Committee Secretary
Senate Finance and Public Administration Committee
Department of the Senate
Parliament House
Canberra ACT 2600
fpa.sen@aph.gov.au

Submission to the Enquiry on Regional Grants – by APD Consulting

My company specialises in providing consultancy services in the regional and industry development field. I formed the company 8 years ago after a 25 year career with the Commonwealth Government. Prior to leaving, I was directly involved with the Regional Development Program of the previous government. I am pleased to say that the RDP was not taken to task for any alleged inefficiencies, although there were some quite serious shortcomings in that program.

More importantly, from my vantage point of now working in the regions and tracking the current Regional Partnerships Program, I have not seen or heard of any serious mishandling of that program.

My reason for making this submission is therefore to highlight to Senate Committee members some of the administrative as well as policy principles that should underpin a regional grants program. I have provided three options for your consideration. I would welcome the opportunity to address the Committee to further explain some of the points raised in this submission.

Summary

The key points are:
- The pre-election debate concerning the administration of the Regional Partnerships Program must not be allowed to detract from the importance of regional grants.
- The Regional Partnerships Program has flexibility and appears, outwardly at least, to be well-administered.
- The problems of the current regional policy and associated programs are four-fold:
  - The budget is too small to cater for the needs of regional Australia.
  - It is too centralised and too slow. This is a legacy of the strong critiques made by Senator Bishop *et al during their period in Opposition.*
  - There is a lack of a strategic framework.
  - Funding has, in some cases, been provided to projects that fail the public interest test.
- The Government should only fund projects that are consistent with agreed long-term economic development strategies within regions.
- The Government should move to a more decentralised system of regional grants, with the machinery that can deliver bottom-up, collaborative solutions.

Relevant Terms of Reference

The terms of reference addressed in this submission are:

- The mechanism for authorising the funding of projects;
- Whether the operation of the program is consistent with the Auditor-General's 'Better Practice Guide for the Administration of Grants', and is subject to sufficient independent audit.
- With respect to the future administration of similar programs, any safeguards or guidelines which might be put in place to ensure proper accountability for the expenditure of public money, particularly the appropriate arrangements for independent audit of the funding of projects.

Background

As a general observation, the current policy and program settings are adequate for the intended purpose.

In the majority of OECD countries, regional grants are provided to either:
- assist specifically-identified regions to cope with the pressures of major structural dislocation communities - such as the Latrobe Valley, western NSW, the Spencer Gulf, the Wimmera and Mallee, or

- to provide funding to cover the 'public interest' of projects where the market is not able or willing to commit.

Declining regions are reasonably easy to identify. However the 'public interest' test is more difficult, and this submission argues that more attention must be given to identifying and measuring it.

Some explanation is perhaps warranted. The **'Lead Local Compete Global'** report by McKinsey & Co., (1994) observed that regions have been regarded as the poor relation in the mainstream economic debate, notwithstanding the fact that it is increasingly regions that compete - not countries. The study noted that business investment was the main driver in terms of regional job growth, despite the job shedding (capital deepening) that can accompany new investment. They concluded that while a myriad of things influence the level of job-creating investment in regions, the investment environment, and the determinants of demand, are critical. Governments also need to understand how investor uncertainty impacts on investment and jobs growth, and how the public interest needs to be married with private risk.

These same issues came to the fore in workshops conducted in the late 1990s by the Australian Council for Infrastructure Development (AusCID) in association with institutional investors (AMP, Commonwealth Bank, Macquarie Bank, NAB etc.). My company was contracted by AusCID to organise the workshops and summarise the discussion of the projects. The salient issues were:

1. Regional markets lack critical mass

Robust revenue streams are required to attract institutional investment to regional projects. Financiers search for sufficient users of a particular piece of infrastructure. However regional markets often lack critical mass. As one investor explained 'economies of scale are the key....the cities have it....there seems to be a stigma on the rural sector which somehow must be overcome if the confidence of investors is to be gained.'

Comment:

2. Preponderance of 'public interest' in regional projects

Around 26 of the 68 projects examined had some degree of 'public interest' - that is, significant parts of the project benefit the community and not the investor. This leads to investors refusing to pay the government's way.

