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A RISK WORTH TAKING ENSURING THE PROVINCIAL GROWTH FUND IS FIT FOR PURPOSE

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The paper in summary...

In 2017, the coalition Government announced the \$3 billion Provincial Growth Fund (PGF), dramatically changing the New Zealand regional development policy landscape. This was, and still is, a controversial move,¹ with some decrying it as a “slush fund” or 2020 election bribe, and others heralding it as a once-in-a-generation opportunity for our regions.² In reality, both sides are right. **Spatial policy like the PGF does have great potential, but also introduces the risk** of “misallocating resources, creating a dependency culture and favouring rent-seekers over innovators.”³

Taking the right risk will **require the PGF to change course** and minimise the associated risks, otherwise **billions of dollars of tax-payer money could potentially be wasted** with the regions no better off than before, and even in some cases, worse off.

This paper outlines the case for and against spatial policy; provides an **international best practice model** for a regional development investment fund; and then develops a picture of the PGF implementation over its first year of operation (based on publicly available information from central and local government). This enables a time-limited but early **comparison of the PGF implementation thus far with best practice**.

Overall, there are **many reasons for hope within the current model**. From our analysis the PGF aligns with best practice because it:

- is spatial in nature without dismissing a good horizontal policy base;
- has high-level objectives it is trying to achieve, like increasing the productivity potential of the regions;
- seeks to base a good proportion of its funding decisions on real input from regions and local knowledge;
- sets out ex-ante goals of individual initiatives and appears to be using conditionalities as part of its funding; and
- is in the process of developing an overall PGF evaluation plan.

However, **the PGF requires adjustment** to be fully fit for purpose. It needs to better focus on fostering and capturing knowledge spillovers; effectively synchronising regional development investments across the regions and with national development policy; and most significantly, to **stop underestimating the well-known risks** associated with spatial policy tools.

This means that the PGF needs to **change its geographic scope** to include our largest cities in regional strategies, to urgently support the **creation or renewal of the mostly out of date regional action plans** (RAPs), to refocus on knowledge spillovers, better collaboration, and policy synchronisation, to enable both **growth and decline policy options**, and to make use of a significantly **strengthened evaluation regime**. Without making these changes it is likely that many of the costs and downside risks associated with spatial planning tools will be realised and the potential benefits elusive.

CONCLUSIONS AND RECOMMENDATIONS

Having outlined best practice for regional development investment strategy and held the PGF up to this standard, we conclude that the PGF is a good place to start but requires adjustment to be fully fit for purpose. To begin this process, **we have come to five conclusions:**

1. The current PGF strategy does not focus enough on capturing knowledge spillovers;
2. There is a concerning lack of collaboration and co-ordination across the current regional development strategy;
3. A sector-based investment strategy that already picks certain sectors over others introduces undue risk;
4. The “growth everywhere” focus limits the transitional opportunities associated with using both growth and decline initiatives to enhance overall wellbeing in the regions; and
5. Evaluation and ongoing monitoring of significant funding initiatives are crucial to success but critically lacking.

From these conclusions **we offer five recommendations** that aim to ensure the PGF delivers long-term positive change for the regions:

1. Add an explicit objective to the PGF that aims to foster knowledge chains and spillovers across the regions;
2. Support all regions (including the major cities) to refresh or create RAPs, including opportunities to collaborate and co-ordinate with other regions;
3. Remove the priority given to sector tier funding;
4. Refocus the PGF on regions’ potential, rather than their growth prospects, thus enabling transitional funding options for communities facing transition and/or decline; and
5. Require any PGF initiative over \$10 million to have an evaluation and monitoring strategy developed and funded before approval can be given.

Making the changes will **require the PGF to slow down** from its current implementation trajectory and will mean pushing back against political urgencies. Ultimately, however, making these changes and ensuring that the PGF is a risk worth taking—rather than just a risk we are taking—might well **unlock the potential of the regions**, improve their resilience, and help people to overcome place-based constraints. It would be a shame if the significant opportunity cost of the PGF was compounded by the PGF being an opportunity lost for our regions.

INTRODUCTION

In 2017, the coalition Government announced the \$3 billion Provincial Growth Fund (PGF), dramatically changing the New Zealand regional development policy landscape. This was—and still is—a controversial move,¹ with some decrying it as a “slush fund” or 2020 election bribe, and others heralding it as a once-in-a-generation opportunity for our regions.² In reality, both sides are right. Spatial policy like the PGF does have great potential, but also introduces the risk of “misallocating resources, creating a dependency culture and favouring rent-seekers over innovators.”³ The Government, having decided to chart this regional development course, needs to ensure they do it well.

The potential costs of moving quickly in this direction without attempting to minimise the associated risks could be catastrophic. Billions of dollars of tax-payer money could be wasted with the regions no better off than before, and potentially even in some cases, worse off. Not only this but the opportunity cost for this kind of spend is immense—this money could go to our ageing hospital infrastructure, provide better schooling for our children or meet many of our mental health needs. Avoidable failure of this investment would also cast serious doubts on the use of spatial policies in future, leaving New Zealand stuck down a different policy path that has already run its course.

Even small adjustments—a few degrees in a different direction—at the beginning of a journey can make a big difference to the eventual destination. We acknowledge that at the time of writing, the PGF is only in its first year of a three-year programme, so this paper is an attempt to understand the PGF, what New Zealand should be aiming for with interventions like the PGF, and to test, after the first year of operation, if we are heading in the right direction. If not, now is the time to make changes.

We start by briefly outlining the case for spatial policy, followed by an articulation of what international best practice looks like for spatial investment. We then undertake a comparative analysis of the various Regional Action Plans (RAPs) to build a picture of the current investment context and hopes of the regions. To augment this, we then analyse how the PGF implementation and spend so far aligns with the goals and content of the RAPs. Finally, we compare our findings with best practice, culminating in our recommendations for change.

We find that there are good reasons to be supportive of a spatial approach in the regions that builds on good nation-wide policy foundations. Unfortunately, we also find that the current strategy of the PGF needs to change if it is to bring long term change for our regions. Changes include helping create knowledge chains, fostering and capturing knowledge spillovers, and synchronising regional and national development investments. We recommend the PGF focus on these areas.

There are real-world implications for this change in focus. The geographic scope of the PGF, for example, needs to broaden to include our largest cities for planning purposes so that leading and lagging areas can learn from each other and collaboratively be part of a wider regional system. All the regions should be encouraged to create or update their RAPs with a view to this collaboration. Part of this will be ensuring multi-level governance and funding becomes a foundational part of this collaborative effort. Alongside this, all investments by the PGF need to have an appropriate monitoring and evaluation plan in place before they are approved, to ensure that lessons can be learnt about what works, undue risks minimised, and bad investments abandoned.

Like road safety, high risk spatial investment policy is another part of life where “the faster you go, the bigger the mess.” These changes will require the PGF to put on the brakes, slowing down from its current implementation trajectory and make corrections to the course, doing our best to make sure this is a risk worth taking. It would be a shame if the opportunity cost of the PGF was compounded by it being an opportunity lost for our regions.

THE CASE FOR (AND AGAINST) SPATIAL POLICY

The PGF dwarfs all recent New Zealand regional development programmes. As a regional development spatial tool it marks a significant shift in programme size, scope and level of funding from the more nation-wide growth focused Regional Growth Programme (RGP) that was part of the Business Growth Agenda (BGA) of the previous Government.⁴ As such it becomes a key regional development tool that sits alongside regional research institutes and skills, education, and immigration policies.

Spatial policy tools like the PGF have proven controversial, dividing regional development experts into two opposing camps: those for and against. Proponents of spatial policy argue that unless we intervene in a particular place, geographic and/or institutional failures will become normalised and overall growth will be lower than it needs to be. Opponents argue that compared with nation-wide policies, spatial policy tools are inefficient and prone to rent-seeking and capture which has the potential to lower overall wellbeing. Our analysis will show that there is truth on both sides.

