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Assisting Regions and Communities to Cope with Structural Change: Context, Objectives, Principles and Good Practice

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Executive Director's Note

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This paper is the final of three papers on regional issues with earlier papers exploring first, the "rejuvenation" of the Provincial Cities following a protracted period of decline through the 1990s (EIP No. 29) and second, Re-Thinking the Approach to Regional Development in South Australia (EIP No. 28).

The authors of this paper are Emeritus Professor Cliff Walsh, School of Economics, University of Adelaide and Assoc Professor Michael O'Neil, Executive Director of the SA Centre for Economic Studies. The views expressed in the report are the views of the authors.

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Assisting Regions and Communities to Cope with Structural Change: Context, Objectives, Principles and Good Practice

Key Points

- Continual changes in economic, demographic and biophysical forces and in the policy environment facing all regions are unavoidable facts of their economic, social and political life.
- Regions have no choice but to adapt to the external forces: indeed it is an important principle that regional businesses, workers and communities themselves should take primary responsibility for adapting to pressures leading to structural change.
- While structural change and structural adjustment are often seen as having negative connotations for businesses, workers and communities, it is through businesses and workers adjusting to changed circumstances that national, state and regional economic growth and prosperity are maximised.
- Regions already, in effect, have available to them "adjustment assistance" on a continuing basis through generally available programs which support *people* facing changed circumstances whatever the cause and wherever they live – particularly minimum income support through the social security safety net and job-search, employment and training programs available to all who meet universally applied eligibility criteria.
- There may, however, be some circumstances in which it is appropriate and desirable for State governments and/or the national government to provide *additional* targeted, **region-specific** assistance (***regional structural adjustment assistance***) to help regions manage the process of adapting to change.
- The assistance to be provided, although region-specific, is not targeted at regions *per se* but rather principally at those *people* and communities most adversely affected – though it might include support for regional organisations which have the potential to facilitate the adjustment process.
- The need for and desirability of providing region-specific structural adjustment assistance needs to be assessed on a case-by-case basis and is likely to be strongest where adjustment pressures occur abruptly, are of unusually substantial magnitude and persistence and disproportionately impact on some regions compared to others.
- While regional structural adjustment policies and programs need to be developed in the context of broader regional development objectives that all spheres of government pursue, it would be neither economically nor fiscally sustainable for regional development assistance to be directly and deliberately targeted at attempting to neutralise the ultimate consequences of structural adjustment pressures for particular economic activities.
- The central objective of regional structural adjustment assistance, where it is provided, should be to help to minimise the transitional costs borne by people and communities, by smoothing the time-path of adjustment and facilitating occupational and/or locational change by workers, families and businesses.
- Important good-practice principles include that assistance measures should be: circumstance and location specific; tightly targeted at identifiable impediments to adjustment; time-limited with clear criteria for when they should be wound-down or terminated; and subject to continual evaluation of their necessity and their cost-effectiveness.

1. Introduction: Regions, Structural Change and the Process of Structural Adjustment

Structural change, and particularly the adjustment pressures that regions experience are the subject-matter of the analysis undertaken in this paper. The principal purpose of the paper is to attempt to develop:

- an overarching framework within which structural adjustment issues can appropriately be considered;
- a statement of general principles of guiding whether, when and how it is appropriate for government to assist regions to cope with structural adjustment *pressures*, whatever their source; and
- a set of good-practice principles to appropriately shape the practical design and implementation of regional structural adjustment *assistance* where it is offered.

It is not necessary for present purpose to grapple with the vexed question of how regions appropriately should be defined *spatially*. However, it is important to recognise that how the geographical boundaries of regions set for administrative and policy purposes can have significant effects on the appropriateness and effectiveness of public sector service delivery arrangements and policy interventions. Shoehorning the regional delivery of different public sector services into a more-or-less uniform set of geographically-defined administrative regions can fail to recognise important cross-border interdependencies between regional communities of economic as well as social significance and which can differ significantly between types of services.

It is also (particularly) important in thinking about regional structural adjustment to recognise – and keep front-of-mind – that the term "region" is shorthand for an interdependent collection of businesses and workers (its economy) and of people, families and communities (its society) and of natural assets (its environment and natural resources). **It is the consequences for them, individually and collectively, of structural change that is the central issue.** While changes in regional aggregate statistical indicators, such as a region's income, its population or its employment level, provide important signals about what is likely to be happening among the region's businesses, workers, families and communities, they can miss as much as they reveal of economic and social policy relevance – and the more so to the extent that the boundaries drawn for the purpose of data collection and publication cut across significant economic, social, and political interlinkages.

Structural change and its implications

Structural change – that is, changes in the composition, scale and location of economic activities and consequential changes in the sectoral and locational patterns of employment and the type of skills required – is occurring continually. The pressures that ultimately lead to structural changes, *through the process of structural adjustment*, especially include economic (market) forces, demographic trends and changes in public sector policies. Biophysical forces, such as prolonged droughts, increased climate variability and reduced security of rural and urban water supplies, while cyclical in nature can also have significant structural consequences. Climate change and policies designed to promote adaptation to it are widely expected to lead to particularly substantial, sustained structural change, with sharply different regional consequences.

At a national economy-wide level, the structural changes that have occurred over the last century or so are well-known: the substantial and persistent relative decline of agriculture as a source of output and employment; the rise and then fall of the relative significance of manufacturing; the long decline then subsequent (post-1960s) reversal in the relative significance of mining; and the rise and rise in the relative significance of the services sector (in the post-World War II years).[1] And, of course, there have been significant compositional shifts *within* each sector – such as the shift from low-tech to higher-tech manufacturing activities and the growth of social business and financial services relative to transport and communications services – and consequent significant changes in the skills required of the workforce.

At sub-national regional level, there obviously have been corresponding structural changes. Indeed, as a matter of self-evident economic fact, the adjustment pressures that eventually lead to significant economy-wide structural changes are first felt by businesses at regional level. How regions respond (adapt) to them has had important consequences both locally and nationally for the patterns and levels of output and employment in different economic activities and sectors and for the future prospects of regions. For example, the consolidation of farms and increased capital intensity of agricultural production in response to adjustment pressures has enabled the farm sector to continue growing its *absolute* output, including for export, and its demand for related inputs (raw materials, equipment and transport business services) at a broader economy-wide level. Overall, whether rural regions have been net beneficiaries or losers, at least in relative terms, has depended on how adaptable they have been to the pressures for change.

Some *broad* generalisations about the likely consequences of structural change at regional level are possible. In particular, the degree of diversification or concentration of a region's economic base is important to how it likely has fared in response to pressures leading to structural change and to its future prospects. Metropolitan regions, with relatively diversified economic bases, are likely to have been net beneficiaries of structural changes – with, for example, any loss in manufacturing sector employment more than compensated for by growth in service sector employment – and are likely to have more secure long-term prospects. Non-metropolitan regions with less diversified economic bases and more disparate comparative advantages are likely to have had more diverse experiences and to have more widely divergent future prospects. They also are more likely to be susceptible to differences in the capacity of *individual* businesses within them to adapt to changing economic circumstances.

Self-evidently, primarily rural regions, other things equal, are likely to have prospered less than many others and often have less robust economic futures especially if their capacity for diversification (e.g., into tourism) is limited. Likewise, many regions that have been substantially reliant on manufacturing employment will have struggled to maintain their economic (and community) vitality and identify ways to growth in future, especially if they have been "specialised" in the manufacture of textiles, clothing and footwear, motor vehicles and parts or basic metals: specialisation in the manufacture of food, beverages and tobacco products or paper products and printing would have been relatively more favourable. Obviously, too, being a region with a substantial endowment of valuable mineral deposits would be a (somewhat fluctuating) source of good fortune, though of varying degrees of direct benefit to regional communities themselves depending (among other things) on whether the required workforce is substantially housed *in situ* (e.g., Bowen Basin coal in Queensland) or operates principally on a fly-in, fly-out basis (e.g., Pilbara iron-ore in Western Australia).

In the face of adjustment pressures, a further factor important to a region's future prospects is what is sometimes termed its *resilience* – that is, its ability to adapt to adjustment pressures, including through envisaging and capturing new opportunities, whether through consolidation or diversification. This appears to depend on both the robustness of regional *institutions* and the strength of informal *networks* between key players in regional business, higher education and training institutions and social communities.

The significance and consequences of structural adjustment and change.

The process of structural adjustment, driven by forces that ultimately lead to structural change, involves resources – labour, capital and land – shifting from uses which have become relatively less profitable and productive to now more profitable and productive uses. This is a central element in continuously enhancing national productivity, economic growth and living standards. Importantly, any impediments that exist or are created to the process of structural adjustment reduce, or at least defer, the potential benefits.

Left to their own devices, flexible markets will tend to naturally (i.e., autonomously) achieve the appropriate reallocation of resources between economic activities and, relatedly, between locations in which they are undertaken. Businesses, acting in their own self-interest, will (variously) contract or expand or diversify their activities in response to price and profitability signals and workers, acting in their self-interests, will respond to changing employment opportunities (albeit usually with some transitional dislocation).

However, there are some circumstances in which the ultimate adjustments might not be fully efficient. For example, resources which flow from less to more productive and profitable uses might also be flowing from less to more polluting economic activities. In the absence of appropriate polluter-pays charges, or equivalent regulations, the resource transfers might exceed those that would be socially efficient. The implication is *not* that governments should directly impede structural adjustment but rather that they should ensure that price signals provide incentives for socially efficient resource reallocation.

Moreover, policy settings which guide the ultimate economic structure of the economy might themselves impede productivity and welfare-enhancing resource-use changes between economic activities and consequently regions. At a macro-scale, the adoption, soon after Federation, of a national strategy of growing the Australian economy (and its population) behind high tariff barriers encouraged an inefficient flow of resources into protected manufacturing industries and into locations with a natural or contrived comparative advantage in producing protected products. A Tariff Board from time-to-time identified adjustments to tariff levels required to continue to give domestic production a competitive edge over imported competition, inhibited subsequent reallocations of resources to potentially more productive uses and locations of use. Policy changes since the mid-1980s, especially trade-liberalisation, but also other microeconomic reforms that have sought to make labour and capital markets more flexible and make the provision and pricing of infrastructure services more efficient and cost-reflective, contributed to a substantial national productivity surge and increase in Australia’s living standards by encouraging and facilitating substantial resource reallocation between and within different economic activities and sectors.

At a more micro-level, a number of agricultural marketing schemes and regulatory frameworks (for example, for dairy, sugar and citrus producers) discouraged relatively inefficient producers from leaving the industries, blocking *both* more productive uses of resources *within* the industries (e.g., by consolidation) and a shift of resources *out of the* industries to other economic activities. Again, it has required significant, and disruptive, policy and regulatory changes to achieve a more productive use of resources.

