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# **Critiquing government regional development policies**

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## Critiquing government regional development policies

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### CONTEXT

#### Australia's history of regional assistance policy

Australian governments are under constant pressure to intervene to support the economies of particular regions, particularly those that grow more slowly. The most prominent recent example is the Commonwealth Government's "Commitment to Regional Australia" in September 2010<sup>1</sup> that promised \$10b over eight years, partly implemented through the "Investing in Australia's Regions" package in the May 2011 budget.<sup>2</sup> Other examples include the Victorian Government's Regional Growth Fund allocating \$1b over 8 years,<sup>3</sup> and the "Royalties for Regions" program of the West Australian Government, allocating over \$1b per year. Although some of this money is for improved regional services, a significant proportion purports to develop regional economies.

Such substantial spending on regional assistance has a rich heritage in Australia, as shown in Judith Brett's Quarterly Essay, *Fair Share*.<sup>4</sup> State-owned enterprises from the Post-Master General to electricity and irrigation utilities to government airlines had mandates to subsidise regional services. Soldier settlement programs explicitly aimed to boost regional populations. The Commonwealth Government redistributes tax revenues between the States using a process that aims to enable states and territories to provide Australians with services at the same standard irrespective of location. This effectively provides additional revenues to states with more people in remote areas, that are costly to service.

In part this spending was driven by what Judith Brett identifies as an "historic sense of entitlement to special treatment", often expressed as a claim to a "fair share". In fact *spending per capita* on services such as schools, police and hospitals is often higher in regional areas than in capital cities.<sup>5</sup> Of course, the higher costs of remote delivery mean that the *quality* of services in regional areas may be lower, and much of the debate is driven by the tension between spend and outcome.

Popular support for equal regional service outcomes may be weakening. As Brett shows, additional spending on regional services was historically justified as recompense to the bush for having to pay higher prices as a result of tariff barriers, and by the belief that national security required Australia to "populate or perish". The popular imagination also clung to the "Australian Legend" of the itinerant male bushworker, whereas urban workers did not seem to be distinctive from their counterparts in cities the world over. These motivations are breaking down. Tariffs have been dismantled. The University of Western Australia no longer bans books that point out that much of Australia cannot support large populations. And increasingly the Australian archetype is a successful graduate with migrant parents in a big city.

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1 Included as an annexe to the agreement between the ALP and two independent members of Parliament (September 2010), [www.minister.regional.gov.au/files/Regional\\_Agreement.pdf](http://www.minister.regional.gov.au/files/Regional_Agreement.pdf)

2 Crean S, *Budget Statement: Investing in Regional Australia* (2011), [http://cache.treasury.gov.au/budget/2011-12/content/download/ms\\_rural\\_and\\_regional.pdf](http://cache.treasury.gov.au/budget/2011-12/content/download/ms_rural_and_regional.pdf)

3 Victorian Government, *Regional Growth Fund* (2011), [www.rdv.vic.gov.au/\\_\\_data/assets/pdf\\_file/0005/67973/RGF-6295\\_12pp-BOOKLET\\_web.pdf](http://www.rdv.vic.gov.au/__data/assets/pdf_file/0005/67973/RGF-6295_12pp-BOOKLET_web.pdf)

4 Brett J, *Fair Share: Country and City in Australia* (Quarterly Essay 42, 2011)

5 Daley J and Lancy A, *Investing in regions: Making a difference* (Grattan Institute, 2011) at p.43, [http://www.grattan.edu.au/pub\\_page/086\\_report\\_regional\\_development.html](http://www.grattan.edu.au/pub_page/086_report_regional_development.html)

## Economic and service objectives

While there is a strong moral argument for providing services to Australians wherever they live, it is less clear that it is worthwhile to encourage equal economic opportunities – let alone outcomes – in every region. Economic opportunity varies substantially between regions depending on natural resources (such as mining, agriculture, ports and rivers), existing infrastructure (such as transport links, buildings and communications), and most importantly, people. The fundamental assumption of the theory of comparative advantage is that on average people will be better off if governments encourage trade between areas with different advantages rather than mandating equal outcomes.

