regions, patching up places impacted by manufacturing closure and lamenting the impacts of droughts and commodity price downturns. A side effect of this long-term debate is that many believe that regional city economic performance inevitably lags metropolitan outcomes and that 'many regional cities are suffering low and negative growth'.

Generally city performance is measured by Gross Domestic Product (GDP) or at the regional level Gross Regional Product (GRP). But, current estimates do not fully reflect local value added output[ii].

However, the 3-Ps (population, participation and productivity[iii]) drive GDP per capita so population, employment growth and production as measured through regional gross value added (GVA)[1] are locally derived estimates of city economic performance.

Data shows that on average regional cities expanded at a compound annual growth rate (CAGR) of around 3 per cent per annum between 2001 and 2013. This is comparable to the performance of Australia as a whole during this period.

Regional cities are strong performers compared to the metropolitan big 5 cities (Sydney, Brisbane, Melbourne, Adelaide and Perth), particularly given the vast differences in population size between most regional cities and the big 5.

Past growth trends in output reveal significant overlap and comparable averages between metro and regional cities (see Figure 2). Over recent history, Australian cities have all grown at similar rates.

'Productivity is the prime determinant in the long run of a nation's standard of living, for it is the root cause of per capita national income. High productivity not only supports high levels of income but allows citizens the option of choosing more leisure instead of longer working hours. It also creates the national income that is taxed to pay for public services which again boosts the standard of living. The capacity to be highly productive also allows a nation's firms to meet stringent social standards which improve the standard of living, such as in health and safety, equal opportunity and environmental impact'.

Michael E Porter, The Competitive Advantage of Nations (1991)

[1] Estimates of GVA provided by PwC Geospatial Economic Modelling Tool, based on Local Government Area derived estimates of national Computable General Equilibrium Model.

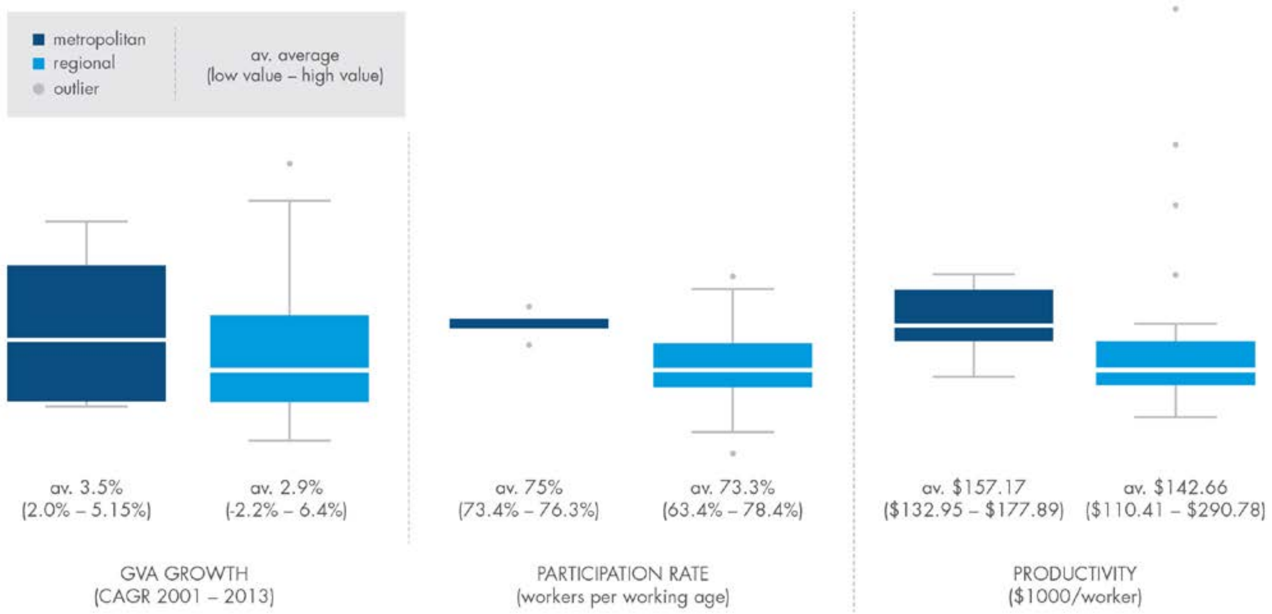

Figure 2. Australian metropolitan and regional city performance in historical growth in output and employees (2001-2013)

Regional cities also have comparable participation rates (averages 73 and 75 per cent respectively for regional and metro). Many of the inland cities, such as Wagga Wagga (78.4 per cent), and Albury–Wodonga (76.2 per cent) along with Mackay (77.5 per cent) equal or outperform the big five on participation rates.

Regional cities' productivity is also comparable to metro with average output per worker being $143,000 compared to $157,000 respectively. Again regional cities with the highest output are mining cities, e.g. Latrobe ($291,000), Gladstone ($204,000) and Darwin ($230,000), all of which outperformed the metros.

Overall, RAI analysis reveals that there is no significant statistical difference between regional and metropolitan city performance in Australia on indicators such as historical growth rates, participation rate, and productivity.

Moving beyond misconceptions – Responding to long-term performance variation

If regional cities are strong performers in terms of production, productivity and participation, how and why have growth outcomes shifted over time and why has growth varied? Answering these questions helps understand and frame policy responses relevant to the economic performance of regional cities.

While medium-term performance has been good, 2001 to 2013 was a period of split performance for regional cities. Prior to the global financial crisis, regional cities grew at a rate of 4.1 per cent which was faster than the growth experienced by the big five cities. However since 2007 the rate of expansion in regional cities has fallen back to only 1.8 per cent. Understanding and responding to this changing trajectory is a central challenge for national cities policy, similar to the priority given to resolving productivity and congestion issues in our major metropolises.

Looking within the group reveals important patterns. Substantial variation in output of regional cities is evident (Figure 3). RAI analysis identifies that the medium-term growth performance of regional cities is best understood as the collective outcome of four different growth trajectories (Figure 3). These four growth groups (Table 1) include:

- Two high growth groups:
    - Mining driven high growth cities based in Northern Australia reflecting the impact of the mining investment boom, and
    - Population driven high growth, based in Southeast Queensland and Western Australia reflecting their proximity to Perth and Brisbane during a period of rapid expansion;
- An average growth group with a mixture of regional cities whose performance sits around the averages for Australia as a whole; and
- A low growth group including mostly inland cities and those in Tasmania.

Fortunately for Australia, only Latrobe in Victoria has experienced a long-term decline in levels of economic activity and unlike many declining cities in the US and the UK, it has maintained a low level of population growth over this period.

