

CHAPTER 9

Relationship between industry and towns

Key points

- The close ties between industry and towns weakened over the twentieth century.
- Industry and small towns shifted their focus towards large regional centres for support.
- Periodic shocks were often the catalyst for change because they exacerbated the existing adjustment pressures.
- Industry was centralising into large regional centres in terms of accessing factors of production, as distribution points and as centres of manufacture.
- Investment decisions are fundamental to a town's growth but investment is a component of the economy which is volatile and difficult to attract, especially at the small scale.
- Confidence in the town's future is vital for local investment.
- Firms are operating in very competitive environments and will adapt and shift their operations to remain viable. This means that towns and regions need to be competitive and better engaged with their local industries.

Introduction

Many Australian towns were established in the nineteenth century, principally to serve nearby industry and its employees. This close geographical link closely tied the town to the fortunes of industry. Over time, technological advancements, productivity gains and structural changes directly challenged this relationship, leading to its weakening.

The loosening of this relationship was a major contributor to changing Australia's settlement patterns. This chapter examines the nature of the relationship between industry and towns and seeks to identify the underlying processes that led to its diminishing role. The chapter firstly presents a stylised model of a town's economy to enable an analysis of the different components, followed by an investigation of the processes that shifted the relationship between towns and industry and the investment decisions involved. Finally, an overview brings together some of the key features of the shift in relationship between industry and towns.

As many Australian regional towns were established based on the agricultural sector, it will often be used as an illustrative example. Agriculture was an important basic industry for many of Australia's towns in 1911, but the underlying factors are also applicable to other industries.

Modelling the relationship

In 1911, industry was closely linked with its local supporting town. Agriculture, forestry, fishing and mining motivated the establishment and underpinned the continued existence of most towns. Co-location benefitted both industry and towns as transport was relatively primitive and the costs of moving people and goods high.

This relationship is consistent with Base Economic Theory (see Chapter 2). The basic industries were the primary source of town growth, with the non-basic industries serving local populations quickly following. This theory provides a useful structure to consider a small town's economy—identifying the various components and markets and the changes occurring in a town's economy.

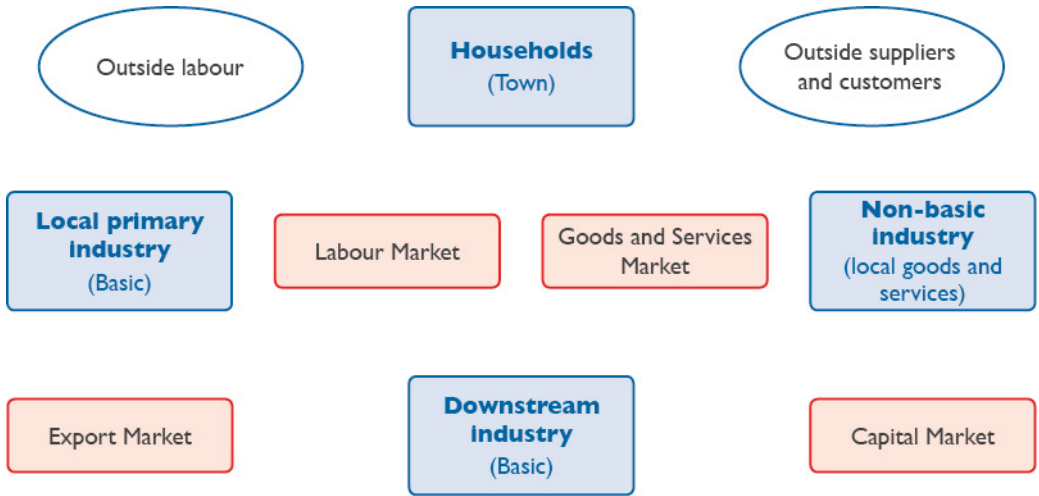
A stylised description of this model is presented in Figure 9.1, which shows the major components of a town's economy in blue.

- **Households** are where the population of the town resides. They supply labour and are consumers of goods and services. Generally, it is the welfare of this group that is the key consideration in the success of a town.
- **Basic industries** produce goods that are sold outside the town. Typically they are primary, but can include downstream manufacturing and some services such as tourism. In this model, basic industries are split up to recognise downstream processors of primary product as local processing was common in 1911, and remains a significant sector in many regions.
- **Non-basic industries** produce and supply goods and services to be sold to local households or industries. These include, but are not limited to, the retail sector and businesses providing input services to basic industries.
- **Locations outside the town** are included to illustrate that towns do not operate in isolation, with labour, customers and suppliers from outside able to operate within the town, and vice versa.

The relationship between the town and the various industry sectors is defined through the workings and outcomes of a series of markets: the export market; the goods and services market; the labour market; and the capital market. The workings of these markets are described below, with a brief observation of the changes that occurred over time.

In the following section this model provides a foundation to consider the various components of a town's economy and examine the process of change.

Figure 9.1 The relationship between towns and industries



Note: This figure could apply to a town or region or even a larger entity. The resident population of the town is shown at the top as a consumer of goods and services and supplier of labour. There are two types of basic industry sector (primary and downstream) that produce output which earns income from outside the town or region. Typically the downstream industry uses the primary product as input (dairy to produce cheese, for example). The non-basic industry sector produces goods to service the local market. The key markets are the export market, labour market, the goods and services market and the capital market. Outside areas interact with the town through the labour market, capital market and the goods and services market.

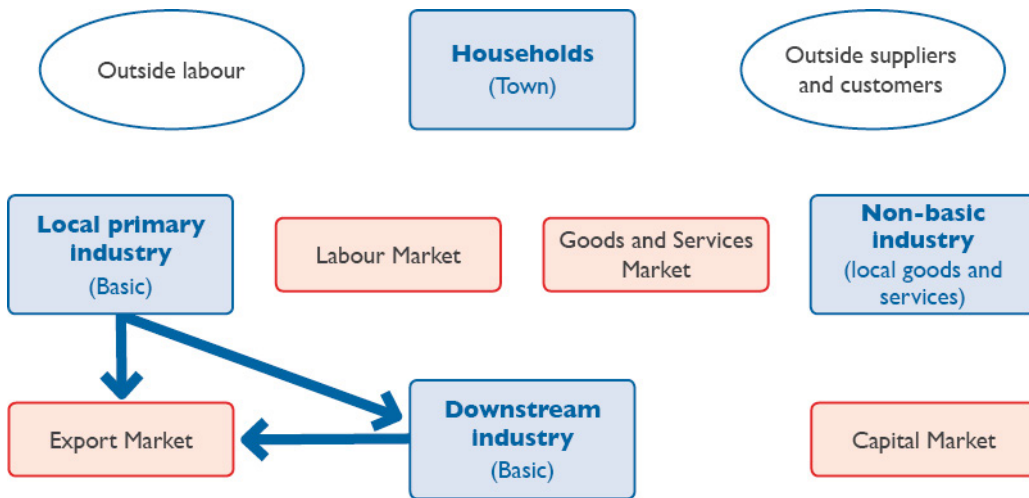
Source: BITRE interpretation of relationship.

The export market

The primary production sector was all-important for many town economies in 1911. Sometimes this was linked to a downstream industry that added value such as dairy factories, abattoirs, flour mills, wool scours and wineries.

These basic industries sold their products in the export market (see Figure 9.2). The arrows shown in the diagram refer to goods that are ‘exported’ from the town and very often sold into national or international markets (wool, wheat, beef and minerals, for example). Through this mechanism towns generated ‘income’ and it was a key component in determining the overall size and prosperity of the town itself.

Figure 9.2 The export market



Source: BITRE interpretation of relationship.