However, there is often substantial overlap – and confusion – between the policy objectives of better regional services and regional economic development. For example, a ministerial media release in 2010 asserted that a \$100m spend to build community facilities such as playgrounds and sporting fields would “not only improve community facilities but at the same time support local jobs and boost local economies”.<sup>6</sup>

It is valuable to be clear about which aim a regional policy is really trying to serve. By contrast, government interventions to raise economic development in slower growing regions are harder to justify on equity grounds – and as discussed below, are potentially futile. Regional economic development policies have different priorities to regional services policies. Policies aimed at regional services should be explicitly directed to the areas of greatest need. Needs may arise if service quality is low because delivery costs more in sparsely populated areas. Alternatively, needs may be greatest in fast growing regions where population growth outstrips infrastructure build.

This chapter focuses on suggestions that governments should intervene to promote economic development in slow-growing regions. It considers the questions, which policies do little for economic development but are equitable because they aim to provide regional services? Which policies are efficient, because they aim to accelerate economic growth? And of policies aiming to increase net economic growth, which are effective because they have worked in practice in the past, and might work in the future?

In analysing these questions, we tend to use population growth as a proxy for economic growth. This is clearly imperfect – some of the fastest growing regions in Australia such as Hervey Bay and Cairns also have among the highest unemployment rates. Nevertheless, population and economic growth are closely correlated over time. And if anything, measuring population understates the economic growth of large capital cities relative to regions as capital city income per capita is higher and unemployment rates are generally lower.<sup>7</sup>

## PATTERNS OF REGIONAL DEVELOPMENT

### Geography of development in Australia

Despite decades of government intervention to promote economic development in regions outside our capital cities, the long-run trends have prevailed. Australian capitals have steadily gained in share of the population; inland areas, particularly towns of less than 25,000 people have lost share; capital city satellites within 150km of a major capital, and coastal cities have

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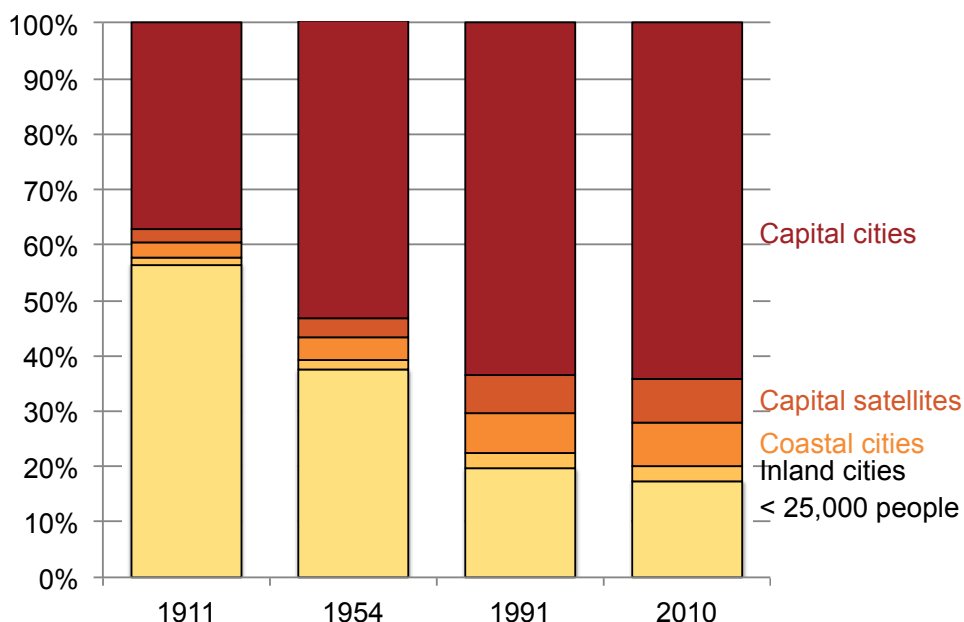
6 Crean S, “\$100 million boost for community infrastructure” (media release, 7 December 2010), [http://www.minister.regional.gov.au/sc/releases/2010/december/sc018\\_2010.aspx](http://www.minister.regional.gov.au/sc/releases/2010/december/sc018_2010.aspx)

7 Daley J and Lancy A, *Investing in regions: Making a difference* at p.16

grown substantially (Figure 1). These patterns of population growth are matched by analysis of shifts in shares of employment between Functional Economic Regions.<sup>8</sup>

### Figure 1: Australian population distribution

Proportion of Australian population



Source: Australian Bureau of Statistics; Grattan Institute analysis

This long-term pattern continued through the last decade. Capital city satellites and coastal cities grew faster than capital cities; inland cities and regional areas grew more slowly. Although some have suggested that the slow growth of inland cities and rural areas in the last decade is a consequence of the decade of drought on the east coast,<sup>9</sup> it is consistent with a much longer pattern.