High Growth: Population 4.4 per cent CAGR	**High Growth: Mining** 5.5 per cent CAGR	**Average Growth** 2.8 per cent CAGR	**Low Growth** 1.4 per cent CAGR
Mandurah	Townsville	Toowoomba	Launceston
Fraser Coast	Darwin	Port-Macquarie	Albury-Wodonga
Sunshine Coast-Noosa	Mackay	Cairns	Greater Shepparton
Gold Coast-Tweed	Gladstone	Geelong	Wagga Wagga
		Ballarat	Bathurst-Orange
		Bendigo	Tamworth
		Rockhampton	Wollongong
		Coffs Harbour	Shoalhaven
		Newcastle	Ballina Lismore
		Bundaberg	Hobart
		Bunbury	Latrobe (negative)
		Central Coast	

Table 1. Regional City Performance Groups with average annual GVA (gross value added) growth rates, 2001-2013
* CAGR: compound annual growth rate

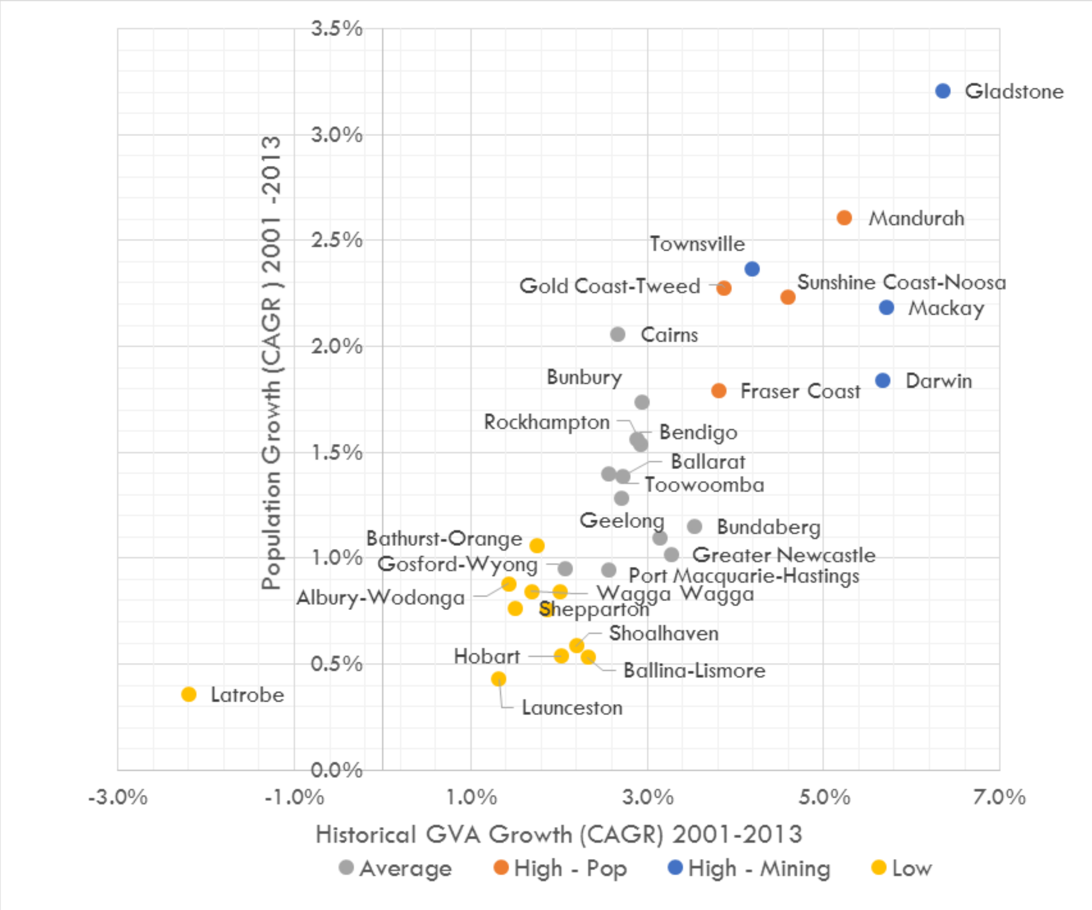

Figure 3. Regional City Historical GVA Growth Rates 2001-13, high growth (red and blue dots), average growth (grey dots) and low growth (yellow dots) negative growth only experienced by Latrobe

Overall, all regional cities, apart from Latrobe, have grown in the last decade. Regional cities outperformed metropolitan areas in economic growth at the beginning of the 2000's and yet at the end of the decade their participation, productivity and growth performances are broadly aligned.

The evidence is clear that regional cities do NOT lag metropolitan outcomes and that 'many regional cities are NOT suffering negative growth'. However, the analysis does identify that some regional cities are growing slowly compared to the national average.

Stimulating economic growth is a key outcome desired by government programs. Key initiatives like City Deals have started to remove the roadblocks to city economic growth[iv].

Myth 2: Regional Cities will be Left Behind in the New Economy World

Australia's economy, like other developed economies, is becoming services focused with the growth of jobs concentrating in new economy industries. It is assumed that regional cities are inevitably being left behind in this trend as significant airtime is given to the benefits of agglomeration and the recent concentration of growth in our metro capital CBDs. However an examination of the data shows that regional cities are in fact making the transition. Regional cities are already producing more output in new economy industries (finance, education, health and professional services) than old industries (agriculture, mining and manufacturing). With all cities growing their new economy industries over the last decade and old industries shrinking, it's time to focus on how to nurture this transition over the next decade.

Global economic trends are seeing the rise of the *new economy*, service based industries and the decline of the traditional or old industry production and distribution industries. Metropolitan cities have been heralded as leading this charge, but we question is it only metropolitan cities or ALL cities growing their new economy service base?

Regional cities are often characterised as being left behind in this transition. They are seen as stagnant and dependent on the old industries of manufacturing, mining and agriculture, not willing or able to grow new economy industries.

Old industries continue to be as important in many regions as they are to the Australian economy as a whole. Agriculture, manufacturing and mining were in fact the reasons many regional cities started and grew in the first place. But these old industries are becoming less important to their future.

Examining the relative growth and decline in regional city industries (Figure 4) shows that the transition from old industries to the new economy is very much a feature of regional city economies.