The close relationship between the industry and town meant that fluctuations in these markets had a strong flow-on effect. Industry typically has very little market power and is effectively a price taker. Once established, the conduct and profitability of industry is driven largely by powerful external factors: overseas markets, exchange rates, technological change, state or national wage settings and the like. From the town’s perspective, these factors are largely out of its control and most fluctuations in the changed opportunities provided by the industry have simply had to be borne by the community. Shocks in these markets are transferred to the town’s basic industry sector and hence to the town through the labour and goods and services markets. Prices received reflect international demand and supply. Typically they change slowly over the long term with changes in tastes, technology and competing products, but domestic and overseas events can create dramatic short-term fluctuations.

Outside markets effectively force basic industries to remain nationally and internationally competitive. Typically in Australia, the returns are also governed by the transport costs in getting the goods to the national market or port. The efficiency of the transport chain (land and maritime) from the town to the market is very important to long-term profitability. As noted in Chapter 3, rail transport effectively allowed the creation of the wheat industry in inland Australia where the earlier cost and inefficiency of transport had discouraged one. Australia’s position far from the ultimate consumer destination traditionally created an inbuilt

transport disadvantage compared to European or North American producers, although the growing importance of Asia as a consumer reduces this effect. With goods for Australian consumption, the issue for towns is the cost of transport relative to other towns/regions to the major cities. With free trade policies there is also a need to compete with imported produce.

One of the drivers of the establishment of local downstream processing is the ability of secondary manufacturing to create a less bulky, easier to transport product. On top of the inherent value adding by downstream industry in converting milk to cheese or grapes to wine locally, there is the reduced cost of transporting the product to the final market. The perishability of raw products can also be a factor in the decision to manufacture locally, although in more recent times modern transport systems have overcome this issue so that milk, for example, can be drawn from a much wider geographical area to a regional factory, reducing the need for a larger number of smaller, local factories across the producing region.

1911 and 2006—shifting relationship

A strong local basic industry provided the towns of 1911 with the foundations of local infrastructure beyond the needs of industry. For example, agriculture was able to generate substantial income and wealth supporting towns, and some towns also had mining activity. Between the 1890s and the First World War, agriculture benefited from high raw material prices and escalating demand, resulting in probably its most prosperous era in Australia's history (Frost 1998).

Sales yards, silos, ports and rail connections formed part of a town's built infrastructure to accommodate agricultural activities. The most important was often rail, which gave a significant advantage to towns that were connected, particularly in the wheat regions. Towns not connected were at a disadvantage as the movement of produce to market was more expensive. Small downstream industry was common even in relatively small towns as farm to factory transport relied on horses.

By 2006 transport had changed markedly. Rail was replaced in many locations by road transport for freight and people. Moving primary products to other locations became relatively easy. Improved transport was accompanied by advances in refrigeration that allowed longer trips without spoilage (particularly for milk and meat). It was possible for downstream factories to access product from much larger regions (and for regional factories to sell to a wider consumer market). This allowed them to grow their operations, take advantage of economies of scale and introduce more efficient processes. It meant that smaller mills came under competitive pressure and many inevitably closed, leaving their associated towns with one less downstream industry to employ its citizens. There was a converse boost to the town lucky (or smart) enough to become the site of the regional factory. The result was that better transport led directly to the centralisation of industry and a loss of downstream industry jobs in many towns.

Goods and services market

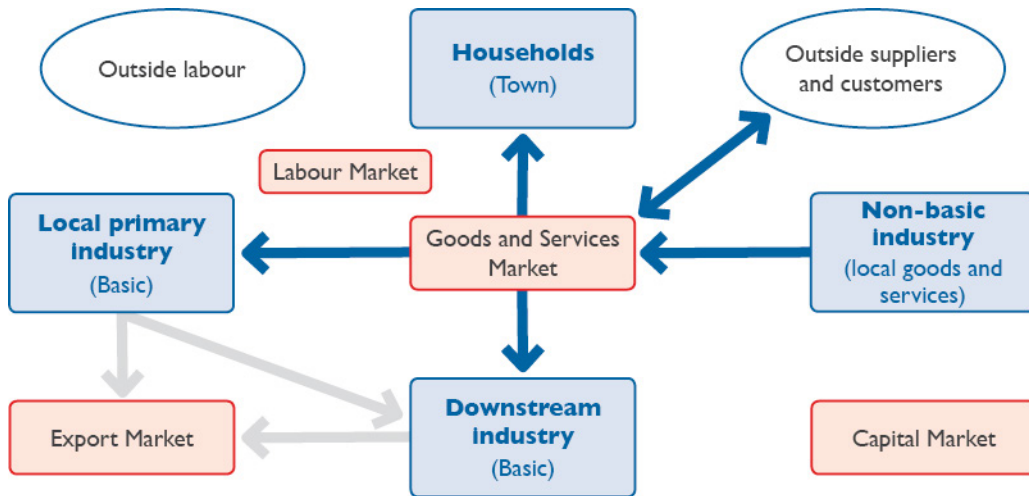
Figure 9.3 emphasises the movement of goods and services from the non-basic industries and outside suppliers to households, outside customers, primary industries and downstream industries. Arrows reflect the flow of goods and services.

This flow of goods and services to households includes the manufacture and retailing of food and groceries, personal and professional services used by families, along with those provided by government (education, health, local government and other services).

In addition it includes support goods and services to basic and downstream industries including specific inputs used only in production (such as drenches, veterinary services, chemicals etc) or more general goods and services (office supplies and services, vehicles and fuel, tradesmen's services etc).

The non-basic industry sector includes suppliers in the town and outside suppliers—including suppliers from the next town or further afield. The services sector notionally has a broad customer base of the town population and other industry but with enhanced transport the town was increasingly subject to outside competition. Key features for long-term success in this sector's business environment were the size of the market (town) and outside competition, although competition with like businesses within the town drew more attention in the short term.

Figure 9.3 The goods and services market



Source: BITRE interpretation of relationship.

1911 and 2006—shifting relationship

Local non-basic industries were the big contributors to the goods and services market in 1911. Outside suppliers were difficult to access and local producers manufactured or processed many products for sale to the local population and industry. Many towns operated as a closed market because of poor and expensive transport that restricted competition from outside and the prospects for local businesses to service outside customers.

Over time, better transport meant that these closed markets became more exposed to each other and the outside world. The retail market, in particular, became much more competitive, resulting in some business closures while others thrived. The effect of these changes on the service sector and the towns themselves was complex and was a major driver of the reorganisation of urban structures and the emergence of larger regional centres. The upshot for most towns was a decline in the local non-basic sector and a rise in the number of outside suppliers for goods and services.

On the demand side the loss of downstream and, in some cases, the basic industry from towns undermined the customer base of the non-basic sector in direct sales or through the loss of employment in the town population. This impact was exacerbated by improvements in productivity which often reduced the number of local employees in basic industries and other sections of the non-basic sector.

Within the non-basic sector, goods and services generally became more complex, requiring more sophisticated skills which were difficult to retain locally. The trend away from repair to more disposable goods (due to relatively high Australian wage rates as well as planned obsolescence) also reduced the need for repair services. This led consumers to place a lower value on local suppliers who could better provide 'after sales service'. Parts of the services sector were transformed. For example, business services such as banking, accounting and legal services evolved as local firms became bigger and financial arrangements more complex.

While this complexity was in part a response to more government regulation, it also was a reaction to better technology, the rise of national and international business models and increased specialisation of support services. Inevitably these models were more centralised than those that they replaced, with increased activity in regional centres or major cities at the expense of smaller towns. Similarly in health services, both expertise and equipment have become more specialised and so a greater proportion is located only in regional centres or major cities. Primary education is less affected but secondary and tertiary studies have become more centralised, and there has been an increase in the number of people pursuing further education.

The impact of these changes has been to push more and more smaller town, non-basic customers toward outside suppliers. While this is an obvious negative for local business, the positive aspect of development was the potential to access business in a wider region and other towns.