The inherent risks that opponents point out are real and should concern us. The literature also suggests that well-implemented spatial policy that moves beyond using factor mobility as the sole solution to persistent geographic disparities can result in significant wellbeing gains for communities. To simply ignore spatial policy is to accept and normalise unnecessary place-based knowledge or institutional failures. We will now outline the case for spatial policy, contrasting with nation-wide policy where appropriate.

Horizontal policy is good policy⁵

Opponents of spatial policy tools rely on classical economic theories of growth and argue for “horizontal” policy tools as they see these as a pathway to maximise national economic growth. These “horizontal” tools aim to treat all places and people the same so that people and firms feel the effects of and respond to market forces. This model prioritises deregulation as a way to minimise interference with market signals, and emphasises the role of people and firm (or factor) mobility as the primary means of regional economic adjustment. Thus as firms realise they can make higher profits elsewhere potentially

due to lower wages, ready access to higher productivity workers, or lower input resource costs, firms will move to take advantage of these gains. Similarly as people realise that better wages or better job opportunities exist elsewhere they will move to take advantage of these gains. At a theoretical level this approach ensures that resources are put to their most efficient economic use and that over time regions’ growth rates should converge.⁶ At a practical level however, horizontal policy has distributional outcomes that at the very least need to be understood. It also means by implication that while some places grow and thrive others will decline or even close.

These horizontal policy tools have been likened to ready-to-wear clothing rather than haute couture in that they are usually more simple by design and cheaper to make and use.⁷ Common examples include general R&D tax credits, funding for public research institutions like universities and simple tax policy for businesses so as to lower the administrative and compliance costs⁸ of doing business. The previous National-led Government in the regional development policy space largely used horizontal policy tools to lower business compliance costs, and through the use of the BGA to increase the capacity of entrepreneurs and to help local governments plan for the future.⁹

Spatial policy can build on these good foundations

Rather than treating all places the same, spatial regional development policy seeks to make tailored and effective spatial investments. Proponents of this approach argue that this ensures that each place reaches its own growth potential. This in turn theoretically means that national economic growth is maximised. Spatial policy relies on evolutionary economic theory,¹⁰ the economic theory of the effects of firm co-location (agglomeration),¹¹ and knowledge spillovers (discussed in more detail below).¹² It also often relies on the existence of good horizontal education and skills policy, because spatial policy requires a base level of spatial knowledge and ability within a place before it can be effective.

Spatial policy, for example, when it is able to take the geographical and institutional context of a place into account, can help a place overcome “path dependency,¹³ sunk costs, and institutional issues.”¹⁴ An example might include a local training institution that no longer meets

the local needs of employers as the area has transitioned from one type of industry to another. Re-tooling the local training institution might require additional transitional funding. Similarly, geographic isolation may mean it costs more for a small or isolated local firm (not part of a national chain) to keep pace with developments in managerial practice, leaving it a priority to provide opportunities for them to keep on top of best practice. Tailored solutions and spatial tools therefore have the potential to assist local places, firms, and institutions to overcome transitional issues and the geographic risks associated with “[u]nderdevelopment traps that limit and inhibit the growth potential of regions or perpetuate social exclusion.”¹⁵

Using spatial policy tools brings advantages

Complementing nation-wide policy with tailored spatial policy options has four main advantages: it pushes back against unnecessary negative regional outcomes; it acknowledges the importance of place and people; it builds local capacity where it is especially needed; and it can help regions transition from a simple growth focus towards other goals, which is especially important for regions facing demographic, economic, or infrastructure ageing and decline.

First, by understanding the geographic and institutional settings in a particular location it can help push back against normalised but unnecessary local issues by using multi-level governance.¹⁶ This type of co-governance and co-design can leverage off local networks, connections, and social entrepreneurship (including the voluntary sector) to find better local solutions.¹⁷ Some of these unnecessary local issues may have even been exacerbated by the application of blunt national-level policy.¹⁸ Raising the minimum wage to meet the costs of living in a big city, for example, may mean that local businesses are unwilling to employ local youths at the higher wage. Without some form of local adjustment, young people may become hardened over time to expect that there are no job opportunities available locally. Similarly, as employers in the example above shun young workers in favour of more productive workers (or indeed even choose a capital intensive production pathway to automate these jobs) these young people may be unable to learn the soft skills associated with employment which further lowers their future employability.¹⁹

Second, it acknowledges the reality that for many in New Zealand, a deep connection with “place” likely outweighs market forces. This may well be part of the very complex reason why New Zealand seems to suffer from persistent regional disparities in household income, youth NEET (Not in Employment, Education, or Training) rates, and employment rates.²⁰ Researchers Sin and Stillman, for example, who investigated labour mobility of Māori, found that while on average the mobility of Māori may even exceed non-Māori, “...there exists a large subpopulation of Māori whose location choices are almost entirely unaffected by labour market considerations.”²¹ This then acknowledges that the assumption of full factor mobility within the New Zealand context is flawed.²² At the very least it means that spatial tools needs further consideration when discussing economic growth policy in the New Zealand context.

Third, by taking into account local conditions and institutions and the theory of knowledge spillovers, spatial policy can be used to help build local entrepreneurial and absorptive capacity²³ in places that need it most. Rather than treating everyone the same it actively aims to unlock new opportunities in lagging places by fostering knowledge spillovers and connections through a deliberate policy process that synchronises both national innovation strategies with regional strategies, as well as regional strategies amongst themselves.²⁴ Alongside this it also bolsters the absorptive capacity of firms by encouraging firms to ask questions like “how much investment will be needed to become a knowledge leader in my industry?”²⁵ and/or via the resourcing of business organisations or industry groups that engage in building knowledge networks and capability.²⁶

Lastly, spatial policy can help regions (and New Zealand) transition from a growth-everywhere focus towards other goals: such as declining well and maximising well-being, to ameliorating the effects of agglomeration, or even shifting to a green economy. To be effective, these overall regional development policy goals—which reflect the kind of future that local communities and New Zealand want to realise—need to be developed at the outset of any spatial planning to provide direction and the foundation for future evaluation and readjustment.²⁷ This is particularly important in a policy context where intergenerational wellbeing is being integrated into wider budgetary processes.

Going beyond a simple “growth-everywhere” model is important, as it enables the heterogeneous growth and population dynamics of different regions to be taken into account. As international evidence suggests, simply applying a “growth everywhere” model often exacerbates existing problems rather than delivering the hoped-for growth.²⁸ Instead, customised spatial policy provides a framework for communities to envision and work towards a different future—one that may well include managing decline.²⁹ This is particularly important for communities facing demographic ageing and population stagnation, for example, allowing for spending on right-sizing infrastructure, making use of multi-purpose planning tools, and ensuring acceptable levels of healthcare are provided. A spatial approach acknowledges that transition comes at a cost—just as growing places need support to overcome growth-related issues like density, congestion and pollution, declining communities need support to become smaller, better, healthier, and more sustainable. This represents a shift from supporting all places to grow to supporting all places to reach their potential through growth and decline policy options.

Minimising the risks of spatial policy

While the above benefits bring hope of change in both growing and struggling regions, the use of spatial policies will introduce the risk of rent-seeking (inefficiencies associated with political, local community, and firm capture of the policy) potentially resulting in the misallocation of resources, and the creation of dependencies. Done poorly, spatial policy can result in the proverbial lolly scramble, where politicians use public money to gain votes in particular places by providing place-based handouts to communities and firms. These communities and firms can then find it easier to rely on these handouts than to find innovative solutions, likely becoming dependent on the handouts over time. Overall, if used unwisely, spatial regional development tools run the serious risk of lowering long-term economic output, making New Zealand worse off.