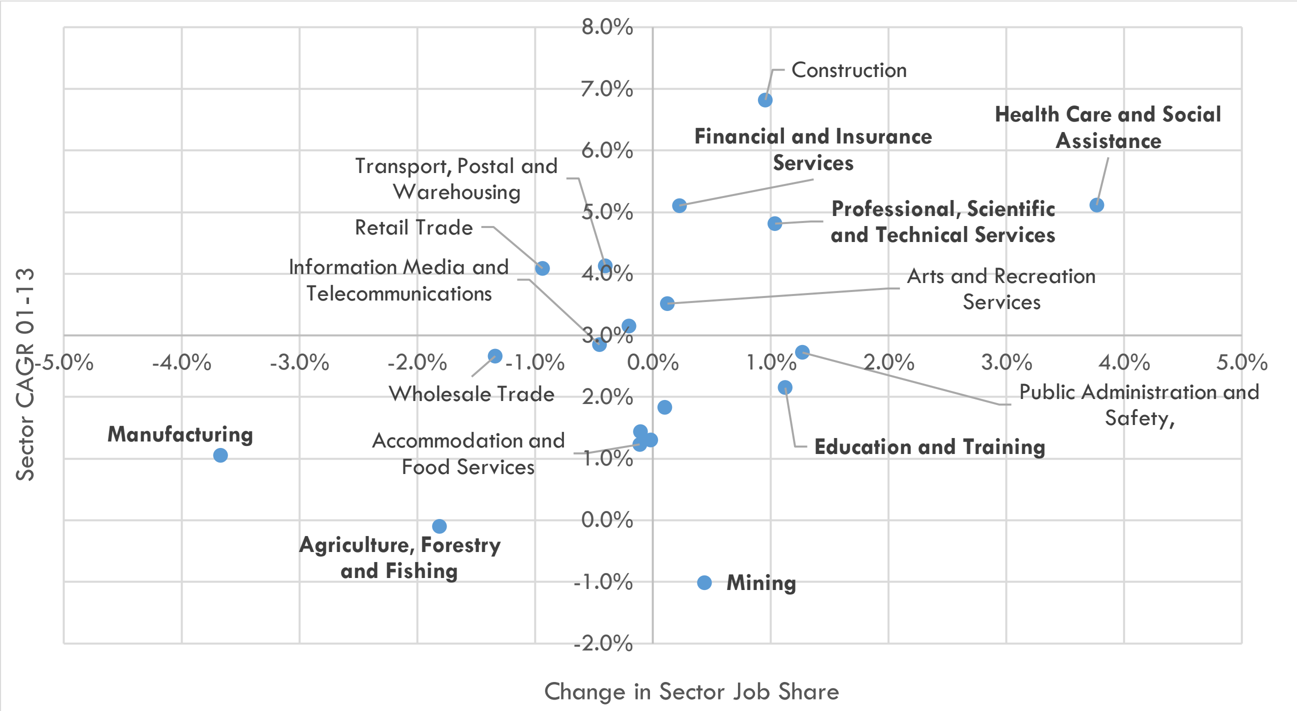

Figure 4. Structural changes to the industry mix in regional cities by jobs
* CAGR: compound annual growth rate

The highest growth industry for regional cities from 2001-13 was construction (top right in Figure 4) which grew at a Compound Annual Growth Rate (CAGR) of just under 7 per cent and increased its share of regional city jobs by 1 per cent. The strength of construction reflects the mining investment boom and high population growth in the two high growth regional city groups identified above.

Beyond this trend and consistent with the old economy to new economy transition, the other key growth industries in regional cities are services. Health care and social assistance increased its share of regional city jobs by 3.8 per cent (CAGR 5.1 per cent) and professional, scientific and technical services increased its share of regional city jobs by 1 per cent (CAGR 4.8 per cent). These are the new economy industries.

The rise of service dominated industries is being accompanied by the declining importance of old economy industries (e.g. agriculture, manufacturing and mining) which are either in decline as sources of economic activity within regional cities (mining and agriculture) or growing too slowly to maintain their position (manufacturing).

Importantly, services growth is occurring across the group, while construction led growth has been centralised in a few cities. The data shows that all regional cities have experienced growth in new economy industries from 2001 to 2013. This change over the last decade has resulted in strong output from new economy industries by all cities. Most regional cities, except Latrobe, Gladstone, Mackay and Bundaberg, produced more output in new economy industries than old by 2013.

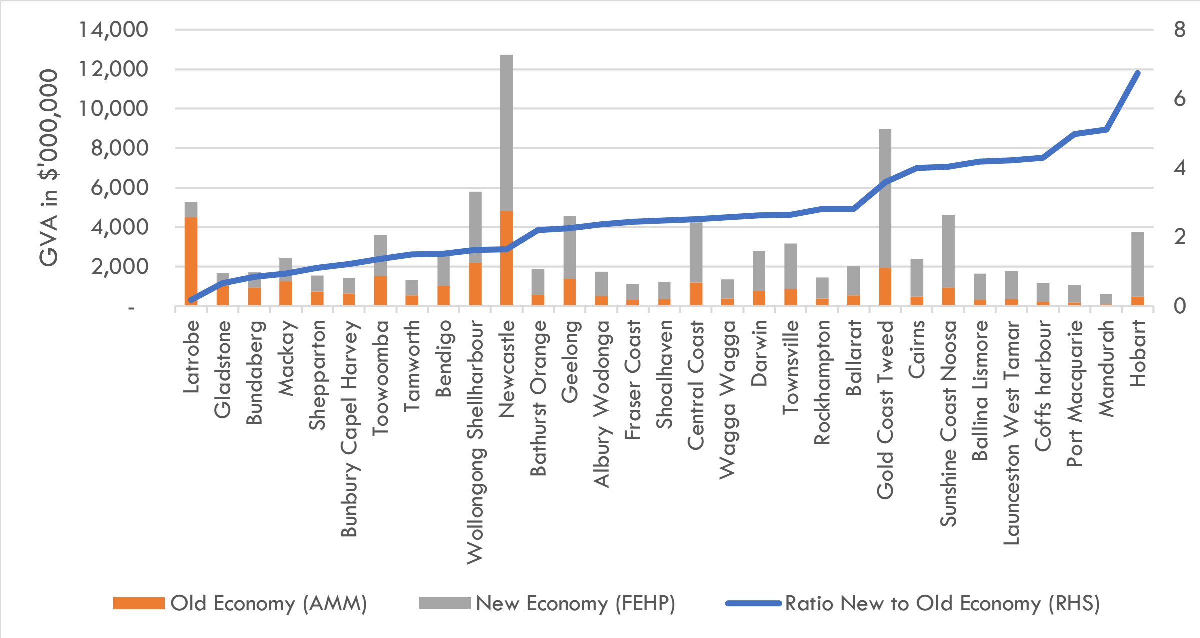

Figure 5. Output and ratio of regional city output from old and new economies in 2013

This structural change in regional cities is also reflected in the changing specialisations of regional cities.

Specialisations are the areas of economic activity in a city that are more highly concentrated locally (as measured by jobs or Gross Value Added (GVA)) compared to other regional cities or in the Australian economy as a whole. Specialisations create the competitive advantage that forms the basis of a regional city's growth path, especially if it is linked to a growing industry[v]. Table 2 provides a comparison of existing regional city specialisations and regional city growth industries.

Table 2. A snapshot of selected regional city industry specialisations and growth industries

	City	Industry specialisations in 2011 jobs (based on 2011 jobs at 3 digit ANZSIC code)	Growth industries from 2001-2013 in output (based on GVA growth 2001-13)
High growth cities	**Townsville**	Defence; health care services (hospitals in particular); basic non-ferrous metal manufacturing and utilities industries (electricity distribution).	Construction; rental; hiring and real estate services; financial and insurance services.
	Darwin	Public administration; defence; public order; safety and regulatory services; air and space transport; and gambling activities.	Mining; professional; scientific and technical services; rental; hiring and real estate services.
	Sunshine Coast-Noosa	Food retailing; accommodation; real estate services; and allied health services.	Financial and insurance services; professional; scientific and technical services; arts and recreation services.
	Gold Coast-Tweed	Real estate services; clothing; footwear and personal accessory retailing; accommodation; real estate services; and amusement and other recreation activities.	Financial and insurance services; health care and social assistance; electricity; gas; water and waste services.
Average growth cities	**Toowoomba**	Defence and agriculture and agro-food industries; particularly sheep; beef cattle and grain farming; meat and meat product manufacturing.	Financial and insurance services; professional; scientific and technical services; agriculture; forestry and fishing.
	Coffs Harbour	Agriculture and tourism; specifically; the fruit and tree nut growing subindustry; accommodation and clubs (hospitality) services.	Construction; health care and social assistance; mining.
	Greater Newcastle	Coal mining and manufacturing subindustries including basic ferrous metal manufacturing and machinery and equipment repair and maintenance; defence; residential care services; machinery and equipment repair and maintenance.	Construction; professional; scientific and technical services; mining.
	Cairns	Accommodation services; air and space transport; and scenic and sightseeing transport.	Financial and insurance services; health care and social assistance; rental; hiring and real estate services.
Low growth cities	**Bendigo**	Meat and meat product manufacturing; financial services and health care services in depository financial intermediation and hospitals industries.	Financial and insurance services; health care and social assistance; professional; scientific and technical services.
	Wagga Wagga	Sheep; beef cattle and grain farming; meat and meat product manufacturing; defence; tertiary education.	Construction; mining; health care and social assistance.
	Shepparton	Agriculture; agro-food manufacturing; fruit and tree nut growing; dairy cattle farming; dairy product manufacturing; fruit and vegetable processing; other food product manufacturing; water supply; sewerage and drainage services.	Health care and social assistance; mining; information media and telecommunications.
	Ballina-Lismore	Fruit and tree nut growing; retail; school and tertiary education as well as health care services; hospitals and residential care services.	Mining; construction; transport; postal and warehousing.
	Launceston	Public administration; retail; education; health; financial and tourism services; school and tertiary education; residential care services and other social assistance services.	Construction; financial and insurance services; mining.
	Latrobe	Pulp, paper and paperboard manufacturing; electricity generation; department stores and central government administration.	Health care and social assistance; professional; scientific and technical services; information media and telecommunications.

