Submission to
An Inquiry into a new Regional Development Program

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Approach

We approach our response to this inquiry systematically. First, we outline the nature of Australia's regional development problems and the processes causing them. Secondly, we focus on those aspects of regional economic performance that might be amenable to public policy action. To do that, we need to know what policy levers can be pulled and the extent to which their use may be able to control or influence improved regional development performance. From that analysis, we thirdly consider what style of policy best assists regions to realise their full potential. By style, we mean the combination of strategic or organic and piecemeal approaches; the appropriate tier(s) of administration; the targeting of interventions (on some regions or industry sectors rather than other)s; their time horizon; the types of policy packages and the magnitude of their funding; and their arms length administration, including grant making processes (if any) and performance assessment processes. This is a lengthy agenda, but a necessary one. In the short space available, we flag the major considerations and hope that we will be offered opportunity during the inquiry process to elaborate on our observations through direct testimony to the committee.

1 The Regional Problem

Over the past thirty years or so, Australia's regional problems have largely been seen in black and white terms: the city or the bush. The latter suffered a range of problems including:

- poor service delivery and lower educational opportunities;
- restricted employment opportunities and higher unemployment;
- a relatively lower level of employment in the professions and high technology industries;
- the lower incidence of growth sectors in the economy;
- higher costs (by virtue of isolation) of production in many industry sectors;
- increasingly substantial out-migration of the brighter youth seeking fame and fortune ;
- an increasingly elderly age structure ;
- financial weakness in many primary industries (mining and farming alike); and
- many declining small towns, whose functions have come under pressure from changing patterns of access and consumer or business demand, and demographic or lifestyle change.

Prominent factors underpinning this city-country duality include:

- superior (in terms of age, investment, efficiency and effectiveness) urban infrastructure and a run-down in several aspects of rural infrastructure (for example, rail services);
- large subsidies to manufacturing industry;
- the emergence of new or greatly expanding industry sectors (e.g. finance, IT, tourism, education, which were significantly urban based)

- the growth of large corporations in the retail and service sectors whose economies of scale favoured larger centres;
- increasing global and national integration;
- increasing pressure to increase returns from scarce capital supply by allocating it to those industry sectors and regions producing the highest returns;
- on-going pressures for farm rationalisation (also featuring advanced production technologies leading to rising scale economies), driving out smaller producers;
- the relative absence of producer subsidies in primary industries; and
- rising producer and consumer mobility, favouring larger urban centres including major rural cities.

The last thirty years or so have witnessed the progressive dissolution of Australia's urban-rural dichotomy and its replacement with kaleidoscopic patterns of rural development often varying sharply from place to place. Some non-urban regions have benefitted profoundly in terms of population growth, quality of life, and economic wealth. These include:

1 sea-change and tree-change communities within the orbit of capital cities or large regional centres and such isolated nodes of lifestyle opportunity as Broome;
2 retirement resorts the length of Australia's east coast;
3 locations with substantial potential for irrigation agriculture: the Shepparton, the MIA, Moree Plains, Emerald and so on;
4 vineyard regions wherever they occur;
5 mineral and energy provinces (for example, the Pilbara, central and western Queensland, the Hunter, and Roxby downs);
6 important tourist destinations (including the snowfields, wine-producing locations, heritage sites, and great national parks, in addition to coastal resorts);
7 nearly all the major regional centres which have attracted trade away from smaller towns and villages;
8 places with opportunities for alternative energy, whether from biomass or wind; and
9 more recently, many parts of the agricultural heartlands which are benefitting, drought permitting, from rising grain and livestock prices.

However, some of these regions still face problems in the form of inadequate infrastructure and services, often the consequence of remoteness and/or rapid population growth. They often have narrow economic bases and are at risk from the contraction of key industries. Substantial declines in many river flows also pose a threat to once booming inland regions which now also face very uncertain futures[1]. There is also the paradox that falling regional population, with its concomitant difficulty in retaining rural services (including education and health), are sometimes associated with substantial rises in per capita wealth. For example, farm consolidation and mechanisation may raise agricultural productivity and profitability, but substantially reduce the number of farm families and wage labour. The resulting two-speed economies and societies herald rising intra-regional tensions between haves and have-nots.

Despite these numerous relative success stories, many regions struggle to provide wealth, lifestyle, services, and economic security for their residents. This is true, for example, of the remoter outback, which is home to many Aboriginal communities, of small town Australia lying

[1] Neil Argent, Fran Rolley and Tony Sorensen (2007), The Economic Geography of the Gwydir and Macquarie River Catchment Towns: Current Features, Future Prospects and Challenges, Report to NSW Department of Environment and Conservation.

off major transport routes, and of resource poor environments. Such locations may well have intractable development prospects precisely because of their remoteness and lack of resources.

