

Submission on Transitioning Regional Economies

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Recent statistical research on incomes and employment by industry in all Australian functional regions in 2006 reveals that median regional incomes depend upon employment in transaction services institutions in the region (O'Malley, 2016) and not on the industrial structure of employment. This result suggests that regional incomes policy following the resources investment boom should focus on strengthening regional transaction services, not on attracting industry. Rather policy should focus on strengthening or developing the trade facilitation activities of chambers of commerce in the functional regions of Australia.

Introduction

The task of the review is to study "...the geographic impacts of the transition of the Australian economy following the resources investment boom" (TOR). The Terms of Reference for this study note that "The different impacts across the geographic regions of the Australian economy occur because of variable factors such as endowments of natural resources and demographics. Some regions may also have limited capacity to respond to changes in economic conditions; for example, due to different policy or institutional settings."

This submission refers to recent Australian evidence that the scale of the resident regional services which govern transactions between the region and the world is the critical factor affecting regional income (O'Malley, 2016). Resident transaction services provide a region with the capacity to adjust to the completion of an investment boom because these private institutions provide governance of regional transactions with the outside world; they give faraway buyers the confidence in regional suppliers which is necessary to finding and winning markets for the goods and services the region can produce. Strong local transaction governance services are necessary inputs to the conduct of reliable transactions with the rest of the world, and so provide a region with the capacity to make successful transitions to new markets.

Major projects in regions do not strengthen resident transaction services. Most construction and mining enterprises manage their product sales and many of their procurement transactions centrally, particularly during the investment phase of mine development. Australian data show that mining regions seldom have a substantial and resident set of private transaction services (O'Malley, 2016).

This evidence suggests that the economic metric of the capacity to develop trade with new customers is the share of the employed workforce resident in the region which is employed in transaction services occupations. In order to make a successful economic transition from the resource development boom regions must have a strong resident population of transaction services providers because it is these service providers who attract external customers by ensuring the integrity of trade with the region. The scope for economic and social development in a region is constrained by the lack of a resident transaction services sector which is capable of demonstrating to new customers that they can trade reliably.

A successful transition requires resident transaction services.

Fly-in/Fly-out and contract employees are not resident in the regions in which they work and have no significant role in developing a regional capacity to govern the transactions of the region with the outside world.

The prospects for changing the structure of a regional economy therefore depend upon attracting or developing transaction service providers to live and work in the region, and retaining them in the long run.

Economic history reports on the gradual withdrawal of services from regions including transaction service such as banking and finance (Frost, 2008).

Assisting the development and growth of transaction and governance services which are resident in the functional regions of Australia should be the focus of the policy recommendations of this inquiry.

The evidence

The available evidence in Australia suggests that regional incomes depend not on the particular industry they support (or on endowments of natural resources) but almost entirely on the regional resources devoted to the governance of transactions (O'Malley, 2016). Transaction services are the primary factor contributing to regional incomes.

The definition of transaction services is based on Wallis and North (1986).

“The measure used to represent the governance sector for each functional economic region in this study is the sum of employment in the region in the industries of (F) Wholesale trade, (G) Retail trade, (J) Information Media and Telecommunications, (K) Financial and Insurance Services, (L) Rental, Hiring and Real Estate Services and (M) Professional, Scientific and Technical Services from ABS (2006a) all expressed as a share of the employed workforce in the region.” (O'Malley, 2016: 109)

Transaction governance services tend to concentrate in major cities (Sassen, 2000) suggesting that some policy intervention may be necessary to improve transaction services in more remote regions.

What is evident from the Australian research is that mining enterprises seldom strengthen the local capacity of the region to govern transactions. The correlation coefficient of the regional transaction services sector with employment with mining employment in the functional regions of Australia in 2006 is negative and not significant (O'Malley, 2016: 121). This result confirms that businesses in the mining sector manage their transactions with the rest of the world from head office, not from the mine.

The capacity of a region to adapt to change is determined by its institutional foundations. Where regions have the institutional resources necessary for governing transactions with external trading partners their incomes are higher (O'Malley, 2016). This analysis confirms that regional incomes are sensitive to the scale of the available transaction services to support marketing of the products and services produced in region.

Methodology: The Modifiable Areal Unit Problem

The scope of regional transaction services can be estimated from Census data on employment by industry. It is important that the data are assembled in functional regions, because the modifiable areal unit problem makes these data misleading if the regions are not defined as functional regions.

Data from administrative regions, such as local government areas, gives misleading results on regional economic performance because residents do not necessarily work in the same region. This is known as the Modifiable Areal Unit Problem. Regional analysis requires the investigator to first define functional regions which take account of the Modifiable Areal Unit Problem (MAUP) (Openshaw, 1984). For a simple clear graphical explanation of MAUP go to: <http://www.restore.ac.uk/geo-refer/91023cwors00y00000000.php>

An analysis of the effects of change in regions which are defined as administrative units, such as local government areas, rather than as functional regions will produce misleading results. To avoid misleading results this inquiry should define regions which incorporate, to the maximum extent possible, both the residences and the work places of the employed population. Few if any of the local government areas of Australia meet this requirement.