These concerns are well-illustrated within New Zealand and more comprehensively covered in our previous work.³⁰ They occurred most notably within the Muldoon “Think Big” era where activity aimed at rebalancing growth across the country and making New Zealand less dependent on imports often meant that “import substituting industries congregated near the main port

and largest market of Auckland, distorting the regional balance of the country.”³¹

As outlined in our previous research, good spatial regional development policy can minimise these risks by following four principles:³²

- having clear, ranked and prioritised **goals** that both enable evaluation and limit political rent seeking;
- making use of multi-level **governance** as part of smart specialisation to overcome knowledge silos and maximise growth wherever possible;
- having **funding** that supports multi-level governance and limits the creation of dependencies via the use of time-limited support; and,
- having a **focus** that makes use of both growth and decline policy options in order to assist communities and politicians to overcome the growth-only policy narrative thereby minimising misallocation problems.³³

This paper is now going to narrow the focus down to how a regional development investment strategy like the PGF might fit within spatial investment best practice.

BEST PRACTICE - A SMART SPECIALISATION REGIONAL DEVELOPMENT INVESTMENT STRATEGY

Across the OECD many have turned toward what has become known as a “smart specialisation” investment strategy. “The concept is now a key element of the EU 2020 innovation plan;”³⁴ it is set as a conditionality³⁵ for the R&I and ICT target objectives of the EU’s Cohesion Policy; and the OECD and the World Bank are launching activities to promote and measure smart specialisation.³⁶ In terms of regional development investment strategies smart specialisation is shaping up to be the best practice model.

As an investment strategy smart specialisation aims to facilitate the emergence of new activities rich in knowledge spillovers (discussed below), diversify a regional economy through the generation of new options, and help build a critical economic mass through networks and clusters.³⁷ It is built on four key components: **clear objectives, entrepreneurial discovery, granular interventions, and time-limited funding**. We will discuss each in turn, highlighting the key components of a well-functioning regional development investment strategy.

Clear objectives

A smart specialisation strategy hinges on having clear objectives, agreed through a multi-level governance process³⁸ whereby the various levels of authority, be they central, regional, or local government, as well as local entrepreneurs and social institutions, work together and are funded in such a way that supports this approach.³⁹ This multi-level agreement fosters two important outcomes: collaboration and synchronisation of innovation investments, and good governance and transparency of public money through evaluation and monitoring tools.

Collaboration and synchronisation: Smart specialisation addresses a key challenge for regional investment: “the need to synchronise, on one hand, the national innovation strategies with the regional strategies, and on the other hand, the different regional strategies among themselves to make them consistent with each other.”⁴⁰ With a limited pool of investment

money, synchronising this spend means different places work together for a common development goal rather than fighting each other for a slice of the investment pie. This working together also means that when economic activity within a functional economic region and regional administrative boundaries don’t align duplication and waste can be minimised. This requires that leading and lagging regions⁴¹ (and even leading and lagging firms) see themselves as part of a wider innovation strategy. A smart specialisation strategy, for example:⁴²

transforms less advanced regions into good followers: a region in transition which is building capabilities and is agglomerating knowledge resources in a certain domain of application, so that it will be able to capture knowledge spillovers from the leaders (those who are inventing the basic technology), to attract further knowledge assets and to develop an ecosystem of innovation with the prospect and the realistic hope of becoming a leader!

While individual interventions may be regional in nature the investment logic needs to be national and multi-level in structure. “Multi-level” governance co-ordination is required to synchronise both the horizontal policy foundations to the vertical or place based initiatives.⁴³

Monitoring and evaluation: Secondly, clear goals enable evaluation and monitoring to occur over the policy cycle. As academics Philip McCann and Raquel Ortega-Argilés outline, these “monitoring and evaluation aspects have to be built into the policy design right from the beginning.”⁴⁴ This limits the ability of politicians, firms, and communities to seek rents, and helps governments to abandon support for non-compliant activities or activities that fail to meet their objectives.^{45,46}

McCann and Ortega-Argilés advocate that the following mix of evaluation types be used across the timeline of an intervention:

- **Ex-ante evaluations:** these occur at the start of the policy implementation process, often as part of the decision-making process for the intervention. They can set in place targets, conditionalities (regarding when and how funding will be distributed), expected outputs from the intervention and how the implementation will be evaluated over its life cycle.
- **Interim and ongoing evaluations:** give insight into how the policy is “progressing over time” and

“help to manage the intervention and to ensure that there is warning if targets are not going to be met.”⁴⁷

- **Terminal evaluations:** are carried out when the intervention ends and aim to ensure the institutional memory surrounding the implementation of the intervention is captured. These can be qualitative and quantitative, and once again, aid in implementing similar interventions in different places or over time.
- **Ex-post evaluations:** take place after the intervention has ended with a view to giving “a more detailed view of the impact of particular measures and whether the actions delivered the expected results effectively and efficiently.”⁴⁸ Knowing what has worked and what has not worked helps to better design future interventions.

The monitoring and evaluation process affords those making governance decisions the “opportunity to learn from good practice examples but also failures.”⁴⁹ This moves the risk-taking dial from one that punishes risk-taking decision makers if any failure occurs, to one that would only punish risk-takers if repeated failures for the same reason occur. This allows policy makers and decision makers to become part of a wider learning strategy.

Entrepreneurial discovery

Entrepreneurial discovery dictates that entrepreneurs within local communities should play the central role in making investment decisions. Rather than the government “picking winners,” decisions should instead be “informed by the local knowledge, ‘of time and place’, and the entrepreneurial knowledge about opportunities, constraints and challenges.”⁵⁰ Because government doesn’t have a crystal ball by which it can discern the future, their role under smart specialisation is one of coordination: to bring together local knowledge that is dispersed, decentralised, and sometimes hidden.⁵¹ As described by the OECD, entrepreneurial discovery policy includes:

- **rewarding entrepreneurs** who discover new activities or so that agglomeration or scale effects materialise;
- **building intra- and inter-regional linkages and co-operation** (e.g. staff exchange, participation

in conferences, joint research programmes) to improve absorptive capacity and to facilitate the mobility of the highly skilled;

- **supporting experimentation** as a way to incentivise firms to reveal and share information on their experiments and explorations; and
- **educational programmes** aimed at updating people’s skills.⁵²

Part of the above is also about the government helping to create and harness knowledge spillovers, where the knowledge capital of one place “spills over” into complementary activities in others.⁵³ To promote innovation, governments encourage the formation of “networks of complementarity and comparative advantage” where firms and systems create and absorb new ideas or ways of working together.⁵⁴ As can be seen in the box on the next page on knowledge spillovers, fostering something new often occurs when different actors in the economy and society are brought together in a way that enables these spillovers to occur.