This reveals that regional cities have a diverse range of current and growing specialisations.

For low growth regional cities, manufacturing remains the key specialisation. These cities also tend to be located in states whose economies have performed more poorly in the new millennium and are also located further from mainland state capitals. The combination of these factors has made it difficult for these cities to grow both their population and their economy.

Average growth cities tend to show both job and output specialisation in service sectors with strong growth in financial services and health care.

High growth cities in most cases have a strong dominance of service industries for employment specialisation, whether they are powered by mining or population growth.

The continuing structural change in regional cities means that we expect all regional cities to shrink their dependence on old industries and increase their reliance on new economy industries into the future.

Moving beyond misconceptions - Nurturing the new economy in regional cities

Contrary to expectations, the transition to the new economy is well and truly on in regional cities. Showing that all cities – no matter their size – are transitioning to a new economy base.

In some cities the growing new economy industries are built on old industries, such as the logistics and business services associated with high-tech agriculture. Highlighting that for many cities a strong competitive base of old industries is driving demand in locally delivered new economy industries.

The analysis has shown that all regional cities, apart from Latrobe, have grown their new economy industries over the last decade. Most regional cities now produce more output in new industries than old economy industries.

The challenge for policy is to better nurture specialisations in cities, while supporting the transition in regional cities towards new economy industries. Specialisations represent both the services that cities offer as hubs for their region, and goods and services that are sold outside the region. Strengthening specialisations can underpin long-term growth and bring a diversity of high and low skilled job opportunities to regional cities.

Growth in new economy industries is vital in cities riding international business trends.

In the short term there are also costs or trade-offs in these growth paths that need to be managed. The RAI has identified that many cities dominated by high performing old industries (e.g. mining) tend to be more specialised in their industry structure. These cities need to ensure that their competitiveness is maintained in their older specialisation, and that they can also accelerate growth through a diversification strategy that creates a local economy resilient to single industry market fluctuations.

Myth 3: Population Size is the Most Important Factor in Predicting Economic Performance

Regional cities are often characterised as interesting, only when they are big. This drives a misconception that all the benefits of cities grow with population size. In fact when it comes to participation, historical growth or projected growth in output there is no statistical difference between big or small regional cities. The challenge for policy makers at the national, state and local levels is to cultivate city performance, not size.

Cities strive to make the best of co-located customers and producers. So the dense city population delivers opportunities for higher productivity and wages, greater capacity for innovation, and larger concentration of internal markets.[vi]

Unfortunately, the relationship between population size and city opportunity often leads to the misconception that increasing size automatically translates to stronger growth, productivity and success. Leading to policy positions that by default proactively encourage the growth of our biggest cities.

So – does city size matter?

Australia's regional cities have a variety of population sizes from 61,000 in Tamworth to 673,000 in Gold Coast-Tweed. With robust historical population growth at an average 1.6 per cent per annum from 2002 to 2013, and strong population projections to 2026 showing an expected total population increase of 16 per cent, as shown in Figure 6.

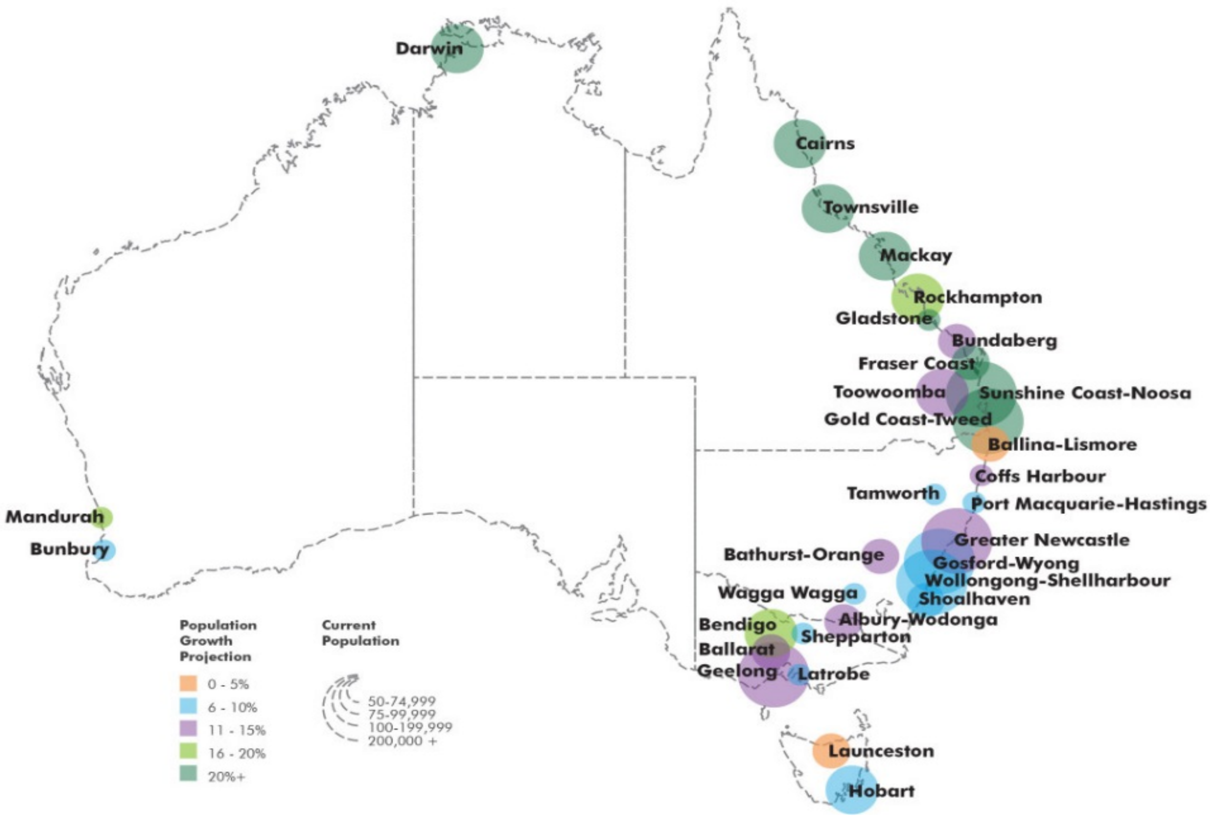

Figure 6. Current (2013) and growth rate (to 2026) populations for Australia's regional cities

No matter the city size, all regional cities have positive population expectations and varying growth rates (Figure 6).