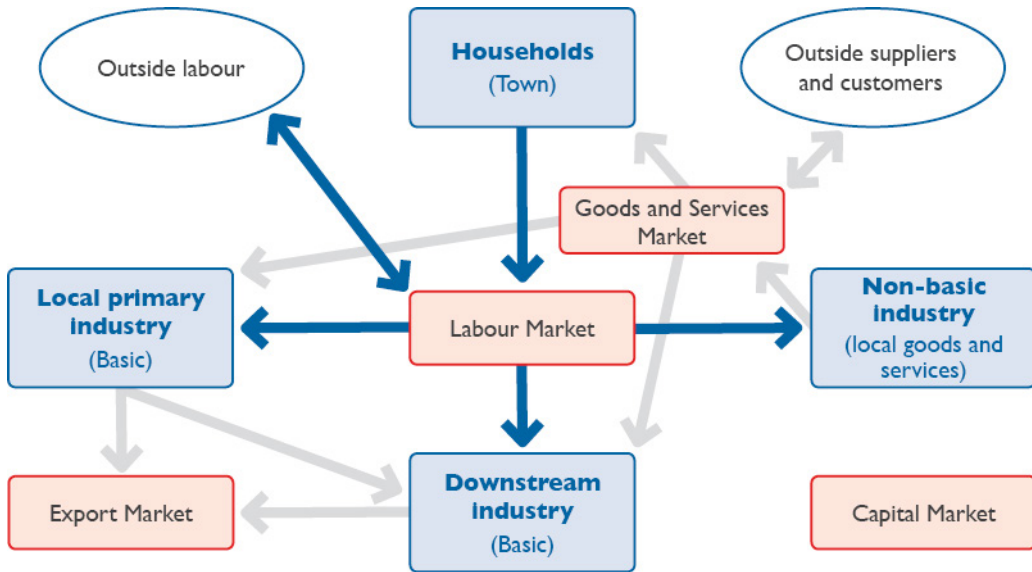
The overall balance of the impact of change in the goods and services sector varied from town to town. Some towns lost, others gained, however for the smaller towns the negative factors seemed to dominate and were largely beyond local control. The stiffer competition from outside suppliers created a difficult competitive environment, with pressures for change and adaptation becoming very strong. The processes and spatial effects within this market are more closely examined in Chapter 10.

The labour market

Figure 9.4 emphasises the dynamics of the town’s labour market. The labour supply is classified by where people live—either from the town population or from the ‘outside’ labour pool. The latter grouping consists of labour coming from anywhere else, whether workers driving from an adjacent town or a fly-in/fly-out worker from the other side of the continent. The model also canvasses the possibility of workers from the town working in other locations (towns). Traditionally workers lived in the town that they worked in, but with advances in personal transport (particularly cars and planes) this became less necessary.

The demand for labour is fourfold: potential employers are drawn from basic and downstream industry and the non-basic (local goods and services) sector and employers outside the town. With all these sectors fully active, there is the potential for residents in even a medium-sized town to access a wide range of job opportunities requiring a range of professionals, both skilled and unskilled. This diversity of opportunity is a positive for towns.

Figure 9.4 The labour market



Source: BITRE interpretation of relationship.

1911 and 2006—shifting relationship

In 1911 many towns had fully fledged local industry sectors which were relatively labour intensive. Outside labour was not commonly used because of transport constraints, and most towns operated in a relatively isolated labour market. Competition for jobs could come from outsiders, but if they took the job they would then have to move into town. This was typical for the professions, with teachers and bank staff typically being ‘outsiders’ who were recruited from other regions. While there was competition between individuals for employment, no matter who got the job the employee ended up residing in the town (at least while they were employed) and contributed to the overall demand for the town’s non-basic industry sector. There were some exceptions to ‘local employment’: for example, the use of outside labour in

rural seasonal work (shearing for example) was relatively routine on the larger sheep stations. 'Swaggies' seeking work on the track were a feature of the Depression.

With the coming of the motor car, labour became more mobile and the potential for people to work away from where they lived increased. This opened up options for a town's population to find outside work but still live in town, but also increased the potential for others to access local jobs, but live elsewhere. There was therefore more competition for 'local' jobs. From the town perspective the key difference was that income earned by 'outsiders' was spent in other towns and did not build the local non-basic industry sector. The previously tight relationship between industry employment and local income started to break down.

Improvements in productivity, particularly in the basic and downstream industry sectors and the growth of regional arrangements for downstream processing commonly had the effect of reducing the overall demand for labour. This was especially true of smaller towns, while regional centres that had expanded services sectors or could attract regional industry not only survived, but prospered.

The capital market

The capital market represents investment in a town by different groups—households, basic and non-basic industries and those positioned outside of the town. It represents the decisions of people to invest in a town, whether to open a business or build a house.

The investment priorities of these groups can be quite different, as they have different objectives. Investment by basic industries is primarily dependent on the state of their output market. Their focus is on market signals—an increase in price is a signal to invest in the market, while declining price means lowering costs or possibly withdrawing from the market. These prices are generally driven by national and world events.

In contrast, non-basic industries serve a local population and the basic sector of the economy. The potential customer base is an important consideration on whether a firm will decide to invest. Their economic environment is the state of the town's economy and its surrounding region. Those already in a particular investment situation (for example, a small business owner in a town) will have different considerations to those who have no assets there but are considering whether to acquire some.

Like non-basic industries, households are concerned with a town's potential. Households attempt to raise their well-being, with a key decision being whether to invest in housing. Households also have broader priorities than financial. Personal and social interests including attachment to place, connection to family and friends, networks, 'roots' and personal history are considered in the investment decision.

For towns, investment is fundamental. Agricultural activity requires investment in sales yards, silos, and rail connections. These types of activities do not occur without someone making the decision to invest in a town. Financial institutions and governments are other types of investors that can shape the location of activity.

1911 and 2006—shifting relationship

The connection between a town and its local basic industry has been shifting. Basic industries have become less dependent on local towns. Consequently, a booming industry may have very little impact or benefit for a town, as industry's operations and investment are directed towards remaining competitive in a market.

In addition, capital has become increasingly mobile. 'Footloose' firms are able to take advantage of short-term changes in locational inducements and then move on. The benefit for a town can be limited.

Some towns struggle to attract investment, compounding a difficult situation for declining towns. This becomes an important issue for individuals tied to a particular town. Their financial commitments, such as in housing and businesses, make it difficult to move because of lack of resale value.

In contrast, as discussed in Chapter 8, a positive reinforcing loop of investment in a town can enable it to grow and attract other investors. This puts larger towns at a competitive advantage as people feel more secure investing in locations where other people have decided to invest.

As investment decision making is complex and subject to different priorities and capacities of the investor, it is examined later in the chapter by considering the role of returns and risks.

Industries and towns: a shared history

The model provided a conceptual framework to consider the major components operating in a town. This section explores the processes changing the relationship between towns and industries.

Rural industries and their supporting towns initially formed mutually dependent structures for producing and sharing income. Towns derived income and employment from industrial activities by providing inputs for production, while the rural sector profited by accessing inputs and labour nearby, because of primitive and expensive transport.

This made small towns attractive nurseries for new businesses able to exploit the economies of location because of high transport costs for competitors. It was cheaper to mill grain, brew beer, make butter and manufacture simple products to be sold locally than to transport large or perishable materials over long distances (Frost 1998).

In the case of agricultural towns, they were to be impacted by three fundamental factors revolutionising their functions—technology, declining terms of trade and transport. These changes, in part, provide a critical explanation of why many of Australia's current small rural towns struggle to survive.

The introduction of rail and later the motor vehicle removed transport barriers by substantially reducing costs. Farmers and miners benefited from lower transport costs as it enabled them to conduct business quickly and over longer distances. For towns however, this meant an erosion of locational advantages that previously promoted local manufacturers, retailers and industry support services. It made it difficult for small town firms to compete with firms in larger towns with economies of scale advantages. Activities gradually shifted towards built up areas. It

followed that jobs would also transfer, which in turn attracted greater levels of investment and migration to the expanding regional centre.