3. The relevance of politics

Institutional investors are wary of some regional projects because they are political footballs. When projects become too political, it raises doubts about the intrinsic worth of the project.

4. The Orphan Syndrome

Infrastructure projects of less than $20 million are not attractive to institutional investors - they will remain orphans unless they can be bundled into bigger projects. The cost of tendering for these projects is a related issue.

5. Interdependence of Projects

Many regional projects depend on each other. An example is around Bunbury - where the container facility at the port, the expansion of Kemerton Industrial Park, the construction of the Kemerton power station, and various resource value-adding projects are inextricably linked.

6. The Need to Understand Risk

Regional (and urban) projects hit the proverbial 'brick wall' because of risk in its various forms:

- **Construction risk** - the risks associated with design, cost overruns and construction delays can be substantial for capital-intensive infrastructure projects.
- **Operating risk** - these stem from shortfalls in production and/or service, and in relation to managing staff, maintenance etc.
- **Revenue/Demand risk** - this is the most important. It concerns ensuring the existence of strong revenue flows in the out-years.
- **Regulatory (policy) risk** - includes risks relating to planning and environmental requirements and competition policy e.g. aviation, water pricing.

7. Thinking Outside the Square

Regional project proponents often fail to think Outside the square, because relatively small impediments close down their thinking much too early. They misread or have no signals from government agencies, and potentially viable projects stall as a result. Conversely, marginal projects may continue to attract interest because no one has provided the proponents with a stiff reality check.

So What?

These seven issues have undoubtedly surfaced continually during the administration of the RPP. So what? The major point is that it is impossible for administrators to address most of these issues under the current program settings. I should emphasise that the former RDP program was equally lacking in this area.

We therefore recommend that the Commonwealth should pay much more attention to overseas experience.

Overseas Experience

The OECD experience is that regions develop advantages that become self-sustaining and self-reinforcing with time. Dominant regions tend to attract business through a clustering effect. An 'expansionist regime' becomes established, based on the exploitation of external economies in conjunction with innovation, skills development and an entrepreneurial culture. Conversely, the OECD argues that, in lagging areas, a downward spiral can commence, leading to population migration and a subsequent decline in investment and the quality of infrastructure, and related business activity. The dilemma facing governments is whether economic decline in particular regions is of:

(i) a long-term structural nature, in which case the policy response is to facilitate adjustment out of the industry (ie. pick up the pieces), or

(ii) a shorter-term cyclical nature, caused possibly by external shocks, thus requiring governments to work with other parties to rebuild or 'shore up' the regional economy.

The current Commonwealth policy is not well-placed to identify or deal with the above dichotomy, because it is focussed on a different set of issues viz. production efficiency, micro-economic reform, access to finance, export orientation, innovation and management skills. A spatial dimension is lacking.

The gap between Australia's regional policy stance and that of other industrialised economies is clearly evident in the findings of experts such as Doug Henton (Collaborative Economics Inc., Silicon Valley) and Prof. Michael Porter (Harvard). They have redefined the roles for government at a national, state and local level. They argue that the emphasis must now be on:

- ensuring the supply of high-quality inputs e.g. educated citizens and physical infrastructure.
- promoting cluster formation, and pursuing competitive advantage and specialisation.
- systematically upgrading public or quasi-public infrastructure that has significant impact on many linked businesses.
- rethinking who does what in the economy, and opening up new public-private avenues for collaborative action based around regional development strategies.

Comment:

Implications for the Regional Partnerships Program

What has the above got to with the RPP? The brutal fact is that, were the Senate Committee choose to assess the RPP projects funded to date, few would pass the Henton/Porter test.

The RPP tends to fund a grab-bag of disparate initiatives with no strategic underpinning because there is a lack of structure and due process within the regions. The problem is with the program design – and not the administrators.

Then what is the alternative?

First, a much better understanding is needed of the development capacity of regional economies and how to build competitive advantage. Get-ahead regions tend to have a collaborative framework - where optimism is pervasive, where trust and cooperation influence feeds through into a can-do culture.

Secondly, governments must find better ways of making their programs 'hit the ground' – this is not confined to the RPP. The Commonwealth must convert its political rhetoric - about empowering local leaders, facilitating and business-government partnerships - into consistent and coordinated actions. The problem is reflected in the raffle ticket aspect of the disbursement of government grants.