The historical growth groups are all a mixture of big and small cities. The high growth groups include the largest regional city Gold Coast-Tweed (673,000) performing at the same output level as the middle and smaller cities of Fraser Coast (105,000), Mandurah (91,000) and Gladstone (70,000). The other growth groups are also mixed with the average growth group including the second largest regional city Greater Newcastle (573,000) along with Rockhampton (87,000) and the lowest growing groups featuring Wollongong-Shellharbour (281,000) with Launceston (92,000).

By taking a closer look at not only output of cities but also the participation rate of workers, and productivity of workers, the RAI analysis has found that there is no statistical difference between big regional and small regional city performance[vii].

Australian city economic performance is not tied to city size.

	Big regional cities	Small regional cities
Participation rate	74%	74%
Productivity workers ($'000/ worker)	137.11	159.26
Historical GVA growth rate (CAGR)	3.2	2.2
Projected GVA growth rate (CAGR)	2.8	2.3

Moving beyond misconceptions – Cultivating city performance not size

Contrary to popular expectations, all regional cities are growing and population size is not the key driver of performance.

The challenge for policy is to cultivate the performance of regional cities so that long-term sustainable growth occurs across the business cycle and through varying macroeconomic trends.

While the size of a city is important, there are also downsides to being big (urban dis-economies). Extremely high house prices, congestion as people from outer suburbs converge on employment and amenity precincts, more pollution and more crime undermine the benefits of increasing size. Greater inequality between those able to enjoy the benefits of the city and those who live far away from the best areas and earn far less are features of most cities that grow to be very big.

As cities grow, these dis-economies rapidly undermine the benefits of being bigger. Unfortunately, these issues are now an established fact of life in Australia's major cities and represent the key development challenges for their future. They feature heavily in Australian current affairs and demand ever increasing government spending to mitigate their impact on the economic performance and quality of life in our largest cities.

The relationships between the positives and negatives of being a big city are complex and there is no perfect size. But these factors mean that small cities that can capture many of the upsides of cities without urban downsides can be both highly productive and great places to live.

Australia has strong performing regional cities of all sizes – managing this growth into the future is the challenge for policy makers of all levels.

Myth 4: Past Performance is the Best Predictor of Future Growth

While trends are important, history does not predetermine the destiny of a city. Changing macro-economic conditions are having a significant impact on regional city growth trajectories and a third of all regional cities have already or are predicted to change their output growth trajectories in the next few years. Some high growth places are slipping back to average levels (e.g. Gladstone and Mackay) and others are expanding more rapidly (e.g. Hobart). Developing smart strategies that respond to changing trajectories is important to successful small cities policy.

The discussion about regional Australia can be quick to condemn places that have been stuck in a low growth phase and are struggling to make the transition from old, declining specialisations to growth in new economy industries[viii]. It is commonly argued that there is not much that governments or others can do to change these trajectories and therefore policy makers should simply look elsewhere to foster growth.

However, international literature on regional development emphasises that the greatest growth is being seen by second tier regions, those traditionally considered 'under performers'[ix]. This 'catch-up' growth plays directly to bolstering national economic performance[x], countering the orthodox economic approach of 'backing winners'. The RAI projections of regional city growth in output to 2031 also reveal a changing picture that cautions against the assumption that the poorer performers amongst regional cities have limited potential to grow[xi].

There are significant opportunities for low growth cities to increase their performance and significant adjustment periods are expected for many of the highest growth cities as their growth returns to more average levels, post mining boom.

Figure 7 presents analysis of projected GVA output trends in regional cities (2013-2031) and in the medium-term past (2001-2013). The modelling predicts that future growth of regional cities will be more even than the period to 2013 and that regional city performance will converge in contrast to the significant differentials between high and low growth cities in the past. This more equal output growth brings no real change to the 2.7 per cent average annual GVA growth rates of cities.

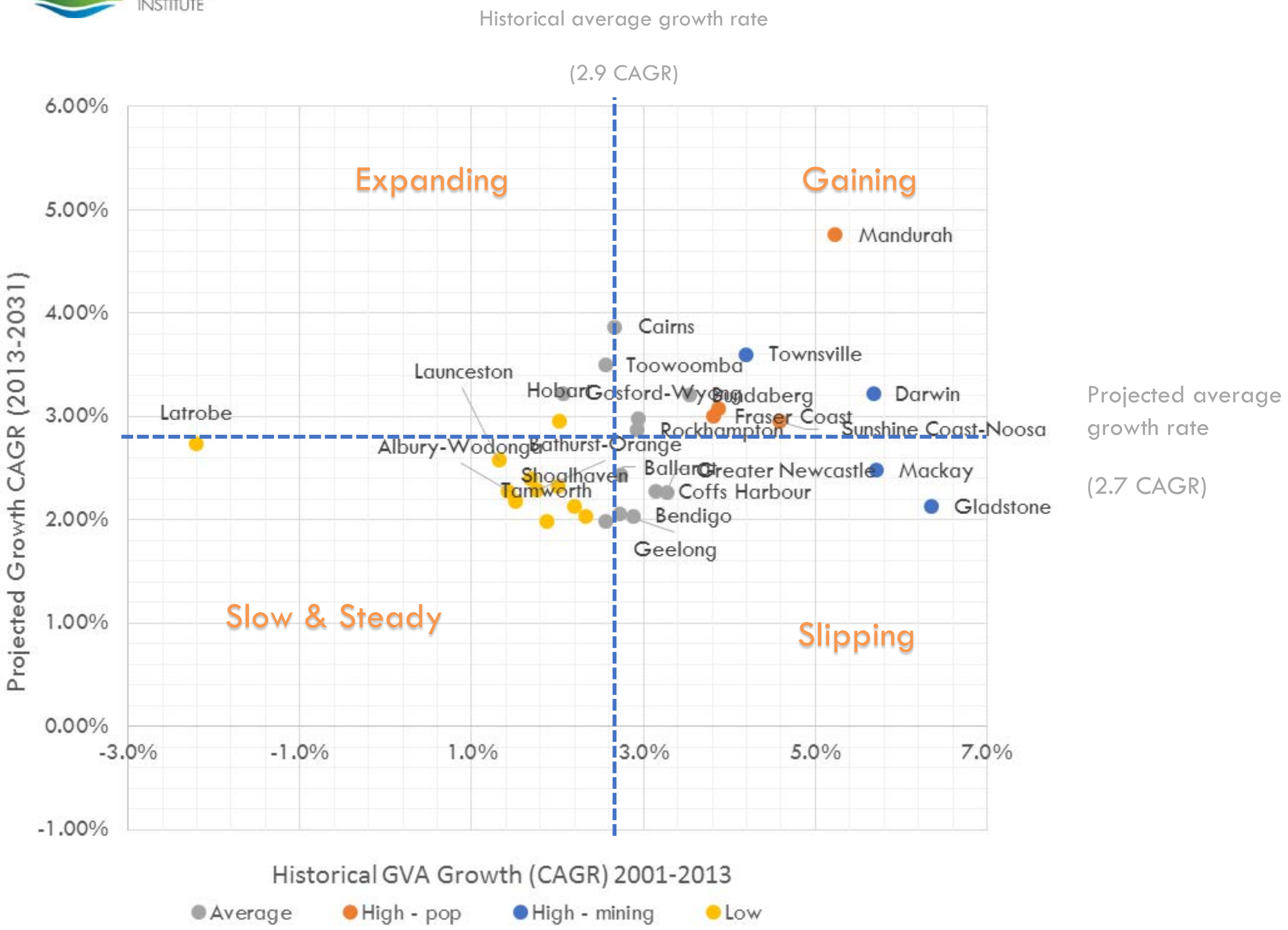

Figure 7. Past and Future Growth Rates for Regional Cities (source PwC spatial CGE modelling)
* CAGR: compound annual growth rate

The projected medium-term growth of individual cities into the future is summarised in Table 3, with some cities maintaining their historical trajectories (i.e. Gaining and Slow and Steady cities) while others are transitioning (Expanding and Slipping).