The general point to be made in both of the preceding examples is that policy changes have led to improved efficiency and productivity in resource use, albeit by correcting previous policy failures. As is also true for the consequences of policy changes more generally *and* many market-induced pressures for structural change, the “costs” of structural adjustment tend to be concentrated (in particular sectors and/or types of economic activities) while the benefits tend to be widely dispersed (across all other economic activities able to use some of the released resources more productively). Whatever the distribution of the costs and benefits between different types of economic activity, they reflect essentially *intended* economy-wide consequences – whether policy or market-induced.

Since many regions tend to be relatively highly "specialised" in particular economic activities, some regions might experience disproportionate regional transitional dislocation costs as a consequence of intended economy-wide industry structural change, especially for workers, families and communities within them. However, these are essentially *incidental*, not directly intended, consequences of the process of structural adjustment.

The intended consequences – whether implicitly "intended" by changes in market forces or deliberately intended by changes in public sector policies – involve resources and profitability shifting from one type of economic activity (line of business, industry or sector) to others. Adversely affected businesses (often whole industries) typically argue the case for assistance to ease the effects of adjustment on their viability and profitability – or even to enable them to resist changes – particularly when the intended adjustment is a direct result of policy changes. Though it is often presented as about the consequences for employment levels (in general and (often) in particular regions), where such assistance is given to businesses, whether for good reason or not, it is best characterised as ***industry* adjustment assistance** even if a result is to "assist" some particularly adversely affected regions. Its consequence actually will be to assist a particular form of economic activity *irrespective of where its activity centres are located.*

By contrast, ***regional* structural adjustment assistance** is not directed at assisting a particular form of economic activity irrespective of its location. Indeed, it might not involve assistance to businesses *per se* at all. Its motivation is to assist specific, targeted regions and communities to cope with adjustment pressures that are unusually concentrated and is principally targeted at workers and families to help minimise the transitional costs to them of changing occupations and/or locations. If any form of assistance to businesses is involved, it, too, is region-specific and aimed at easing the transitional costs of closing down, or relocating or adopting more efficient and productive technologies or business practices.

Whether, when and how governments should assist regions to adjust have been contentious issues. In what follows we first (Section 2) put the causes and consequences of regional structural change into broad context, attempting to provide a framework for thinking about the process of structural adjustment, its impact on regions and appropriate public sector responses to its regional impacts. We then turn (Section 3) to developing a clear statement of what we consider to be the core objectives of regional structural adjustment assistance, where it is provided and a set of general principles intended to guide how it is provided. A final section (Section 4) provides an attempt to give some more substance and concreteness to the principles and to head towards a statement of good practice.

While we have principally used economists' standard approaches to the discussion of public policy, with identifying "market failures" and how to correct them at its core, we have also included some discussion of "government failures" and "systemic failures". Attachment A expands on the meaning and nature of these three types of "failures" and introduces some elements of both social policy consideration and a more "political economy" perspective.

2. Context and Framework Issues

It is an inconvenient but unavoidable reality that pressures arising from forces either largely or completely beyond their control are continually experienced by regions and eventually lead to changes to their economic structure – that is, changes in the composition and scale of economic activity within them and the consequent workforce size and skills required.

The *process* by which the *structural changes* occur is referred to as ***structural adjustment.***

Its central feature is that it involves resources – labour and capital – shifting between business activities and locations to where their locational and business use has become relatively more productive and profitable (or, in the case of land, its use changing). It is this fact which leads to the often-repeated observation that, from a national perspective, structural change, and structural adjustment as the process by which structural change is achieved **is a natural and desirable aspect of economic development and growth:** it helps to attain and sustain the highest possible levels of national productivity and hence living standards. What the ultimate consequences might be for particular regions is less clear-cut. As a matter of logic, with flexible labour and capital markets, the consequence of adjustment pressures will ultimately be to change the pattern of workforce employment, of capital investment and of demand for raw material inputs towards economic activities that become *relatively* more profitable. Depending on the degree of locational concentration or dispersion of the beneficiary activities (including of input suppliers), the consequences for employment, incomes and population within and between regions can range from substantial to slight. This is further explored later.

Adjustment pressures leading to structural change can arise from a number of sources, of greater or lesser significance in different regions at different points in time. They include especially:

- changes in underlying market forces faced by businesses – for example, changing consumer demands or production costs, national or international competitive pressures, and technological or workplace innovations;
- population growth or decline, or changes in its composition – arising variously from, for example: the consequences of changes in the level or composition of a region's economic activity,

progressive changes in the age structure of its population; and changes in people's preferences about where they want to live, work or do business (including sea change or tree change preferences);

- changes to the economic, social or environmental policy or regulatory context in which regions operate – such as those caused in recent decades by tariff reductions, economic and financial deregulation, National Competition Policy and reforms to State infrastructure and service provision, and also those now in progress or prospect through the COAG Reform Agenda, through developments in water policy at State and national level and through the application of mandatory renewable energy targets and, eventually, a carbon price; and
- other external factors – such as biophysical forces leading to prolonged drought, natural disasters, increased climate variability, reduced security of urban and rural water supplies or the potential long-run consequences of climate change; or such influences as changes in societal values which *directly* impact on economic activities (e.g., attitudes towards live sheep or cattle exports).

There are also some less easy to classify forces, such as the insidious, cumulative consequences of poor business management practices. The most dramatic examples include the ultimate consequences of poor, short-sighted land management practices which lead to increasing soil salinity or soil erosion. But businesses more broadly can undermine their own productivity, profitability and viability by, for example, failing to maintain and enhance the skills of their workforce or the technology with which they operate and while they might not be particularly significant from a State or national perspective, such businesses sometimes might be (very) significant at a regional level.

2.1 The Impact and Consequences of Pressures Leading to Structural Change

The initial impact of adjustment pressures unleashed by forces that eventually will lead to structural changes in regional economies and hence the national economy are first felt by businesses. Their decisions about how to respond to the pressures transmits the effects to workers (and other input suppliers) who, in turn, broaden the transmission to communities in which they work (or operate) and live, and especially to families and to a range of local businesses. This leads to further, broader effects both within and beyond the initially affected region(s). Since businesses, workers, other input suppliers, families and communities that feel the first round effects of adjustment pressures and those that feel the ever-broadening subsequent effects are located somewhere, geographically speaking, in a non-trivial sense ***structural adjustment is an inherently regional phenomenon.*** The State-wide effects of responses to adjustment pressures are neither more nor less than the cumulative effects on regions within them and the national consequences neither more nor less than the cumulative effects on all States – taking into account all the relevant interdependencies.

Pinpointing where and how episodes of structural adjustment begin and understanding how and where the initial impacts are transmitted ever more broadly is a key requirement for the design and implementation of effective structural adjustment policies and programs. Where it is considered that providing regional structural adjustment assistance is necessary and desirable, directing the assistance principally at the consequences of the first round of ripple effects – especially the effects on workers, families and communities most immediately affected – is likely to be much more effective (and cost-effective) than spreading substantial parts of it to later rounds of ripple effects.

Transition Mechanisms and Pathways

The mechanisms and pathways for increasingly more widely transmitting the effects of adjustment pressures are essentially the same whether the initial impacts are adverse or beneficial (but obverse in their consequences, of course). If the initial impacts are adverse (for example because overseas businesses competing in domestic markets have reduced their costs (and supply prices) through early adoption of new, cost-reducing technologies or shifted their production to lower-wage locations, or because microeconomic policy reforms have reduced import protection or subsidies to domestic businesses) directly affected domestic businesses will potentially become less profitable because, other things unchanged, they will experience reduced sales or have to cut their selling prices to maintain their sales. How affected business respond to these potential consequences can differ in different circumstances but, one way or another, it will result in businesses transmitting adverse consequences to workers and/or other input suppliers – very likely to both.

In the case of adjustment pressures arising from market forces, if the adversely affected businesses can negotiate lower wages and reductions in other input costs, they may be able to maintain their sales, or at least retain a significant part of them, while still earning a reasonable rate of return on their investment – though if they are essentially price takers in downstream markets (i.e., can't sufficiently differentiate their product from that of other producers in the minds of downstream purchasers to enable them to charge a higher than average price) they would have to be able to achieve cost savings sufficient to match the supply-prices of other producers in the relevant market to avoid having to close-down entirely. If they can't negotiate wage-cuts or reductions in the cost of other inputs, they will have to *at least* downsize their workforce and reduce their purchases of other inputs – including possibly also introducing new, cost-saving production technologies if that was the commercially most profitable approach. Again, if the affected businesses are price-takers and can't directly reduce their labour and other input costs, they would *have to* be able to (profitably) introduce a sufficiently cost reducing new technology to avoid having to completely close-down.

In the case of adjustment pressures arising from microeconomic policy changes, it is the *deliberate intent* of the policy changes that adversely affected business (industries or whole sectors) should, at least initially, downsize and release resources for what are regarded as more beneficial alternative uses. As with the case of market-led adjustment pressure, there will be a transition period during which at least some resources, labour especially, will be disemployed for periods of varying length.

In all cases, adverse initial impacts, and their first-round flow-on consequences involve reduced incomes to workers, either directly through wage cuts and/or disemployment of workers in the initially affected businesses, or indirectly through wage cuts or disemployment of workers in businesses that are upstream producers and suppliers, or most likely some of both. Since the initial adversely affected business and the upstream input suppliers are located somewhere, there will be a further flow-on effect through reduced turnover and profits in local businesses (shops, service stations, cafes, restaurants, hairdressers and so on) – and ever more widely dispersed ripple effects will flow. The earlier rounds of flow-on consequences are obviously likely to be more “localised” than the later rounds. However localised, and hence region-specific will be circumstance-specific. Where the initially adversely impacted business(es) are in non-metropolitan regions there is likely to be a stronger nexus between where people work and where they live and where they spend much of their incomes: that is, the early-round effects are likely to be more concentrated, the more “remote” is a community and its wider region and particularly substantial where initially adversely affected businesses are significant sources of employment and incomes in the communities and regions in which they operate.

Conversely, where the initial impacts of adjustment processes are beneficial to some businesses (for example, through increased overseas demand for their domestically produced goods or domestic microeconomic reforms that lower business costs of import competing domestic businesses) the initial effect will be to increase the profitability of those businesses. In this case, the transmission of the impact effect on businesses will be to *increase* employment of workers in the businesses and in other input suppliers, increasing their incomes and consequently their demand for locally supplied goods and services, resulting in further, ever widening, ripple effects. The more significant a beneficially affected business is to its local and regional economy, the more substantial the local and region-specific effects will be.

Of course, some forces leading to structural change can have both adverse initial effects on some businesses and beneficial impacts on others more or less simultaneously. For example, a continuing growth of consumer preferences for white-meat (especially chicken) over red-meat increases the profitability of chicken-meat growing and processing and reduces the profitability of beef and sheep growing and processing. The flow-on effects of increased output of chicken meat is increased employment and incomes in the industry and the opposite in red-meat production and incomes. Because chicken meat growing and processing tends to be concentrated near major markets – especially near cities – and, for logistical reasons, hatcheries, growing facilities and processing facilities tend to (need to) be in close proximity to each other, chicken meat production is highly regionally concentrated but most often near large labour markets that are only moderately dependent on the industry for employment and incomes. Beef and sheep growing and processing tend to be more geographically dispersed but in regions each of which may be relatively highly dependent on them for employment and incomes. That is, the regional as well as industry-specific consequences of this sort of structural change can be very different between the two parts of the meat production industry.