Thirdly, information on a web-site and the occasional roadshow are poor substitutes for ongoing face-to-face contact.

Fourthly, regional players must be encouraged to think more strategically and on a broader scale, in order to link agendas, and address issues on a more concerted basis.

Fifthly, governments must reduce the cost of tendering, and they must better appreciate how bad policy, poor coordination and slow decision-making impacts on regional project. Some officials have only a basic grasp of what constitutes 'public interest', and how to marry public and private sector objectives without compromising either.

Solutions

Identifying problems is easy. We have given considerable thought to providing a range of solutions.

Option One – Expand the RPP

This involves the Commonwealth expanding and refocussing the RPP. In brief:

- Annual allocation of around $100-150 million, drawn from the sales of Commonwealth infrastructure assets.
- Funding to exclude current road funding and similar arrangements, and to be mainly available as one-off grants. It might involve the Commonwealth taking equity in a limited number of projects.
- Eligibility to be restricted to projects where a specific public benefit can be identified i.e. private sector business ventures would be ineligible. The RPP and the ACCs have strayed into deep water in this area.
- Criteria to include the need for the project to facilitate regional best practice, sustainable jobs and export development, and evidence of matching funding from other key parties.

Option Two – A Code of Practice

The Auditor-General's 'Better Practice Guide for the Administration of Grants' is insufficient.

The problems identified in the run up to the 2004 election were mainly that that expenditure was held back by politicians after DOTARS had undertaken its assessements. This practice has been going on for years by both parties.

I identified this problem in August last year - see Attachment 1. I argued that a Code of Practice to govern the processing and announcement of government grants is sorely needed. It would involve a cap on the percentage of program expenditure that can be announced in the run-up to elections, and possibly the introduction of quarterly expenditure allocations without rollovers.

Option Three – Serious Devolution

The best option is to move to a full devolution model where regions would have annual budgets - and senior regionally-based officials who would oversee the grant process with local MPs and local leaders.

This would put regional stakeholders into the loop, and respond better to their concerns. It would:

- largely overcome the raffle ticket problem.
- remove the master-servant relationship.
- most likely win the respect of regional stakeholders.

I floated some scenarios for a more devolved approach to the regional grants process in 2002. And we received some serious feedback from a senior government official. His comments, provided below, actually support the current flexibility within the RPP.

"We must make the effort to better understand our clients' needs, and deal with their legitimate interests. If that means trying to push the boundaries of the way we do things, then so be it. If it means we have to get off our arses and actually talk to some of our colleagues in other agencies to try to come up with a "whole of government" response (to use the current jargon), then that's even better. It's a difficult thing to do, but how much harder is it for our clients to do the rounds of agencies when they don't know the pressure points and entry points as well as we do...

If, at the end of the day, a Minister decides that he/she would prefer to run a program within its existing parameters, then fine - that's the nature of our democracy. But let's not take those decisions away from Ministers because some lazy public servant insists on doing business on his or her own terms, without making an effort to find a way to a solution. And I don't think too many Ministers would want to be seen to "knock back good proposals because of a technicality" - they're the ones who want us to find solutions. How many program managers have rejected a proposal on the grounds that it didn't meet the criteria, only for the proponent to appeal to the Minister, who then asks the Department to see if it can find a way to fund it? Why don't we save ourselves, our clients and our Ministers both time and aggravation, by bringing a more open or creative mind to the proposal in the first place?"

REDOs should not be a dirty word

Another aspect of the devolution issues are REDOs. They are a dirty word with the current government, probably because they are a reminder of the Keating/Howe Government. Most REDOs have folded. Other reasons are that regional development has gone off the boil, there has been a shift to short-termism, and the Area Consultative Committees have assumed their place. In actual fact, we would argue that the ACCs should be re-positioned as REDOs as part of Option 2.

The merits of REDOs are well-appreciated in Europe and indeed North America.

Recent US studies have emphasised that most businesses understand that economic strength and prosperity are generated at the regional level, and that relevance of local, state, and national political boundaries as economic units is continuing to erode. That is, what happens in Tijuana may be more important to San Diego's economy than what happens in Chicago, or even San Francisco.