This analysis provides for the significant decline in growth rates in high growth cities as the investment boom recedes. This is already well underway and these cities are now in the midst of an adjustment period, highlighted by high current unemployment rates and declining house prices in many of the very high growth regional cities (e.g. Townsville).

Moving in the opposite direction are the regional cities with solid economic fundamentals, but historically average or low output levels, e.g. Cairns and Hobart, which will grow. These expanding cities have been hindered in recent times by external factors such as GFC, poor macro-economic conditions in key industries such as tourism and low state growth. As these conditions change, their growth has already improved and should be stronger in the medium-term.

There is a cohort of regional cities that have experienced historically average growth rates, but their future prospects are divergent – from Gaining (e.g. Bunbury and Rockhampton with high past growth and strong future output growth) to Slow and Steady (Ballarat and Port-Macquarie-Hastings below average past and future growth).

Finally there are a number of cities that will see little change. These Slow and Steady performers like Shepparton, Launceston and Wagga Wagga will all experience positive economic growth into the future. Some will experience stronger than historical growth due to favourable economic conditions (lower dollar) and rising demand for regional city specialised outputs such as agriculture and tourism.

	Gaining Cities (3.3 per cent CAGR)	Expanding (3.4 per cent CAGR)	Slipping (2.2 per cent CAGR)	Slow & Steady (2.3 per cent CAGR)
High Growth: Population	Fraser Coast Gold Coast – Tweed Sunshine Coast Noosa Mandurah			
High Growth: Mining	Darwin Townsville		Gladstone Mackay	
Average Growth	Bunbury Bundaberg Rockhampton	Cairns Central Coast Toowoomba	Bendigo Coffs Harbour Newcastle	Geelong Ballarat (C) Port Macquarie-Hastings (A)
Low Growth		Hobart		Shepparton (C) Albury-Wodonga Ballina-Lismore Bathurst-Orange Latrobe (C) Launceston (C) Shoalhaven (C) Tamworth Regional (A) Wagga Wagga (C) Wollongong-Shellharbour

Table 3. Projected Four Groups of Regional City Performance, based on past and future GVA growth rates 2001-2013 and 2013-2031

Moving beyond misconceptions – Responding proactively to changing growth trends

RAI projections of future regional city growth are positive. Regional cities have the potential to produce $375 billion in output in 2031, representing a 65 per cent increase from 2013 levels and a contribution of 15 per cent to the national economy.

But important changes are taking place in growth trajectories as recent growth performance of the high growth group has declined. The upside potential available in low and average growth regional cities will not come as easily as the growth fuelled by the mining investment boom. Effective regional city policy will understand these changes and respond at the individual city level and across the group as whole.

Importantly the large number of slow and steady city growth performers are all projected to see positive growth, and have the potential to do more. Many of these cities are predicted to perform below the national forecast growth rate (2.8 per cent), identifying them as cities with potential growth constraints that, with targeted intervention, could deliver greater benefits for the city and the nation.

Lighting Up Regional City Potential

This report has challenged the misconceptions that regional cities are inevitable economic laggards in a spiral of decline, that they cannot transition to be successful in a new economy and that size is an easy reference point for potential. By 2031 regional cities will have added $375 billion to the national economy. But they could contribute more. A further $3 billion could be generated by stimulating low growth cities, producing an estimated $378 billion in output. Achieving this medium-term economic performance is about intervening to stoke the economic engine that drives growth in each city.

This report has shed light on the recent performance of regional cities, challenging commonly held misconceptions including that size matters more than anything else, dependence on old industries is not changing, historical growth predicts future performance and that metros will inevitably outperform regional cities now and in the future.

If the growth potential of regional cities can be fully realised, the economic potential is significant. Raising the future growth rates of the slow and steady cities to the national growth average (2.8 per cent per annum from 2013 to 2031 [xii]) would be an increase of only 0.6 per cent annual compounding growth for these 19 cities. This marginal increase equates to an additional $3 billion into the national economy by 2031, delivering a total output (GVA) of $378 billion from regional cities. Overall, regional city output will grow by 65 per cent from 2013 to 2031.

This means that regional cities will maintain their strong contribution to the national economy with 2031 output contributing 15 per cent to national output, similar to the 2013 contribution of 16 per cent.

Putting the output in today's terms, regional cities in 2031 will produce twice as much as all the new economy industries (education, health, finance and professional services) produce in today's metropolitan cities.

This growth potential, in today's dollar terms, is equivalent to half of what the government is expected to spend in 2016/17 on the fuel tax credits scheme[xiii]. This highlights that even low performing regional city economies are still growing strongly and require little stimulation to achieve average national growth.

Improving growth rates requires an approach that increases city productivity, the participation of the local workforce in the economy or increases population growth rates.

These areas of focus are different in small cities compared to big cities. In big cities, the challenge is to ease the downsides of being big, particularly congestion, and to better connect residents to jobs.

In small cities, the challenge is to stoke the economic engine to deliver outsize performance. The most effective levers for growing a small city's economy are those where a modest investment of capital or better use of existing resources can have a direct flow through to the overall economic performance of the city as measured by productivity, participation and population. Four components of a small city's economic engine[xiv] should be a priority for policy intervention to achieve this goal:

1. **Business dynamo**. The capability and ambition of the local business community is essential to generating new growth and supporting city productivity. Supporting the development of entrepreneurial skills and targeting support to growth-orientated businesses is a proven strategy, as is increasing new business formation and supporting innovation that leads to commercialisation of new products.

   Raising the level of innovative activity is the key challenge for governments. RAI analysis shows that business start-up rates are significantly higher in high growth cities (see Appendix A for analysis). For example, Townville, a city that has been dominated by large old economy industries is now seeing success with the highest start-up rates for regional cities at 13 per cent of businesses. Building employment in knowledge intensive business services and increasing innovative activity as measured by trademarks are other key targets for enhancing business dynamic policies.

2. **Specialisations.** While we often focus on diversity in discussions of regional Australia, to thrive every city needs nationally and (ideally) internationally competitive businesses that can accelerate future growth. These specialised industries are most effective if linked to growth industries that can generate new output for the region. These specialisations create jobs, increase the scale of trade in goods or services outside the city, attract talent and investment and foster something unique that differentiates a city from its competitors.