Where There are Regional Winners There Initially Must Also be Regional Losers

Importantly, even where the *initial* impacts of adjustment pressure produce only "winners" there must, as a matter of logic, be flow-on effects that result in "losers" being created, particularly where labour and capital markets are relatively tight. That is because, to actually *be* winners, the favourably affected businesses must be able to attract resources – labour, capital and other produced inputs (and sometimes land) – away from other uses, usually by offering labour higher wages or salaries and offering investors higher returns than in their pre-existing uses. As a consequence, some other businesses must be losers with reduced output (determined by the extent to which they lose workers, in particular) and reduced profits (determined, *among other things*, by the extent to which their output is reduced *and* the extent to which they have to pay higher wages and salaries to retain at least part of their initial workforce). The effects on regions of there being losers in this sense could be highly dispersed or relatively concentrated. Factors important to determining the degree of regional concentration of losers include the type of skills required of the workers the winners seek to attract (the more specialised they are, the greater the likelihood that there may be regionally concentrated adverse effects) and whether the businesses that lose workers with those skills and reduce output are major employers or major purchasers of other produced inputs, especially in regions with narrow economic bases which, in turn, may be affected by whether there are logistical cost-related reasons for business location decisions (for example, to reduce transport costs of bulky inputs to be transformed into products easier and less costly to transport to downstream customers, such as near coalmines in the case of electricity generation; in the midst of cattle or sheep country in the case of abattoirs; or in proximity to ports for iron and steel production).

For example, the increased competitiveness of manufactured or processed imports into Australia following the phased-reduction in tariffs beginning in the late 1980s clearly has had persistent adverse effects on some parts of the manufacturing sector, especially Textiles, Clothing and Footwear manufacture and Motor Vehicle production.[2] Regions particularly concentrated in some part(s) of the manufacturing sector experienced adverse consequences as a result, at least initially. However, the consequences also included making imported inputs into other production processes cheaper and freeing-up resources (labour and capital) for other uses relatively more cheaply because of an initial excess supply as adversely affected manufacturers downsized.

Even the introduction of a carbon price – whether directly through a carbon tax or as an outcome of an Emissions Trading Scheme – which must, as a matter of economic logic, result in lower *national* output and employment growth than would otherwise have been the case if it is to achieve its objectives – would produce some early-round regional winners.[3] Regions which have a comparative advantage in the production of renewable energy – especially initially wind-power – would experience higher levels of regional output, employment and incomes than otherwise. Although possibly to a lesser degree, so, too, would regions with a comparative advantage in the production of large-scale "carbon sinks" – e.g., forests of trees – if the purchase of offsets is allowed. On the flip-side regions that are involved in the production of sources of carbon-based energy – especially coal, and more so brown coal, but also gas – would be adversely affected in the early rounds. Indeed, they probably would be sufficiently adversely affected that their regional incomes and employment might fall *in absolute terms*, not just relative to what they otherwise would have been. Between the two extremes of smallish groups of regions that are either substantial winners or substantial losers, other regions will be early round "losers" relative to the base case (expected growth trajectories in the absence of a carbon price) to a greater or lesser extent depending on the carbon-intensity of economic activities within them.

Conversely, a source of adjustment pressure that on the face of it is a boon to the national economy can nonetheless have adverse consequences for some regions. An obvious case-in-point is the China-led resources boom which began in early 2000s, punctured briefly by the Global Financial Crisis – which is expected to be long-lasted, producing structural, not just cyclical change. The associated surge in commodity prices especially for iron ore, coal and LPG and new investment expenditure in resource extraction not only has increased employment levels and business and employment incomes in regions in the resource-rich States, but also raised national income, including through the demand for goods and services produced in other regions including regions in other States. In fact, it is almost certain that, both in terms of employment and incomes, the bulk of even the first-round benefits are *not* captured by regions within which the resource extraction occurs and the more-so where mines are operated on a fly-in, fly-out basis.

The flip-side of a resources boom involves two consequences adverse to other sectors and the regions in which they exist. One of them is that the booming regions will increase their demand for labour and capital. On the labour market side, mining operations are not very labour-intensive but expansion of the extraction capacity of existing mines or the development of new ones (usually by contractors) is much more so. When national employment levels are at or near full employment, labour attracted to mining sector activities, directly or indirectly, must be from other economic activities and the regions within which they are located. This will increase wages and salaries not only for mining operations and related contracting and service provisions but also for employers elsewhere attempting to retain labour. One way or another, there will be a squeeze on other economic activities either through loss of workers or increased wages and salaries or both. How regionally concentrated the other economic activities that are particularly squeezed is not obvious.

The second source of adverse consequences of resources booms, however, most likely will also have some regionally concentrated effects. The effect of a resources boom in response to overseas demand for minerals (iron-ore and coal especially) and sources of energy (especially LPG additional to coal) will be to push-up the real exchange rate. This will adversely affect sectors of the domestic economy that rely substantially on export market demand or are import-competing ("trade-exposed" sectors). In most cases, Australia is a price-taker in international markets – and profitability and possibly viability – of business in trade-exposed sectors will, fall eventually leading to reduced production and employment.[4] Among Australia's top exports some tend to be largely located in cities with diversified economic bases – for example, vocational and tertiary education and, to some degree, international tourism – while others are more predominantly based in non-metropolitan regions with less diversified bases – especially agricultural products, including, for example food and wine (sometimes with processing of them also occurring in regional hubs) and sheep and cattle; and also can be locations with significant tourist attractions.

From a regional structural adjustment perspective this resource boom case poses two particular challenges for policy-makers. First, the regions that most directly benefit from the boom – the resource extraction and (in the case of LNG) processing regions – are high among those regions facing substantial adjustment stresses: they typically face challenges in attracting the required supply of labour and in expanding required infrastructure. Second, since it is predictable that the commodity price rises which spark the initial boom will taper-off as supply expands, and eventually goes into reverse (particularly substantially when demand growth slows or halts), the exchange rate will fall (other things equal) resulting in a potential revival of economic activity in sectors and regions that were initially adversely affected. But if they had been allowed to hollow-out during a long-sustained mining boom, capturing the potential benefits of their revived potential might involve substantial adjustment pressures.

Finally, in the more common, recurring cases where market-driven or policy changes are more moderate and/or incremental, the initial impact effects and subsequent adjustment pressures will involve much less adjustment stress and lower transitional costs. This will be so whether the initial impacts are adverse (e.g., growth in competition from low-wage overseas economies that have been first-adopters of innovations in technology or management processes; or from changes in consumer preferences that are adverse for production of commodities in which Australian regions have been particularly specialised) or are beneficial (e.g., increased overseas demand for products in which Australia has a competitive advantage or have adopted cost-reducing or quality enhancing new innovations). Nonetheless, the impacts can be relatively substantial for regions highly concentrated in the provision of the affected goods or services.

The Potential for Benefits Nearly-all-Round

While the initial effects of structural adjustment pressures will unquestionably be adverse for some communities and regions and beneficial for others, it can often be the case that in the longer-term the adjustment process can lead to benefits to a number of regions (possibly most) that initially were adversely affected. This is especially the case where structural change is initiated by (economically rational) microeconomic policy changes (reforms) since its deliberately intended effect is to shift some resources from lower productivity to higher productivity uses.[5] As a consequence, national aggregate output and incomes will eventually be higher than previously and at least some of the resulting increased consumption of goods and services will flow to regions initially adversely affected. That is, in a manner of speaking, there sometimes (often?) might be "benefits almost-all-round" when the process of structural change has substantially worked its way through the broader economy.

For example, while the introduction of water trading in Victoria resulted in employment in Agriculture, Forestry and Fisheries falling in all irrigation areas except Sunraysia (which had been the only net-purchaser region of permanent water entitlements), all but one significant other irrigation area has eventually achieved a net increase in total employment through expansion of other economic activities. Similarly, a Productivity Commission Inquiry reported that National Competition Policy had, after initial adjustments, resulted in negative economic impacts in only a few regions across Australia (PC 1999). This reflects the fact that *policy* changes most often are directed at increasing national output and productivity, in which, in principle, all regions can share. The net national consequences of changes in market forces, however, are less predictable.

2.2 First-Best Public Sector Responses to Structural Adjustment

Must structural change – especially when it is market-driven – is "evolutionary" (occurring progressively over time), is highly dispersed in its effects and may be obvious only to those directly affected. It most often can be adapted to by businesses and workers without significant transitional costs, especially in periods during which there is sustained national and regional growth, *if* labour and capital markets are (sufficiently) flexible.

As a matter of general principle, the best (long-run economically preferred) way for structural adjustment to play-out is to have businesses and workers acting in their own self-interest in response to undistorted market signals about their future prospects. Business owners and workers who adjust earliest and in the most prospective directions have the greatest potential to prosper.

When transitional assistance is provided, it has the potential, depending on its design, to distort the signals businesses and workers receive about their future prospects and hence about adjustments they should make to maintain or enhance them. In a worst-case type scenario, if potentially adversely affected businesses were offered (even temporary) support through, for example, employment subsidies, the consequences of structural adjustment pressures for their future profitability, and the future employment prospects of their workers, would be less obvious to them all and their incentives to prepare to make adjustments to whether and how they continue in operation in the longer-run deferred and likely distorted. Equally importantly, non-assisted businesses which have the potential to provide relatively more productive and profitable production and employment opportunities will find it harder to attract the capital and labour – and other resources – they need to enable them to develop their full potential. As a consequence, national productivity and well-being is diminished relative to what it otherwise could be.

Moreover, to the extent that there are transitional costs – for example, disemployed workers whose skills are not adequate or appropriate to other employment opportunities that open-up –there needs to be in place generic, continuing support mechanisms, variously at national and State level, that assist in easing the transition process and its costs.

This on-going adjustment assistance supports *people* facing changed circumstances, whatever the cause and wherever they live and it especially includes: social security income support available to displaced workers; and job search, employment and training programs provided (variously) by the Commonwealth and State governments that are available to all who meet universally applied eligibility criteria. These forms of support are neither region-specific nor, generally, regionally-differentiated, but their regional incidence differs according to regional economic circumstances.

Furthermore, as part of their regional *development* strategies State governments provide – or should provide – programs designed to help regions to develop the capacity to better anticipate and cope with adjustment pressures over time. These capacity building (resilience building) activities generally are directed at a community-wide, or region-wide, level, recognising both that there are networks of inter-relationships across communities and regions that can become stressed, and that leadership is an important ingredient in communities and businesses responding successfully to structural change.[6]

As explained more fully later in this analysis, the general presumption among economists as policy advisors is that businesses should not receive financial assistance to help them cope with any adverse consequences of structural change and the process of structural adjustment, particularly where it is market-driven. The case for providing direct assistance to businesses is considered doubtful other than where the costs to businesses are very large and even then the preferred forms of support to businesses are either to assist them to exit the industry or to assist them to adopt cost-saving innovations in their business practices or production technology.