However, it is notable that over the last decade, *no* city with more than 25,000 people lost population. Of course, some smaller towns are shrinking, particularly as their population moves to the larger regional centres. The fastest growth areas are principally the satellite cities close to major capitals, generally also on the coast, such as Mandurah near Perth, and the Gold and Sunshine Coasts near Brisbane, as well as a number of the West Australian and Queensland coastal cities such as Geraldton and Hervey Bay.

### Theory of development

These Australian patterns shouldn't be a surprise. Agglomeration economics – the benefits that accrue to individuals and businesses when they concentrate in the same place – is becoming increasingly influential in explaining the central role of large urban areas in economic growth.<sup>10</sup> It is entirely consistent with this theory that the most rapidly growing areas are in or close to major capital cities, and that inland regional cities grow faster than their surrounding districts. Australia is more concentrated than any other country in the OECD, with 64 per cent of its

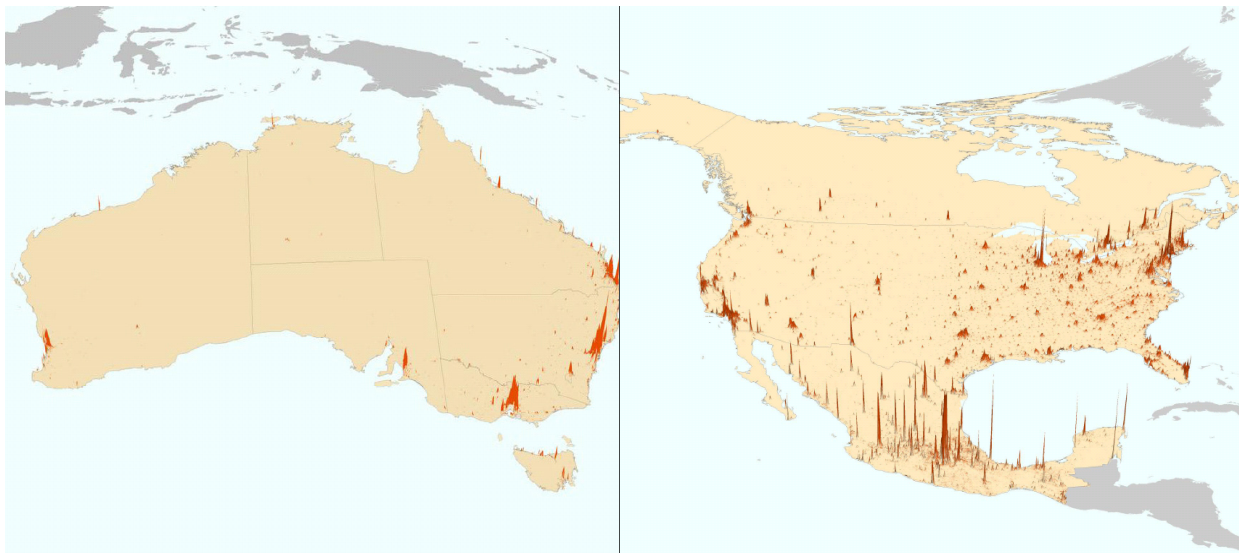
<sup>8</sup> Stimson R, Mitchell W, Rohde D, and Shyy T, Using functional economic regions to model endogenous regional performance in Australia: Implications for addressing the spatial autocorrelation problem, *Regional Science Policy and Practice*, (Vol 3 (3), 2011), p.131, at p.140

<sup>9</sup> Crase L, O'Keefe S, and Dollery B, "Nuances of Regional Growth and Its Public Policy Implications: Some Comments on the Flaws in the Grattan Institute's Investing in Regions; Making a Difference Report" *Economic Papers* (December 2011, v. 30, iss. 4) p. 481 at 485-487

<sup>10</sup> See the references collected in Daley J and Lancy A, *Investing in regions: Making a difference* at p.8.

population living in just 10 per cent of the regions.<sup>11</sup> Australia is a series of concentrated cities with large relatively unpopulated areas between, as shown in Figure 2.