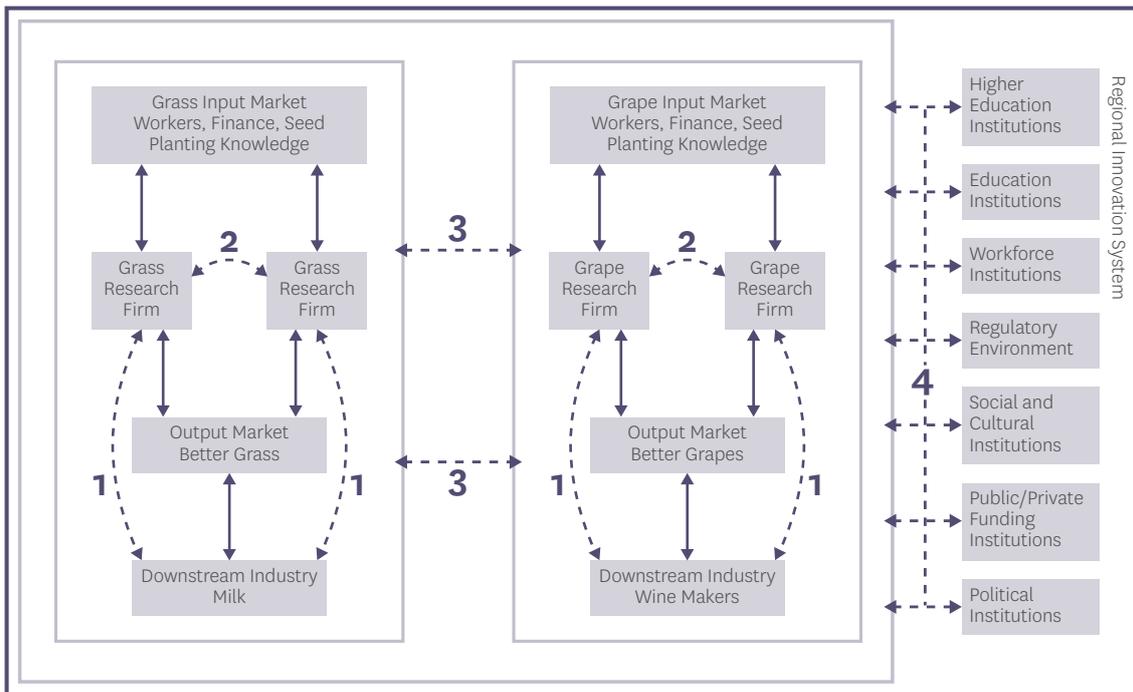
Granular interventions

The third element of a smart specialisation strategy is a focus on granular interventions: investing in innovative “activities” rather than industries or sectors. As outlined by Professor Foray, “smart specialisation is not a planning doctrine that would require a region to specialise in a particular set of industries.....but instead asks questions about whether a region would benefit from and should specialise in certain R&D and innovation projects....”⁶² While investing in industries or sectors like forestry or tourism is too broad and investing in particular firms too narrow, smart specialisation finds the “granular” middle ground by directing funding to groups of firms or research partners doing something new.⁶³ Trialling something new and “hitherto unknown” as Professor Foray puts it, is a key concept for smart specialisation,⁶⁴ as it helps to avoid the risks and inefficiencies of top-down investment. This approach promotes both regional diversity (exploring areas for research and development that form a region’s comparative advantage) and the creation and development of knowledge chains and spillovers across the economy. For example smart specialisation would not dictate a region invest in the “rocket industry” or the “boat-building industry,” but instead focus on supporting clusters of firms or even a single firm to explore the potential of composite

Box 1: Knowledge spillovers explained

There are four major theories of knowledge spillovers, illustrated in Figure 1 and discussed below. The solid arrows highlight direct market relationships, and the dotted lines represent potential types of knowledge spillovers, labelled 1-4.

Figure 1. Types of knowledge spillovers



Source: Author adaptation from Richard Grey et. al. (2005)⁵⁵ and Stuck et. al. (2016)⁵⁶

1. **Within-industry financial spillovers** occur when innovations by firms upstream or on the supply chain financially benefit downstream firms in the same industry. Firms will tend to cluster to take advantage of the above-normal profits gained through this process. In the example above, a grass research firm innovates, resulting in cheaper grass production by the grass producers, which then results in lower milk input prices that benefit the milk firms in the downstream industry. Here, the milk firms still sell the output product for the same price as they previously did but enjoy the spillover benefit of cheaper input prices without having borne the cost of innovation. These are known as pecuniary “Marshall, Arrow and Romer” (MAR) spillovers in the literature.⁵⁷
2. **Within-industry non-financial spillovers** occur when firms in the same industry are able to exploit a shared knowledge pool. The more firms co-locate, the more likely these spillovers will take place. In the example above, workers from one grass-growing firm will flow to another (and vice versa), taking their expertise and knowledge with them. In the literature these are known as non-pecuniary or non-financial MAR spillovers.⁵⁸
3. **Across-industry spillovers** occur when firms from different industries learn from one another. In the example above, innovations in local pest control in the grass-growing industry may spill over into the grape-growing industry which shares the same pest problems. In New Zealand, carbon fibre hull and sail technology from ship-building is now being used for fuel

tanks in the space rocket industry.⁵⁹ These are known as Jacobian spillovers, named after Urban Studies expert Jane Jacobs who showed how the automobile industry learned heavily from the shipbuilding industry.⁶⁰

4. **Across-society spillovers** occur when the different parts of the regional economic environment work together to form what is known as a Regional Innovation System (RIS). Unlike the previous MAR and Jacobian spillovers that occur within firms or across industries, a RIS “focuses on the effectiveness of the wider regional environment to generate synergies...”⁶¹ These synergies that are illustrated as number four above comprise how well entrepreneurs and firms interrelate within the wider regional system of institutions, including:

- *Education institutions:* higher and secondary education, including industry training organisations;

- *Workforce institutions:* Work and Income, Immigration New Zealand, WorkSafe New Zealand, unions, and employer organisations;
- *Public and private funding organisations:* publicly-funded Research and Development grants, university research funding, and philanthropic private funders of research;
- *Regulatory and political institutions:* local government, central government, economic development agencies, and legal institutions; and
- *Social and cultural institutions:* local iwi, hapū, charities, and not-for-profit organisations.

For example, participants in a RIS will be seeking to align education and industry training to local firm needs and then allowing others to learn from this process and build on the networks needed for this to occur. Similarly, firms will be seeking to engage with social and cultural institutions to enable better outcomes for their employees and build relationships that enable knowledge and innovation diffusion to and from other firms.

materials in their area of expertise, be it building rockets, building boats, or growing trees.

Further to this, Foray also outlines how regions should invest in activities that help push them toward diversification and structural change by following the principle of related variety.⁶⁵ Related variety means investing in activities “where innovative projects complement existing productive assets,”⁶⁶ but also diversifying and linking the region to knowledge that exists outside the region. So, taking composites once more, if a region has a natural advantage in the fishing industry, it should invest in exploring how composites or other innovations like nano-technology could be applied within that industry. Again, this would rely on strong knowledge chains and collaboration between firms and regions.

Time-limited funding

Finally in regard to funding, there is the need at the outset for “a self-destruction mechanism’ associated with all

priorities, through which support will be discontinued after a certain period of time has elapsed.”⁶⁷ This aspect of smart specialisation is a necessary measure to ensure that investment continues to be focussed on activities that are new and innovative. Even successful interventions should cease to receive smart specialisation funding after a few years, for example, as what they are doing is no longer new—there are no exceptions to this rule.⁶⁸ This helps minimise the potential for firms to become dependent on external funding and keeps investment on the cutting edge.

From theory to practice: the Provincial Growth Fund

We have mapped out the reasons why spatial regional development policy should be a policy consideration on top of traditional growth or “horizontal” innovation policy. We have also described the major aims and components of a smart specialisation strategy, offering a best practice model that minimises the inherent risks of spatial policy.

Given this best practice, we will now analyse and assess New Zealand's current regional development investment fund, the PGF, to see how it stacks up. We will start with a brief overview of the current PGF investment model, then undertake a side-by-side analysis of the current RAPs and explore how the funding allocated over the first 12 months aligns with these plans.

OVERVIEW OF THE PROVINCIAL GROWTH FUND

The PGF, officially launched on 2 August 2018, is a three year, three billion dollar commitment by the current coalition Government to support regional economic development. This represents a major increase in investment from the previous Government's Business Growth Agenda which had a spend of \$11 million per annum through Regional Growth Initiatives.⁶⁹ The upscaling has led to the establishment of the Provincial Development Unit (PDU), a cross-government team "that will lead the implementation and administration of the PGF" within the Ministry of Business, Innovation and Employment (MBIE) and an Independent Advisory panel to provide independent advice on a range of proposals.⁷⁰ We will now look briefly at some of the key features of the PGF.

Purpose

As set out in the Investment Statement for the PGF, "the primary objective of the PGF is to accelerate regional development through increasing the productivity potential of and contributing to more and better-paid jobs in the regions."⁷¹ There are five supporting objectives taken from the guide to the PGF entitled "Powering up Aotearoa – New Zealand's Regions:"⁷²

- creating jobs, leading to sustainable economic growth;
- increasing social inclusion and participation;
- enabling Māori to realise aspirations in all aspects of the economy;
- encouraging environmental sustainability and helping New Zealand meet climate change commitments alongside productive use of land, water and other resources; and
- improving resilience, particularly of critical infrastructure, and by diversifying our economy.