Simultaneously, small towns lost agricultural jobs, principally from substantial productivity gains through technological advancement. While this often raised production for farmers and made them more competitive, it also led to significant labour reductions. For example, in 1911 a third of Australia's workers were employed in agriculture, but this fell to just 3 per cent by 2006.

The need to raise productivity was partly driven by declining terms of trade. Industry had to adapt or go bust. As part of this adaptation, farm amalgamations to obtain economies of scale, reduce costs and raise output, became a feature of the process. Farm numbers declined by almost 46 000 or one-quarter over the 20 years to 2002–03 (Productivity Commission 2005b). Using a conservative average household size of 3 persons, this equates to roughly 140 000 people moving away from agriculture and their rural communities. As discussed in Chapter 5, the visible effect on the landscape was highlighted by Bell (1998, p.33) for the northern areas of South Australia, with many unoccupied houses among the wheatfields.

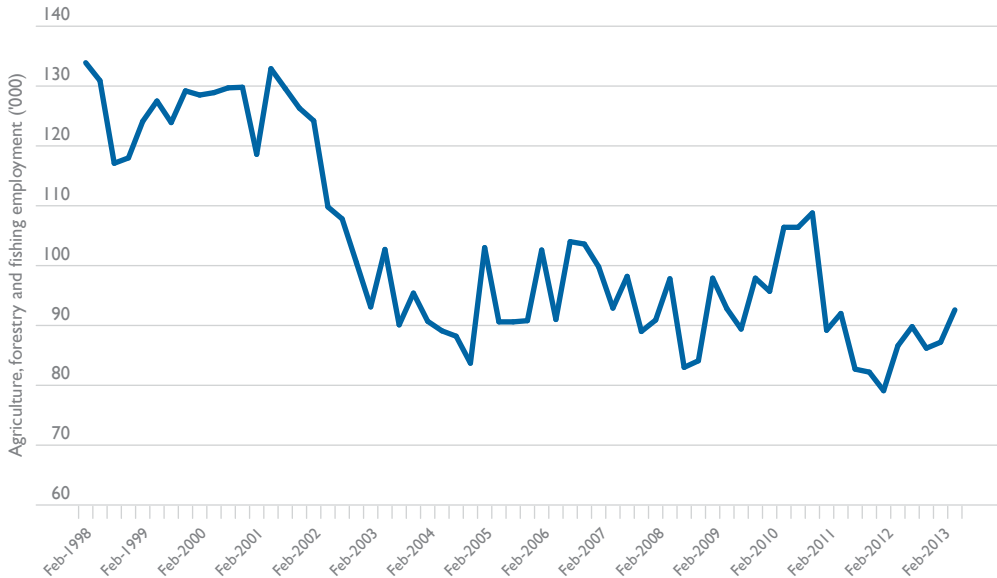
When much of the local town's economy serviced agricultural industry, a decline in the number of people and businesses in agriculture had a negative impact on a local economy. The 'loss' of regional towns did not result in entrenched poverty, as people were able to shift to unskilled and labour-intensive manufacturing jobs in urban areas (Frost et al. 2002) and later to the expanding service industries in regional centres and cities.

Shocks

Change from transport and technology appeared to be more gradual, whereas periodic shocks have often been the catalyst for adjustment. Periodic droughts are part of the environment and a risk that farmers must contend with. Some are short, while others have lasted for years with striking consequences. Eastern Australia's drought in the 2000s is an illustration of a substantial shock, with a drop of around 30 000 jobs very quickly (see Figure 9.5). The fall appears to have become entrenched, with agriculture, forestry and fishing employment typically ranging between 80 000 to 100 000 in New South Wales thereafter.

While long-term adjustments, such as declining terms of trade and technological advances have been the major source of change for agriculture, it has often been shocks that have sharply shifted the industry to a new structure. The shock has exacerbated the existing adjustment pressures.

Figure 9.5 Employment in agriculture, forestry and fishing in New South Wales from 1998 to 2013



Source: ABS (2013b).

These shocks directly affect towns. There is a tension between incremental and sudden impacts on settlement patterns with industry outcomes playing a crucial role in this process. The degree to which an industrial shock impacts on a town depends on a town's ability to mitigate negative outcomes, with its severity varying depending on a town's degree of dependence on the industry. For example, towns with greater economic diversity have sometimes been able to insulate themselves.

ABARE's investigation into income expenditure activity of broad acre farmers illustrates the varying degree of dependence of towns on agriculture. Farmers' expenditure within towns was broken down into three components: household, farm inputs and capital items (ABARE 2000). In aggregate, most farm expenditure in 1998–99 occurred in larger towns. Centres with more than 20 000 persons attracted over half of the expenditure. In contrast, towns with fewer than 1 000 persons and those with between 1 000 and 2 000 people each attracted less than 10 per cent of total expenditure (ABARE 2000). While broad acre farmers concentrated activity in larger centres, the economies of small towns were highly dependent, providing an indication of the lack of resilience of these small towns to shocks in farming activity (ABARE 2000). The report also highlighted the high reliance was correlated with a 'clear pattern...whereby the greater the reliance of a town's economy on expenditure of farmers, the lower the population growth' (ABARE 2000, p.5).

This illustrates that adverse shocks are felt well beyond the farm gate. Declining agricultural activity directly impacts on dependent businesses such as farm machinery manufacturers and harvester operators. Falling agricultural output flows to downstream processors, resulting in falling production. Falling production and incomes result in reduced working hours or loss of jobs. This flows through to falls in demand for goods and services in the towns—a negative feedback loop.

The overall impact on a town depends on the extent to which the expenditure of the displaced worker is directed toward locally produced goods and services. If, as was likely the case in 1911, most was directed this way, the loss of the job/income to the town would be keenly felt.

The decisions made by the people who lose jobs can greatly influence the ability of a small town to absorb the shock. Analysis by the DPCD (2007) of Murtoa, which lost about 100 jobs (from a population of 878 in 1991) from the scaling down of six government departments during the 1990s, found three decision types. About 50 per cent of the workers decided to move away, while the remaining 50 per cent was split between people taking packages and staying in the area, and people staying to commute to their re-located jobs in Horsham (DPCD 2007). The decisions taken provide an indication of the complexity in forecasting the effect of shifting economic activity between locations and how people would respond to these changes. The proximity of a major centre provided the option to commute, while more remote regions would not have this option and would potentially have a higher out-migration component.

Those moving away are likely to represent a greater loss to the local economy than those that stayed. The shift of employment also impacts on how and where people will spend their income. For small town residents whose employment has shifted to a regional centre, often a proportion of their economic activity also shifts to the regional centre, regardless of whether the person has decided to remain living in the small town. A daily commute may incorporate dropping the kids off at the regional centre's school and a shopping excursion on the way home. This reduces demand in the small town and affects the viability of local goods and service providers. The larger regional centre is usually the primary beneficiary.

This cycle of decline is reinforced by the potential loss of employment in local service industries. This cycle of 'Dying Town Syndrome' is difficult to break (Forth 2001) as industry and individuals become reluctant to invest.

Many towns faced with declines in agricultural activity were transitioning to different functions and industry mixes forming part of an expanding economic structure. While wheat-sheep belt towns were struggling, other towns positioned along the coast transferred their economic focus to other activities such as tourism, or to becoming lifestyle locations. Yet another group of towns had an extra economic component, such as a mining operation, or were strategically positioned to be a hub for the surrounding region.

Centralisation of basic industry

The key trends in rural and mining industries over the twentieth century have been the move towards enhanced industry efficiency with reduced labour; a reduction in downstream processing and increasing use of outside labour. With some exceptions, industries have restructured so that they are more productive, usually through economies of scale, and to be internationally profitable. Unfortunately, this has been at the expense of their ability to support their nearby small towns. There are fewer opportunities for local employment and less demand for locally supplied goods and services.

