BEYOND THE MENDICANT ECONOMY: INNOVATING REGIONAL ECONOMIC INSTITUTIONS AND ARCHITECTURES – KEY ELEMENTS OF A BLUEPRINT

Keynote Address

Australian Regional Economic Development Conference

Canberra, 5 September 2016

My name is Warwick Powell. Like my boss of 25 years earlier, I'm also from Queensland, speak Chinese and I'm here to help.

As you can see, I survived Kevin, even if my hairline didn't.

In the intervening quarter century, I have had the privilege and opportunity to work for a while in government, but for the most part in the non-government world of economic and business advisory, data analytics, being an expert witness, investor, business owner and eventually in what can only be euphemistically called "investment banking".

I've worked all over Queensland, and other parts of our country; and I've also spent time abroad building business in Hong Kong - the city of my birth - and China. In the past five years, through my boutique "for profit" investment bank in Hong Kong, my partners and I have driven investment and trade deals with combined values in excess of $500m across mining, tourism, property and agricultural sectors.

If my time working for Kevin Rudd was about the power of government, my experiences over the past 25 years lead me to conclude that there is tremendous capacity for prosperity once civil society and communities are empowered and configured appropriately.

So this is my story.

Armed with the experience of global investment banking, it was clear to me that one of the missing links in regional Australian prosperity is financial capacity and financial literacy.

What regional Australia didn't need, however, was another private "for profit" investment bank. Rather, what is needed is the rebuilding of public value developmental banking and financial infrastructure and know how, which can underpin a new chapter of ingenuity, adaptation and prosperity.

And so, a bit over two years ago I formed and launched Sister City Partners. It is a not for profit investment banking operation, firmly with its mission set on building the regional capital architecture that can underpin future generations.

I based it in Townsville because I've had almost 25 years experience in the region, have invested and owned businesses there and could see a region suffering and in need of something. I hoped that our injection would be part of that something that it needed.

With my partner in Townsville, Mark Dunworth, we hope to build something that shows that "business as usual isn't the only way" and leave something for the community.

SCP is grounded by four principles:

Prudentia, the mother of all virtues; fiducia, meaning to trust; Com, meaning together or with; and Munos, which means reciprocity in gift. Put the last two together and we get community.

We have three core groups of activities:

1. We create and nurture enterprises
2. We help raise capital or contribute directly ourselves, and
3. We provide analytics, diagnostic and advisory services to enterprises, regional organisations and local authorities seeking to find new paths to renew and rebuild regional economic and social fabric

As I noted at the outset, place matters and our broader region of interest is north and far North Queensland. It's a vast region with about half a million residents. It's not our only focal point, but it is the main one at the moment.

If that's too large a region, then we are immediately focused on activities within a two hour drive distance of Townsville. In this district, we've a population of around 220,000, which annually spends $370m on electricity, $270m on fruit and veges, $257m on meat - of which around $113m is on beef ... and saves through compulsory superannuation around half a billion dollars.

In three basic household essentials, we are talking about a consumption base of almost $900m each and every year. And, over the past ten years this small patch of the country has contributed some $5billion to the national savings pool.

You'd think with these numbers things would be rosy. They were for a long time, but the wheels began to fall off about five years ago.

We knew something wasn't right with the region's economy. As early as 2012, a number of lone voices - myself included - began cautioning that the post GFC boom was soon to end, and the combined effects of the financial crisis and the collapse in the terms of trade would result in major social and economic dislocation.

There were statistical signs of emerging downturn, most notably in soft labour force data. Yet, there were worrying signs of institutional complacency. Analysing labour force dynamics, particularly focusing on the qualitative dimensions of changing industries of occupation and micro-simulation modelling of participation rates and their impact on mortgage stress among other things, led to serious concerns that a combination of cyclical downturn and secular structural transformation would leave long and deep scars.

The changes that we saw in labour force statistics told a story of a regional economy heading into a vicious cycle of production and consumption characterised by a deterioration in the conditions of demand. We also started paying closer attention to data on insolvencies, and kept our ears close to the ground on the state of regional banking business. Rising residential vacancy rates and commercial vacancy rates that refused to budge were also signs of over-capacity.

I became increasingly convinced that a new analytical frame was needed to come to grips with what we were witnessing. The region wasn't simply experiencing an episodic "blip". Rather, what we were seeing were the signs of "hollowing out" ... There would be no quick-fixes.

The workforce was hollowing out as jobs in better paying industries disappeared, only to be inadequately offset by part time and casual private sector jobs, and lesser paying public sector employment. Working aged people in their mid 30s through to late 40s have left the region in search of work.