Parallel to this there is an additional operational objective: "to realise enduring benefits, in part by leveraging the capital of co-investors."⁷³ This means that operationally the PGF is seeking to co-invest in the regions, rather than simply dispersing grants, as this means that capital is returned to the PGF as investments pay off. This then enables "further investment in regional development or other government priorities."⁷⁴

Geographic scope

The geographic scope of the PGF, outlined and agreed to by Cabinet, has excluded some areas and prioritised others. New Zealand's three largest cities: Auckland, Wellington, and Christchurch have been excluded, unless the initiatives "are primarily for the benefit of the regions."⁷⁵ This means that urban lower socio-economic areas like South Auckland are excluded, although Helensville and Wellsford are seen as marginally included. Similarly, Porirua, Upper Hutt, and Lower Hutt cities outside Wellington are excluded, but Kāpiti is included and Wairarapa is marginal. In the South Island Christchurch city is excluded although Selwyn, Hurunui, and Waimakariri are included. New Zealand's fourth and fifth largest cities, Hamilton and Tauranga, are not excluded from the PGF, but the focus of any investments in these areas should be on benefiting the surrounding regions.⁷⁶

Other areas have been prioritised for PGF investment and have been labelled as "surge regions." These are: Tai Tokerau/Northland; Bay of Plenty; Tairāwhiti/East Coast; Hawke's Bay; Manawatū-Whanganui; and the West Coast.

Funding types

The PGF has three investment tiers, namely:

- Regional funding which aims to support economic development projects and includes feasibility and capability building projects identified by the regions themselves;
- Sector funding which targets high-value sector opportunities especially in the surge regions (including food and beverage, tourism and forestry via the One Billion Trees Programme); and
- Infrastructure funding aimed at enabling regions to be well connected from an economic and social perspective.

There are also three exclusions from funding:

- housing;
- water and large scale irrigation; and
- social infrastructure such as hospitals and schools.

Funding criteria, priorities and considerations

Aside from the geographic scope and surge regions above, there are a number of other key criteria for funding. Any funding initiative in question must:⁷⁷

- lift the productivity potential of a region or regions;
- create additional value and avoid duplicating existing efforts;
- link to regional priorities and have key local stakeholder support; and
- be well managed, well governed and have an appropriate risk/reward trade off.

There are also a number of operational ranking priorities and additional requirements. Projects that are multi-regional in scope will also be given priority,⁷⁸ and there is also “a strong expectation that region specific proposals will form part of a region’s agreed action plan...”⁷⁹ These RAPs are the regions’ own thinking on what regional development actions best fit the region. These will be discussed in more detail below.

Similarly, because of the operational objective to “realise enduring benefits” via co-investing, there is a 50 percent minimum co-contribution requirement for commercial and quasi-commercial projects. In addition, while considering a range of co-investing financial instruments—including grants, debt, underwriting and equity—debt is ranked ahead of grants and equity, as debt provides a higher “means for return on capital.”⁸⁰ There is also an additional requirement that all “major commercial projects with whole of life costs in excess of \$10 million will be required to submit a detailed business case using Treasury’s Better Business Case methodology.”⁸¹

All this suggests that different types of investments will be given different priorities, depending on the type of investment requested as well as the overall mix of non-commercial projects, quasi-commercial projects, and commercial projects in the investment pipeline.

Final funding authority

Cabinet has agreed that the final decision authority to fund individual projects depends on the dollar value of the initiative under consideration. Senior Regional Officials

(SROs) will make a final decision up to a limit of one million dollars. The RED Delegated Ministers group (the Minister of Finance, the Minister of Regional Economic Development, the Minister of Economic Development, and the Minister of Transport) can make a final decision to fund an initiative that is between \$1-\$20 million dollars. Cabinet has final decision-making responsibility for initiatives that are over \$20 million dollars.⁸²

Evaluation

At the time of writing the overall evaluation strategy for the PGF has not been made public—it is an ongoing stream of work. The goals of evaluation have, however, been outlined by Minister Jones: to “understand how the fund operates and contributed to regional outcomes; identify early markers of success; and identify opportunities on how the PGF can better achieve its outcomes.”⁸³

Having said this, a range of evaluation indicators and tools are outlined in various parts of the PGF investment strategy. Officials have been directed, for example, to track a wide range of indicators aimed at measuring a range of established outcomes.⁸⁴ Due to the time lag between data and evaluation and the difficulty of discerning causation, it is unlikely that it will be possible to observe any causative change in these indicators in the short term.⁸⁵

[t]he Fund is only one of the many factors that will contribute to regional outcomes, so these outcomes are not measures of the performance of the funds. Cabinet noted it will be at least 2-3 years after our investment before the improvement in regional outcomes will be observable and agreed that the success over the term of this government be measured in the terms of the effectiveness of the investment activity of the fund.

There is also a commitment to monitor the outcomes of each individual project, with “each funded project having a set of contracted outcomes” and officials have been tasked with assessing the “impact of our portfolio of investments at a more aggregated level e.g. by region, sector...”⁸⁶ Funding is generally provided on the basis of specific conditions being fulfilled and on the achievement of specific milestones. These funding conditionalities require ongoing monitoring to see if the conditions are being met.⁸⁷

COMPARATIVE ANALYSIS OF THE PGF AND REGIONAL ACTION PLANS

In this section, we will undertake a comparative analysis of how the PGF aligns with the RAPs. Detailed regional activity reports and regionally collaborative action plans have been critical documents that articulate the region's bottom-up strategies and now serve the additional purpose of outlining how the PGF might partner with regions to achieve its goals. These regional activity reports and action plans form a basis for a range of investment activity. The PDU will work with "each of the regions to help integrate national strategies and priorities with bottom up initiatives generated and owned by regional leaders."

This analysis is based solely on publicly available information as at 5 November 2018, encompassing the first 12 months of PGF operation, and, as such, is only part of what will be at least a three-year programme.⁸⁸ While this is necessarily an interim report, because of the proactive and voluminous release of information by the Government, we believe there is sufficient information to reveal some key insights so far.

The findings of this analysis serve as a test for the PGF, assessing how well it lines up with the best practice outlined above, whether it is heading in the right direction, and highlighting where gaps or potential improvements can be made. We note that updating the RAPs is a key priority for the PGF, one which we think is urgent. We also acknowledge the real world challenges involved in inter- and intra-regional planning in the updating of these plans. The existence of the PGF itself creates natural incentives for regions to compete with each other for resources, funding and investment, rather than collaborate. Finding a way to collaborate and share the benefits of spillovers will be a time- and resource-costly exercise. However, we hope that our analysis will inform and help guide these updates.

Method

Initial data collection on PGF funding and RAPs

We began our initial data collection by creating a synthesis of all available funding and planning information. Funding-wise, we copied a complete set of PGF spending information from the MBIE website on 17 September,

27 September, and 5 November.⁸⁹ This included both the information available from the overall summary page as well as information available via the individual regional pages. We then accessed the available planning documentation: the RAPs, regional activity reports, Cabinet papers, the latest Regional Development Weekly Reports, and Ministerial media releases for the funded initiatives.

Challenges and limitations of the data

Due to inconsistencies and omissions, the publicly-available PGF funding information required data cleaning:

- There were significant differences between the summary funding page and the details outlined under the individual region pages. For example, a total of 11 initiatives were listed under the Bay of Plenty region page on 27 September, but there were only 5 PGF funding initiatives outlined on the summary page. A similar story was found under the Hawke's Bay regional page;⁹⁰
- An additional initiative was located by cross referencing the PGF media announcements with the funding summary pages;
- Some multi-region initiatives were assigned to regions and some were not;
- Several initiatives appeared to have been double-entered in different rows of the summary funding announcement spreadsheet;⁹¹ and
- The dollar totals on the main PGF summary page did not match a summation of the individual initiatives included. Even with some trial cleaning to remove double entries and multi-region initiatives we were unable to find a total that matched those that were given.

These inconsistencies pose a challenge for analysis, and highlight how fast-moving the process is. More positively one could also argue that it highlights the speed and the somewhat proactive approach that MBIE has had toward the release of information as part of the PGF delivery process. However, given the commercial nature of much of the information there is still a significant time lag associated with the release of information and, as we shall see, significant gaps in information provision.