While agriculture is naturally dispersed it has contributed to the centralising of industry activities by transferring its focus to the large regional centres. Small local towns have been by-passed as farm managers seek cheaper and more sophisticated farm inputs from the high-turnover businesses in regional centres. Often these regional centres were also the site of a key

transport link or marketing infrastructure—livestock selling centres, abattoirs, fish, vegetable or other produce markets where farmers would be making business trips anyway. These centres were well placed to service farm inputs. They often were, or became, transport hubs for a wider region. They were also well placed to be the natural location for manufacturing—resulting in greater levels of concentration of manufacturing activities.

Before Federation, manufacturing was mostly 'goods for local use', such as food, bricks and furniture, as well as machinery repair and basic treatment of primary goods (ABS/CBCS 1963, p.179). So a structure of scattered small scale manufactures met local demand.

Larger factories, initially located on the waterfront, expanded into 'fringe suburbs' (making boilers, bricks, working with iron) (ABS 2001). Large factories concentrated 'in places offering the greatest facilities for the production of particular commodities. In Australia...the tendency throughout has been to concentrate the manufacturing establishments in each metropolis. This has accentuated the growth of the capital cities to an extent which, when compared with that of the rest of the country, appears somewhat abnormal' (ABS/CBCS 1929, p.906). Large-scale industrial manufacture also expanded into several regional cities (see Chapter 6).

The rail network, which was set up to funnel rural produce through major ports in capital cities, contributed to this 'abnormal' distribution. This meant that the focus of activity was directed towards the capitals. It followed that manufacturers would locate in major cities to obtain inputs, have the ability to transport goods and have customers access them at one central location. Manufacturers also took advantage of economies of scale and new technologies (Frost et al. 2002) that provided them with a competitive advantage over small firms in rural areas.

The largest impact on small firms in rural areas has been the reduction in the cost of transport. This gave producers the opportunity to access other towns, effectively creating larger regional markets in place of the smaller town-based monopolies of the past. The effect was the closure of smaller manufacturers who found it difficult to compete. Improvements in transport enabled a regionally-based system of production with fewer firms which could develop economies of scale.

The dairy industry in northern Victoria illustrates the amalgamation process. In 1950 the Murray Goulburn Co-operative factory was established in Cobram. From this beginning, mergers followed with smaller factories in the towns of Nathalia, Kyabram, Berrigan, Swan Hill, Rochester, Gunbower, Pyramid Hill, Cohuna, Kerang and Koondrook—illustrating one industry's shift to regional manufacturing. Milk for the factory, moved by refrigerated trucks, is now sourced 'from suppliers extending south of Shepparton and north and west to Jerilderie and Deniliquin and east to Corowa' (Murray Goulburn Co-operative n.d.p.). From this central location milk is now distributed widely, including internationally.

Centralisation did not happen in isolation, however. History and geography were also strong influences on the location of the large downstream regional factories that strengthened local economies and transformed towns into regional centres. For example, Mount Gambier developed on the back of 'Australia's largest concentration of saw-mill and paper pulp' manufacture, as it is positioned near '80 per cent of South Australia's forest plantations' (Forestry SA 2013; Griffin and McCaskill 1986).

Centralisation of non-basic industry

Structural reform pressures have also changed the service industry. Traditionally, towns and regions were based on primary or secondary industries exporting outside the region. Services, in contrast, were for local consumption. Service providers have been transitioning to form an important source of 'export' funds for towns. This has generally been to the advantage of larger regional centres. Consequently, service employment forms a major part of larger centres' industry mix.

The impact of changing goods and services access is examined further in Chapter 10, but the structural shifts in this industry are considered here, as concentration of services has had a profound impact on the development of many towns.

Service industry employment increased dramatically over the past hundred years—both in terms of the number and share of jobs (see Chapter 6). Growth in service employment generally benefitted urban centres rather than the surrounding hinterland, as service jobs have different locational requirements than traditional industrial jobs (Tonts 2000). This produces an uneven spatial spread of service based industries, with rationalisation and centralisation common (Collits 2001). A clear example is the emergence of supermarkets to replace many corner stores. In 1947–48 there were over 18 000 grocers and mixed businesses locations. By 1990–91, the number had halved to around 9000 supermarkets and grocery store locations (ABS 2001), illustrating a greater degree of concentration in economic activity.

Ultimately, the private sector operates in locations that are profitable. 'This means that there has to be enough demand by consumers to cover the cost of providing the service. In rural areas the private sector is less able to provide services that are readily available in urban setting' (OECD 2010, p.18). Asthana et al. (2003) identifies several characteristics that impact on the cost of providing services in regional locations:

- Lack of economies of scale
- Additional travel costs
- High level of unproductive time (more time spent travelling)
- Additional communication costs
- Poorer access to training, consultancy and other support services (cited in OECD 2010, p.26).

These costs are part of the reason for a greater degree of concentration of activities. The concentration is occurring for a wide range of goods and services with activity increasingly shifting into regional centres, which in turn is increasing their degree of diversity as highlighted by Bowie and Smailes (1988).

Centralisation of government services

The provision of government services has also been centralising in regional centres, with a similar impact on towns to the concentration of the private sector. The provision of government services in towns provides stable employment for local residents and the surrounding region, injecting money back into local economies; and draws people into the town to access services

(CentreLink, administration offices, schools, hospitals and police etc), which are part of the town's economic base.

Governments continuously review their own performance in providing public goods and services. Like private suppliers, governments need to make decisions on the range, quantity and locations in which they provide services to the public. Obvious judgments include the location of schools and hospitals, but similar spatial choices are required in relation to the provision of services such as social security and industry support.

Although not subject to the same competitive pressures as the private sector, governments face many of the same issues. Delivering government services involves balancing between economic efficiency and distributive equity criteria. Governments face the challenge of delivering cost effective services into regions with lower populations and have the same difficulties with small turnovers and high overheads as the private sector (see Chapter 10). Consequently, as Gerritsen (2000, p.124) states, the spatial effects of the centralisation of government services 'have mirrored those caused by the restructuring of the private sector'.

Chapter 8 illustrates this with the amalgamation of local governments. More generally, centralisation is especially apparent as services become more sophisticated—for example, modern healthcare and the growth in secondary and tertiary levels of education—and more expensive.

Services in regional locations are usually more expensive (and less sophisticated) than those provided in dense urban environments. As a result fewer services are available at the local scale and/or people are required to travel further to access services. Often this means traveling to the capital city. The inequality of service delivery to residents of non-urban regions is recognised by most service providers.

Understanding regional investment in Australia

Investment decisions are fundamental to a town's growth. Chapter 8 highlighted the role of history and geography on the growth of towns and the incremental nature of the investment in building a legacy of infrastructure, which continues to influence the actions of investors in the future. This decision-making process is examined further here because of investment's critical role in growing a town.

The volatility of investment is a challenge for towns and is sometimes difficult to measure or predict. Volatility comes from the degree of confidence in an economy, risks and uncertainty with the investment, the ability to source funds, and technological advancements creating both positive and negative prospects.

There are also several different types of investors: households, industry, institutions and governments. Each has a different set of priorities and different values to measure the best option for their investment dollar. Even within each investor type a great deal of variation can exist, including different attitudes of locals and non-locals, and different knowledge of local opportunities.

Choices reflect the different priorities and attributes of different investors to access rates of returns and associated risks, given their risk preferences, values, knowledge base, resources and expected returns.

Returns and risk

All investors regard rates of return as a major consideration. Returns relate to the amount of revenue an investment generates from increases in income and changes in the value of the asset. While it is important for all investors, evaluating rates of return can vary for the different investor types. Assets also have different rates of return depending on risk. Riskier assets attract higher returns because of volatility. The key is the expected likely returns to the asset holder. The rates of return on financial assets providing a monetary flow are sometimes easier to measure, while returns of sole business operators or family businesses are more difficult to measure because they are based on more than monetary flows and include the satisfaction or utility given to the owner.