All this has to be set against a seismic shift in perceptions of the role of government since about 1980. Prior to then, many Australian governments – whatever their political philosophies – actively supported communities afflicted by the list of disadvantages noted above. Since then, governments have become distinctly more circumspect about their abilities to promote local development and acceptable means to do it. Governments are no longer in the business of tilting economic playing fields in favour of some places rather than others, just as policies for assisting some industries have largely fallen by the wayside. Neither of these policy approaches worked at all effectively and both are out of favour in a globalising world where the principal issue is maximising the wealth and efficiency of Australia Inc. This environment favours the allocation of scarce public resources both efficiently and effectively, and not on the basis of sentiment.

Yet, the perennial problems of inadequate infrastructure and services, of narrow and seasonally risky economic bases, of limited wealth, and sometimes of lower incomes pose major problems for Australia's political parties. They are keenly felt by non-metropolitan residents who aspire to similar life chances to their city counterparts. It is hardly surprising that parties and candidates promise to deliver such outcomes and this applies in varying degrees across all tiers of government. Regional development is one of the few policy arenas pursued simultaneously by the Commonwealth, the States and local government.

Thus, it is also an arena with exquisite tensions. It is contested by these same tiers of government. Some places are much more desperate for economic development than others. Indeed, some coastal regions – Byron and Noosa spring to mind – have long sought to curtail development. The nature of the regional problem differs greatly from one region to another. As we shall see, the rectification of many problems is complex and difficult for government to manage. And, finally, there is considerable contest over the best approaches to take in terms of strategy and finance.

2 Scope for Policy Action

The process shaping Australia's regions are, to be blunt, hugely diversified, operating at mostly national and international scales, and often beyond significant domestic government control or influence. Table 1 lists most of the principal mechanisms at work, indicates the tier of government responsible, indicates whether policy focuses on national or regional issues, and estimates public control or influence in our largely market economy.

Table 1: Major Factors Influencing Regional Performance[2]

#	Factor	Tier [3]	Region Specific? [4]	Government Control or Influence [5]
	Macro-Economic			
1	Exchange Rates	C	N	I
2	Global Trade Settings	C	N	C/I
3	Interest Rates	C	N	I
4	Availability of (Venture) Capital	C	N	i
5	Level and Structure of Taxes	C	N	C
6	Research Policy and Expenditure 1	C	Y/N	c/i
7	Protection of Intellectual Property	C	N	I
8	Regulatory Environment – impact on efficiency: e.g.	C	N	C
	8.1 prudential regime for finance	C	N	C/i
	8.2 competition oversight	C	N	C/I
	8.3 penalties against predatory behaviour	C	N	I
9	Labour Regulation	C	N	C/I
10	Labour Supply (including immigration)	C	Y/N	C/i
11	Accurate & Timely Economic Intelligence	C	Y/N	C/I
	Micro-Economic			
12	Industry Subsidies and Boards	C,S	Y/N	C/i
13	Infrastructure Supply and Pricing	C,S,L	Y/N	C/I
14	Inter-sectoral Flows of Goods and Services	C	N	c/i
15	Extent of Business Innovation	C,S	Y/N	i
16	Business Intensity (effort)	C,S	N	i?
17	Business Leadership / Skills	C	Y/N	i
18	Willingness to Take Risk / Future Orientation	C,S	Y/N	i
19	Strategic Thinking / Planning	S	N	i
20	Research Policy and Expenditure 2	C	Y/N	c/i
	Social and Human Capital			
21	Education Systems (to deliver economy's skill needs)	C,S,L	Y/N	c/i
22	Institutional Variety and Competence	C,S,L	N	i
23	Community Leadership / Skills	C?,S,L	N?	i
24	Quality of Social Infrastructure	C,S,L	N?	c/i
25	Community Psychology (confidence, risk taking ability, future orientation)	C,S,L	N?	I
26	Diversity of Expressed Opinion (rather than agreement)	C,S,L	N	i
	Environmental Settings			
27	Form and Extent of Regulation (re. water price / rationing; carbon trading; vegetation clearing; bio-diversity; mining)	C,S,L	N	C
28	Urban and Regional Amenity (quality of life)	C?,S,L	N	C/I