**Figure 2: Population distribution: Australia and US**



Source: Tomaney J, “New thinking on local and regional development”, presentation to ANZRSAI Conference, Canberra (6 December 2011), citing European Commission.

## POTENTIAL POLICY INTERVENTIONS

### Areas of policy focus

Given these large-scale historic economic forces, what can Australian governments do that would promote economic and population growth in our slower growing regions?

Policy interventions that simply redistribute growth from one Australian region to another are unlikely to promote net economic growth. In general, markets encourage economic growth wherever it is most efficient, so government intervention to move economic activity will usually impose a drag that is ultimately paid by the entire community as lower productivity and lower living standards. For example, providing subsidies for businesses to set up in a particular region ultimately just redistributes activity around Australia, but with the additional costs of the subsidy and the associated taxation borne by the Australian community.

Instead, successful regional economic policy makes a particular region more productive than it would be otherwise. In technical terms, it increases “endogenous growth”. Such policies could increase the total size of the Australian pie, making both the region *and* Australia better off.

Even amongst policies that do aim to promote net economic growth through “place-based” approaches, there is little evidence that many are effective in doing so.

The OECD’s work on regional development suggests that higher regional economic growth is driven by education, supporting infrastructure (such as transport links), and propensity for innovation.<sup>12</sup> Proximity to other regions with large populations and higher growth rates also influences growth – consistently with the rapid growth of “capital satellites” in Australia. These

<sup>11</sup> OECD, *OECD Regions at a Glance 2011*, (2011) at p.21, [http://dx.doi.org/10.1787/reg\\_glance-2011-en](http://dx.doi.org/10.1787/reg_glance-2011-en)

<sup>12</sup> OECD, *How regions grow: Trends and analysis* (2009)

findings are consistent with new growth theory, which explains productivity growth as ultimately a consequence of education, infrastructure and innovation, alongside institutions that promote competitive markets and reliable legal frameworks.<sup>13</sup>