Local businesses had been hollowing out, as owners sold on to national chains in readiness for their own retirements. And with that the foundations were laid for a dilution of endogenous business know how and social capital. M&A lawyers and business brokers locally confirmed these broad patterns. The end result is a structural inhibition against the creation of a growing cohort of medium sized enterprises with longstanding commitments to the regions from which they emerge.

If these were more immediate and tangible symptoms of hollowing out, they took place against a broader backdrop of the hollowing out of regional finance. Since the early 1980s the banking sector has seen a sustained process of concentration institutionally. The retreat of local branches is the most obvious consequence of this, but the real kicker for regions is the centralisation of transactions management and capital management backed by increasingly sophisticated technologies.

At the same time, regional advocates would simply cry poor and demand more funds from government.

The dominant model of regional development is what I have called the Mendicant Economy, where peripheries seek fiscal alms from the centre. The relationship is one of benefactor and beneficiary.

Federalism, vertical fiscal imbalance and constitutional conditions shape this dynamic. Regular electoral cycles at three levels create conditions of mendicancy arbitrage.

The mendicant seeks special privileges and extra funding. Wish lists of pet projects, on the back of an audit of regional attributes, are the norm each election season. You win some, you lose some.

This cycle of special pleadings and pork barreling masquerading as something else, will no doubt continue, but it has its limits.

Firstly, there are real fiscal constraints. Secondly, most budgets actually have very little discretion. And, third, in my region of immediate interest, a high level of State Government capital expenditure - at above per capita rates - plus way above-average government sector wages (43% v 30%) has accompanied a period of significant contraction.

High relative government funding in both capital and wages does not necessarily equate to or result in economic growth.

Structural change is inevitable. Getting a grip of it, to deal with it and where possible to shape it, requires institutional building and cultural change.

Any set of prescriptions presupposes a diagnostics of one sort or another. In our work, we have largely eschewed the conventional "regional attributes plus wish list" approach. This approach has tended to result in cookie cutter responses from government in any case, which don't necessarily deal with root cause problems or genuinely unlock opportunities.

Instead, our diagnostics has identified the dynamic conditions of virtuous cycles, or as the case has been in North Queensland, vicious circuits of contraction.

We need to achieve a structural change for the better. That means more SMEs becoming strong grounded "middle firms".

That means regional financial structures and solutions that encourage the development of multi-generational enterprise ownership and wealth.

That means putting in place the institutions and mechanisms to participate in national and global capital flows.

Local finance capability - institutionally and in terms of broad literacy - has been eroding ever since financial deregulation of the early 1980s. The progressive concentration of business and development banking has detached circuits of capital from deployment outside of the mainstream institutions of equity markets, indexed funds and capital city housing markets.

That means harnessing technology to build internal strength, and empower outward engagement.

The advent of modern ICT was seen as a saviour for regions. The Internet would overcome the tyranny of distance and enable regionalisation. One suspects the opposite has actually been the case. The proliferation of web-based services and the ongoing march of procedural digitalisation means regional communities can be serviced from the Cloud. The tyranny of distance was overcome, but in the opposite way to what many had thought and hoped for.

Yet, technological determinism would be a flawed view. While the centripetal forces are strong, innovative applications of new technologies can be designed to build local resilience by shortening consumption and production chains on the one hand, and opening regions to the circuits of financial products and global capital flows.

It also means we need to get especially good at specific things, rather than be jack of all trades, when it comes to applied technology. Here, I make a small concession to the "catalogue of regional attributes" frame, and argue that specialisation in domains of expertise - usually based on notionally unique characteristics of a place, its climes and its people - are critical to building thickness in the regional human capital base.

And, in all this talk about high-tech, we need to ensure we don't lose sight of the human - that's why I talk of "high tech / high touch". The experiential economy of embedded engagement - be it in the lengths and breaths of regional cuisine chains, or the enriching potential of "the regional great outdoors" - opens up new prospects where the world of analog embodied experiences can be harnessed and extended through time and space by the application of technologies like augmented reality.

There are seven key elements of regional institution building and reform.

Talking about money may not be polite dinner table conversation but for us, the heart of regional resilience is our ability to create capital institutions that can harness local and global capital flows and channel them, responsibly, into regional communities and enterprises. That's number one.