Until the last few years, only one federal regional development body existed - the Appalachian Regional Commission (ARC) (www.arc.gov). But in the past few years, three other regional bodies have been established through acts of Congress - The Denali Commission in Alaska (www.denali.gov), The Delta Regional Authority in Mississippi (www.dra.gov) and The Northern Great Plains Authority.

Meanwhile, two other regional bodies are being considered in Congress - a Southwest Border Authority to promote economic development in the border regions of Arizona, California, New Mexico and Texas, plus a Southeast Crescent Authority (SECA) to assist economically distressed communities in Alabama, Georgia, Florida, Mississippi, North Carolina, South Carolina, and Virginia.

The change of heart is the recognition that regions are the key unit of the 21st century economy and the growing body of evidence that regional solutions work. ARC evaluations show that its investments have played a critical role in reducing poverty and generating economic activity in the 13-state Appalachian region.

While each new authority has unique characteristics, most are based on the ARC's proven model - a partnership between Washington, with Governor managing the authority and making key decisions. Projects are developed region-wide, or by state, or from local initiatives e.g. projects like highways and other infrastructure, training, business assistance, other forms of technical support. The organisations can control significant funds e.g. the Denali Commission manages around $US 65 million.

Capacity building should be the buzzword of REDOs. Many US regions already receive substantial federal dollars - mostly income security and agricultural payments. What is needed is funding to build a sustainable economic base, to foster entrepreneurship, provide technical assistance, and encourage private sector investment. Simply shifting decision-making authority to the regions is not enough - a new focus for federal investments also is needed.

Concluding remarks

As stated at the outset, there are structural problems with the RPP. It is set up as the centre-piece of the Commonwealth Government's regional development policy. However it is under-resourced and lacking in strategic intent. These are the issues that must be addressed. Faults will undoubtedly be found in the administration of the RPP, but these are likely to be minor. A substantial overhaul of regional policy is required.

Silly Season in full swing

(Extract from 'Good Oil' column, by Rod Brown - Local Government Focus magazine, August 2004)

As I write, federal agencies are in limbo, awaiting the announcement of the election date. Departments are busily preparing briefs for incoming (or returning) Ministers, and processing grant applications. Meanwhile the politicians and journalists are in a lather. The Silly Season is in full swing.

Judging by the number of grants waiting for a sign-off by Ministers, if PM Howard calls an early election, there will be a lot of disappointed grant applicants.

The compression of expenditure commitments into a narrow window, and the accompanying uncertainty for those with funding applications in the system, raises the question of whether it's time for some sort of Code of Practice to govern the processing and announcement of government grants. From where I sit, there is a case for a cap to be placed on the percentage of program expenditure that can be announced in the run-up to elections. Another option, which the Department of Finance has surely ruminated over, is the introduction of quarterly expenditure allocations without rollovers – this would mean that if Ministers don't spend their budgets within a specified period, they would lose it. A bit radical perhaps.

On the bright side, the loosening of the federal government's purse strings is well overdue. It would be nice to think that the Australian Government is picking up on the international trend, most noticeable in the European Community, towards increased expenditure on economic and social infrastructure. Will the largesse currently being displayed continue after the election? I doubt it. But in any case, the Prime Minister is correct in pointing out that the States are moving into a much healthier financial position by virtue of GST revenues, and that organisations seeking funding for 'public interest' causes should be looking more to State governments.

Rod Brown is Managing Director of Australian Project Developments Pty Ltd, based in Canberra. Until 1996, he was Assistant Secretary – Regional Development, within the Commonwealth Department of Transport and Regional Development. He held various Commonwealth SES positions over a ten year period, including responsibility for building and construction policy, investment attraction, the Partnerships for Development Program and Commonwealth/State purchasing policies. He also headed the Australian Manufacturing Council Secretariat in Melbourne and was a policy analyst at the OECD in Paris (1979-82), where he specialised in industrial investment and industry adjustment issues.

The role of local leaders was a cornerstone of McKinsey's recommendations. There are many instances of a positive correlation between the initiative, energy and attitudes of the region's community leaders on the one hand, and a region's ability to cut through red tape, win broader industry support, and basically 'run an agenda' to generate investment and jobs on the other hand.