There are numerous reasons for the general presumption against providing structural adjustment assistance to businesses, of which two are particularly important, both of which are explained more fully later. First, investors in businesses – small as well as large – are, or ought to be, aware that they are taking-on market-specific risks: if they have reason to believe (from observation or experience) that governments are likely to, in effect, compensate them if their judgement proves to have been wrong, their incentives to adequately assess the risks and to make provision for absorbing the effects of unfortunate outcomes is diminished. Second, providing assistance to business actually feeling adjustment pressures can diminish their incentives to release resources (labour and capital) to enable them to flow from now less productive uses to now more productive uses.

Policy responses to moderate structural adjustment pressures

It is hard to see how any case, less still a strong one, could be made for governments to provide regionally-targeted structural adjustment assistance when structural change is essentially evolutionary. Even where the adjustment pressures are stronger and more rapid than could reasonably be characterised as "evolutionary", and transitional costs correspondingly higher, if they are progressive rather than abrupt, the economic costs of providing adjustment assistance are highly likely to outweigh the economic benefits. Indeed, even structural changes that are abrupt when they happen, such as the closure of a significant regional business (e.g., a motor vehicle producer in a metropolitan region, or a cannery or abattoir in a non-metropolitan region), will often have been foreseeable, though possibly not seen as inevitable, and, ideally, contingency plans made to as rapidly absorb the impact as possible if and when actually it happens.

A further and final point to be made in favour of allowing moderate, reasonably predictable processes of structural adjustment to run their course despite there being non-trivial transitional costs concerns the matter of building community and regional resilience. As mentioned earlier, building resilience – that is, the capacity to anticipate and adapt to the pressures that arise in the process of structural adjustment at business, community-wide and region-wide levels – is an important objective to help minimise dislocation while adjustment is occurring. Since its essential purpose is to avoid having to provide regional structural adjustment assistance, *per se* or at least minimise the necessity of doing so, it seems to be best considered to be a key component of regional *development* policies and strategies – one that should be high on the list of must-do's. As in other contexts, a necessary element of capability-building is learning on the job and, to mix metaphors, eventually being left to fly-solo and subjected to stress-tests while doing so. If adjustment assistance is readily available whenever adjustment pressures are stronger than usual, a culture of dependence on assistance is likely to develop, wasting resources devoted to capacity-building as well as using-up resources in the provision of structural adjustment assistance.

All that said about the general case *against* providing regional structural adjustment assistance, we turn now to consider in what circumstances such assistance might be economically desirable. The focus on the *economics* of structural adjustment and policy responses to it is *not* because we think social and political considerations are unimportant. Rather it is because we wanted to comprehensively "codify" the economic considerations before attempting to build into the analysis broader – including social and political – considerations and both the interconnections and the trade-offs between all particularly relevant considerations, though we do touch on both social and political considerations in Attachment A. For what it's worth, our intuition suggests that the nexus between economic and social perspectives is at least moderately strong in our analysis to this point, though we concede that that intuition hinges to a significant degree on substantial resilience in regional communities, based on strong social as well as business networks, and that moderate structural change isn't so persistently adverse to some communities that they become hollowed-out to a point at which their social capital is shredded and their continued economic viability is at risk.

Where Structural Adjustment might be desirable

It is when pressures for structural change are abrupt and to a significant degree unexpected, and their potential impacts on regional economies very substantial, regionally differentiated and highly likely to persist for long periods, that a case arises for ***considering*** the provision of time-limited, targeted, circumstance and location-specific **regional structural adjustment assistance** in addition to the generic, continuing assistance available through the social security safety net and jobs market programs. Its purpose, when it is provided, is *not* to attempt to 'interfere' with the direction of change but rather to help minimise the transitional costs inevitably borne by people and communities when the structural changes are in process. This most often will involve helping to smooth the time-path of adjustment and facilitating occupational and/or locational change by workers and families (and sometimes businesses).

In addition to changed underlying market forces which might tip regionally concentrated businesses into rapid decline (or rapid growth), the impacts on regional economies arising from *policy changes* sometimes can be abrupt and substantial. However, it is only where policy changes are in response to crises that they could be said to have been essentially unpredictable (though the proposed introduction of a "super-profits" tax on mining in 2010 was something of an exception). Most often, likely changes in the "policy environment" will have been evident for some time before the policy changes actually occur, giving regional businesses and communities signals about what might be likely to impact on them and at least some time to develop strategies to adapt to them. Nonetheless, the usually limited time between recognition of likely policy changes and their actual implementation, and the magnitude of the impact of the policy changes when they are made, can pose serious challenges for business and regional adaption and adjustment, just as can be true for recognition lags when market conditions change. It is these circumstances that are appropriately the central focus of the principles for designing and implementing regional structural adjustment assistance programs and initiatives.

The National Water Initiative provides an interesting case in which issues about who should bear risks of "market" and policy changes have been pre-considered and set-out for industry participants. The Commonwealth-State Agreement indicates that any reduction in the size or reliability of a water allocation will be borne:

- by water entitlement holders if the reduction is the result of seasonal or long-term changes in climate, or of periodic natural events such as bushfires and drought;
- by a government if the reduction is the result of changes in that government's policy; or
- by water entitlement holders and governments (according to a specific formula) if the reduction results from improvements in knowledge about the environmentally sustainable level of take of water.

Among the many sources of policy changes that can have substantial, regionally concentrated and differentiated impacts are those deliberately promoting *industry structural adjustments*. These include the consequences of tariff reductions for the size and structure of both the Motor Vehicles and the Textiles, Clothing and Footwear industries, or of deregulation in the case of, for example, the Dairy industry, usually accompanied by measures designed to facilitate restructuring of them, wherever they are located. They provide a useful illustration of a more general fact. That is, like for most other policy changes, any differential *regional* structural impacts are incidental to, not targets of, the *industry* structural impacts. The case for industry structural adjustment assistance and that for regional structural adjustment assistance rest on conceptually different foundations.

2.3 Economic Concepts Relevant to Regional Development and Adjustment

From an economic perspective, the principal factor appropriate to choosing how to approach the provision of regional structural adjustment assistance is the identification of policy-relevant *market failures*, which hinder the adjustment process and raise transitional costs for workers, businesses and communities. Market failure does not generally refer to markets literally failing completely, (though they sometimes might). Rather it refers to *distorted* market outcomes compared to those that would be socially efficient. Perhaps the most common and familiar example is the case of *externalities* (external effects) where the private decisions of economic agents do not reflect the full benefits or costs of their production or consumption decisions. So, for example, in the absence of fully complete and flexible markets for water, up-stream water users have no incentive to take into account the potential consequences of their water extraction for downstream users.

In times of water scarcity, more productive downstream uses of water could be ‘displaced’ by less productive upstream users – there would be a negative external effect impacting on downstream users, unless governments step in to tax or regulate the volume of upstream extraction (or subsidise reduced use). The first-best option, however, would be to facilitate water-trading, as has now occurred.

The opposite case – of an external benefit – is illustrated by the provision of on-the-job training by businesses or employer subsidisation of off-the-job training. If the training employees receive at the expense of one employer is potentially valuable to other employers because they could attract trained employees to move to them, all employers would be likely to under-invest in non-firm-specific training unless governments subsidise its provision by them to in effect recognise the external benefits their private decisions create.

Attachment A to this paper further explains the concept of market failures; explains the several potential sources of them (especially asymmetric information, public goods and concentrated market power) explores the concepts of system failures and government failures and puts their relevance into the context of other influences on policy development, including equity, community sustainably and political pressures.

Most of the market failures generally identified as likely to be especially relevant to regional development and adjustment exist on an on-going basis and either are assessed as not policy-relevant (the costs of attempting to correct them exceed the potential benefits) or are addressed, to some extent, in generic policies and programs. Unusually abrupt or substantial changes in adjustment pressures can often make a strong case for location-targeted additional measures because the costs of on-going market failures (i.e. the benefits of reducing them) are sharply increased.

Theory, logic and past experiences point to impediments to *labour market adjustment* as the most policy-relevant and most substantial sources of market failure likely to be intensified by significant structural adjustment episodes. Limited information by displaced workers about alternative employment opportunities, especially beyond their current locations, and the potential costs of moving if that is necessary or desirable, are a source of stickiness in adjustment that can be reduced by appropriately designed and targeted job-search and/or mobility-support programs above and beyond those generally available. Where displaced workers are also particularly occupationally immobile because their skills have been made obsolete or redundant, this problem is intensified, including because potential new employers are likely to under-invest in retraining where retrained workers have the potential to be mobile between employers. Providing more diverse education and skills training to help regions grasp new opportunities, or to assist workers to relocate, is also a desirable response.

On the flip-side of the labour market information issue is the fact that businesses outside a region generally have limited information about business opportunities in it – including of labour available that is appropriately skilled, or cheap to re-skill. This clearly can cut two ways in relation to adversely affected regions – it can hinder both in-migration and out-migration of businesses. Lack of information about, for example, new technologies or better management practices and about effective business planning can also be hindrances to the (re)development of business opportunities.

Another context in which market failures might impact on the efficiency of structural adjustment concerns the *provision of infrastructure*. A region's prospects in the face of adverse structural adjustment pressures might be improved if, for example, road and/or rail infrastructure was upgraded between it and other regions allowing more efficient freight, transport of products that might potentially be efficiently produced in the region enabling people to more rapidly commute to work opportunities in other areas. In the absence of government investment in the infrastructure upgrades, they are unlikely to be made. Individual potential new employers in the region would have limited incentive to offer to contribute to the cost of upgrades, in the hope they could free-ride on contributions by others – a so-called *public goods* problem (see Attachment A). Similar problems would arise where, say, a region in decline has significant potential to generate wind-powered electricity, but in areas distant from existing transmission infrastructure and where it is uncertain what other economically viable business developments might be opened-up if the transmission network was extended, enabling the wind-farm operator to defray the costs of investing in the infrastructure itself through access charges by other businesses subsequently set up along the extended network.

A number of what often are termed *government failures* also can be relevant to adjustment issues. In its broadest sense, government failure refers to situations in which public sector decisions reduce rather than increase economic efficiency and productivity overall. For example, in the case of water use discussed earlier, governments might over-regulate, or mis-regulate, upstream water use to such an extent that more productive upstream water-use is "squeezed out" in favour of much lower productive uses downstream and the overall productivity of water use is lower with the upstream regulation than without it. In a manner of speaking, market failure is over-corrected – possibly because governments have inadequate information to more efficiently set regulations or are subject to particularly intense pressure from (captured by) downstream users.