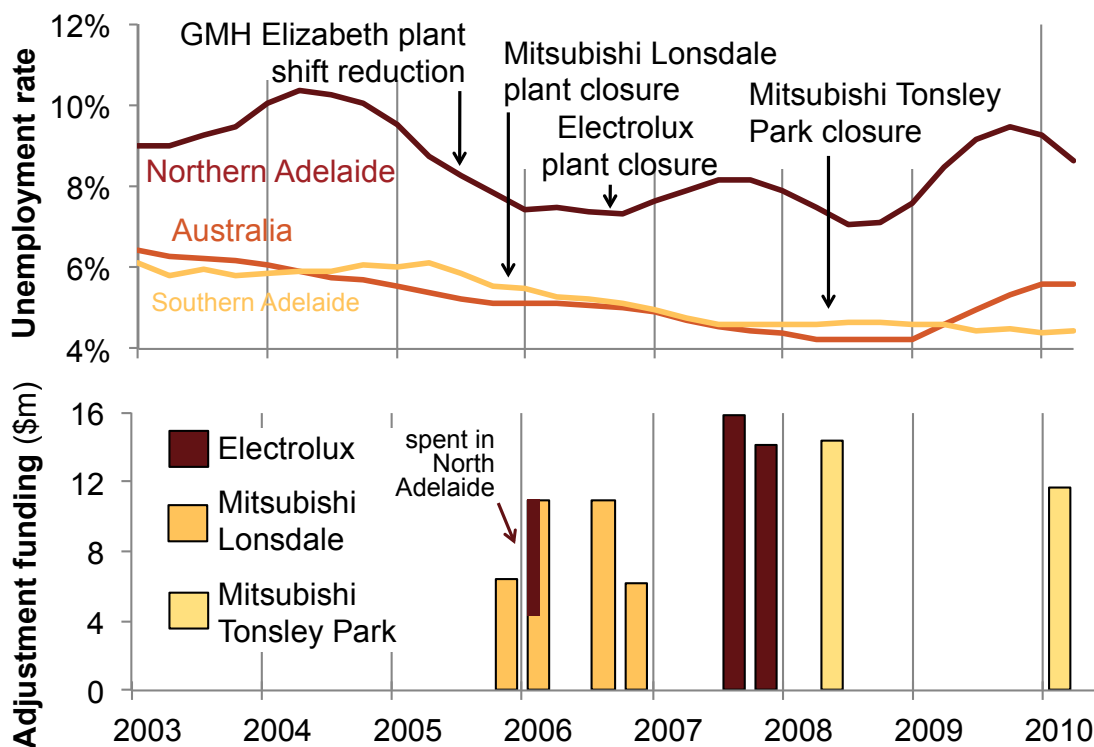
### Regional job creation

Despite this theory, Australia has a long history of regionally focused job creation programs, particularly where industries are in decline. Faced with local job losses, there is often substantial political pressure for government to “do something”. But as outlined above, business encouragement or job creation programs are unlikely to do more than redistribute economic activity around the country, imposing costs on taxpayers in the process. Even worse, it is not obvious from the available evidence that they succeed in creating local jobs.

For many of these programs, evidence of their impact is simply not collected, as numerous reports by Auditors-General have complained.<sup>14</sup>

Where evidence is available, these programs appear to have little impact, much less justify the costs that they impose on other taxpayers. As a case study we reviewed government spending of \$90m in Adelaide to encourage new businesses and job creation following a number of high profile plant closures. We found little link between unemployment rates and either plant closures or government spending, as illustrated in Figure 3.<sup>15</sup>

**Figure 3: Unemployment rates and structural adjustment spending in Adelaide**



Source: Australian Bureau of Statistics; Grattan Institute

This is reasonably consistent with interviews conducted with the people employed in the Mitsubishi motor vehicle plant closure in Adelaide. These showed that 12 months after closure,

<sup>13</sup> See the extensive theoretical discussion in OECD, *How regions grow: Trends and analysis* (2009) at p.70-78

<sup>14</sup> See Daley J and Lancy A, *Investing in regions: Making a difference* at p.24.

<sup>15</sup> See Daley J and Lancy A, *Investing in regions: Making a difference* at p.26-27.

only 13 per cent of the workforce were still unemployed, three per cent were retired but would prefer to be working, and four per cent were not working due to a disability.<sup>16</sup>

The Adelaide case study may not be representative – manufacturing workers in these areas are often highly skilled and may be more valuable to other employers than the subjects of other job attraction schemes. However, the case study is a reminder that government intervention to “create jobs” may have little impact on the target region – as well as being expensive. The general failure to collect evidence about these programs, encourages the suspicion that those responsible are aware of the significant possibility that they neither work, nor justify their costs.

## Education

By contrast with regional job creation programs, there is at least some theoretical justification for government intervention to increase education levels in regions that are growing relatively slowly. In Australia this often translates into advocacy for a regional university in the belief that it will contribute to long-run economic growth for the region.

Unfortunately, advocacy for regional universities often does not analyse carefully whether they are contributing to long-run productivity. Many of the claims about regional universities focus on their employment of academic staff, attraction of students, and the associated economic activity servicing these people.<sup>17</sup> But on this basis, a regional university is ultimately just another regional job creation scheme that redistributes activity around Australia, but does not contribute to productivity growth and overall living standards. Headline numbers about the economic activity attributable to the university are only rigorous if they include analysis about how much economic activity would have been generated if the university had been located in or close to a major capital. In any case, such analysis is highly dependent on dubious assumptions about the “multiplier effects” of regional or urban academic jobs.

There are clearly costs to redistributing activity through regional universities, which are generally more costly per student. The Commonwealth Government pays a regional loading per student to regional universities recognising their own claims that teaching at regional campuses has higher costs as a result of remoteness and fewer economies of scale.<sup>18</sup>

If regional universities in Australia succeed in accelerating regional productivity growth rather than merely redistributing activity, one would expect that university cities would innovate more than cities without a university. But patenting rates – a partial if not perfect proxy for innovation – are not materially higher for university cities in Australia than for non-university cities of a similar size.<sup>19</sup> Although some point out that there are many other facets to innovation that should be measured,<sup>20</sup> patenting rates are the measure used in the only study (from Sweden) referred to by the Commonwealth Department of Education, Employment and Workplace Relations to justify claims that regional universities increase total economic productivity.<sup>21</sup> There is little evidence in Australia that regional universities contribute to productive innovation on this measure.