In doing so, and this is the second element, we are able to become less dependent on fiscal largesse. In saying so, our message isn't that government has no role. Rather, we acknowledge the limitations of the fiscal policies of governments of all hues, and believe that with new regional institutions like those we are describing, the role of government in the future can be reformed and fine tuned.

Thirdly, we need to think short-chain economy. Long, complex chains have not delivered the goods. Often, they have created higher orders of systemic risk and contagion, as is the case with the long chains of financial derivatives. In other cases, the benefits of long, imbalanced supply chains - such as in the food sector - are debatable at best, and demonstrably non-existent at worse.

We have both a need and an opportunity to create, for example, an "agriculture of the middle" to refashion local economies, and it's something I will touch on again shortly.

And fourthly, regional aggregation - in the real and also in-virtuo - are strategic moves that can deliver new developmental opportunities for an otherwise fragmented and vulnerable set of regional enterprises.

Aggregation platforms are necessary to effectively tackle the balance sheet preconditions and address the risks associated with new market entry and development. This is more so the case as focus turns to tapping into the growing export markets of Asia. So, the fifth element of regional institution building is to actually build permanent presences outside of the region.

If you're serious about China, have a presence in China. If ASEAN is the focus, think hard about whether it's Singapore or KL. To address these markets through infrequent "trade missions" is simply not enough.

We also want to see large national firms that profit from regional communities do more for the communities in which they profit. Retailers are a classic case in point, where they - and the shopping centre developers - are effectively granted a social license to profit through restrictive land use planning authorities, and yet one must ask: are they really doing enough for this duopoly privilege?

Same goes for major construction firms, who are often the only ones in the running for the larger public works projects being let by government. With all the talk of local employment, we should be insisting on far more transparency and accountability as to what actually does happen when these major projects are procured.

So, the sixth element is greater transparency from national firms when they do come to the region. And we can do this by adopting some new technologies, which I will mention in a while.

Lastly, insofar as local institutions themselves are concerned, these must be built on the basis that everyone in the community can have a meaningful stake in them. A regional development blueprint must be for everyone, not just a few, if it is to be sustainable and meaningful in the long-run.

New models of ownership are needed, a point well-made by Adrian Wooldridge, an editor of The Economist magazine, who argued that new ownership models are needed if modern capitalism is to successfully navigate the transition from the "era of Keynes" to the "era of Schumpeter".

If institution building and reform is hard enough, there's also the imperatives of driving socio-cultural change. This is the "glue" that holds it all together.

We need to learn to do more with less. This is a challenge of productivity and ingenuity, and speaks also to the more austere fiscal climes. It will mean thinking more creatively about the kinds of community capital that can be harnessed and mobilised, and creating new ways of acknowledging and rewarding the contributions of various forms of local capital.

Despite the frequent preference of local politicians to focus on luring new firms to town - the new big investor, I submit that our primary obligation is to build on what we already have. This doesn't presuppose an indifference to new participants - far from it in fact - but does say that the embedded capital in existing businesses and people should be nurtured.

As we do this, we must also look outward. An openness to difference and the "new", to forms of cultural cosmopolitanism that is the bedrock of creativity and innovation, is actually critical to regional futures. Retreating to the comfort zone of nostalgia won't help.

An open disposition also strengthens our ability to deal with change through experimental actions. Be willing to try new things, but be just as willing to adapt or pivot. A culture of openness is a precondition to a successful learning polity. We must embrace difference, be hospitable to experimentation and enable the new on a "without prejudice" basis.

If we are to ask communities to embrace change and the uncertainties of 21st century economic fluidity, then we must ensure that everyone has a stake in the changes being wrought. Pathways for active participation and contribution from all walks of life must be encouraged through the provision of tangible ownership stakes in the future.

If these are the key elements of a blueprint, I will end with a very quick overview of some of the activities we've undertaken in the past 2 years or so that pick up on the themes.

I will briefly describe the core corporate architecture, before introducing some "on the ground" activities in rebuilding a beef value chain and introducing renewable energy opportunities to the region. I'll also briefly talk about our work in contributing to a community effort to establish an "innovation ecology" before wrapping up with some thoughts on our present work in financial technology for integrated regional resilience.

We are actively exploring new models of enterprise ownership. At the heart of this work is the creation of ownership and capital structures that effectively create the mutualisation platforms of the 21st century utilising the instruments available under the Corporations Act.

Our enterprises are anchored by a common not-for-profit foundation, which acts as the public interest ballast. Foundation partners are then enlisted, and are usually drawn directly from the relevant supply chains. Like-mindedness is a key consideration to ensure cultural fidelity and alignment of purpose.