The Table is indicative and conceals a vast range of subtle inter-connections within and between variables. It illustrates several crucial conditions surrounding the formulation of regional policy:

2 This table concerns the extent of government influence in respect of the factors listed.
3 Predominant or Joint Responsibility: Commonwealth (C), State or Territory (S), Local (L)
4 Yes (Y), No (N)
5 Control (C), Influence (I) (A '?' indicates uncertainty; upper / lower case = strong / weak effects)

1. It indicates a large variety of complexly overlapping and interrelated factors shaping regional economies, societies and even environments.
2. All three tiers of government are involved, sometimes in the same policy arena.
3. This justifies all three tiers having an interest in regional wellbeing, irrespective of Constitutional provisions which were framed at a time when the regional development imperative was barely conceived.
4. The macro-economic policy arena is far ahead of the others in terms of shaping regional economies.
5. It is also overwhelmingly a Commonwealth arena AND moreover one in which national and international events (goals) heavily outweigh specific regional conditions.
6. The macro-economy is one policy precinct in which governments (mainly the Commonwealth) also have a high level of control and influence, though even here relatively few effective levers are available given the deregulated financial system we now work within, and the power of international money markets.
7. The implication of points 4 to 6 is that government's macro-economic settings crucially determine business profitability and investment, which is the cornerstone of regional economic performance.
8. Government **control** largely resides in negotiating global trade settings, fiscal policy, financial regulation, competition policy, labour relations and supply, immigration, and economic intelligence.
9. Substantial Commonwealth **influence** is brought to bear on issues like interest rates, intellectual property, competition settings, labour regulation, and socio-economic statistics, reinforcing or mutually acting with government's control mechanisms to shape the overall investment climate. On the other hand, Commonwealth influence over exchange rates is often tenuous and indirect.
10. Australia's micro-economic business environment is more spatially variable, especially at the state level, and results from co-responsibility on the part of the Commonwealth and State governments for a raft of issues affecting business management and financial performance.
11. These include industry support measures (mainly subsidies and producer boards of varying kinds, although these are much reduced over the last 25 years), infrastructure supply (both public and private), and a range of often psychological incentives relating to skills, effort, risk perception, strategic thinking, research and innovation. The moulding of business behaviours can be both national and regionally (or state) targeted, but is much more often the indirect consequence of other government policies – such as the creation of strong pro-investment climates or forward planning activities.
12. Both the Commonwealth and the States are wisely engaged routinely in forward thinking about: industry structure, trade, labour requirements, population growth and age composition, governance, environmental trends and regulation, education and health developments, and a host of others. These activities provide important stimuli for business development along with private thinking on a similar range of issues.
13. The development of social and human capital frequently engages all three tiers of government whose demarcation of responsibility is even more confused. Their combined impact on local development is unsurprisingly somewhat diffuse. Yet we will argue shortly that much of regional policy over the last 20 years or more has rightly seen development initiatives as a largely psychological and infrastructure development activity. This is because the critical matter of business investment is largely a Commonwealth, and not a regional, responsibility, although the States' payroll tax settings are an important exception.
14. Environmental management (of both built and natural environments) is also increasingly critical for regional prosperity. However, Commonwealth and State Governments nearly always develop their powerful policies / strategies in line with international scientific

norms rather than local development perceptions or preferences. Such norms are crucial for long term sustainable futures not just across Australia's environmentally interconnected regions, but globally. Individual regions will have to work within these parameters, and even exploit them. They also adopt the precautionary principle as a yardstick, seeking to anchor the status quo rather than create a brave unknown world of the future. In many respects, environmental management, which is frequently guided by the precautionary principle, is profoundly conservative and is frequently ill-at-ease with development defined in terms of profitable business expansion. On a few occasions, however, development is congruent with environmental protection, especially in the realms of tourism and sustainable agriculture.

Australia's vaulting to fourth spot in the US Heritage Foundation's Index of Economic Freedom for 2008[6] lists Australia as being just behind Hong Kong, Singapore and Ireland. This is testimony to the substantial withdrawal of Australia's superior tiers of government from any significant attempts to mastermind economic development along governments' pre-determined tracks. It also testifies to significant reliance on private investment to provide goods and services and their concomitant: employment. We think it true to say that the private sector rules in regional development and that government action is largely confined to encouraging private investment in innovative, profitable and sustainable enterprises.

