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Welcome to the twenty eighth issue of *Economic Issues*, a series published by the South Australian Centre for Economic Studies as part of its Corporate Membership Program. The scope of Economic Issues is intended to be broad, limited only to topical, applied economic issues of relevance to South Australia and Australia. Within the scope, the intention is to focus on key issues – public policy issues, economic trends, economic events – and present an authoritative, expert analysis which contributes to both public understanding and public debate. Papers will be published on a continuing basis, as topics present themselves and as resources allow.

This paper is one of three papers on regional issues with two further papers exploring first, the "rejuvenation" of the Provincial Cities following a protracted period of decline through the 1990s (EIP No. 29) and second, assisting regions and communities to cope with change based on good practice in the design and delivery of structural adjustment assistance measures (EIP No. 30).

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The authors of this paper are Michael O Neil, Executive Director of the Centre and Cliff Walsh, Emeritus Professor of Economics and Visiting Research Fellow in the School of Economics, University of Adelaide. The views expressed in the report are the views of the authors.

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	ke-1 ninking the Approach Regional Development in South Australia

Regional development in South Australia is an agenda without a policy framework or strategy.

A State s economy and its society are neither less nor more than the sum of the economies and societies of its constituent regions and their communities. Given this truism, it is surprising how often – how persistently – State governments appear to think and act as if the State s overall economy and society, somehow, "transcend" those of the regions, rather than being mere statistical artefacts, and behave as if attention to the economic performance and social well-being of regions is almost an optional extra – important for political reasons perhaps (because of the shape of electoral boundaries, if nothing else), but otherwise of limited relevance to the development of State policies and the assessment of their effects.

The fact that a substantial proportion – some 40 per cent – of South Australia's overseas export income and a larger proportion of its interstate export income are generated by regions outside the Adelaide metropolitan area (especially tourism, food, wine and minerals) has not gone unnoticed but has principally led to the development of *sectoral* policies with little broader regional content as such. And where regions have captured priority attention, it most often has been sporadic and largely in response to regionally-concentrated crises – in recent times, the effects of the closure of Mitsubishi on southern Adelaide and the consequences of reduced water availability

to make the State-level targets plausibly feasible/conceivable. Putting it this way makes clear that, just like the regionalisation of State government service-delivery, the original formulation of the State Plan was, in effect, tops-down without involving even so much as cross-checking whether conceivable regional outcomes would "add-up" to State-level aspirations.

The likely source of this deficiency in the initial process of formulation of the State Strategic Plan – and one that will infect the process of developing a regionalised version of the Strategic Plan – is that there was not, and still is not, an official overarching State regional development policy within which a regionalised Plan could have been, or can now be, coherently and consistently developed. To the extent that there have, nonetheless, been regional development *initiatives*, they have been narrowly conceived and, at best, pragmatic rather than principled – and this despite the fact that, more than a decade ago, the Report of a South Australian Regional Development Task Force (1999) set-out how a contemporary and good-practice model of regional development should be developed and implemented.

Over the last decade (and in decades before) South Australian governments approaches to regional development have largely been articulated as about regional economic development only, with the twin objectives of increasing investment attraction and employment growth. Regional development in South Australia has long been based on the premise that regional structures (e.g., Regional Development Boards) could provide a regional focus for the South Australian Government in partnership with local councils in economic development. The Boards were funded to promote and support business development in the regions including, inter alia, to act as a focal point for the three tiers of government, investors and developers. Quantitative performance indicators were largely designed to record the volume of investment attracted to the region (including government capital works) and "jobs created and jobs retained". Over time, the Boards assumed additional roles including business advisory services, providing information on government programs, workforce development including through skilled migration and acting as grantees/hosts of funding to support local labour market initiatives.

Notwithstanding the many successes of regional development boards, the narrow focus on "economic development limited the effectiveness of these structures and constrained regional capabilities (e.g., limited coordination of government agencies at a regional level for place-based initiatives). Indeed, it would seem altogether plausible to argue that while the establishment of the RDBs gave the *appearance* of "inclusive partnerships", the reality was largely quite different. Through the eyes of those who made, advised on and implemented what was presented as regional development policy, regions appear to have been seen as agencies of the State government through which the government could drive its aims and ambitions when it suited it to do so, but otherwise were left to cope by themselves with the help of poorly resources RDBs, the

CEO s of which were hobbled by excessive red-tape and subject to multiple accountabilities.