<sup>16</sup> Beer A, “Risk and return: housing tenure and labour market adjustment after employment loss in the automotive sector in Southern Adelaide” *Policy Studies* (Vol 29 No 3, September 2008) p.319 at 324.

<sup>17</sup> For example, Charles Sturt University, *Regional Development Report 2010* (2011) at p.6, [http://news.csu.edu.au/uploads/documents/F1672%20Regional%20development%20report\\_WEB.pdf](http://news.csu.edu.au/uploads/documents/F1672%20Regional%20development%20report_WEB.pdf)

<sup>18</sup> Department of Education, Employment and Workplace Relations (DEEWR), *Review of Regional Loading: Final Report* (2011) [http://www.deewr.gov.au/HigherEducation/Documents/Regional\\_loading\\_final\\_report.pdf](http://www.deewr.gov.au/HigherEducation/Documents/Regional_loading_final_report.pdf), and see Daley J and Lancy A, *Investing in regions: Making a difference* at p.31

<sup>19</sup> See Daley J and Lancy A, *Investing in regions: Making a difference* at p.49.

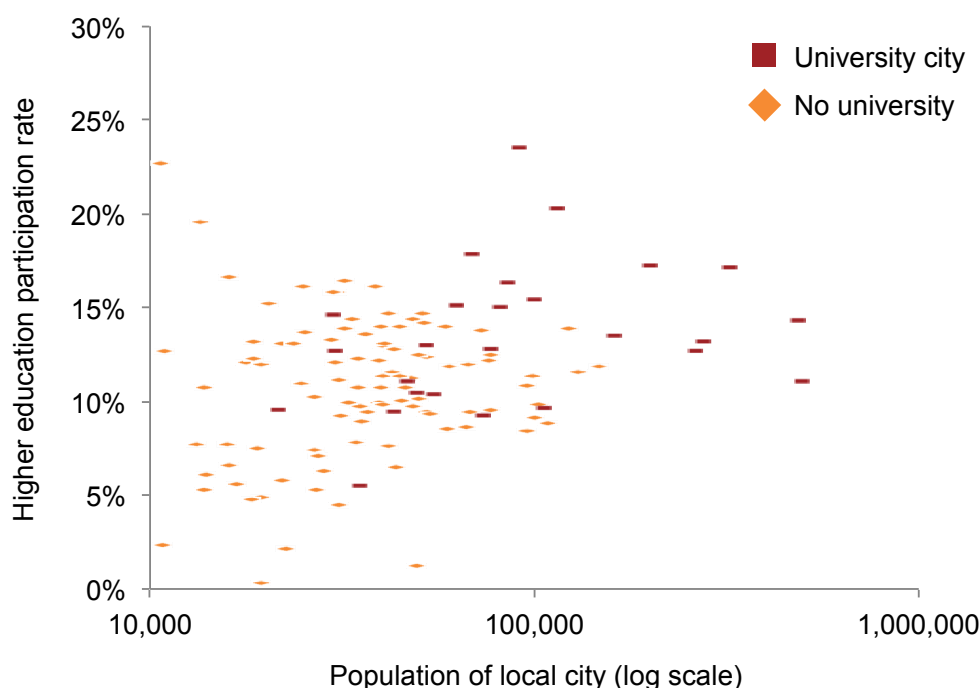
<sup>20</sup> Crase L, O’Keefe S, and Dollery B, “Nuances of Regional Growth and Its Public Policy Implications: Some Comments on the Flaws in the Grattan Institute’s Investing in Regions; Making a Difference Report” *Economic Papers* (December 2011, v. 30, iss. 4) p. 481 at 488

<sup>21</sup> Department of Education, Employment and Workplace Relations (DEEWR), *Review of Regional Loading: Final Report* (2011) at p.4-5

Similarly, one would expect that the private sector would grow faster in university cities than in non-university cities. If regional universities do more than redistribute growth, then this would not merely be a one-off increase in private sector employment. Instead, one would expect to see these cities generating more economic activity – and growing employment faster – than in non-university cities. But the data shows no material differences in private sector employment growth.