The measurement of risk is an important consideration and how people respond to risk differs. Robison and Barry (1987) define risk as those uncertain events whose outcomes alter the decision maker's well-being (cited in OECD 2009). When outcomes significantly impact on the decision maker's material or social well-being, they will tend to move towards less risky options. Risk is the probability of suffering damage or loss after evaluating factors such as sovereign risk, inflation risk, income risk, economic risk, interest rate risk, market risk, mortgage risk and so on.

In the following section, investor attributes are examined further:

Households

A household attempts to maximise its well-being given its budget constraint and personal preferences. Household well-being includes more than economic well-being, as it also incorporates wider concepts such as satisfaction. It is often proxied by measuring a household's income and wealth.

For most Australian households, the family home is their main source of wealth (see Chapter 6). The family home has been a major source of increased household wealth because of increased property capital values over past decades. Household decisions on property are important, with a significant part of that decision based on location (Location! Location! Location!).

The locational factors influencing the decision include access to schools, community connections, environmental amenities, employment opportunities, likely length of stay and affordability, and the potential for capital returns. The household's expectations on a town's prosperity and future sale price are also pertinent factors. Falling property values have the capacity to 'entrap' households, as people find themselves tied to homes that have little market value (Econsult 1989 cited in Tually et al. 2010, p.34). Potential loss of capital and return significantly alter a household's economic position and encourage strong risk-averse behaviour. People investing in housing are reluctant to consider a (perceived) risky option that could jeopardise this asset. Households weigh up their exposure to risk and uncertainty carefully.

Perceived risk means that small towns are in competition with peri-urban, coastal and high amenity locations for in-migrants—and are often fighting a losing battle. This is especially so for small rural towns already struggling with population loss and/or economic re-structuring. As discussed in Chapter 8, however, low house prices can attract people, albeit people with limited resources, to declining towns.

Evaluation by households can also vary. A local may be willing to forgo higher direct rates of return for indirect returns. For example, local residents may forego higher capital returns in order to gain satisfaction from being close to family or for the lifestyle benefits of the area and to remain part of the community. This concept of amenity will be discussed in Chapter 11.

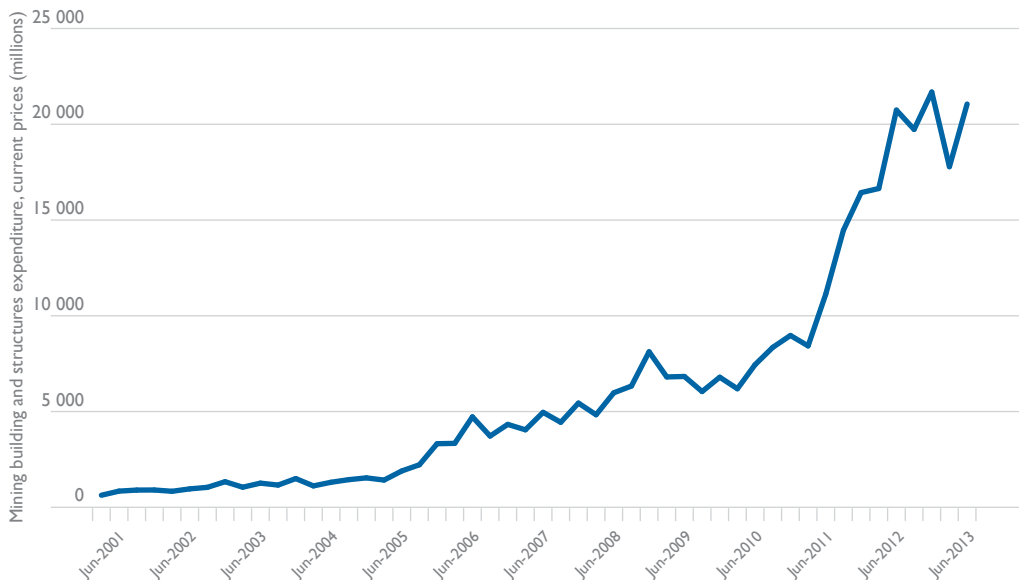
Households are also private enterprise investors. BITRE's (2009b) study into household wealth found net business assets have grown strongly but are owned by only a small proportion of households. Business assets tended to be much more important in regional areas, especially for rural households. Rural households had high rates of farm business ownership, raising average net worth of rural households to \$591 600 in 2003–04, substantially higher than national net worth of \$467 600 (BITRE 2009b). While rural households had high levels of wealth, regional urban centres of between 1000 and 100 000 persons had low average wealth (\$337 600), because of relatively low property values and business assets (BITRE 2009b). Consequently lower average net wealth can result in fewer resources to raise consumption, generate income flows and increase business start-ups for these towns.

Flows of household capital out of regional locations also occurred with the introduction of superannuation. From 1992 it became compulsory for employers to make tax-deductible superannuation contributions on behalf of their employees (APRA 2007). The scheme is a form of retirement savings which resulted in a substantial and growing source of capital funds over the past twenty years in the hands of fund managers. While this has greatly benefited many people in retirement, it has also meant that a substantial source of 'local' funds have shifted away from potentially local and regional investments toward those considered by the formal capital markets. A consequence of this shift in the capital towards institutions is explored further later in this section.

Industry

Like households, businesses are essential to a functioning economy through producing, consuming and investing in the local market. They attempt to maximise profits but often have other objectives and constraints associated with other business strategies such as being the first mover in a market.

Individual firms evaluate an investment depending on the type of business. Basic industries focus on the wider economic environment in which they operate. For example, mining companies react to price fluctuations in the ore market or shifts in demand for commodities. An increase in demand for mineral commodities prompts companies to invest in mining projects encompassing exploration, construction and production. In recent years, mining investment has increased substantially (see Figure 9.6), to meet increasing demand, particularly from China.

Figure 9.6 Mining building and structures expenditure

Source: ABS (2013c).

Mining and agriculture operate in global markets. The state of the industry is often the driving factor for businesses to invest in projects. The rate of return and risk are focused on the broader environment rather than an individual town. The state of the local town's economic conditions may not play a significant role in industry investment decisions. As Banks (2002) has highlighted, a large majority of firms consider commercial or market-related factors to be the key for their choice of investment.

Non-basic industries have similar considerations but focus on serving a population. They assess investment options based on a potential customer base locally and regionally. An important investment consideration is the viability of the town which they are considering and the degree of likely competition. These types of investments are town-focused and, like households, businesses are concerned with the locational factors that could include the growth prospects of the town, whether it is a transport hub, if the firm can become a part of a wider network and so on.

An important aspect but more difficult to quantify, is the level of business confidence and expectations for future economic growth of both the business and the town. The level of business confidence of a local economy (and if they operate in a base industry, their export prospects) directly influences investment. Access Economics (2005, p.107) describes business investment as the simplest indicator of corporate confidence. The situation of a town with a declining population, lowering consumer demand, will impact on business activity and reduce confidence in the economy making businesses unwilling to invest further and/or employ workers in the town.

As with households, a distinction can be made between businesses operating in the local market and those outside that wish to invest. Existing local businesses have an advantage in understanding their local market and interpreting signals in this environment. They are at

least partially tied to local economic fortunes through sunk costs and as members of the community. While maximising profits is a primary objective of businesses, owner operators, local family-run firms or local enterprises will also place value on maximising their well-being, which could include social benefits for the town in which they live.

While social benefits will also be considered by non-local firms, businesses outside the local area are likely to place a higher priority on maximising profits. These firms could also have greater access to resources to make investments but in contrast to local businesses will have to organise access to accurate and timely information to make informed decisions. They may also be investigating several locations. Towns perceived as being in decline will often be overlooked or ignored, reinforcing their decline.