The functional regions of Australia have been defined and published for the years 2006 and 2011 (Mitchell, 2008; Mitchell et al., 2010; Stimson, Mitchell, Flanagan, Baum, and Shyy, 2016). In functional regions the share of the employed population who both live and work within the region is maximised.

Responses to Specific Requests in the Terms of Reference

“In undertaking the study, the Commission should:

1. Identify regions which are likely, from an examination of economic and social data, to make a less successful transition from the resources boom than other parts of the country at a time when our economy is reconciling the impacts of globalization, technological and environmental change.”

Response: Functional regions which had workforces containing relatively few persons employed in private sector transaction services as a share of the employed workforce had relatively low median incomes in 2006. This suggests that regions with relatively few private transaction service providers in their workforce will make a less successful transition from the resources boom. Functional regions have been identified for 2006, and for 2011. By using Census data on occupation and income by industry for the 2011 functional regions (Stimson et al, 2016) it is possible to avoid results which suffer from spatial auto-correlation.

- “2. For each such region, identify the primary factors contributing to this performance. Identify distributional impacts as part of this analysis. “

Response: The primary factor contributing to poor prospects of making a transition to higher incomes is relatively few residents employed in private sector transaction services as a share of the employed workforce in the region. (O’Malley, 2016)

“3. Establish an economic metric, combining a series of indicators to assess the degree of economic dislocation/engagement, transitional friction and local economic sustainability for regions across Australia and rank those regions to identify those most at risk of failing to adjust.”

Response: The key metric is the number of persons employed in each functional region in private sector transaction services relative to number of persons in the employed workforce in the region.

“4. Devise an analytical framework for assessing the scope for economic and social development in regions which share similar economic characteristics, including dependency on interrelationships between regions.”

Response: The key metric for the scope for economic development is the number of persons employed in private sector transaction services relative to number of persons in the employed workforce in the region. The scale of the regional transaction service sector determines the capacity of the region to create and sustain reliable transactions with the rest of the world. This capacity is a necessary condition for trade. An appropriate policy step would be to strengthen chambers of commerce within the remote functional regions.

“5. Consider the relevance of geographic labour mobility including Fly-In/Fly-Out, Drive-In/Drive-Out and temporary migrant labour.”

Response: The key metric is the number of persons employed in private sector transaction services relative to number of persons in the employed workforce in the region. In my view Fly-in/Fly-out and other migratory employees make little or no contribution to transaction services in the region; these institutional services are provided by residents who live and work in the region. However, I do not have evidence for this view, other than the obvious fact that migrant labour do not reside in the region.

“6. Examine the prospects for change to the structure of each region’s economy and factors that may inhibit this or otherwise prevent a broad sharing of opportunity, consistent with the national growth outlook.”

Response: The factor limiting structural change in regional economies is the number of persons employed in private sector transaction services relative to number of persons in the employed workforce in the region. Employment in transaction services has grown over time in most developed economies (Wallis and North, 1986; Dollery and Leong, 1998). The association between regional income and the scale of transaction governance in remote areas in Australia in recent times is demonstrated (O’Malley, 2016). In mediaeval times, the trading guilds in regions whose traders suffered mistreatment in other places would threaten to withdraw their traders from those places if the bad treatment continued (Grief et al., 1994; Furubotn and Richter, 2010). Developing and strengthening chambers of commerce in the more remote functional regions of Australia may be an effective means of improving the economic prospects of those regions.

Recommended Actions

Locate a business services hub in a chamber of commerce in each of the functional regions identified in recent research.

Sustain, develop and engage regional chambers of commerce in education, in developing regional transaction services, strengthening retail businesses, providing training in quality assurance, management, and marketing. Chambers of Commerce can engage with accounting and legal specialists, encourage business development, conduct marketing visits, and attract speakers on key topics.

Conclusion

The inquiry should seek to define policies which encourage the retention and development of employment in private transaction services in regions.

The problem of sustaining trade is not new. Mediaeval communities also had to address problems of coordination, commitment and enforcement of trading relationships (Greif, Milgrom and Weingast, 1994).

Large areas of Australia have experienced the withdrawal of banking, financial, trade and other transaction services (Frost, 2008). The relative concentration of transaction services in major cities is a well-documented global phenomenon (Sassen, 2000).

Transaction services are a necessary condition for all trade. The relative lack of these services in regional communities stifles their capacity to innovate, to access and secure new markets and to sustain existing markets.

An implication of this research for regional economic development is that policy makers should consider the incentives affecting the location of transaction services in remote regions. Banking licences could be conditional on regional service provision. Art traders do provide transaction services for the products of local artists, and this raises the incomes of some remote regions. It is not apparent whether other regional retail traders provide access to external markets for regional produce.

Further research will analyse the relative importance of different transaction services to regional incomes, and to update the analysis using data from Census 2011.

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