Snapshot of RAPs and growth studies

We pulled together all the data from the RAPs, regional growth studies, and Māori economic development reports from the MBIE website, or individual regional, council and other institutional websites. We found that 10 of the 13 regions included in the design of the PGF have publicly available RAPs.⁹² Two of these 10 regions had explicit Māori Economic Development reports, namely the Manawatū-Whanganui, *Te Pae Tawhiti*, and the Tairāwhiti, *Kimihia He Oranga*. The remaining four regions included in the PGF at the time of writing appear to be either developing RAPs (Otago) or remain silent on the topic (Nelson, Marlborough, and Tasman). While the three excluded cities (Auckland, Christchurch, and Wellington) all have economic planning documents in various forms (regional economic development strategies or long term planning documents), they were considered to be outside the scope of this paper. And finally, because knowledge spillovers are so important, we also gathered information on the previous Government's four regional research institutes/centres: PlantTech Research Institute in the Bay of Plenty, NZ Winegrowers Research Centre in Marlborough, New Zealand Institute for Minerals to Materials Research in the West Coast, and the Centre for Space Science Technology in Otago.

A qualitative regional development matrix

We then funnelled this data into a single matrix to support a comparative analysis. Each region's RAP was separated out into a separate column and then each initiative was placed in a row aggregated into broad sector and industrial categories. We found there were significant overlaps between categories depending on the nature of the initiative. Any listed explicit goals related to the initiatives like export volumes, population, Gross Domestic Product, or jobs goals were also recorded in separate rows. The PGF funding initiatives were then also placed in a regional column alongside their corresponding RAP, and then once again aggregated in rows by broad sector or industry. This enabled a PGF region and sectors, non-statistical "goodness of fit" and gaps analysis with the RAPs to be undertaken.

Findings from the regional development matrix: a comparative analysis

After putting the RAPs side by side, it becomes clear that they are largely regionally-siloed documents. Even though a number of similar initiatives are intended to take place in different regions, the plans don't appear to "talk to each other." They also largely ignore any links to New Zealand's largest cities and growth nodes. Having said this the Māori economic development reports were generally more collaborative. While opportunities for knowledge spillovers abound both across and within the regions it seems that the potential gains from synchronisation are largely ignored, and as such, lost.

RAPs are regionally siloed and increasingly out-of-date

While the RAPs are intra-regional collaborative documents by nature, they appear to have been written in isolation from each other. One reason for this may be that the documents have been authored over several years (2015-2018) rather than concurrently. It could also be because the documents almost always map well to their intra-regional "regional growth study," commissioned as part of the previous government's Business Growth Agenda which were also regionally bound by nature. Surprisingly, the regional research institutes were mentioned in their own region, but did not rate a mention in any other regions' action plans.

There are some promising collaborative initiatives

Having said this, there are a handful of notable collaborative initiatives or goals in some of the RAPs. Taranaki's Clean Energy Development Centre and H₂ Hydrogen initiative, for example, has a specific goal to connect with other countries and regions to seek opportunities to work together.⁹³ Similarly, Southland's aim to create an "age-friendly community in Gore [is] based on the concept developed for Levin in Horowhenua."⁹⁴ The Bay of Plenty offers another example of good collaborative practice, both in exploring who they could work together with in special interest tourism and in mānuka honey, and also through their connections to Waikato University in particular.⁹⁵ The regional neighbours of Tairāwhiti and the Hawke's Bay also both make mention of the Napier-Gisborne cycleway in their action plans.

There are limited regional links to New Zealand's growth nodes

Not only did the plans not seem to talk to each other, they largely ignored New Zealand's centres of economic activity. Indeed, only one report, *Te Pae Tawhiti*, the Manawatū-Whanganui Māori Economic Development strategy, explicitly aimed to connect with the economic activity in our major cities. By not including the three major centres of economic activity, namely Auckland, Wellington, and Christchurch, as part of the overall PGF strategy, there are very limited opportunities or incentives for the RAPs to cross-pollinate with initiatives from these cities. Partially countering this, PGF bids may include activity in the main cities if this helps to maximise the benefits to the associated regions.⁹⁶ At the moment however, it seems like this is a significant loss to the overall regional development strategy as the exclusion of the major cities undermines the ability of the PGF to co-ordinate or synchronise knowledge spillovers effectively.

Māori action plans tend towards a more collaborative approach

Interestingly the plans that stand out as having the most connections to other regions, are *Te Pae Tawhiti*, the Manawatū-Whanganui Māori Economic Development strategy, and *Kimihia He Oranga*, the Tairāwhiti Plan. Both plans explicitly acknowledge the "good intentions" of their respective RAPs,⁹⁷ but go on to say that they don't reflect Māori aspirations and values.⁹⁸ Overall, plans drafted by Māori tended to look at regional development in a different way that encompasses a broader or more collaborative focus.

There are good opportunities for collaboration

Looking across the plans, we also noted that while there is little sign of inter-regional collaboration, there is a high degree of similarity in apparent opportunities or initiatives worth exploring. For example, half of the RAPs make explicit mention of mānuka honey. Of those five, all aim at planting mānuka trees and three aim for processing facilities. Only one mentions working with other regions, and only one explicitly mentions establishing regulatory standards or intellectual property around mānuka honey production. This is a good example of where inter-regional collaboration and the building of knowledge chains across the regions could be explored.

Similarly, almost all the RAPs were looking for ways to improve regional tourism. While these initiatives are

often highly localised, this highlights once again how collaboration could well mean efficiency gains can be made, especially in terms of tourism infrastructure. For example collectively purchasing washroom facilities or agreeing on minimum standards for refuse disposal could well save individual councils re-inventing the policy "wheel." (However, it is also important to bear in mind that a wholesale investment in tourism is not without risks).⁹⁹

Some regions are already looking at ways to vertically integrate initiatives

This widespread use of mānuka honey not only illustrates the potential value of inter-regional collaborative connections, but also highlights that many regions are already looking to improving the forwards and backwards linkages between industry output and input needs. The one example where this occurs is the analysis of the skills and labour needed and hence initiatives needed to support the needs of the agricultural, forestry, or mānuka industries. Like the tourism example above, collaboration could reduce the waste and redundancy of each region investing in the same thing.

There is a desperate need for widespread infrastructure investments

Broad infrastructure pinch points are also highlighted. Almost all rural regions, for example, highlighted the need for the rural fibre (Ultra-Fast Broadband) rollout to be implemented. Almost all of the regions also highlighted a set of roading priorities, often linked to local industry needs. This underscores the complex nature of regional development and how having New Zealand-wide local input into these funding decisions is important, especially when the central government struggles to balance big city growth (with its headline-making commuter woes) against significant regional infrastructure needs.

Analysis of PGF funding and RAPs

Secondly when looking at the regional PGF funding beside the RAPs it becomes clear that the RAPs are in need of a refresh, that different regions are at different planning stages, and that while multi-region initiatives exist, the current RAP framework doesn't inform this funding very well because of the lack of overall co-ordination and strategy. We will discuss each of these findings in turn below.

The RAPs need a refresh

Timing is critical, and unfortunately, we found many of the plans are beginning to show their age, increasingly becoming out-of-date and less relevant to the current regional situation and needs. This is partly because the RAPs were mostly written within the previous Government's BGA and RGP, which, as already mentioned, had only limited funding outside of baseline. Because they were not written within an environment that included substantial additional funding, their scope was bounded, reflected in the limited and often overlapping nature of the proposals. Similarly, just because funding is now available doesn't mean that local and central government election cycles are synchronised. While the current PGF is running on a 3 year electoral cycle, not all local body election cycles are on the same timeframe and local planners may be reluctant or unable to enter into a planning phase if they are near to their own election timeframe. Indeed, sign-off on planning decisions may need to wait for incoming elected officials to take office.