Government failure can also be seen as involving impediments to efficiency, including impediments to efficient structural adjustment, created by public sector policies. For example, stamp duties on real estate transfers which increase the costs of mobility for home-owners and businesses, zoning regulations which limit flexibility in attracting new business investment, institutional inertia in the Vocational Education and Training system and inflexibilities and lags in decision-making processes in relation to public sector infrastructure or service provision, are commonly cited examples of a wider array of 'imposed' obstacles that need be recognised. In water-use context, the development of markets in water, facilitating both temporary and permanent water-trading is a move in the direction of improving the productivity of water-use. However, caps (even if to be progressively relaxed) on the volumes of water that can be traded, set by governments, constitute impediments to desirable trade that can hinder adjustment to changed water available in parts or all of a river system. Where possible, those sorts of impediments should be eliminated, or at least ameliorated, especially where adjustment pressures are particularly intense.

Additional to these fairly generic examples of government failures is the fact that there can be particular inflexibilities in public sector decision-making about regional service delivery. For example, application of 'routine' formulas for deciding when a school should be closed or a police station shut-down can lead to an escalation in the rate of decline of a community, adding to the hurdles they face in attempting to recover following a period of adjustment. There might sometimes be a case for allowing a degree of flexibility in applying standard formulas until it becomes clearer whether "community sustainability" is, or is not, capable of being restored.

A further source of inadequacy in the capacity of regions to smoothly adjust to structural pressures is what might be termed *systemic failure*. This arises where institutions or relationships between key stakeholders in regional communities are not sufficiently well developed to ease the strains caused by adjustment pressures: the "system" is flawed. Like government failures, this is an endemic problem which regional adjustment strategies have to work around where it exists. Its ultimate resolution is a matter for on-going regional *development* strategies.

All of the sources of market, government and systemic failures relevant to adjustment to adverse circumstances, it should be noted, can also act as impediments to enhanced economic activity in areas potentially favourably affected by structural change. Inadequacies in public sector responses to increased pressure on infrastructure and public sector services and difficulties in attracting appropriately skilled labour are likely to be particularly pertinent in such circumstances.

Of course, ultimately, there are factors at play which hinder regional adjustment which may not be amenable to influence (to any great degree) by adjustment assistance initiatives. These include, for example, family and social ties, housing costs, children's schooling and partners' employment. For these (and other) reasons, governments sometimes might supplement adjustment assistance measures with others directed at a broader array of policy objectives, some of which are themselves inherently regional in their consequences.

A number of newly emerging (inter-related) sources of adjustment pressures – in particular, a higher degree of climate variability, reduced security of water supplies and the longer term consequences of climate change – are taking people, businesses and governments into relatively unfamiliar circumstances. They raise particular challenges for the design of adjustment assistance policies and programs which require special attention, including the need to recognise interdependencies between them. It is important that there be consistency in policies and initiatives aimed at addressing their particular consequences.

The relevance of other regional policy objectives

Regions that cannot cope with on-going pressures for structural change or, more broadly, would have their economic prosperity, social vitality and community sustainability substantially diminished, despite both general adjustment assistance and additional targeted, context-specific forms of structural adjustment assistance available to them, typically will have more intractable problems such as a disproportionate reliance on a narrow and fragile economic base, especially one based on a declining industry or sector. Where it would be consistent with State and national policies to do so, such regions might be provided with more fundamental pro-active ***regional development assistance,*** focused explicitly on building and/or diversifying their economic base. Many rural and remote regions are particularly likely to be candidates for this form of additional assistance: among other things, they are most often regions with both narrow and fragile economic bases, local governments and regional development organisations within them often have limited capacity to contribute to facilitation of adjustment, their residents typically have particularly strong attachments to them, and there may be more-than-usually limited information readily-accessible about employment, housing and/or business opportunities elsewhere.

However, the issues involved and the nature of the regional development assistance potentially to be provided are conceptually different from those involved in the provision of regional structural adjustment assistance *per se*.

- **Regional *structural adjustment assistance* aims to manage the <u>process</u> of change while not interfering with resources (labour and capital) ultimately being (re)allocated to their most productive uses, wherever that might ultimately lead them to be located.**
- **Regional *development assistance* aims to influence the allocation of resources between locations, and within them, so as (to the extent possible) to underpin the economic prosperity, social vitality and community sustainability of regions**.

In short, regional structural adjustment assistance is essentially about promoting economic efficiency whereas regional development assistance also encompasses equity considerations and other broader social and political objectives.

Nonetheless, it would appear unlikely that pursuit of regional development objectives sustainably could, in the long-run, seek to completely neutralise the effects of structural adjustment pressures on potentially adversely affected *economic activities*: to do so would be to encourage businesses to try to go on operating where they have a competitive disadvantage (and possibly increasingly so over time) and would commit governments to providing continuing (and probably increasing) support to enable them to attempt to do so. Fiscally and economically sustainable regional economic development strategies would, rather, focus on economic activities in which a region has, or could be assisted to develop, competitive advantages – which *might* (but only might) include some sub-sectors of an otherwise declining industry or business activity. Time-limited and context-specific support to temporarily slow the decline of adversely affected sources of regional economic activity more than might otherwise be chosen as optimal *might* be considered – on equity grounds or to meet wider political objectives – as part of managing the structural adjustment process. However, the short-run benefits desirably should be assessed against the long-run costs and policy-makers clearly informed about the trade-offs involved. In the longer-run, the other regional development objectives are likely to be most effectively promoted by other, broader strategies.

Another context in which other regional policies might be considered to potentially be in conflict with first-best regional structural adjustment assistance policies and strategies relates to the fact that governments also respond to *cyclical* downturns in regional economic activity (whether, for example, the results of some regions being (disproportionately) adversely affected by periods of drought or by macroeconomic instability) by providing ***regional cyclical adjustment assistance.*** However, as with regional *structural adjustment* assistance, there is a general presumption that *cyclical adjustment* assistance should be targeted principally at workers and families and that, as with regional *development* assistance, any trade-offs with the objectives of structural adjustment assistance should be temporary in nature and not such as to resist or distort the ultimate path of structural adjustment.

From a long-run perspective, feasible-best design of regional structural adjustment assistance strategies – that is, as they would be designed in the absence of other regional policy objectives – is likely to also be economically, fiscally and politically preferred, even when other objectives are also recognised. In the short-run, some moderation of the regional impacts of structural adjustment might be economically and/or politically rational, but not so as to distort the direction and pattern of structural changes in regions' economic activities that would result from simply facilitating efficient outcomes.

3. Objectives and General Principles for the Provision of Regional Structural Adjustment Assistance

It is to be (re)emphasised that where pressures leading to structural change are progressive and moderate, it should be expected that a region's businesses, workers and communities can (and should) adapt to the changes without the need for tailored, region-specific structural adjustment assistance initiatives. Inappropriately providing region-specific assistance can lead to a region's adaptive-capacity being weakened or remaining underdeveloped: it should be reserved for "exceptional circumstances". As further discussed in Section 4 below, although there are no self-evident hard-and-fast criteria for determining what is to be considered "exceptional", the speed, magnitude and likely longevity of adjustment pressures are important considerations in forming what inevitably will be *judgements* about whether providing adjustment assistance is appropriate/desirable in particular circumstances as they arise.

It is equally as important that, in circumstances where the provision of region-specific structural adjustment assistance is being considered, there should be clarity about the objectives of doing so and about core principles that should guide the design and implementation of assistance initiatives, including because:

- agreement at both political and bureaucratic levels about when it is appropriate to provide region-specific adjustment assistance, and how best to provide it, can help to minimise the risk of knee-jerk, "unprincipled" and inconsistent reactions to regional community agitation about adjustment stresses they face; and
- consistency over time in decisions about when and how to provide adjustment assistance gives regions some degree of predictability and clarity about circumstances in which they might, and might not, reasonably expect to receive assistance—making clear, among other things, that in most circumstances they will be expected to have the capacity to adjust to structural changes unaided, other than by the on-going universally-available adjustment support available to *workers and families* adversely affected by changes in their economic circumstances why ever and wherever they occur.

Overarching Objectives of Regional Structural Adjustment Assistance

The provision of regional structural adjustment assistance should aim to help regions to cope with and manage *the process* of change in circumstances where there otherwise would be *exceptionally* abrupt, substantial and sustained disruption and dislocation of some components of regional economic activity, and hence to the viability of businesses, the employment prospects of workers, the lives of people and the vitality of communities within them.

More specifically, provision of adjustment assistance should aim to help to ensure that change occurs as smoothly as possible, at a manageable pace and with least (avoidable) transitional costs, while not interfering with resources (workers and business investment) being (re)allocated to their most productive uses wherever that might ultimately lead them to be (re)located.

In short, it can be said that:

- The central objective of governments in providing regional structural adjustment assistance should be to help to minimise the transitional costs inevitably borne by people and communities when they experience unusually abrupt, substantial and sustained structural adjustment pressures.
- This most often will involve helping to smooth the time-path of adjustment and facilitate occupational and/or locational change by workers, families and businesses.
- Adjustment assistance initiatives should *not* involve attempting to resist or distort the scale and direction of structural change.
- They *should* be designed so as to avoid undermining the incentives for regions to develop and maintain their on-going capacity to manage change themselves in less exceptional circumstances.

General Principles for the Provision of Structural Adjustment Assistance

Where the provision of regional structural adjustment assistance is being considered:

1. it should be assessed on a case-by-case basis, and provided only where the pace, magnitude and persistence of required adjustments by businesses, workers and communities are beyond any reasonable expectation of their capacity to adapt to them unaided;
2. it should principally aim to remove any impediments which exist to regions achieving smooth adjustment within manageable time-frames;
3. it should include measures designed to strengthen the capacity of regional businesses and organisations to anticipate and adapt to adjustment pressures in order to build on-going regional resilience;
4. it should be context and location-specific, reflecting the particular nature of the adjustment pressures and where they are likely to have disproportionately large impacts;
5. it should be adaptable and flexible enough to enable it to meet particular local circumstances, including those reflecting differences in the economic structure or circumstances of different regions;
6. it should principally be targeted at workers, especially those with skills made obsolete or redundant by structural changes;
7. it should be provided on a time-limited basis, with clear, rigorously applied criteria for determining when initiatives should be wound-down and terminated;

8. examination of the case for and the design of adjustment assistance programs and initiatives, where they result from policy changes, should pre-date the policy change announcements and their availability should be announced at the same time as the policy change wherever possible;
9. eligibility for assistance should be based on clearly specified, transparently applied criteria, established at the outset of an assistance program or initiative;
10. there should be regular reporting of the financial costs of adjustment assistance measures, transparent processes for on-going monitoring of the outcomes for target groups and regions, and regular reviews of the cost-effectiveness of the measures implemented;
11. design and delivery should be consistent with the Regional Development Council's *Framework for Cooperation on Regional Development*, especially to ensure that interventions by each sphere of government do not work against those of other spheres;
12. where policy changes are the source of adjustment pressures, as a general rule the government(s) responsible for the policy changes should be primarily responsible for funding any required regional structural adjustment assistance initiatives;
13. in the case of policy initiatives in primarily State areas of responsibility promoted through COAG or other cooperative interjurisdictional mechanisms, facilitation or reward payments should be made available to the States as a means of cost-sharing by the national government; and
14. whatever the causes of, or responsibility for, regional structural adjustment pressures, State government agencies generally should have principal carriage of the design and delivery of regionally-differentiated structural adjustment assistance programs, in consultation with other governments, and with affected communities, through local Regional Development Australia committees.