Policy Goals and Levers

Drawing on the above analysis, with its dominant focus on governments' central role in shaping favourable national or international investment climates in a largely market economy, we clarify two critical arenas where governments can influence spatial development. These are infrastructure and regional psychology. The provision of business grants or loans from the public purse looks dodgy because worthwhile business propositions should be able to raise private capital from Australia's increasingly well-financed and well-run capital markets, a conclusion we reach despite temporary financial stresses experienced from the melt-down of US sub-prime mortgage market.

Governments do not have the experience to adjudicate applications for business loans or manage them effectively and should leave it to those who do. Awarding grants to private enterprises is also fraught with danger, not only from difficulties in assessing worthy recipients and calculating rates of return, but from the temptation to make donations to politically connected businesses or those in electorally sensitive regions. Moreover, the number of businesses assisted in this way will be very small relative to the total and almost certainly not enterprises yielding the highest rates of return on investment (which would have no trouble raising private capital. In addition, the pay-off from such public outlays to private business might be very limited.

During calendar 2007, Australia's GDP approached $1 trillion and we can assume that roughly one-third was accounted for by rural regions (or c. $312 billion at current prices). If the regional partnerships program costs, say, $250 million annually, that represents only 0.08% of rural regional output. In comparison, Australia's farm sector is supported by government to at least 4% of the value of production, or $774 million annually – more than 3 times the regional partnerships outlay. However, the farm sector only accounts for 6% of the non-metropolitan economy so its level of support is 3/.06 (or 50 times) the level of support from regional partnerships for non-metropolitan economies overall. In that sense, the inquiry is dealing with what appears to be a very small issue!

6 http://www.heritage.org/Index/topten.cfm

In another sense, the outlay of $250 million for regional development might have considerable flow-on effects if spent wisely on the two themes of infrastructure and regional psychology we have identified. Infrastructure is central to production and a decent standard of living, whether transport, telecommunications, utilities (e.g. water, power, or waste disposal), hospitals and clinics, clubs and meeting places, or facilities for education and recreation. Most infrastructures are surrounded by universal or community service obligations (USOs / CSOs) which imply cross-subsidies from those living in cheaply serviced regions to residents of locations whose servicing is expensive. Since governments fund a lot of infrastructure and provide closet – if not open – support for USOs / CSOs, cross-subsidy is endemic in infrastructure supply and largely unquestioned for generations. The main difficulty is defining the level and type of entitlements, how to fund them, and where to invest in facilities. These issues have rarely been thought through and certainly not synoptically because each infrastructure component is typically funded separately by a raft of managing agencies across three tiers of government and their Quangos. We know of no national infrastructure audit including facilities, services, fitness for purpose, extent of shortfall, optimal locations of facilities to maximise benefit within a given budget, or preferred maintenance or management regimes. In addition, the audit might need to consider ownership (e.g. private or public) and funding issues.

On the other hand, the cost of a synoptic audit might better be spent on providing facilities on the rationale that the private sector proceeds by perceiving opportunity and realising it on a disjointed incremental basis. Moreover, such an audit may be infeasible because of the huge cooperative effort needed across tiers of government and their numerous agencies. We therefore suggest another approach to rational infrastructure spending, using such existing regional agencies as the Area Consultative Committees (ACCs) or their state counterparts such as Industry Development Boards. The style of policy we envisage is as follows:

1. Create a National Infrastructure Improvement fund (with sufficient funding estimated by the government to make a substantial difference to development prospects in regions receiving funding).
2. Invite competitive bids for the funding from ACC or comparable regional organisations for infrastructure funding legitimately in the province of the Commonwealth. [This could include transport, energy, post-secondary education, telecommunications, water supply, and maybe some health facilities, but not those items typically funded by state governments.]
3. The competitive bids would have to justify the proposed expenditure on either or both of facilities (new or upgraded) and their management systems in the context of existing regional infrastructure supply and its major defects or shortfalls. Such justification could involve outlays necessary to bring facilities up to national standards; the cost of rationalisation and improvement of existing facilities in the light of recent economic and population growth trends; and benefits expected to flow from the facilities sought. The latter may well include mutual reinforcement of other infrastructure investment currently in train or expected. [We see this involving substantial and open consultation between key regional stakeholders on projects of regional significance. Evidence of such consultations would be part of the submission]
4. Given the likely scale and complexity of such bids, one would anticipate a single annual funding round.
5. Competitive bids would be assessed by one or more independent peer review teams, not dissimilar to ARC assessment processes. Focus would be on the quality of the projects and their justification relative to a checklist of performance criteria. [This could greatly reduce Ministerial interference or regional favouritism and impart prestige to the process. A rigorous process of project formulation and assessment should also raise the multiplier

effects of infrastructure investment. It would also allow regions to better play to their strengths.]