   In 2011 regional city specialisations were more commonly in old economy industries, that have strong export potential and capacity to generate growth, but the last decade has seen high growth in new economy industries, heralding a change. Geelong provides a good example of how this can be turned around with specific investment into new economy growth industries of finance and education to deliver a specialised industry structure counterbalancing its traditional industry base.

3. **Workforce engagement.** Communities are concerned about jobs and the ability to earn a good wage. The way in which a city engages its working population, builds their capacity to contribute to the economy and connects them with local opportunity is crucial to participation and productivity.

   The high population growth cities have traditionally had strong productivity and participation rates. These cities also have significantly fewer high income earners and greater income inequality[xv]. Mandurah with its high population growth only has 1.9 per cent of the population earning over $104,000, highlighting the growing trap for some high growth cities to manage workforce engagement in order to sustain long-term population attraction and economic growth.

4. **Lifestyle.** Regional cities have a lifestyle advantage. No one argues with the mental and productivity benefits associated with less congestion, cultural creativity, greater access to green space; in essence a better lifestyle[xvi]. Regional cities are currently better positioned to deliver on this through more affordable housing and shorter commuting times. Policy can help to generate better returns from this advantage by supporting cultural diversity and small city planning.

   It is the great small cities that show strong cultural lifestyle performance (as shown using the Bohemian Index - Appendix A). These are the bigger population growth driven cities, dominated by new economy industries. Many of these big, sea change cities, have experienced historically strong economic growth e.g. Gold Coast-Tweed and Sunshine Coast-Noosa, while still offering lower commute times and significantly better housing affordability than metropolitan cities.[xvii].

Focusing City Deal and other policies to deliver investment that stimulates these four components of the economic engine will deliver enhanced economic performance, and sustained city growth.

Each city's pathway to achieving this goal is unique. A companion policy paper ***Blueprint for Investing in City Deals: Are You Ready to Deal?*** proposes some of the key intervention points for each of our small cities and how to ensure the readiness of a regional city for making a good deal.

It is time to put aside misconceptions about our regional cities and invest for success in this important part of our national economy.

Appendix A: Statistical Analysis of Myths

	Indicators	Myth 1: Slow or declining growth	Myth 1: Metropolitan cities always outperform regional cities
		Low/Average/High-Population/High-Mining	Regional Cities / Metropolitan Cities
3 P's	Population 2016	105,063 / 176,848 / 305,470 / 137,053	162,837 / 2,919,467
	Population 2026	112,687 / 200,362 / 381,532 / 172,032	188,973 / 3,419,274 *
	Working age population (15-65 years)	62,638 / 104,078 / 168,543 / 80,828	94,691/ 1,825,644 *
	Employment 2013	37,840 / 57,465 / 81,420/ 46,863	52,224 / 1,102,302 *
	Participation rate (workers/ 15-65 population)	73.2 / 73.1 / 71.0 / 76.0	73.3 / 75.0
	GVA (millions aud) 2013	5,222.3 / 7,656.5 / 11,537.2 / 8,489.0 /	7,400.8 / 177,112.3 *
	Productivity of working age population ($'000/working pop.)	84.7 / 72.0 / 63.0 / 109.5*	80.2 / 95.8
	Productivity of employed persons ($'000/worker)	140.7 / 131.7 / 135.6 / 187.8	142.7 / 157.2
	Historical GVA growth	1.4 / 2.8 / 4.4 / 5.5 *	2.9 / 3.5
	Projected GVA growth	2.3 / 2.7 / 3.4 / 2.9 *	2.7 / 3.3
	Historical population growth rate (2001-2013)	0.8 / 1.5 / 3.1 / 2.5*	1.6 / 1.8
	Projected population growth rate (2016-2026)	0.7 / 1.3 / 2.2 / 2.4	1.4 / 1.6
Business dynamo	Knowledge Intensive Business Services(KIBS)	4.2 / 4.5 / 4.8 / 6.0	4.6 / 3.3*
	New Business Entrants (startups)	9.8 / 10.7 / 11.7 / 12.7 *	10.8 / 14.9*
	Trademark applications	6.5 /.3 / 4.3 / 2.6	5.2 / 11.3*
	Business owners and managers	14.7 / 14.7 / 17.9 / 11.4 *	14.7 / 15.5
Economic Specialisation	Ratio New to Old economy 2013	2.7 / 2.5 / 3.8 / 1.7	2.6 / 9.7*
	Hachman index	0.49 / 0.48 / 0.46 / 0.41	0.47 / 0.51

	Specialisation (Herfindahl-Hirschman Index)	0.10 / 0.07 / 0.08 / 0.10*	0.09 / 0.07
Workforce engagement	% of working age pop with incomes >$104,000	3.53 / 3.24 / 2.31 / 6.79 *	3.68 / 7.67 *
	Unemployment Rate	6.1 / 6.5 / 7.6 / 6.5	6.5 / 5.8
	Proportion of working age population with Bachelors or higher	16.86 / 16.07 / 14.36 / 14.18	15.88 / 25.21
Lifestyle	Bohemian Index score	0.29 / 0.26 / 0.30 / 0.21	0.27 / 1.07
	% Housing Affordability (average house price/annual income)	292 / 310 / 360 / 290	307.7 / 500.2 *
	Proportion of workday spent commuting	3.0 / 3.2 / 3.2 / 3.3	3.16 / 4.44 *
	Income inequality (P80/P20 ratio)	4.70 / 4.81 / 5.42 / 4.35 *	4.79 / 4.87
	Gini Coefficient	0.45 / 0.46 / 0.48 / 0.42 *	0.45 / 0.47

	Indicators	Myth 2: Regional city left behind in the new economy world	Myth 3: Population size is the most important factor in predicting economic performance	Myth 4: Future growth is reliant on past growth and performance
		New Industries / Old Industries	Big Regional / Small Regional	Gaining/ Expanding/ Slipping/ Slow & Steady
3 P's	Population 2016	136,964.1/ 95,899.0	379,963.7/ 71,511.4*	203,998 / 205,582 / 193190 / 109,514
	Population 2026	160,751.4 / 111,598.7	446,028.9 / 81005.1*	251,560 / 231,649/ 222,570 /119,590 *
	Working age population (15-65 years)	78,882 / 55,292	218,011/41,210 *	117,018 / 122,588 / 111,979 / 64,002 *
	Employment 2013	45,325 / 31,452	115,695/ 24,194*	58,692/ 68,472/ 66,767/ 37,153 *
	Participation rate (workers/ 15-65 population)	72.8/73.8	74.0/73.6	72.4 / 74.5 / 74.3 / 73.1
	GVA (millions aud) 2013	5,806.5/5,070.4	16,096.7/3,875.2 *	8,855.5/8,985.8/ 9,824.1/ 4,974.2 *
	Productivity of employed persons ($'000/worker)	125.9/164.6	137.1/ 159.3	150.4 / 132.0 / 153.0 / 136.6
	Productivity of working age population ($'000/working pop.)	72.0 / 93.5	73.4/ 92.9	75.8 / 76.9 / 90.9 / 80.2
	Historical GVA growth	2.98 / 2.78	3.2 / 2.2	4.1 / 2.3 / 4.3 / 1.7
	Projection GVA growth	2.97 / 2.65	2.8 / 2.3	3.3 / 3.4 / 2.2 / 2.3
	Historical population growth rate (2001-2013)	1.7 / 1.6	1.7 / 1.4	2.5 / 1.4 / 1.8 / 0.9 *
	Projected population growth rate (2016-2026)	1.5 / 1.3	1.6 / 1.2	1.9 / 1.2 / 1.8 / 0.8*
Business dynamo	Knowledge Intensive Business Services(KIBS)	4.2 / 4.9	5.6 / 4.2	4.5 / 5.5 / 5.5 / 4.2
	New Business Entrants (startups)	10.3 / 10.3	11.9 / 10.1 *	11.6 / 10.7 / 11.1 / 10.1
	Trademark applications	6.0 / 5.6	2.7 / 5.6 *	4.6 / 4.9 / 3.8 / 6.3*