4. More on Design and Implementation Issues

Within the context of the overarching objectives and broad principles identified in the previous section as the core elements of a framework for the provision of regional structural adjustment assistance, there is potentially substantial flexibility in the design and implementation of adjustment assistance programs and initiatives. However, a number of more detailed principles and practices can usefully be identified.

PRINCIPLE	OBSERVATIONS
1. A clear distinction should be maintained between policies, programs and initiatives designed to provide regional structural adjustment assistance and those designed to provide structural adjustment compensation or to give regional development assistance.	• Adjustment *compensation* policies aim to offset the consequences of structural change for household incomes or business profits (asset values) and are generally to be considered of dubious merit other than when the changes involve, in effect, "expropriation" of property rights. • regional *development* assistance is generally explicitly designed to attract business investment and people to locations they otherwise would not, or might not, have chosen: that is, it seeks to achieve specific outcomes rather than to simply "oil the wheels of change" whatever outcomes that might lead to.
2. Regional structural adjustment assistance programs should consist of time-limited, circumstance- and location-specific measures designed to help manage and facilitate — not to resist or neutralise — adjustments by businesses, workers, households and communities, necessitated by forces that lead to changes in the sustainable long-run structure of regional economies.	• Reference to "... sustainable long-run ..." reflects the fact that the policies at issue are focussed on *transitional* support for coping with circumstances that inherently involve changes to the size, composition and/or location of economic activity across regions, as opposed to *transitory* support in circumstances that lead to temporary changes, such as droughts or economic cycles (though both of the latter can have structural consequences, too — such as driving marginal farms or firms permanently out of business).
3. Decisions about whether to implement regional structural adjustment assistance policies and programs should take full account of the existence of on-going policies and programs at national and State levels of government which, in effect, support individuals and businesses adversely affected by structural change irrespective of their location: the key policy issue is whether additional, targeted, region-specific structural adjustment assistance is warranted.	• The national social security and tax system, and a variety of job-search, employment, training and retraining programs, all of which are generally available, help to facilitate and smooth the consequences of structural change in regional economies everywhere, whether market-induced or policy-induced. The case for *additional* assistance requires a demonstration that this base level of support is "inadequate", in the sense that further, targeted assistance would have benefits greater than its costs.

PRINCIPLE	OBSERVATIONS
4. ***Relying on the social safety net and generally available adjustment support measures should be regarded as likely to be the most appropriate vehicle for assisting the process of adjustment and moderating adverse distributional impacts in most cases ("the default option"), especially in the context of market-driven evolutionary structural change.***	• While they cannot handle all circumstances and their design might be capable of being improved, generally available adjustment support mechanisms have the advantages of, for example: treating individuals in similar circumstances equally, wherever they live or work; addressing the *net* effects of varying influences on the circumstances of individuals and families; and supporting individuals and families rather than particular sectors, industries or businesses.
5. ***While both market-driven evolutionary forces and economic policy changes implemented by governments impact on the efficient and sustainable size, composition and location of economic activity in regional areas across Australia, the case for governments providing targeted structural adjustment assistance should be regarded as likely to be strongest in the context of substantial changes to economic, social or environmental <u>policies</u>.***	• "Evolutionary" structural change arising from on-going changes in underlying market forces and government policies external to individual regions is simply a (generally desirable) fact of economic, social and political life. Resilience to change is learned by the process of coping with it, not by being sheltered from it. • Only in (likely limited) cases ─ where, for example market-driven changes are unexpectedly rapid and large relative to the economic base of a region ─ is a strong case likely to exist for additional structural adjustment assistance when underlying *market* forces change.
6. ***Initiatives designed to assist regional businesses and organisations to strengthen their capacity to anticipate and adapt to adjustment pressures should be available on an on-going basis.***	• Capacity-building underpins the development of regional resilience in the face of change. It can be a relatively inexpensive way of avoiding having to design and implement other initiatives in many cases.
7. ***Regional structural adjustment assistance policies and programs should be targeted at assisting the process of adjustment ─ helping to smooth and manage the magnitude and time-path of impacts on workers and communities in particular ─ not at achieving particular outcomes in terms of patterns and locations of economic activity***	• Adjustment to changed economic circumstances unavoidably involves transitional production losses and disemployment as resources are released from existing uses to enable them to flow into alternative uses which have become relatively more productive. The released resources typically will have to adapt, or be adapted, to meet the requirements of their potential new roles.
8. ***Policy-relevant sources of market distortions (market failures) which increase transitional adjustment costs should be regarded as the principal determinants of the nature and design of additional, targeted structural adjustment assistance***	• This is not to say that equity and other considerations (such as threats to community viability or other political objectives) are not also relevant. However, ensuring that resources move to more highly productive uses is the ultimate purpose of providing adjustment assistance since this maximises community income.

PRINCIPLE	OBSERVATIONS
9. Market failures associated with labour market adjustment should be regarded as likely to be particularly pertinent sources of transitional costs that can be reduced by appropriate targeted initiatives.	• Theory, logic and previous experiences suggest that addressing labour market adjustment failures is the single most effective adjustment assistance strategy. A lack of occupational mobility when specific skills become redundant and/or a lack of knowledge about employment opportunities elsewhere, for example, act as obstacles to smooth, timely adjustments by workers in the face of structural change: they increase transitional costs.
10. While addressing policy-relevant market failures should be the principal determinant of additional, targeted, regional structural adjustment assistance measures, equity in adjustment processes and outcomes and issues concerning community sustainability, for example, should also be considered potentially policy-relevant since the ultimate objective of public policy is to maximise <u>social</u> well-being, not just "economic well-being". However, addressing these considerations is usually appropriately the concern of regional <u>development</u> policies and programs.	• While equity and other considerations are clearly potentially policy-pertinent, whether and how to address them is often difficult to determine or get agreement about, given their subjective nature. • These sorts of considerations are most likely to bulk-large where regions have relatively narrow economic bases and their principal source of economic activity is the one adversely affected. Whether and how regions should be assisted to diversify their economic bases is a matter for regional <u>development</u> policy, not structural adjustment strategies.
11. The desirability of providing (additional) targeted regional structural adjustment assistance should be assessed on a case-by-case basis. However, there are some broad indicators of the likelihood of a case existing such as where: the structural change is policy-induced; the change occurs abruptly or rapidly; the likely effects are large relative to the size of the economic base of a region; alternative employment opportunities are limited because the region has a narrow economic base; or workers adversely affected do not have readily transferable skills.	• It might be possible to devise some rough rules of thumb around some of these indicators – for example, what is considered a 'large' effect relative to a region's economic base, and what constitutes a 'narrow' economic base. However, a substantial degree of discretion will need to be built-in, including because the criteria are somewhat interdependent and "tipping points" for regions typically are variable and not easily identified.
12. Consideration should be given to whether pre-existing policies or regulations incidentally act as impediments to regional adjustment and to whether their impacts can be eliminated or at least ameliorated	• Stamp duties on real estate transactions; land use zoning regulations; and institutional inertia in the TAFE system are often mentioned examples.

PRINCIPLE	OBSERVATIONS
13. Although the initial impact of structural adjustment pressures is experienced by businesses, as a general rule regionally-targeted structural adjustment assistance should be concentrated on workers, families and communities, not businesses directly.	• The principal argument favouring concentration of assistance on workers, their families and communities is because their "capital" (human, such as skills, or physical, such as houses) is often industry and/or location-specific. Business investors (especially shareholders) have a greater capacity to hold a diversified portfolio of assets (although small business owners might be less able to do so, especially in the start-up phase) and better able to understand and take account of the risk of future policy changes. • This is not to say that desirable policies will not bring benefits to businesses ─ for example, information about alternative business and employment opportunities and training subsidies indirectly benefit businesses, though their principal objectives are to ease transition costs for workers, families and communities.
14. Decisions about whether to provide structural adjustment assistance, the choice of measures and the design of their implementation should be subject to rigorous and transparent evaluation of the costs as well as the benefits of providing assistance and subject to regular, rigorous review of the continuing appropriateness and effectiveness of, and need for, them.	• Evaluation processes, both at the design and implementation stages, should be mandated so that a recurring cycle of 'design, test, re-design, and re-test' is applied. Key questions include: whether the proposed measures are less costly in their implementation and flow-on consequences than the transitional costs they are intended to reduce; whether the measure(s) effectively target the source(s) of avoidable or reducible transitional costs and appropriately facilitate the adjustment process; whether they constitute the most cost-effective and cost-efficient way(s) of addressing the perceived adjustment problems; and whether they can and should be adjusted over time. • Both *ex ante* and *ex post* evaluations involve significant methodological and data collection challenges. Failure to collect appropriate base-line data and continuously monitor emerging outcomes as best as that can be done is a common weakness in the design and implementation of evaluation strategies.

PRINCIPLE	OBSERVATIONS
15. Proposed adjustment assistance strategies and programs preferably should be developed prior to implementation of policy changes which are likely to result in significant structural change, and preferably should be unveiled at the time of the announcement of the policy change itself: it often is good politics as well as good policy to pre-announce both the content of the proposed strategies and the processes by which they will be reassessed over time.	• Pre-announcement of measures that will have the effect of ameliorating how, or managing the rates at which, structural changes impact on people and businesses facilitates forward planning for adaptation to new circumstances by those likely to be most affected. Partly as a result, it can diffuse political resistance to the changes or a backlash against the policy changes after their implementation. This does not mean that the pre-announced strategies are thereby set in stone, however. • The alternative view ─ that reactive development of adjustment assistance strategies has the advantage of the consequences being known with somewhat greater certainty ─ involves a significant risk of knee-jerk reactions by policy-makers in response to community angst, rather than leading to the development of considered responses.
16. As a general rule, governments responsible for developing and implementing policy changes which give rise to the need for structural adjustment assistance should be responsible for funding the required assistance programs.	• This reflects the obvious point that otherwise there would be perverse 'cost-shifting' incentives in decisions about whether to undertake policy reforms. Nonetheless, there may be circumstances in which national well-being would be enhanced by the Commonwealth offering to share the transitional costs to State governments of policy reforms within State spheres of responsibility. The new National Partnership agreements and payments arrangements provide a vehicle through which incentive payments could be made to the States where policy changes are initiated through COAG processes.
17. Even where national policy reforms appropriately require regional structural adjustment assistance funded by the Commonwealth, State governments, in consultation with regional organisations, should have the principal role in the design and delivery of any location-specific adjustment assistance programs ─ applying nationally agreed design principles so as to, among other things, ensure equitable treatment of people in similar circumstances in different States.	• There are two inter-related points wrapped-up in this principle. The first is that only State governments ─ including through regional development organisations and local governments ─ have the effective administrative capacity to *deliver* location-specific programs. The other is that the most effective capacity to *design* adjustment assistance programs reflecting regional differences also lies with State governments, with input from regional communities • This is not to deny the case for design *principles* to be nationally agreed.