Institutions

Institutional investors organise large sums of money from various sources to invest in securities, property and other assets. They endeavour to maximise returns for their investors while considering risk. Institutional investors include banks, insurance companies, hedge funds, superannuation investors and venture capital investors.

Institutional investors act as financial intermediaries and provide investment opportunities for others at varying levels of risk. They provide funds for local infrastructure projects, local businesses and household property purchases and a wide range of financial assets. These investors are unlikely to capture any indirect returns and are mainly concerned with direct financial returns.

To assess risk appropriately, information is required—at a cost. Better information makes for better decisions. For locals, the cost of gathering information could be minimal, as well as having access to important tacit information that is only available from continuous local interaction. For institutional investors gathering information can be difficult and costly, which affects their perceptions of risk and potential returns. This 'cost' of regional investment information can deter some investment, for instance by superannuation funds.

Differences in perceptions of risk can deter banks from lending to some population categories. Some lenders restrict how much they will lend based on geographical systems such as postcodes. Houses in metropolitan locations are considered generally low risk, while medium sized regional cities can be rated as low to medium risk. However, small towns and remote locations can be classed as high or very high risk. In practice this means financial institutions may lend a maximum of 70 per cent of the rural property value, while houses in well developed areas may be more easily financed with up to 95 per cent. Part of the difference is the assessed risk based on the available information or for many small towns the lack thereof. For instance, a low turnover of properties results in banks having little information to guide them on the appropriate risk factors for particular locations; as a result they raise the risk assessment and put a premium on finance.

This risk premium is a challenge for regional businesses. The Australian Council for Infrastructure Development (AusCID) (1997) identified several challenges for regional firms in obtaining funds—lack of critical mass, a prevalence of 'public interest' and politicisation of development which makes private investors wary to contribute, and the small scale of projects (those below \$20m) (cited in Braund 2000). Small-scale investments can make the administrative costs prohibitive. Institutional investors generally have expertise in the national and international

markets in which they operate giving a different focus to their investment choices. Approaches to overcome these barriers include regional approaches to funding local government infrastructure requirements or the growth of local community banks with a stake in the local economy and awareness of local conditions.

Government

Governments invest in towns and regions for broad objectives such as promoting economic growth, raising societal well-being, responding to equity concerns, offering public goods, reducing negative externalities, addressing market failures and providing economic management. Governments perform these important roles through regulation, direct intervention and monetary contributions.

National, state and local governments invest in towns at different scales. The Commonwealth Government initiates reforms at a national scale to create an economic environment that promotes economic growth and well-being. A major component of state government investment is provision of services to raise the well-being of residents—such as education and health.

At the town level, local governments provide many of the place-based investments, and have been expanding investment in social functions (SCEFFPA 2003)—beyond roads, rates and rubbish. This increasing role has been driven by devolution, 'raising the bar'⁴⁰, cost shifting, increased community expectations and policy choices (SCEFFPA 2003, p.11). A parliamentary inquiry found that the functions and services provided by local government 'cover a wide range of services that often include engineering, recreation, health, welfare, security, building, planning and development, administration, culture and education' (SCEFFPA 2003, p.6). A submission to the inquiry highlights the scale at which councils are investing locally. Ilfracombe Shire Council, in remote Queensland, 'runs the post office, the railway station, a general store and a café' (SCEFFPA 2003, p.7). The Aramac Shire Council provides a rent-free surgery office for the local doctor, accommodation for nurses, and runs the bakery (SCEFFPA 2003). These examples provide a clear illustration of the degree to which local governments actively invest in their local towns.

The challenge for governments (and community leaders) is how to allocate community resources among alternative services and infrastructures to achieve the highest quality of life for communities (Amanor-Boadu and Burns 2008, p.6). The investment by governments is generally geared to advancing the quality of life in the community, but it is subjective, multidimensional and dynamic. (A discussion into government policies and service provision challenges is also provided in Chapters 6, 8 and 10).

Government plays a significant role in addressing uncertainty in decision-making. All investors are discouraged by uncertainty because they are unable to assess future outcomes and the potential for substantial losses could be enormous. Uncertainties in these calculations create difficulties and demand higher returns in compensation.

Governments attempt to address this by setting the economic environment in which people operate. All levels of governments have an interest in raising confidence and reducing uncertainty on investment transactions. Policies that have tended to be more successful fundamentally

⁴⁰ Raising the bar refers to the situation in which another sphere of government raises the complexity or standard of a local government service resulting in an increase in costs.

changed the economic characteristics of a region and worked with the underlying economic forces. A study by BTRE (2003c, p.xxvi) into the investment trends in the Lower Murray Darling Basin found that governments shaped investment patterns through policies such as water administration. These policies created an environment that influenced the spatial pattern of investment over the long term that still influences current activity (BTRE 2003c).

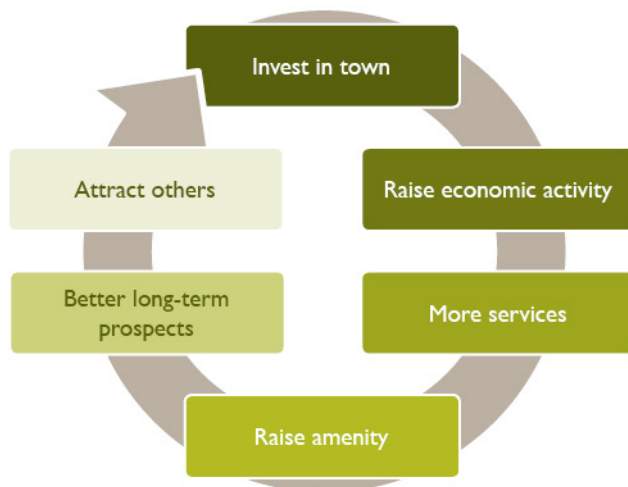
Investment over time (impacts on towns)

Rates of return and risk minimisation are motivators for investors, but what does this mean for towns? As highlighted previously, investment in a town provides a growth mechanism (see Chapter 8). Figure 9.7 presents a stylised representation of the positive feedback loops that can be generated from investment.

Once a decision has been made to invest, this can generate a number of positive effects for a town:

- The money from the investment raises local economic activity by injecting funds into the economy, providing employment and having a new business or household in the town.
- This can stimulate the delivery of more services into the market—raising the availability, range and quality of products and services for local residents and businesses.
- The increase in services raises the overall amenity of a location.
- As the attractiveness of a town improves, it increases the long-term prospects of the town because people are more confident in its future.
- A confident town is able to attract businesses and households, which in turn encourages them to invest, to continue the positive cycle.

Figure 9.7 Positive investment feedback loop



Source: BITRE stylised representation.

Generally, larger towns have had a clear competitive advantage over smaller towns in attracting investment. They have been regarded as more attractive places to invest and attract further investment—the perception of success creating success. This is evident with the general observation that the largest towns in 1911 were often also the largest town in the region in 2006. Households and businesses have had more confidence to invest in locations that other people have also been confident to invest in. Underscoring this, a large majority of firms consider commercial and market-related factors to be the key for their choice of location (Banks 2002). Businesses operating in tough environments make decisions based on their needs. This includes the ability to access thick labour markets and position in locations regarded as good growth prospects. This generally results in the promotion of growth for the regional centre through a virtuous circle of activity as described in Figure 9.7.

The initial stimulus to invest, however, is driven by numerous factors such as a change in government policy, new local competition and technological change. In some cases a change in conditions can promote new investment, such the bypassing of Berrima along the Hume Highway. BTCE (1994, p.7) found that the bypass enhanced Berrima's tourist appeal as reducing heavy traffic made the town an attractive destination. The result was a substantial increase in investment: 'approximately half of the 45 retail and tourist businesses surveyed in Berrima had opened after the bypass, and many of these new businesses occupied premises which had been built after the bypass', expanding the local economy. This flowed into property values for local residents, making Berrima attractive for further investment and internal migration.