While policy makers have moved a considerable way from subsidy-based interventions to attract business investment, they continue a largely top-down, narrow approach to regional development that reflects little

to unleash and enhance the capacity of regions to mobilise their region s assets, knowledge and capabilities to promote regional innovation, business development, investment attraction and export participation;

to help regions to build the capacity to understand, anticipate and adapt to continual, sometimes rapid, changes in their external environment that ultimately inevitably require structural adjustment by them, whether the changes are market-induced, policy-induced or nature-induced:

to do all this without the need for subsidies or concessions from central governments, so avoiding potential distortions in how regions use their endogenous resources (and which subsidies and concessions are likely to eventually prove to be either wasted or fiscally and economically unsustainable anyway).

Importantly in South Australia's context, a community-based and community-led approach to regional development is what regional communities have made clear is what they want during the recent first-round

about, and in at least some jurisdictions the practice of, regional development policy has evolved over time. Second, we then revisit the Report of the SA Regional Development Task Force, including to identify where the regional development model it proposed for South Australia fits in relation to both contemporary literature about regional development and growth and contemporary ideas about good-practice regional development strategies, policies and programs. This naturally leads on, third, to a proposed rethinking of the way regional development is practiced in South Australia and, fourth, to an identification of what might desirably constitute a new model for the future and how it might be achieved. A final section provides a short statement of our overall conclusions.

In this section, we provide a brief overview of what have been the predominant theories of regional economic development and key characteristics of their application in regional development policy over the period since World War II. A more extensive coverage is contained in Appendix A and elements of the latest thinking and practice are more fully developed in later sections.

Over the period since the middle of the last Century, the literature based on economists ways of thinking about regional development, blended with perspectives drawn from other disciplines, has evolved through two distinguishable phases. Correspondingly, though with lags, what are regarded as best-practice regional development policies strategies and initiatives have been shaped by them. However, within each phase there was a continuity in the dominant "philosophy", in both there were progressive shifts in emphasis on the design of mechanisms for the promotion of regional development, the most decisive of which is reflected in the latest thinking which the academic literature refers to as "new federalism" and the OECD terms a "new paradigm".

Phase One: Exogenously-Driven Development and Growth

In the post World War II years at least until the 1970s, the principal way of thinking about – and applying – regional economic development policy involved central government interventions. There was broadly strong economic growth and low unemployment but regional disparities, and policy focused on lagging regions. Based on Keynesian thinking, and associated theoretical growth models, it was considered that central government policies could increase demand in lagging regions through public sector spending. Regional interventions consisted of a mix of public sector investments, especially in infrastructure and government business enterprises, and support for strategies to build lagging regions economic bases focused on exploiting their *comparative* advantages, reflected in their factor endowments.

Porter's approach stressed the role of industry clusters and networks leading to mutually reinforcing competitive advantages, with *local* factors, including demand, institutional and regulatory factors and collaboration by networks of suppliers contributing to growth. He also emphasised that innovation depends on knowledge and skills embodied in people and regions, and that skills creation and their influence on innovation are intensely local.

Romer s (endogenous/new) growth theory also emphasised local knowledge and its consequences for regional growth. In regions with relatively high levels of knowledge creation, learning (including tacit) tended to reinforce the process of new knowledge creation, dissemination and use, he argued.

While these theories and empirical studies based on them emphasised the significance of factors endogenous to regions they initially had a strong focus on innovation and technological change, including the importance of local culture, entrepreneurship and leadership networks and collaboration in stimulating and sustaining it. This led to "technology-based" approaches to regional development and spawned centrally-driven regional development strategies designed to try to build the basis for

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lagging regions the approach is now one that advocates a bottoms-up

on a "smaller number of strategic planning regions for the State" (p. ix). Arguably this, at last, has been achieved (more than ten years later) with the creation of twelve uniform state government regions (SGRs) -4 metropolitan and 8 non-metropolitan and, more recently, Regional Development Australia (RDA) establishing (almost) co-terminus South Australian regional committees

With the establishment of Regional Development Australia (RDA), which has led to the amalgamation (or incorporation) of RDBs with RDA, South Australia now has fewer and potentially stronger regional strategic governance arrangements. This is precisely what was envisaged by the Task Force. At that time they urged the following:

"Strategies be adopted to develop a coordinated approach to regional economic development with State and Commonwealth governments and ... the State and Commonwealth governments form a partnership relationship to regional development in South Australia, in collaboration with Local Government" (4.12.1; p. xxvi).

The Task Force had consulted widely with regional representatives and reported on the need that those representatives had expressed to involve regional leaders in decision making

"... the emphasis was on genuine involvement in decision making processes in their region ... plea for empowerment and involvement in setting and implementing the future directions of regions ..." (p. viii).

Governance arrangements needed to be established, the Task Force emphasised, to help regions "shape their own futures", to identify opportunities and to collectively set a pathway to achieve the growth potential of each region.

