BEYOND THE MENDICANT ECONOMY: INNOVATING REGIONAL ECONOMIC INSTITUTIONS AND ARCHITECTURES – KEY ELEMENTS OF A BLUEPRINT IN READINESS FOR WHEN THE RUSH ENDS

Keynote Address

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There's something refreshing about a regional development conference that has as key themes ideas like change, uncertainty, innovation and adaption. And no more so is this the case for regions that have ridden – and continue to ride – the vicissitudes of global commodity markets.

So, let me set the scene a little.

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Part 1 – rushes always end

That the Central Highlands has over the past 2 generations become heavily dependent on the coal industry for its economic foundations and prosperity is beyond dispute. This is both its strength, and also its greatest vulnerability.

The mining sector contributes 52.5% of the region's total wages pool or some $826m per year. It employs 1 in 3 workers in the region, or 5,700 or so people. And it contributes almost 85% of the region's total exports or 5,000 million dollars.

Yet, with this level of exposure to a product whose price is determined globally, the region's economic wellbeing is also exposed to tremendous risks that are frankly beyond its control. Not surprisingly, therefore, as coal prices fell precipitously after 2012, the number of local businesses in the region contracted.

Between June 2012 and June 2015, the total number of businesses in the region fell by between 5% and 5.5%, depending on the measure. In concrete terms, this has seen somewhere between 166 and 183 fewer businesses than was the case when coal prices last peaked.

Despite this contraction in the number of businesses, the region's labour force has actually recovered since the lows of early 2013. This is certainly a good sign, and something to cling onto, especially when compared to regions not far north from here in which the labour force has actually shrunk in absolute terms.

At least the Central Highlands regional economy continues to grow on this measure, even if the number of unemployed persons has trended upwards since 2010, moving in opposite directions to quarterly changes in the labour force.

So far so good, then.

But before we get too carried away, it is worth reflecting briefly on the experiences of other parts of the world for whom coal carried their livelihoods for many a generation.

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With a surname like Powell, you'd guess that I've some Welsh heritage. And you'd be right. The Welsh are rightfully reknowned for their hymns and their mines. I can't sing to save myself, but have over 20 years involvement in natural resources and energy. I guess I'm only half-Welsh in that sense.

Coal was the bedrock of the economy of Wales for many decades. But it came to an end. The demise took thirty years to fully materialise, which meant there was actually plenty of time to prepare for a different future. Sadly, the Welsh economy continues to languish behind its UK cousins in most key measures.

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On the other side of the Atlantic, we've also been witness to the progressive emaciation of coal communities in the Appalachian Mountains. What appeared to be an albeit modest recovery in employment in the late 2000s, peaked in 2012, and evaporated in the years since.

The long-run pattern on both sides of the Atlantic is all one way.

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There are salutary lessons in the experiences of Wales and the Appalachians.

Geoffrey Blainey's much-heralded history of mining in Australia eulogised the idea of the never-ending rush; but alas, global history tells us that rushes eventually have their day. We can only ride our luck for so long.

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We don't need to get caught up in the debate about whether coal <u>ought</u> or <u>ought not</u>. What we need to do is ensure we, as communities, are well-prepared for all possibilities and build the institutions necessary to withstand or enable the adaptation to, the winds of change.

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The conditions of pre-GFC growth are over. As a country we suffer from high private household debt levels and flat-lining income growth. We have deteriorating labour force conditions, evidenced by the ongoing decline in full-time employment and the rise of part-time and casual employment. We see declining business credit growth and governments of all hues exercising fiscal constraint.

The commodity price boom that underpinned our post-GFC survival has gone. Modest recoveries are unlikely to see a return to the days of Chinese-backed record commodity prices.

Regions themselves are experiencing, to different extents, the processes of hollowing out. Future industry growth is likely to be as much driven by technologically enabled productivity growth as anything else; and that means an ongoing trend towards the replacement of routine-manual and routine-cognitive jobs at the hands of technology.

Regions must adjust, adapt and reform.

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Part 2 – Learning from Nature

All regions across this large continent of ours are different. When I prepared a regional economic development strategy report for the Queensland Government in 1998, it became clear to me that Queensland was in fact “many economies”.

Since then, 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.

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.

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

As noted, 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 are heading to capital cities 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 in various regions have 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 the 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.

Out of this emerged the dominant model of regional development, which 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.

There are real fiscal constraints. And, in any case, most budgets actually have very little discretion.

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

Through our detailed diagnostics and analysis of regional economic statistics, we've come to focus on key features of structural change for the better.

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That means striving for more SMEs becoming strong grounded "middle firms". Regions must do better at maturing businesses so that they are employing more than 20 people, or are configured in robust networks or clusters that sustain employment levels *as if* they were a single enterprise employing more than 20 people.

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.

It also 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.

And it **means we need to get especially good at specific things, rather than be jack of all trades**, when it comes to applied technology.

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.

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There are seven key elements of regional institution building and reform that enable us to drive towards these broad aims.

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 <u>number one</u>.

In doing so, and this is the <u>second</u> 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.

<u>Thirdly</u>, 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 <u>fourthly</u>, **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.

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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".

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If institution building and reform is hard enough, there are 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.

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Part 3 – Case Studies

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-plus years or so that pick up on the themes.

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To begin with, 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. Foundational 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.

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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.

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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.

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We're also building aggregated collaborative owned platforms to enable food exports into the China market. We will be opening in April next year the Australian pavilion in the Eco Food Hub in Dongguan – a city in the heart of China's Pearl River Delta. This facility lies within a development with 220,000 square metres of space dedicated to the display and distribution of imported foods from all around the world. Dongguan is strategically located within arms' reach of Hong Kong, Shenzhen and Guangzhou, and provides a platform to reach over 60 million consumers.

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Regional producers and manufacturers are now invited to find out more and get involved in this one stop shop, where in one location there will be display, storage and distribution; testing and import accreditation; and access to e-commerce platforms.

The regional market is too small, and viable agriculture of the middle and downstream value-adding can only be achieved through accessing export volumes. That's a lesson we can and must learn from the coal industry.

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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 all 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.

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.

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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. Regional institutional innovation is critical to re-empowering communities and harnessing the strength that comes in numbers.

Thank you.