Attachment A which follows examines market failures and other pertinent policy issues in some detail for those who might be interested in an exposition of the concepts involved.

Attachment A

Notes on Market Failure, Government Failure, Systemic Failure and Other Policy Considerations Relevant to the Design of Regional Development and Structural Adjustment Policies and Programs

MARKET FAILURES AND OTHER POLICY CONSIDERATIONS

A. Introduction

In this Attachment, the principal focus is on market failures – their nature and their implications for regional development and regional adjustment assistance policies. However, it begins, in this Section, with a general discussion not just of the role of efficiency considerations in policy-making but also of equity, community sustainability and political considerations. In Section B sources of market failures are identified, along with some of their implications for adjustment assistance. Section C discusses systemic failure in regional development and adjustment.

Efficiency

Fundamental to economists' approaches to (good) public policy is the concept of ***market failures*** which result in distorted market outcomes compared to those which would be economically efficient. The design of good policy, on this account, is to take corrective action ─ or, in some cases, pre-emptive action ─ using instruments available to governments to do so. Typically, the instruments considered include one or more of: appropriately targeted taxes, subsidies, regulations, and information provision or, in more extreme cases of market failure, government provision of a good or service.

A few general points to be made include:

- the selection of the appropriate instruments, and the policy design itself, needs to be appropriate, if they are to achieve the intended outcomes: poor design can result in unintended, and possibly perverse, consequences;
- most often the selection and design of the corrective action is made under conditions of uncertainty: a recurring cycle of design, implementation, evaluation and adjustment/refinement is highly desirable, although market participants need a degree of predictability about what adjustments, and when, might subsequently be involved; and
- in contexts where there are multiple sources of market failure, efficient design can be particularly complex: the effects of different sources of market failure can be offsetting or, alternatively, reinforcing, requiring both perceptiveness and caution in policy responses.

Clearly, on all these counts, evaluation of proposed policies and of implementation processes, both *ex ante* and (recurringly) *ex post*, is essential to good policy formulation and implementation. In many circumstances, taking action where distortions are evident may not be worth the costs of implementation of, and compliance with, programs of corrective action or of the likely distributional consequences.

Where substantial, systemic reforms are being contemplated, *ex ante* evaluation poses particular challenges and even *ex post* evaluation is challenging because of uncertainties about the counterfactual (what would have happened otherwise, including if different policies had been applied).

The sources and nature of market failures pertinent to regional adjustment, and appropriate responses to them, are further discussed in Section B.

Equity

Important as efficiency issues might be, equity issues have equal claim to consideration in policy development: they are at least as important to achieving the highest possible level of ***social*** well-being, which is, or ought to be, the ultimate aim of good policy. However, equity considerations involve issues in which economists have no comparative advantage and they tend to get limited treatment in economic policy discussion – on the (usually implicit) assumption that efficiency and equity considerations can be treated separately and equitable outcomes achieved through the tax-transfer system.

Not only is this a logically dubious proposition – virtually all forms of both taxes and transfers distort decisions of both taxpayers and beneficiaries – but also, in the context of different region-specific adjustment *pressures*, there are consequential region-specific *impacts* that can lead to inequities: the people and communities in some of them will bear a greater burden of adjustment than others. This fact warrants a focus beyond addressing market failures to include offsetting, or at least assisting with, the costs of adjustment, or the consequences of reduced opportunities or diminished access to services, for those disproportionately adversely affected.

These considerations add greater complexity to policy design. Policies designed to offset inequities in impacts (for example income support for families) can distort decisions about location or work-seeking behaviour. It is to be re-emphasised, however, that equity has as substantial a claim to policy-relevance as efficiency – maximising ***social*** well-being will often require making a trade-off between equity and efficiency implications. At a minimum, policy advisors should identify the distributional effects and the trade-offs involved in addressing them.

There are no general design-principles for dealing with equity issues, other than that, as a general rule, any compensation or additional adjustment assistance made available should be to people, families and communities, not businesses. This is, in part, because investors in businesses can spread risks by holding a diverse portfolio of assets whereas, for workers, their assets in the forms of skills and training are most often tied up in a particular industry and location, and their investment in home-ownership (where relevant) is location-specific too.

Small business owners *might* sometimes be an exception to the general rule because they often (have to) commit all or most of their assets to their businesses, at least at start-up. However, they know (or should know) the risks they are accepting and compensating them for the effects of policy changes could be seen as akin to repaying bets on losing horses. The predictability of policy changes, and the magnitude of their effects, however, might be considerations in deciding whether assistance might appropriately be given to small businesses.

Community Sustainability

Closely related to the equity component of social well-being is the question of community sustainability (or critical mass). In current context, this has two policy-relevant components. The first is the generic issue arising from the fact that people have attachment to locations for many reasons relevant to their well-being and are willing to trade-off income and even, to some degree, local amenity, to remain. While the optimally *efficient* response to structural adjustment pressures might be to let communities decline, those that choose to remain face the risk that the quality and quantity of local economic and social infrastructure, and of social capital, will at some point fall below a critical mass necessary for community sustainability, significantly reducing their well-being. The question for policy-makers is whether it would be appropriate to let the relevant community go into (possibly spiralling) decline and, if not, what to do about it. Again, there are no general policy principles. Decisions are likely to be built around a mixture of assessments of fairness and of prospects for new economic opportunities eventuating. They will also appropriately be shaped by other policies close to governments' hearts – particularly their broader regional policies.

The second component is that communities most likely to be at risk from particular policy changes could enjoy a revival in future if technological developments or other changes restore, to some extent, their economic viability and vitality. This involves hard-to-anticipate issues. For example, if carbon capture and storage technologies prove to be feasible and commercially viable, regions initially adversely affected by introduction of a carbon-price (where coal-fired electricity generation is a significant source of employment, for example) might eventually recover their economic vitality – but how this can and should be taken into account in regional adjustment assistance policy development is not obvious. While policy approaches to adjustment assistance appropriately might adopt a no (or low) regrets principle, the reality is that unknowns are unknowable – and even known possibilities are uncertain of being realised. How much is too much when it comes to supporting communities (and workers) just in case the prospects of future 'revival' prove to turn-out to be confirmed?

The politics of economic policy

The economic theory of public policy, with its particular emphasis on achieving efficiency in outcomes from *economic* institutions, self-evidently ignores the role of *political* institutions. In much of the relevant literature, the position taken (at least implicitly) is that the economist's role is to inform policy-makers about what good economic policy consists of and leave them to deal with the politics of implementing it, including deciding on what trade-offs between, among other things, efficiency and equity are to be made. Even where economists have attempted to put their analysis into frameworks that include models of political institutions (so-called public choice theory), the implications for policy ***advice*** are not often the focus. However, as policy-advisors are well aware, an understanding of political dynamics is essential to shaping policy advice – at least to try to minimise the risk of unambiguously bad policy.

A particularly pertinent requirement clearly is consistency with other established policies and strategies.

Also pertinent is the fact that, because of the way political processes work, there is always a risk of government failures in policy making and/or program design. In some circumstances, government failures can be greater than the market failures the policies are intended to address. If so, the best advice would be to do nothing.

While not complete government failures, some pre-existing policy settings or agency performance issues can act as impediments to regional adjustment. For example, stamp duties on property transfers act as an impediment to mobility; land-use zoning and development approvals processes can affect whether new business development occurs and when; and education and training systems (e.g., TAFE) can be slow to recognise changing needs and opportunities. In these cases, first-best policy would be to eliminate, or at least modify, the constraints. However, if this is not possible, it might sometimes be appropriate to make temporary concessions, especially in the context of regions adjusting to decline. For example, location-specific stamp-duty concessions would help to facilitate desirable mobility and reconsideration of zoning and related regulations might take into account the more pressing need to enhance business attraction. Circumstance-specific training (or retraining) initiatives also can play an important role in getting around the inertia evident in mainstream training institutions.

B. Market Failures

As noted earlier, redressing market failures (where they are policy-relevant) is at the heart of economist's approaches to 'good policy' — promoting the efficient use of resources and, as a consequence, enhancing social as well as economic well-being. There is a well-established list of sources of market failure which have relevance to economic policy generally, not just to regional economic development policy. In what follows, the focus in on how they might hinder *specifically* regional economic development and inform good regional policy development.

It is important to recognise that market failure analysis is *most* pertinent to the formulation of regional *development* policies. While it also can contribute to informing whether and how context-specific regional *adjustment* assistance should be given, the case for adjustment assistance most often is about "easing" or "facilitating" inevitable changes. In that context, the consequences of pre-existing market failures which provide part of the conceptual foundations of regional development policies and strategies are likely to be magnified. Indeed, some sources of market failure generally regarded as not policy-relevant or best dealt with through general rather than region-specific programs might be magnified so much as to make them policy-relevant in the design of structural adjustment programs. A more complete analysis would put the discussion of market failures in the framework of an economic growth "model", with the analysis of market failures directed at identifying likely sources of distortions to, or unnecessary limitations on, regional economic growth.

If regional policy is good practice, including having addressed the relevant market failures, then the case and need for circumstance-specific adjustment assistance should be less than otherwise. However, where adjustment pressures on a region are particularly intense, there is likely to be a case for putting greater location-specific effort and resources into the policies which address market failures because the benefits, relative to the costs, are likely to be greater. By the same token, additional measures might also be justified, if they assist to ease particularly significant adjustment costs, on grounds of equity and sustainability as well as efficiency. These might include, among others: compensation; subsidies to meet relocation costs; or targeted infrastructure provision which would underpin new employment opportunities in the affected region. These are not considered in detail here.

(i) Information Asymmetries

Asymmetric Information exists when one party to a potential economic transaction has less information than another. This can lead to missed opportunities and, in extreme circumstances, exploitation of the "information deficient" party. Augmenting and rebalancing information can reduce the risks.

In the context of regional economic development and adjustment, there are likely to be two-way asymmetries.

- Workers and families have limited knowledge about employment and training opportunities outside their proximate region, and employers in other regions have little incentive to provide that information other than when they face labour shortages.
- Businesses in any one region have limited knowledge of business opportunities in others and many have limited capacity or inclination to get it for themselves.

This leads to the standard recipe of regional development agencies – and often State governments – preparing information packages for distribution elsewhere, including in other States, especially targeted at businesses. Transmission of information, other than through job ads, is more problematic in getting the attention of workers and families: as a result, this activity tends to be concentrated around significant change events through enhanced job search and training programs – whether because of the relevant region being in decline or another region facing acute scarcity of workers.