Progressively, the enterprise is communitised through ordinary share offers. This way, we at once overcome free-rider concerns associated with "receiving something for nothing" and at the same time, provide a clear pathway for affected communities to acquire a stake in the supply chains as participants - whether they are suppliers, manufacturers or consumers.

In 2013 I led an investigation of a possible new greenfield abattoir development in North Queensland for Hong Kong and Chinese investors. At the time, beef cattle fetched between $1.60 and $1.90 per kilogram live-weight. Despite the region's households spending over $113m a year on beef, with prices like this the grazing industry was in crisis. A new $80m abattoir was not feasible, given the fragmented structure of the supply chain and the concentration of risk in the new facility. The proposal did not proceed.

Ongoing drought plus a sustained rise in demand from China has now driven live cattle prices to closer to $5.50 per kilogram. Supply shortages are, however, constraining the ability of large scale regional abattoirs to successfully achieve cost-recovery volumes. The region's beef sector is again in a bind.

In this context, we saw the prospects of a better way to mitigate risks to all players in the supply chain by establishing a vertically integrated operation that would suit the scale demands of many smaller and medium scale graziers. Through integration, all participants would benefit from the margins achieved from a "whole of chain" basis, rather than be pitted against each other at each transactional point.

Graziers and feed producers are now coming onboard as foundational shareholders, and overtime, we will deliver a grounded mutualised corporate structure in which risks are mitigated through supply chain balancing, and a long term view is taken to whole of chain sustainability.

This is a specific effort to build a mutualised agriculture of the middle model in one sector, but it is also a model that can be applied in other sectors and localities.

Over the past three years, we've also actively participated in the creation of a not for profit industry driven innovation and creative entrepreneurship ecology. We call it INQ. At its heart is a not for profit association, paralleled by a mutual corporate structure in which participating members share risks knowing that upside outcomes will be unpredictable but only realisable if early stage obstacles are collectively overcome.

This is the story of insurance in reverse. If insurance is about sharing the costs of dealing with calamities, mutualising innovation is about sharing the costs of realising serendipity. At the outset, who knows which entrepreneur will succeed, if at all. But, through the treating of innovation as effectively an insurable problem of serendipity, we are able to tackle front-end costs and risks while ensuring the appropriate distribution of benefits down the track.

We're doing similar things with renewable energy, though this is in a much earlier stage of development. Anchored by the right to commercialise a pyrolysis-based bio oil manufacturing technology in the regions, the business model again is to open up the enterprise to the ownership participation of oil and energy users and feedstock suppliers.

The underlying aim is to build institutions that harness regional balance sheet strength, and tackle tangible problems, so as to manufacture invest-ability for regional economies. Global circuits of capital, anchored by indexed funds and rating agency rated products must be in our sights.

Alternative and impact-rated investment priorities are also part of the mix, but are only meaningful if local enterprise, including social enterprise, is more financially literate.

These channels or conduits of finance operate in parallel to the burgeoning world of self managed superannuation, which is the fastest growing segment of the compulsory savings industry. The property spruikers know it too well, but we must act to create risk-mitigated, asset-backed regional development opportunities that pass the legal and fiduciary tests of fund trustees. This is the responsible thing to do.

New technologies that enable efficient local financial mediation can shorten the chains of consumption, production and circulation and - at the same time - deliver a risk mitigated and trustworthy "set of aggregated regional accounts" suitable for ratings purposes.

And so, now, we are moving forward with our collaborations with block-chain and smart contracting technologies to build the modern technology architecture for future financial strength and regional resilience.

These technologies are also the means by which we can achieve supply chain transparency and trustworthiness in transactions, and we hope to introduce this thinking and the underlying technology to major civil construction projects in the not too distant future. Here, we pair lean manufacturing with smart contracting to create seamless systems of bankable project delivery. The power structure of lead builder and a myriad of subcontractors can be effectively evened out, so that subbies - local smaller players - are actually able to participate in large projects knowing that their risks are effectively bankable.

Lastly, the underlying technology enables risk mitigation on the revenue side, because those who will spend money on a service or product are by and large also those who will be invited to invest in them.

But we need to reach out beyond single regions. Cross regional collaboration to build geographically diversified regional portfolios of investable activities, backed by the information symmetry of the block-chain, can create a new class of investment asset that can turn the tables on regional hollowing out.

There are no easy fixes, but we are confident that we have the guts of a corporate and technological model that will give regional communities a renewed stake in their local economy's future. And that's what regional institutional innovation is all about.

Thank you.