In contrast, towns in economic distress struggle to attract investment. An adverse perception of a location can influence investors' assessments. It is difficult to quantify but plays an important role for a town's expectations of future growth. This is relevant to the assessments by institutions and businesses.

In behavioural economics, this 'framing' of information can exacerbate a difficult situation. It influences regional investment decisions through a constant negative discourse suggesting rural towns are in continuous crisis. It discourages potential investors. While the lack of confidence by non-locals is important, confidence in a town's future by locals is vital. Once local households and businesses are reluctant to invest locally, the town is in considerable economic trouble. As the McKinsey report (1994) highlighted, with up to 70 per cent of new regional investment coming from existing local enterprises, if locals are unwilling to invest, the results for towns can be terminal. Even though local governments continue to encourage investment in the town and attempt to support local residents, it will be from a position of lower financial capacity and an increasing reliance on the longevity of existing infrastructure.

This section has discussed how investment is the basis for town growth. Ironically, it can also have negative consequences. As highlighted previously, investment and productivity gains in the agriculture industry have adversely affected once tightly connected small towns. Productivity has raised farm output, but at a cost for towns in employment opportunities. This has led to a sequence of reinforcing factors—a loss of employment, income, people, demand and services. This bleak outcome was not universal, as many towns have prospered and undergone structural shifts that have promoted growth. But it has been a real consequence of investment to improve agricultural productivity in order to remain competitive and survive.

An overview – the relationship of industry and towns over time

This chapter has provided a description of the shifting relationship between towns and industry. This section brings together these processes to provide a general overview and bring out some of the key features.

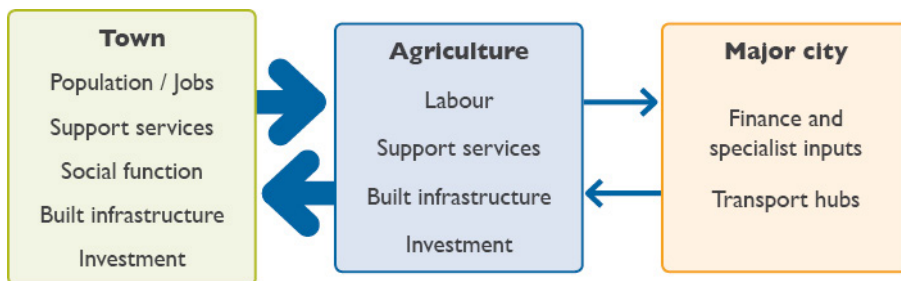
The complex relationship between industry and towns has changed over the century. Previously, the close geographical link between industry and a town provided the impetus to grow. These close linkages were best described by Base Economic Theory. A town's basic industry provided a multiplier effect for economic growth by injecting external funds to promote a town's economic expansion, with only minimal leakage to major cities for specialist inputs or haulage of produce: it provided the basis for the growth of many of Australia's towns.

To examine this relationship the agricultural sector is used as an illustrative example in Figure 9.8, which is a stylised representation of this relationship with the size of the arrows reflecting the degree of engagement between the three components of an economy—town, agriculture and major city.

The figure illustrates the mutual relationship that developed to the benefit of both industry and the town. The connections between the components include:

- Agriculture benefited through labour, support services, investment and a built environment that facilitated production.
- Towns grew on the back of industry through jobs, investment in downstream and supporting industries and built infrastructure, all of which attracted further investment and people to raise local economic activity. Towns were also the social hub for the area to create a close community that would support families in difficult times.
- The connection to a major city was weak for both industry and towns. These locations provided specialist input such as legal expertise or were the transport hubs to export produce—as rail funnelled produce into the ports of capital cities or large coastal towns such as Cairns.

Figure 9.8 Mutual support for agricultural activity and supporting town, 1911



Source: BITRE interpretation of relationship.

Towns that grew had an important basic industry that provided the stimulus for their growth and the overall town size.

Weakened connections

The weakening of this previously close relationship between town and industry has been a driver of change in Australia's settlement pattern. It produced two effects. First, some towns benefited and transitioned to become regional centres, while other towns lost ground economically. The processes are well known. The closure of a firm or service from a town's basic sector directly results in a loss of employment and income for town residents. From this there are flow-on effects in the non-basic sector as the lost income reduces expenditure on local goods and services, which leads to further pressure on the income and employment of those businesses. If this leads to further job or income losses, it creates even more pressure.

There were several significant factors contributing to changing the relationship over the twentieth century. These include productivity gains, declining transport costs, improvements in communications, technological advancement, shifting economic conditions, international competition and periodic shocks such as droughts. As a result agriculture slowly shifted its focus to larger regional centres and cities.

Subtly, the relationship between town and industry was redefined over the century. The balance shifted: small rural towns now needed industry much more than industry needed small rural towns.

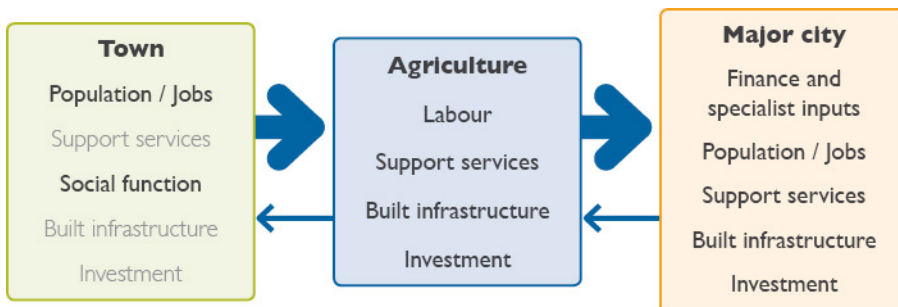
Paul Collits describes the shift:

'The nature of the services provided to farms by the communities has changed and their level diminished, and the formerly close relationship between farms and rural communities has declined' (Collits 2001, p.10).

Agricultural activities were transferred to regional centres (see Figure 9.9), diminishing the connection with local towns. In contrast, small rural towns remained heavily reliant on the activities of agriculture.

However, two important shifts also occurred in regional towns. Firstly, towns were redirecting their focus towards regional centres for employment in the growing service and manufacturing industries and for the purchase of goods and services. This is examined further in Chapter 10 (on goods and service provision). Second, many towns were shifted to amenity, providing them with a mechanism for growth and reshaping a location's competitive advantages. This is examined in Chapter 11.

Figure 9.9 Refocusing agricultural activities towards the regional centre, 2006



Source: BITRE interpretation of relationship.

The change resulted in three distinguishing and interrelated underlying features:

- Industry's dependence on local support declined.
- Stimulus for economic growth from industry for small towns declined.
- Industry and small towns shifted their focus to large regional centres and cities for support.

This relationship shift occurred over a long time. The major challenge for towns is that while industry faced an increasingly competitive environment, both towns and regions needed to be competitive in providing inputs to industry, because having a local industry does not necessarily translate into economic benefits if the town is not effectively engaged.

Conclusions

The close geographical links between industry and towns were created for their mutual benefit as transport was expensive. Towns grew on the back of the expanding local industries by supporting both the local firms and households. However, this link was weakened through technological advancements, productivity gains and structural changes.

The effect was that small rural towns needed industry much more than industry needed small rural towns and the stimulus previously generated by industry for small towns declined. This was due mainly to the shift to regional centres for support, access to factors of production and as distribution points and centres of manufacture.

The transition continues in regional locations but has not been smooth. Often shocks to the economy have had the largest apparent impacts on towns, with some more vulnerable than others. However, key underlying changes to industry are often more important.

The challenge for towns is to remain relevant to industry. Firms are operating in a competitive environment and will adapt and shift their operations to remain viable. This means that towns and regions need to be competitive in providing inputs into industry. A local basic industry no longer guarantees a town will grow.