One would also expect university cities to have higher local participation rates. Higher education participation rates are generally higher in larger cities. But in cities of similar size, participation rates of school leavers appear to be similar, whether or not there is a substantial local higher education campus, as illustrated visually in Figure 4.

**Figure 4: Higher education attainment by region**



Source: Daley & Lancy, *Investing in regions: Making a difference* at p.36, analysing all 22 year olds in the 2006 census.

However, this analysis of school-leavers may understate the impact of regional universities on the participation of mature age students. Regional universities attract more mature age students than urban universities, with a higher proportion of students who care for others at least 10 hours a week (31 per cent vs 17 per cent at urban universities).<sup>22</sup>

Nevertheless, the presence of a local university does not seem to be the major driver of university participation. The majority of students from regional areas who attend university do so in major urban areas, as shown in Figure 5. Indeed, on the assumption that students from remote areas do not have a local regional university, the presence of a local university only diverts about 11 per cent of potential higher education entrants from an urban to a regional university.

<sup>22</sup> Australian Council for Educational Research, *Higher education & community benefits: The role of regional provision* (Joining the dots research briefing, 2011) at p.3



**Figure 5: Schooling location and university location**

<b>Primary school location</b>	<b>% of those in higher education going to urban institution</b>
Remote	69%
Rural	61%
Regional	58%
Urban	89%

Source: Graduate Pathways Survey, as reported in Australian Council for Educational Research, *Higher education & community benefits: The role of regional provision* (Joining the dots research briefing, 2011) at p.4; Grattan Institute analysis

Nor do regional universities significantly influence school leavers who participate in higher education to stay in their home town. Again, analysis of the census shows that the presence of a local university has little impact on the number of people who participated in higher education, and who still lived in their “home town” aged 22.<sup>23</sup>

Regional universities do have a significant impact in *attracting* people to their region, who then stay after completing their studies, disproportionately in domestic service sectors. Graduates of regional universities are much more likely to reside in regional areas than graduates of urban universities (66 per cent vs 16 per cent). However, regional university graduates in disciplines leading to employment in the market sectors of the economy (other than agriculture) generally move to large cities after their studies. By contrast, 34 per cent of graduates who went to regional universities and then stay in a region work in education. This local service sector employs much more of the graduate workforce in regions than in urban areas, where only 22 per cent of graduates work in education, whether or not they attended a regional university.<sup>24</sup>

Therefore, there is limited evidence that regional universities contribute to endogenous economic growth – that is, productivity growth rates higher than otherwise. However, clearly they succeed in redistributing economic activity around Australia. They probably contribute substantially to improving the labour pool for regional services, and it is likely that they play a significant role in the cultural and social life of their area. However, it is hard to find clear evidence in Australia that they increase total economic growth and productivity.

## Infrastructure

Governments also allocate significant funds to regional infrastructure on the basis that it will contribute to economic growth. The Victorian Government’s Regional Growth Fund documents, for example, note \$220m in local road funding, justified on the basis that it will “further support regional growth”.<sup>25</sup> Again, it is obvious that such spending improves regional services, and the quality of life in regional areas. But it is hard to find evidence that the costs of infrastructure deliver higher economic growth than simply leaving the money in taxpayer pockets.<sup>26</sup> The spending may well provide services benefiting the community that only government can provide. But these programs then need to be justified on this basis rather than claiming the rhetorical force of contributing to economic growth.

<sup>23</sup> Daley J and Lancy A, *Investing in regions: Making a difference* at p.36-37

<sup>24</sup> Australian Council for Educational Research, *Higher education & community benefits: The role of regional provision* (Joining the dots research briefing, 2011)

<sup>25</sup> Victorian Government, *Regional Growth Fund* (2011) at p.10

<sup>26</sup> See Daley J and Lancy A, *Investing in regions: Making a difference* at p.38-41.