The Task Force argued for a "change in attitude of government and agencies" by which it meant developing a "shared vision and the creation of a culture of commitment to regional development within government" (p. ix).

The emphasis of the Task Force was that regional development is about regional communities "improving their economic, social, cultural and environmental wellbeing, by fully developing the potential of a region and its people" (p. x). These objectives would be achieved by

improving regional competitiveness and encouraging private investment;

building social and human capital;

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Victoria has adopted this

"new approach to local and regional development based around investment in education and training, encouraging firms to innovate through working together; letting regions take an entrepreneurial approach to development based on their existing assets [endogenous assets] and promoting social and economic inclusion.

... government has reorganised at a regional level to join-up different agencies, business, educational institutions and communities and strengthened ties between them through building social capital."

The emphasis on human capital and innovation is well placed because a number of OECD reports consider the importance of, particularly, secondary education for innovation, productivity and regional economic performance (see Appendix B for a review of empirical findings about factors contributing to regional growth).

The Victorian Government also reorganised

"public administration arrangements and introduced new policy instruments to invest in the capabilities of local communities and regions ... including e

investment in human capital but the critical point is that the theory suggests policy initiatives (and they are essentially pro-competitive policies) can impact on the long run growth rate of economies.

In addition, a set of "external issues

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regions need to address. In any event, following the Report of the Sustainable Budget Commission, and its reflection in the 2010-2011 State Budget, it is not clear what role DTED will have in regional development in the future. Given that it is being gutted of financial resources and strategic person-power, even the limited role it played in coordinating regional development through the Office for Regional Development would appear unsustainable.

What is required in future is not central government agencies deciding

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Literature Overview: Approaches to Regional and Economic Growth

In this Appendix, we provide an overview of the policy approaches to regional *economic* development that have predominated at different times over the period since the 1950s and of the economic circumstances and economic theories that have influenced the choices between alternative policy approaches.

Approaches to regional development continue to evolve in response to "new economic models", insights into the competitive advantage of regions (and nations!), the emergence of fast growing regions and the revitalisation of industrial centres.

Regional areas have some similar but also many different, sometimes unique, characteristics, which give rise to significant challenges for policy makers. The second half of the 20th Century saw several distinct approaches to regional development which had their origins in a mixture of changes in the economic forces acting on nations and regions; changes in the views of economists about the role and nature of economic policies in promoting increased living standards; and changes in broader understandings about the influence of the different characteristics of different regions on their growth potential. They have also reflected shifts in confidence about each approach as a result of observed failures and/or successes. The timing of the shifts in confidence between approaches has been relatively simultaneous across developed economies.

Although in the main text we categorised the changing approaches to regional development and growth into two main phases, for this more extended discussion it is useful to divide the second, more contemporary phase, into two. The three approaches are summarised as: the Exogenous Approach, the Endogenous Approach and the combined Exogenous/Endogenous Approach. They each see different regional characteristics to be important and infer different policy implications.

In what follows, we outline each of the three approaches, including the theoretical basis of each, and identify implications for government policies.

The Exogenous Approach

The exogenous approach argued that potential stimulants to regional economic growth should be introduced to regions through an externally-determined, top-down process.

The exogenous approach dominated regional economics literature and practice from the 1950s until the 1970s in Australia and Europe and to more like the mid-1980s in the United States. It was considered that, through a centralised, top-down approach, economic development

incentives were reduced or removed, firms relocated elsewhere, illustrating the temporary or transient nature of businesses initially attracted by locational incentives (Stephens et al, 2003).

what types and mixes of capital – human and physical – a region chooses to invest in alongside its other resource endowments is likely to influence the growth rate it achieves.

A direct policy implication of the endogenous growth models is that, since knowledge-creation, and innovation and its adoption, most productively occur where there is rivalry, pro-competitive policies are required at national and sub-national levels. Protection or other forms of preferencing of particular industry sectors or businesses is likely to stifle knowledge

The role of central government (and all its agencies) is to set the framework conditions including reorganising government, to promote competition and innovation, thereby contributing to "high and rising levels of productivity" and it should be single minded and strategically focussed to this goal (i.e., to act as a "pusher rather than a doer").

Combined Exogenous/Endogenous approach

The combined exogenous/endogenous approach reinforces the requirement for local development to be in the context of external conditions – "think global, act local .

The exogenous/endogenous approach gained popularity in recent decades, and has been aggressively implemented in Europe, has thus far with much success. It draws heavily from the endogenous approach, but in addition emphasises the requirement for external players to support the development process, as well as local players to be aware of this requirement. The perspective of local players, especially in those cases where autonomy for major decisions has been transferred to the local level, must be global and forward-thinking, in order to be *pro*active rather than *re*active in policy formulation.