	Business owners and managers	17.0 / 13.9*	14.9 / 15.0	14.9 / 14.6 / 13.4 / 15.1
Economic specialisation	Ratio New to Old economy 2013	4.7 / 1.0 *	2.6 / 2.1	2.8 / 3.7 / 1.8 / 2.5
	Hachman Index	0.52 / 0.42 *	0.47 / 0.44	0.47 / 0.53 / 0.43 / 0.48
	Specialisation (Herfindahl-Hirschman Index)	0.08 / 0.11	0.07/0.11	0.08 / 0.07 / 0.08 / 0.09
Workforce engagement	% of working age pop with incomes >$104,000	3.0 / 4.3	3.6 / 4.3	3.2 / 3.6 / 5.5 / 3.3
	Unemployment Rate	6.2 / 6.8	6.5 / 6.0	7.3 / 6.2 / 6.4 / 6.1
	Proportion of working age population with Bachelors or higher	17.7 / 13.3 *	17.4 / 14.0 *	14.5 / 18.4 / 14.6 / 16.6 *
Lifestyle attributes	Bohemian Index score	0.3 / 0.2 *	0.4 / 0.2 *	0.3 / 0.4 / 0.2 / 0.3 *
	% Average house price/annual income	357 / 256 *	357 / 278 *	319 / 329 / 297 / 298 *
	Proportion of workday spent commuting	3.1 / 3.1	3.6 / 3.0 *	3.1 / 3.5 / 3.2 / 3.1 *
	P80/P20 ratio	5.09 / 4.95	4.73 / 5.02	4.88 / 4.45 / 4.92 / 4.78
	Gini Coefficient	0.47 /0.45	0.45 / 0.46	0.46 / 0.45 / 0.45 / 0.45

End Notes

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[i] Found at http://www.budget.gov.au/2016-17/content/bp1/html/bp1_bs5-01.htm

[ii] Recent estimates by SGS Economics and others have used national figures disaggregated to regional level, which are indicators of city product including turnover, value added and taxes – but as the model does not construct from the ground up for each city there are no clear measures of city value added specifically.

[iii] Henry, K (2003) 'Economic Prospects and Challenges' Address to the Australian Business Economists, Sydney, 20 May 2003 found here: http://www.smh.com.au/articles/2004/05/18/1084783509354.html

[iv] See Townsville City Deal at https://cities.dpmc.gov.au/townsville-city-deal

[v] References for specialisation include; Beer, A. and Clower, T. (2009) Specialisation and growth: evidence from Australia's regional cities. Urban Studies, 46(2), pp.369-389. Porter, M.E., 2000. Location, competition, and economic development: Local clusters in a global economy. Economic development quarterly, 14(1), pp.15-34. and Clarke, G., Martin, R. and Tyler, P., 2016. Divergent cities? Unequal urban growth and development. Cambridge J Regions Econ Soc (2016) 9 (2): 259-268.

[vi] Quigley, J.M. (1998) 'Urban Diversity and Economic Growth.' Journal of Economic Perspectives 12: 127-138 and World Bank (2009) 'Reshaping Economic Geography', World Development Report 2009

[vii] City size is measured in population, comparing the biggest cities (seven cities counted with populations over 200,000 in 2016) and the smallest regional cities (eight counted with populations less than 80,000).

[viii] Daly, J. (2016) Productivity and Geography, presentation to the Productivity commission at http://www.pc.gov.au/inquiries/current/productivity-review/conference/john-daley.pdf

[ix] Parkinson, M., Meegan, R., Karecha, J., Evans, R., Jones, G., Sotarauta, M., Ruokolainen, O., Tosics, I., Gertheis, A., Tönkő, A. and Hegedüs, J. (2012) Second-tier cities and territorial development in Europe: Performance, policies and prospects. SGPTD Final Report.

[x] OECD Promoting Growth in All Regions found at http://www.oecd.org/gov/regional-policy/promotinggrowthinallregions.htm

[xi] Predictions are based on modelling, undertaken using the PwC Geospatial Economic model at Local Government level for Gross Value Added and jobs. As with any projections the sensitivity of outcomes is determined by the underlying assumptions of the modelling and economic expectations. To test the sensitivity of the regional cities to alternate economic expectations, we undertook three scenario analyses on future growth; base, pessimistic and optimistic[xi] as related to structural adjustment to mining boom and assuming enhanced organisational capacity and leadership. The results presented here are the base.

Modelling results show that sensitivity of regional cities output performance to each scenario is related to their historical growth group (High – mining, High – population, Average or Low). With highest sensitivity for the regional cities in the low growth group – as an addition of 1 or 1.5 percentage points to a historically low growth rate is effectively a doubling of the growth rate. While the same percentage point impact on a historically high growth rate is relatively much less. Therefore, while all cities are sensitive to future growth scenarios at the macroeconomic level – those low growth cities are particularly exposed.

Future growth forecasts of regional cities are not dependent on a single variable, as no single variable predicts historical growth rate or performance. However, the modelling identifies that there are variances in the growth trajectories of cities. The challenge for local leaders, policy makers and others is to identify how to improve the growth trajectory of each city, to ensure it delivers above its expectations, not below.

[xii] Australian Government (2015) Intergovernmental Report, Treasury.

[xiii] Found at http://www.budget.gov.au/2016-17/content/bp1/html/bp1_bs5-01.htm

[xiv] The business engine components are useful in understanding city performance on a range of broad goals, such as: SMART city performance and UN Sustainable Development Goals (e.g. number 11, which has the target to '*make cities inclusive, safe, resilient and sustainable*').

[xvi] Brueckner, J.K. (2000) Urban sprawl: diagnosis and remedies. International regional science review, 23(2), pp. 160-171.; Cooke, P., Clifton, N. and Oleaga, M. (2005) Social capital, firm embeddedness and regional development. Regional Studies, 39(8), pp.1065-1077, and Huggins, R. and Clifton, N. (2011) Competitiveness, creativity, and place-based development. Environment and Planning A, 43(6), pp.1341-1362.

[xvii] The 20:20 ratio compares how much richer the top 20 per cent of populations are to the bottom 20 per cent of a given population, this can be more revealing of the actual impact of inequality in a population, as it reduces the effect on the statistics of outliers at the top and bottom and prevents the middle 60 per cent statistically obscuring inequality that is otherwise obvious in the field. The measure is used for the United Nations Development Programme Human Development Indicators. Nationally, the 20:20 ratio for example shows that Japan and Sweden have a low equality gap, where the richest 20 per cent only earn 4 times the poorest 20 per cent, whereas in the UK the ratio is 7 times and in the US 8 times. Some believe the 20:20 ratio is a more useful measure as it correlates well with measures of human development and social stability including the index of child well-being, index of health and social problems, population in prison, physical health, mental health and many others.