(ii) Public Goods

Public goods are goods for which their consumption or use by one user/consumer does not reduce the amount available to others (they are "joint in consumption") ***and*** **it is not possible to exclude anyone from consuming them irrespective of whether or not they offer to pay (they are non-excludable). Because everyone has an incentive to try to benefit without offering to pay, markets will fail to provide efficient quantities, and possibly fail completely. Government subsidies to production, or government provision, would be required to correct the failure**.

Information has some characteristics of a public good, especially generic information (such as about a region's lifestyle, employment or business opportunities, and social infrastructure, for example). If produced, it can be consumed by many without one person's use of it reducing the amount available to others. Moreover, if it's produced by one business, say, its benefits will accrue to all in that region: all businesses have an incentive to hold-off in the hope that others will provide it. Unless government or regional agencies support the production of *generic* information about regions, it will be undersupplied. This, of course, is not the case for *business-specific* information, for which the returns are essentially private to the relevant business.

The results of R&D also have public goods characteristics and, absent patents, copyright and so on, too little will be undertaken but, with them, use of their advances will be inefficiently restricted. There is, consequently, a case for governments to support innovators, with the quid pro quo that licensing of the use of innovation (whether product or process) will be relatively low-cost. Alternatively, governments can support businesses wanting to acquire user rights, especially small businesses.

Some infrastructure – especially roads and electricity, gas and telecommunications transmission systems – also have these public good characteristics.

At least until congested, roads can be used by many without reducing use by others. Where charging for road use is not possible or too costly, roads (unlike railways) will not attract private investment (other than for special purposes of direct benefit to the investor) and hence have to be public sector funded. Road systems are an essential element in regional development in all dimensions, and the fact that, in budgets, funds for roads are in competition with other political priorities can result in under-investment, or undesirably delayed investment, in some regions compared to others (i.e., there can be government, as well as market, failure).

Even where access to infrastructure with substantial capacity can be charged for, and hence privately provided, there can be policy-relevant considerations concerning not only efficient access pricing but also "first-user" issues. For example, new electricity transmission infrastructure that would be needed to connect remote wind-farms might (at least initially) have few other potential users over which to spread the costs and might delay investment in the potential generation facility. In some circumstances, government support for funding the infrastructure might be warranted, where doing so would meet other policy objectives – such as meeting an MRET or attracting new economic activity to a struggling region.

(iii) External effects (spillovers)

Externalities or "spillovers" exist when the decisions of an economic agent have impacts on others ─ positive or negative ─ which they have no incentive to take into account. If the externality involves a benefit to others, the agent's decisions will result in too low a level of output, investment or activity ─ and conversely where the externality involves costs to others. Subsidies and taxes, respectively, would be needed to correct market outcomes. In some circumstances, regulations might be the most efficient and effective policy tool.

The classic example of spillovers in regional development context is education and training. Because they generate substantial external benefits, subsidies are provided to encourage higher levels of education and training (especially for schooling and TAFE) than individuals would choose on their own account. However, where training programs are regionally supported, the fact that other regions might benefit because of the potential for trained workers to "migrate" is likely to result in under-investment in the provision of training. Similarly for on-the-job training provided by businesses: the potential mobility of trained workers reduces the incentives of employers to provide it, which public provision or training subsidies can overcome. A focus on education and training is part of the standard recipe for regional economic development – and a stronger focus on it at times of regional stress (positive or negative) can ease the burden of adjustment and smooth its path.

Besides positive spillovers between regions (or States, for that matter), there can be negative spillovers associated with regional development. For example, the establishment in one region of a business activity that pours effluents into rivers up-stream of other regions calls for appropriate effluent clean-up charges or appropriate regulations. Some of these responsibilities might lie with local governments which have incentives not to enforce them to an ideal extent. Corrective action at State level might be required.

(iv) Irreversibilities

Irreversibilities exist where a decision taken today has consequences that cannot be undone (reversed) in future. These circumstances call for an approach of limiting potential regrets.

The most clear-cut cases of irreversibilities lie in ecological context where species of flora and fauna can be, in effect, wiped-out. This can have regional dimensions when decision-makers subjugate environmental consequences to economic progress.

It might also have some application to the community sustainability issue. When a community's population and economic and social infrastructure fall below a (hard to define) "tipping point", it can spiral into sustained decline. While not literally irreversible, to reverse the decline, if warranted, could involve very substantial new investments in infrastructure and attracting people. As discussed earlier, where a structural adjustment event threatens to push a community over the tipping point, there is a serious policy challenge for governments about whether to intervene in some way to prevent this happening.

This issue has sometimes been categorised as involving a form of market failure known as merit goods. The idea is that some outcomes have an "intrinsic" value to society not reflected in decisions of individuals in a market economy. The sustainability of communities has been argued to be a merit good. The argument goes that some preferences of society can only be reflected through political processes and it is certainly true that political decisions appear to attribute values to outcomes that do not appear to be reflected in citizens' private behaviour. However, the merit good concept is a very slippery and contentious one which can be wheeled-in to reflect the personal preferences of analysts or observers. It would seem safer to attribute political decisions in the context of community sustainability to social well-being considerations or electoral politics rather than to some "intrinsic value" attached to it.

(v) Market Power (monopolistic elements)

Where businesses have market power ─ that is, unlike in competitive markets, they can be price-setters, at least to some extent ─ prices will be set above marginal costs to earn profits, and output or activity levels will be lower than is socially optimal. Policies that limit the potential for the emergence of excess market power are contained in "Trade Practices" legislation. In Australian context, however, this does not include the power to break-up ("bust") monopolies that have become established.

Regional or community monopolies – such as supermarkets, petrol stations or equipment suppliers – can have adverse consequences, such as by pushing up prices to regional communities. The (potential) capacity of people to travel elsewhere to shop or buy petrol or buy business equipment acts as a constraint on the degree of market power that can be exercised, but doesn't generally eliminate it entirely.

However, while communities themselves, perhaps aided by governments, can help to overcome this situation in some cases – such as by offering inducements to other suppliers to set-up – the most likely reason for the market power being able to be exercised is the small size of regional markets: two or more suppliers might be commercially unsustainable. Nothing short of price regulation could address the problem, and that is not a likely outcome. In short, regional monopolies may often be simply a fact of regional life.

C. Systemic Failure

In addition to market failures, the sources of which are well-known and which are amenable to corrective action of more or less known nature, there can be ***systemic failures*** – that often are difficult to fully diagnose and resistant to change – that can hamper adjustment in regional economies. Regional development and adjustment to change happens within a "system" with a multiplicity of parts and stakeholders. A flaw in any part of the system can hamper adjustment to change, whatever its source.

While the system is complex, some of its component parts can be readily identified, even though some might not be easily observed. For one thing, regional development occurs within a policy framework consisting of both overall economic policy settings and regional policy settings at both national and State level. At regional level, there are usually institutions which help to shape regional strategies – for example, local governments and/or specialised regional development agencies — which interact with State agencies and personnel and sometimes national agencies. All of these are connected to a network of stakeholders – businesses and workers, and also the whole community to some extent – whose actions deliver adjustments to change and who must be connected to the formulation of regional development and adjustment strategies if they are to be successful. Through these institutions and networks, information is gathered and used to develop strategies and implementation plans to roll out the activities necessary to ensure both on-going development and adjustment to change. And there are many more dimensions of the "system" besides.

A weak link anywhere has the potential to seriously hamper development and change. This could be because policy settings or programs are inconsistent with what is required – for example education and training systems slow to respond to different and changing regional needs, or zoning laws that prevent adaptation to new business opportunities. Or it could be because strategies and implementation plans misunderstand stakeholders needs or their inter-relationships with activities in other regions or how globalisation has changed the nature of regional development – or that there is conflict about future directions between institutions and/or key stakeholders and conflict resolution processes are inadequate. Or it might be that a key element of effective policy and program development, such as monitoring, evaluation and adaption to the results, is missing.

Any of these flaws can lead to the system as a whole being inadequate for its intended purposes. Some flaws might be easy to identify, if there's a will to do so, and might, or might not, be easy to fix. Others aren't so easy to identify, or there is resistance to changing the causes of them, resulting in sustained dysfunction in the system, and in the region's capacity to adapt to ongoing change. The issues surrounding leadership, governance and participation are bedrock issues for sustainable development and responsiveness to change. Without them being recognised and responded to, the system of regional development and adjustment can "fail" even if all else for effectively and efficiently promoting regional development is in place.

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Regional Development Council: *Framework for Cooperation on Regional Development* (updated 2009), http://www.rdcouncil.gov.au/framework/framework.aspx

End Notes

1 It is often overlooked that the services sector was the single largest source of employment even before it post-World War II surged – indeed throughout the 20th century. When rural and regional (largely agricultural) production was a larger source of employment and correspondingly rural and regional communities represented a larger proportion of Australia, transport services (getting products to the cities and ports, and goods out to communities), communications (including telegraphic and postal) and local banking services, for example, were vital services, as were intercity links, coastal shipping and so on.

2 On average, the *effective* rate of assistance to domestically produced manufactured products fell from around 25 per cent in the early 1980s to around 5 per cent in the late 1990s and has remained at that level since TCF and MVs, however, still have above average assistance. [For those interested, the "effective rate of assistance" roughly speaking measures the sum of *net* tariff assistance and budgetary assistance relative to *value-added* in the manufacturing process – as opposed to measuring them relative to the *sales value* of the end product (the nominal rate of assistance, which will invariably be lower than the effective rate). The use of *net* tariff assistance in the measure reflects the fact that domestic producers might use inputs that are subject to import duties, reducing the value to them of any import protection they receive on their final product. Obviously, net tariff assistance for some products could be negative.

3 It is important to understand the meaning of the qualifier "than would otherwise been the case". Without the introduction of a carbon price, the national economy would be projected to have a particular trajectory of future growth in economic activity, employment and incomes (the 'base-case' as it is sometimes referred to). The introduction of a carbon price at an initially modest level would have the effect of reducing the *rates of growth* of national activity, employment and incomes, not of reducing their *absolute levels*. However, as the remainder of the discussion in this paragraph indicates, for ***some*** particularly adversely affected regions the early-round effects might in fact be to reduce their output, employment and income levels in absolute terms, while some beneficially affected regions would have their output, employment and incomes grow faster than otherwise (faster than the base).

4 This effect of mining booms is often referred to as "the Dutch-disease" because it was first most notably observed in Holland when revenues from their North Sea Oil supplies substantially increased the country's exchange rate. In Australia, it is more commonly known (in the economics profession at least) as the Gregory effect, named after Professor Bob Gregory of ANU who undertook the first full analysis of the theoretical underpinning of the Dutch Disease phenomenon and exploration of the challenges facing policy-makers when it occurs.

5 The qualifier "economically rational" [policy changes] reflect the fact that some policy changes – for example, increasing tariffs – would reduce national productivity and output overall.

6 An in-depth exploration of the meaning of "resilience building" and of the appropriate content of programs designed to build resilience is beyond the scope of this paper. We have begun such an exploration and *may* become another EIP at a later date.