## Local involvement

The area of regional policy that perhaps requires most attention is the role of government in encouraging local networking and participation to create new businesses and activities. The shift towards “place-based” approaches adopted in the European Union over the last decade emphasises the need for local involvement and local government to identify local assets, and then determine local strategies.<sup>27</sup> There are some success stories internationally,<sup>28</sup> although it is seldom obvious which interventions are responsible for improvement, nor is it clear if the benefits outweigh the costs of similar but unsuccessful interventions elsewhere.

Such local involvement is not a new prospect for Australian regional development. A paper in 2002 by Paul Collits, then a Manager of Regional Policy in the NSW Department of State and Regional Development, cited half a dozen studies and a number of programs over the previous 15 years emphasising the importance of local involvement and ownership for local strategies.<sup>29</sup> More recently, one fifth of the Victorian Government’s Regional Development Fund is for the Putting Locals First Program that funds opportunities for development identified by local organisations and governments.

However, local involvement does not necessarily lead to productive investment in the right skills and infrastructure that leverage genuinely distinctive local assets to sustain businesses for the long term. Local leadership has many political incentives to propose projects that redistribute resources from elsewhere in Australia to improve local services and facilities, and increase local spending in the short-term, but do little to promote long-term local businesses or increase national productivity.

Indeed, it is arguable that the allure of “free” government money for such local projects may divert local leadership from the hard choices implicit in building sustainable local businesses. Being honest about which assets are truly distinctive, building a network of relationships, and creating businesses competitive with the outside world despite remoteness is always going to be a challenge. It is easy to see how attention could be distracted by “farming the grant” rather than “building the business”.

However, it is unlikely that Australian governments would adopt a policy of official neglect simply to send an unambiguous message that viable activity must be sustainable without government intervention. And some viable long-term activities do require government support for infrastructure and skills that private enterprise is unlikely to supply given problems of coordination, free-riding, and spill-overs.

As a result, there is real tension between the desires to promote genuine local initiative, to respond to political imperatives, and to target genuinely productive infrastructure. This tension makes it all the more important that programs for regional economic development are clear about their objectives, and require rigorous evaluation as a condition of government intervention. This clarity and rigour would make it more likely that government intervenes to promote economic development only when it is truly required.

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<sup>27</sup> Tomaney J, *Place-based approaches to regional development: global trends and Australian implications*, (Australian Business Foundation, 2010), [http://www.abfoundation.com.au/research\\_project\\_files/52/Tomaney\\_Rev.Final\\_Colour.pdf](http://www.abfoundation.com.au/research_project_files/52/Tomaney_Rev.Final_Colour.pdf)

<sup>28</sup> Pring S, White G, Pates R, Cook J, Seth V, Beaven R, Tomaney J, Marques P and Green A, *Rebalancing the economy sectorally and spatially: an evidence review: Volume 2 – International case studies* (UK Common for Employment and Skills, 2011); GHK and Centre for Urban and Regional Development Studies, *What Works in Regional Economic Development: Learning from International Best Practice* (2006)

<sup>29</sup> Collits, P, “Australian regional policy and its critics”, paper presented at the 11th Biennial Conference of the Australian Population Association, Sydney 2002 [http://www.apa.org.au/upload/2002-4D\\_Collits.pdf](http://www.apa.org.au/upload/2002-4D_Collits.pdf)

## **CONCLUSION**

The evidence is underwhelming that the current suite of government policy interventions are doing much to increase Australian regional growth and productivity. Evidence is often unavailable. Over the long run, patterns of regional development reflect long-term economic and social shifts, rather than regional policy initiatives. Where evidence for particular programs can be gathered, there are seldom clear indications that they have increased regional growth rather than just redistributing activity around Australia, and no evidence that they have increased regional activity by more than they have reduced it elsewhere in Australia.

Objectives of improving regional services are often blurred with claims about driving higher economic growth. If intervention in a region genuinely increases economic productivity of the region, then it is ultimately in the interests of all Australians – which is presumably why proponents of regional assistance are quick to make this claim even when the major impact is to improve regional services. Improving regional services is often a legitimate equitable goal, but it imposes costs on the rest of the Australian community. The historical forces that encouraged governments to pay these costs may be weakening. Clear eyed analysis of whether government intervention will truly promote regional economic growth is therefore even more important today than in the past.