Discussant comments

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Graeme Hugo's paper raises a number of interesting issues that are emerging in Australia about new patterns of migration to non-metropolitan areas. He also poses some important questions about regional policy and future directions for regional development and decentralisation.

My comments come under three headings. The first relates to the insights from spatial economics and the new economic geography that are useful in understanding Graeme's findings. The second concerns some general issues in regional policy. The third is, as Graeme asks, whether a new consideration is warranted. Many of my comments touch on some of the same issues that Richard Arnott discussed in his paper on urban economics.

Spatial economics

There is a long history of economic thought from Adam Smith to Johann von Thünen and Alfred Marshall in the nineteenth century to the new economic geography in the past 20 years from Paul Krugman and others that focuses on understanding where economic activities and people are located and why. The observed concentration in some regions and not in others is the result of the interplay of some important forces.

Concentrations result from agglomeration economies, or what are called in the new economic geography, 'centripetal forces'. These include economies of scale, which lower unit costs at larger outputs, as well as reduced transport costs of moving goods and people. So, too, larger and 'thicker' markets that reduce search costs and allow more specialisation are advantageous. Most of these agglomeration benefits are captured by individuals, but others, such as informational spillovers, are externalities in that the benefits accrue to third parties without cost.

At the same time, there are centrifugal forces for deglomeration. Expansion in an area increases the rents to immobile factors of production, most notably land, and thus provides an incentive for the activities that most intensively use those factors to move to where they are more abundant. Expansion also increases the usage of unpriced public infrastructure and other common resources. The resulting congestion degrades their use and creates a negative externality and an incentive to locate elsewhere.

So Graeme's finding of increasing migration to regional areas is that *net* centripetal forces have been decreasing in Australia. Certainly, lower transportation and communication costs and the Internet have contributed, as have increased land prices and congestion externalities in metropolitan areas.

Regional policy

Regions are not only faced with constantly evolving centripetal and centrifugal forces. They are also faced with other continuously changing market forces, such as changes in consumer tastes, technology and international trading relationships. Dealing with these changes does not require any central planning. Individuals, in deciding what is in their best interest, will respond and the resulting reallocation of resources across regions and industries is generally the most efficient outcome. What is important in facilitating these constant changes is reducing impediments that keep markets from working efficiently.

The effects of constant change on incomes are generally uneven across different regions and industries. Some parts become worse off and others better off. It is here that regional policy's role is often seen in terms of reducing regional income disparities. But not all beneficiaries of regional policy are going to be low income; nor are all those adversely affected going to be high income. If the concern and policy objective is equity and income distribution, then the best and most direct policy to deal with it is through the national income tax and transfer system, not regional policy.

There is also the question of whether there may be efficiency gains from decentralisation and whether regional policy can achieve this. That is, does an expansion in non-metropolitan regions reduce the negative congestion externalities in metropolitan areas by more than it reduces the positive agglomeration externalities? The answer is that we do not know: it may increase welfare but it may decrease it. These externalities — especially the agglomeration externalities — are difficult if not impossible to measure. If the concern and policy objective is to correct urban externalities, then it is best to try deal with them directly, not indirectly through regional policy.

Is a new consideration warranted?

Graeme raises the question of whether it would serve the nation better if a greater proportion of future growth were located in non-metropolitan Australia. It may be that this will occur naturally without policy change, but if policy is going to actively encourage this development beyond where it would naturally occur then that will involve giving assistance in some form to the selected regions.

Should policy try to direct future growth and give special treatment to particular regions? This question is very much the same as the question as to whether policy should assist particular industries. Whether a regional city such as Ballarat should be given assistance to enable it to be larger than it otherwise would be involves the same issues as whether the car industry should be given assistance. A very real problem is in the choice of which regions or industries are to be given special assistance. Beneficiaries — especially region- or industry-specific factors that have most to gain — are a relatively small group who are well aware of the potential gains and will find it in their interest to expend resources to obtain favourable policy outcomes. This rent seeking is most successful when the costs are widely spread (and less recognised) across a larger number of voters and the policy is extolled as being in the public interest. But the important point is that rent seeking is fostered by policymakers not treating all regions equally or all industries equally. Given that rent seeking and the subsequent misallocation of resources is welfare reducing and given that assistance is always difficult to remove, a future policy direction of giving special treatment to any region should be avoided.

One way to assist regional development is with infrastructure. Graeme sees this as 'the key to shifting the balance of growth from the large cities to regional areas' and suggests that there is 'a need to think strategically about where infrastructure investment is targeted'. But the important thing with investment decisions is that they should be subject to a rigorous cost–benefit analysis. Investments with the highest net present value should be chosen, not those located in particular regions. What is a truism for an individual investor — that choosing investments with the highest expected net present value leads to a more prosperous future — is also very relevant for government investment. There are always opportunity costs. Making an investment choice solely on the basis of location means that other, more profitable, investments are forgone.

A further investment principle that is increasingly being recognised is the value of 'real options'. When the future is uncertain and large irreversible sunk investments are being considered, there can be considerable value in delaying the investment until further information is revealed. By delaying, potentially costly mistakes can be avoided. This is especially important for infrastructure decisions. As Graeme has highlighted, there are forces that are changing the geographical distribution of the population. But we don't know precisely where people are going to be. We cannot, with any degree of accuracy, look that far in the future. We certainly do not want to be building infrastructure in the speculative hope that people will come and use it. A much better approach with infrastructure decisions would be to be prepared, but not necessarily commit until things become much clearer as to exactly how things will play out.