6. Funded projects would (a) receive substantial capital, (b) be prominent in regional thinking, (c) entail considerable regional collaboration – necessitating the development of important negotiating and leadership skills, (d) embody forward thinking, such that regions develop a portfolio of significant forecasting skills.
7. As with all such government funded projects, there would be periodic reporting requirements of progress made (a project management issue) and project outputs or, less likely, outcomes since these will multiply in unknown ways over the long term.
8. Feedback from a comparison of projects might help refine public policy in line with suggestions published in the May 24, 2008 issue of New Scientist[7]. [In the article's view, far too few controlled policy experiments are conducted. For the types of funding we are advocating, this might be difficult given regional diversity and different starting points with infrastructure supply. Experimentally, though, it might be profitable to compare events with nominally similar projects on different regions.]

The notion of regional psychology might appear elusive, but in practice we believe it has considerable substance. The extent to which places (or more correctly their inhabitants) exude confidence or despondency (or somewhere in between) is of great material importance to their future prosperity. Success in regional development begets success and our long-term engagement with rural and regional affairs confirms these impressions. The residents of Coolah, Longreach, Emerald, Gladstone, Guyra or Inverell appear more confident of their place in the world than many other struggling communities. Place psychology is a multi-faceted and strongly inter-linked concept. It involves such human dimensions as sense of place attachment and belonging to the local social collective, leadership and entrepreneurship, hope, confidence, effort (or vigour), imagination and invention, acceptance (or aversion to) to risk, future orientation (or its obverse, longing for some past golden age), and adaptive capacity are all central to future prosperity. Some of these skills, beliefs, or outlooks have been the focus of past policies, like Strengthening Local Economic Capacity (SLEC) back in the early 1990s, but never in any concerted way. At best, many of Australia's most successful regional communities have been blessed with the presence of strong leaders who possess simultaneously a large range of these interlocking capacities. One thinks of Col Brown in Gladstone, Sir James Walker in Longreach, Paul Bell in Emerald, Barry Johnstone in Inverell, and Richard Torbay in Armidale[8] (all mayors) or the 'gang of four' in Coolah who understood the regional development game and played it successfully for all their worth employing whatever resources at their disposal.

That is often very effective, and all the more so when backed enthusiastically by local residents. The Coolah District Development Group (CDDG) got attendance of up to 800 people from the town surrounding district in the mid 1990s as it attempted to refloat its economy ravaged by the closure of its timber mill. That's not bad from a town population of 800 people. Led by the 'gang of four', the community bid, often successfully, for whatever funds were held in various discretionary pots by a raft of government agencies. Our report to DoTARS in 2002, *Telling the Coolah Story*, noted the beneficial psychological effects of competition for public funds for small-scale local projects. These include focusing the community on its problems, grant writing and project management, offering openings for community leaders to hone their skills, the elation and sense of achievement from winning project funding, learning financial discipline, and developing a future orientation. In a sense, these were hoped-for outcomes from the SLEC project, which did not really eventuate because of the way it operated. Small pools of money were often not worth bidding for and too much store was set by local government leadership. The CDDG, for example, was community based and at arms length from local government.

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7 Muir (2008), Science rules OK!, *New Scientist*, 24 May 2008, 40-43.

8 Now Speaker of the NSW Legislative Assembly

In our view, it would be a good idea to have a second community focused grant scheme for local (rather than wider regional) infrastructure supply and service development projects funded competitively. It would also be useful to bring together numerous current Commonwealth grant schemes under a single grant authority with common rules to streamline bidding and management processes. We are aware that small communities chafe at bureaucracy and paperwork. These are important parts of developing ideas and learning about project management, and vital for assessing applicant's *bona fides*, assessing performance, and analysing results to fine-tune programs dispensing public moneys. We advocate a similar style of program management to the large regional infrastructure grants noted previously. The Commonwealth has a role in this kind of funding because, in our view, such incentive schemes should be national. The improvement of local outlooks and psychological behaviours will vary little from one part of the country to another, and it would e analytically beneficial to assess the outputs and outcomes of large numbers of projects for their efficiency and effectiveness. Indeed, it would be fascinating to ask project managers about their perceptions on changing community attitudes in grant winning communities, and compare them with studies of communities failing to apply for, or receive, such funding.

As with regional infrastructure funding, we would hope that the processing of grant applications would be in bulk once a year, and handled by arms length professional assessors.

We would welcome an opportunity to discuss our ideas at length personally with the inquiry.

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