In striking contrast to older plans, Taranaki, with the most recent action plan, appears to respond to the PGF extremely well and take a broader funding approach. We note with interest that the refresh of the RAPs is underway and seen as part of the PGF process, but also that the Government "will continue to progress proposals while this work is proceeding."¹⁰⁰ The need to deliver funding, it would seem, is overruling the vital need to synchronise policies between Government and the regions and across the regions themselves. We acknowledge that there are a range of real world challenges to overcome in regard to collaboration and synchronisation not least of which is the incentive the PGF in itself creates for regions to compete for funding. In our view this highlights the essential need for the PGF to be explicitly clear around its objectives in regard to collaboration and synchronisation.

Different regions are at different planning stages and this appears to have impacted the ability of different regions to receive funding

It also appears that some regions are at different stages in their regional development planning cycle and as such have been able to receive different value from the PGF to date. This means that regions on the planning frontier have been able to access funding, while regions who are relatively new to the process are struggling to receive funding. One can compare the rollout of the PGF

in Northland or Taranaki with Otago to see this stark difference. Unfortunately, in terms of co-ordination and synchronisation just because an application from a particular region is investment-ready doesn't mean it is the optimal investment overall to make. Quick funding wins are not necessarily the best funding decisions until they are found to be better than alternatives. At this stage it may be better to invest in capacity building across regions and to enable PGF frontier regions to inform more laggard regions in the development of their action plans.

Multi-region initiatives oddly highlight the lack of overall policy co-ordination

A third item of note is the priority given to and the existence of multi-region initiatives. Theoretically, when done well multi-region initiatives are one of the major ways that the PGF can unlock the innovation spillovers that potentially exist. This is because (as covered in the section above on knowledge spillovers) better inter-regional connections enable better local solutions to be found. As knowledge diffuses and opportunities for learning are broadened, previously embedded institutional settings can change. Good multi-region initiatives should enable systems and linkages between leading and lagging regions to be built. Important here is that each region will be both a leader and a laggard in different areas of expertise and so all regions can in theory realise gains from working together.

Unfortunately, rather than proving the theory correct it would seem that some of the existing initiatives like the Upper North Island Port study highlight the lack of multi-level governance, overall policy co-ordination and synchronisation. In the case of the Northport initiative it would seem its rather top-down nature combines with Auckland's exclusion from the PGF to mean that the regions involved are not working together. Indeed, it would seem that Auckland sees little to gain from being part of the wider regional development strategy.¹⁰¹ At a theoretical level one can easily see that excluding our largest cities from the PGF means they are not considering how to link to the wider regions and take part in the wider economic development and PGF strategy. Similarly for lagging regions, most RAPs are not considering how to best interface with these regional economic hubs. The partial coverage of the PGF is going to continue to lead to geographic tensions and lost opportunities.

Sector strategies need refinement

There is also a significant focus on sector-based funding, with many initiatives fitting within the food and beverage, tourism, and forestry sector focus of the PGF. It would appear that a number of funded initiatives have progressed without being part of any RAP process, a particularly common situation for forestry sector initiatives. Some of this risk should be mitigated via the application and assessment procedures of the PDU alongside the co-investment requirements of sector-tied funding, however, while the business case for an initiative may well stack up in isolation, it says nothing about overall co-ordination and how these sector-based strategies stack up against their respective opportunity costs. While not perfect, the RAP planning process is an important way to understand how a sector-based initiative could be placed alongside other initiatives in a region and wider regions. A key question here is how the sector initiative fits alongside all the other opportunities vying for attention in a region. Had all the opportunities been through the rigour of an action plan process what would be the most important long term investment? All this means that the evaluation of initiatives is especially important when the initiative is sector-based rather than regionally-based.

Regions are still almost entirely growth-focused rather than looking at using funding for transition purposes

The vast majority of regions are pursuing a growth-only focus to their investments. This continued focus on growth will be an opportunity missed especially given the long term demographic and ageing concerns for the wider regions.¹⁰² There are, however, a handful of transitional, non-growth funding initiatives outlined in the RAPs. Taranaki's Clean Energy Development Centre, aged care in Gore and Levin, and the widespread use of tree planting as a way to offset carbon emissions or soil erosion highlight efforts in this area. Greymouth has also received \$125,000 from the PGF to help the development of its revitalisation master plan.

Greymouth, with its long history of population decline and economic stagnation following the fall of the mining industry there, serves as a good case study for a wider range of communities needing to transition over the next 30 years. The community has self-identified a number of issues associated with lack of economic activity, density, and worn-out infrastructure (exacerbated by national-

level minimum earthquake standards).¹⁰³ A smaller, better, healthier, and more sustainable Greymouth, for example, might need funding for demolition, green space creation, or relocation initiatives focused on creating density. Now is the time to start making use of decline or transitional funding opportunities that are based on local co-design and governance, not to try to simply revitalise a place by arresting decline but to help enable a place to transition to something new. The use of smart decline options alongside more growth-focused initiatives brings us back to the underlying question about what we are trying to achieve via the use of the PGF. Is it to enable all places to reach their potential or to enable all places to grow?

Evaluation information is thin

While there is a plan to have an overall evaluation strategy as we outlined earlier, the publicly available information on the evaluation of individual projects remains extremely thin. We were, for example, unable to locate any proactive information release about the evaluation of any individual initiative thus far. Similarly, within the information collected there was no mention of evaluation budgets, or details of how a project may be evaluated over its life-cycle. This is despite Cabinet receiving the proposed operational criteria for the PGF in February 2018 in respect to governance, risk management, and project execution, which outlined that depending on the scale or size of the initiative there needs to be "potential exit gates and stop/go points, and a clear exit strategy."¹⁰⁴

However, while evaluation strategy is thin, it is not non-existent. Discussions with officials suggest that the PGF is making use of conditionalities within its funding arrangements, and this aligns well with best practice. We also acknowledge that there is a need to keep compliance and transaction costs proportionate to the funding available so as to not place an undue reporting burden on smaller initiatives.

There was also widespread use of ex-ante goals within many press releases associated with PGF funding decisions. A good example is from Minginui, where prospective funding "will allow Minginui Nursery to grow up to one million native trees every year and expand its current workforce from nine to 90."¹⁰⁵ The East Coast has set a similar well-designed goal, writing that \$500,000 in "[f]unding from the PGF will also help speed up the Mill's production capacity, which is currently only operating at 10 per cent, while also returning 50 jobs to the local

economy.”¹⁰⁶ The existence of ex-ante goals reflects at least to some extent the need for a business case to be developed as part of the application process. When it comes to transparency, however, there is no background information released as to how these ex-ante goals are established nor how they are to be monitored and evaluated over time.

It is clear that information on individual projects is being collected and reported to the relevant Minister in an ongoing monitoring capacity. This aligns with Cabinet papers assessing early proposals in Northland released under the Official Information Act. Sections of these papers related to governance, risk management, and project execution often include the following text: “Appropriate project governance and implementation plan to be agreed if initiative approved.”¹⁰⁷ This ongoing monitoring is also highlighted in the *New Zealand Herald’s* recent article into the Far North’s Ngāti Hine Forestry Trust, where documents also released under the Official Information Act show that the Government planned to plant 1100ha with pine trees this year and had ordered about 1,100,000 seedlings to meet its commitment.¹⁰⁸ Unfortunately officials later reported that as the condition of the land was revealed the “number of seedlings able to be planted collapsed to 191,000.”¹⁰⁹

It is also apparent that there is some front-end debate over the readiness of some investments, with an aide memoire from Treasury showing that the One Billion Trees “[g]rant scheme does not appear to be investment ready... [highlighting that] ...there is no detail around how many trees, or what kinds of trees will be delivered in the 2019 planting season.”¹¹⁰ Another instance was “Treasury urging Finance Minister Grant Robertson to reject a \$116m grant scheme because of the ‘lack of detail around grants’ and a \$127m partnership package, again because ‘little detail’ came with the Budget bid.”¹¹¹

CONCLUSIONS AND RECOMMENDATIONS

Perhaps we cannot raise the winds. But each of us can put up the sail, so that when the wind comes we can catch it.¹¹²

Having outlined best practice for regional development investment strategy and held the PGF up to this standard, we conclude that the PGF is a good place to start but requires adjustment to be fully fit for purpose.