EU policies on regional development have been influenced by relative differences in growth rates of regions and nation-states, a desire to assist "lagging regions" (if only to ensure social cohesion) and EU wide policies on innovation, technology transfer and adaptation to a knowledge-based economy.

The McKinsey and Co (1994) report stressed the development of regions through expanding economic and export activities (i.e., "focus on markets beyond the region") suggesting that regions should "act locally while thinking globally" (i.e., increase their competitiveness), promote investment to achieve employment growth, build leaders at the regional level to manage and respond to change and establish a vision for the region. A guiding principle underpinning the report (and others, e.g., The Kelty Report, 1993 and the Industry Commission Report on Impediments to Regional Industry Adjustment, 1993) was

It is critical to appreciate that regional development policies, whether broad or narrowly based, industry/sector or labour market, whether targeted at "lagging regions" or "leading regions" have borrowed heavily from the endogenous approach, specifically to address regional competitiveness through new governance structures capable of building local skills and knowledge, capable of orchestrating high rates of educational achievement, able to integrate education and labour market programs and build and support business and community networks and partnerships.

The intent is to achieve much more effective and efficient outcomes through supporting greater regional autonomy and influence across government programs, policies and funding.

Appendix B provides a discussion, through a review of empirical findings, of those factors said to contribute to regional growth. They include population growth and the labour force participation rate, human capital development, strategies to diversify the industry base of a region, local taxes, transport and communication infrastructure, local amenities, the role of innovation and entrepreneurialism, social capital development, and marketing.

Participation rate

A population with a large concentration of people of main working age (16-64 years) is likely to have a higher participation rate and be more productive than a very youthful or elderly population. Finland and South Korea (as above) illustrate how high participation rates and labour force growth can mitigate the adverse effects of a stagnating population in the pursuit of economic growth (SACES, 2008).

This was also found to be the case in the mid-west states of the U.S., with the variable "proportion of population aged 34-65 having a statistically significant positive coefficient (Monchuk, 2005). Butler and Madenville (1981) hypothesised this to be the case, by indicating that in-migration of working age immigrants may be a key determinant in regional development.

Skilled migration of those people of working age and raising the workforce participation rate of those who are unemployed or not in the labour force can assist to raise productivity, offset an ageing population and potentially contribute to innovation by individuals and organisations. Regional organisations have considerable scope in partnership with local government and local business to provide and promote attractive locational packages for new migrants and their families.

Human Capital Development

A highly skilled labour force contributes to productivity growth as well as fostering innovation in management practices, production processes and technology. The presence of a highly skilled workforce may have an

Diversified Industry Base

When one industry dominates a region s employment and income, the region s economic fortunes are closely aligned to the fortunes of that industry. In contrast, a diversified industry base provides flexibility to adapt to changing market conditions which are most often externally determined. The impact of global economic conditions on regional areas is well illustrated by trade liberalisation and even the recent global financial crisis; however numerous examples exist where "rise and decline" is a response to changes in technology, new forms of energy, product innovation and policy decisions of government.

The industrial revolution of the 18th Century moved traditionally southern-concentrated populations in the United Kingdom north and west, to Glasgow, Newcastle, Leeds, Sheffield, Manchester, Liverpool, Cardiff, and later Birmingham. These became leading industrial centres of the 19th Century, based on coal mines, steel mills, shipyards, and ports. Between the world wars, and particularly following the end of World War II, these industrial centres continued a path of slow decline due to the slow exhaustion of natural resources and the growth in international competition in ship-building and steel production. Similar trends have been observed in the French mining and steel districts of Lorraine and Nord-Pas-de-Calais, the agricultural and steel-dominated south-eastern regions of Austria, the northern mining and industry cities of Germany (Illeris, 1993) and the mountain energy-boom states of America (Markusen, Noponen and Driessen, 1991).

In addition, (Illeris, 1993) hypothesised that the emerging dominant family structure to a "two bread-winner household renders industry diversification increasingly important in order to provide job opportunities for both partners. Terluin (2003) found there to be a positive correlation between diversification of the industrial base and economic growth. However, it was noted that in some cases specialisation has been successful, but only when the reliance is on tacit knowledge, specific societal and institutional settings, vertical differentiation and a high rate of p1 28016ern \$\mathbb{T}JETBT1(be)4(e)4(n1c 0 0 1 337.15)

Amenities

Various studies hypothesise that employers will site businesses near

Terluin (2003) discovered a positive empirical relationship between the strength of internal networks, measured by concentration of local actors involved, and economic growth. In addition, a positive empirical relationship was evident between number of external relationships and economic growth. It was noted that the majority of external relationships