There are many reasons for hope within the current model. From the analysis above, the PGF does align with best practice because it:

- is spatial in nature without dismissing a good horizontal policy base;
- has high-level objectives it is trying to achieve, like increasing the productivity potential of the regions;
- seeks to base a good proportion of its funding decisions on real input from regions and local knowledge;
- sets out ex-ante goals of individual initiatives and appears to be using conditionalities as part of its funding; and
- is in the process of developing an overall PGF evaluation plan.

The PGF, however, needs refinement if it is to bring about long-lasting positive change in the regions. Our research suggests that if it does not focus on innovation, synchronisation, and further evaluation, the real risk is that any long-term benefits to the regions will be lost. We acknowledge that this exercise is a point-in-time stocktake of publicly-available information following the first year's operation only. Luckily, this means there are potentially still years of delivery to go¹¹³ and as such, there is still time for change. Now is the time to make significant changes to the overall PGF strategy, giving it the best chance to make a positive difference in the regions while minimising the inherent risks associated with PGF-type funding.

To begin this process, we outline 5 overall conclusions and make 5 recommendations:

Conclusion 1: The current PGF strategy does not focus enough on capturing knowledge spillovers

While the PGF has done well to set some overall explicit goals, they do not include fostering and capturing knowledge spillovers across the regions as a way to improve regional productivity. Given the best practice smart specialisation theory outlined above and the acknowledged difficulties in actually fostering spillovers in the real world, we think this is a serious omission. While it is encouraging that the funding application process prioritises applications that are multi-region in scope, which could encourage regional collaboration, fostering and capturing knowledge spillovers is sufficiently important to warrant adding an explicit reference to this in the PGF's objectives.

Recommendation 1: Add an explicit objective to the PGF that aims to foster knowledge chains and spillovers across the regions

Conclusion 2: There is a concerning lack of collaboration and co-ordination across the current regional development strategy

There is a concerning lack of collaboration and co-ordination across the current RAPs, exemplified by the fact that the RAPs and funding decisions appear to be largely regionally-siloed and increasingly out of date. We note that updating the RAPs is a key priority for the PGF, one which we think should take higher priority. There is little point, for example, in five regions all separately developing mānuka honey intellectual property, or developing separate skills and training strategies. While a collaborative approach will require an ongoing effort, significant gains can be made from a more collaborative approach. As such the RAPs need to be updated and synchronised to avoid duplication and to maximise each region's strengths.

Similarly, the omission of New Zealand's major cities (or growth nodes) from within the wider PGF and RAP strategy (aside from where they are required to maximise a particular regional investment) compounds this lack of overall co-ordination and the ability to foster knowledge chains across the economy. We argue, therefore, that the proposed RAP refresh must include information about

the whole country, not just those areas included in scope for funding as part of the PGF. The knowledge spillovers and regional innovation systems theory suggests a key role here for central government to encourage these key regional collaboration linkages. The PDU alongside the SROs would be best placed to take a lead in encouraging these linkages either through the planning process or the PGF application process.

As such, we recommend that all regions, including those areas excluded from the geographic scope of the PGF, create or refresh their RAPs including a focus on seeking collaboration and co-ordination with reference to other regions. Where obvious synergies exist, regions should be required to show how they intend to work together. This will involve assisting some regions to upskill economic development planning. We acknowledge that this will be a costly and time-consuming exercise but one that we feel will reap long-term benefits.

Recommendation 2: Support all regions (including the major cities) to refresh or create RAPs, including opportunities to collaborate and co-ordinate with other regions.

Conclusion 3: A sector-based investment strategy that already picks certain sectors over others introduces undue risk

The current sector-based investment strategy in the PGF prioritises particular sectors like tourism, food and beverage, and forestry. This introduces inordinate risk to the success of the investment fund. Best practice highlights that using a sector-based strategy is too blunt a policy tool to overcome the inherent risks of spatial investment policy. Rather, a sector approach is most likely to default toward simply “picking winners” and thus choosing the most expedient over what is best. Already it would appear that some of the sector based initiatives appear to be at very high risk of failure due to a lack of due diligence. Similarly, encouraging broad sector investment also fails to meet the need to link investments to a discovery process of something new or hitherto unknown.

We thus recommend removing sectors as a basis for funding priority. Instead all investment activity should prioritise solutions aimed at the discovery of something

new, no matter the sector or industry. Part of this is to acknowledge that all initiatives need to be ranked and prioritised according to the goals of the regions and their potential to link the region to knowledge that exists elsewhere rather than being based on political urgency for action. The best process for this ranking and prioritising to occur is as part of the wider RAP development process.

Recommendation 3: Remove the priority given to sector tier funding

Conclusion 4: The “growth everywhere” focus limits the transitional opportunities associated with using both growth and decline initiatives to enhance overall wellbeing in the regions

Because growth everywhere is not a realistic or achievable goal, the PGF’s focus on fostering economic growth in the regions is a missed opportunity to enable some communities facing decline to consider how they might become smaller and better. Good spatial development policy focuses on both growth and decline policy options as a way to maximise wellbeing and transition toward a new future. Just as our growing centres need transitional funding to overcome congestion, density, and pollution issues, places in decline need transitional funding to enable them to become smaller, better, healthier, and more sustainable. This may require putting out-of-scope areas like schooling, housing, and health on the PGF funding table in response to local needs.

Recommendation 4: Refocus the PGF on regions’ potential, rather than their growth prospects, thus enabling transitional funding options for communities facing transition and/or decline

Conclusion 5: Evaluation and ongoing monitoring of significant funding initiatives are crucial to success but critically lacking

Good spatial regional development investment relies heavily on an effective, independent monitoring and evaluation regime to minimise the many risks associated with spatial policy tools. While there is a plan to evaluate

the overall PGF strategy, ex-ante goals associated with many initiatives, and conditionalities applied to funding decisions, the public need to know that significant funding decisions will be monitored and evaluated so that poor performing initiatives can be improved or if need be dropped and the money used more effectively elsewhere. It is concerning that there was no evidence of an evaluation budget associated with any significant funding decision and that there was no pro-active public release of monitoring or evaluation information aside from that obtained via the Official Information Act.

We therefore recommend that any initiative with a budget of \$10 million or more in total require an evaluation strategy to be developed and appropriately funded from within the PGF before approval can be given. This evaluation strategy and monitoring information would need to be pro-actively released to enable transparency.

Recommendation 5: Require any PGF initiative over \$10 million to have an evaluation and monitoring strategy developed and funded before approval can be given.

Overall

Over the last year, the PGF has moved from a coalition agreement announcement to a significant source of spatial investment in the regions. This level of investment is set to steadily increase over time as current proposals and initiatives in the approval pipeline meet approval criteria. As outlined above this is both an opportunity for change in our regions and a significant risk for New Zealand, the balance of which depends on how the PGF is implemented. A good investment strategy depends on us learning the lessons from our own history as well as current international best practice.

While the current strategy of the PGF shows promise, it needs to: focus on fostering and capturing knowledge spillovers; effectively synchronise regional development investments across the regions and with national development policy; and most significantly, avoid underestimating the well-known risks associated with spatial policy tools. The real world implications of this mean that the PGF needs to change its geographic scope to include our largest cities, refocus on knowledge spillovers, better collaboration, and policy synchronisation, and make use of a significantly strengthened evaluation regime. Without making these changes it is likely that many of the costs and downside risks associated with spatial planning tools will be realised and the potential benefits elusive.

Making the changes required will require the PGF to slow down from its current implementation trajectory and will mean pushing back against political urgencies. Ultimately, however, making these changes and ensuring that the PGF is a risk worth taking—rather than just a risk we are taking—might well unlock the potential of the regions, improve their resilience, and help people to overcome place-based constraints. It would be a shame if the significant opportunity cost of the PGF was compounded by the PGF being an opportunity lost for our regions.

ENDNOTES

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- 2 Ross and Goldsmith.
- 3 Fabrizio Barca, *Agenda for a Reformed Cohesion Policy* (European Communities, 2009), 11.
- 4 Etienne Nel and Teresa Stevenson, 'The Catalysts of Small Town Economic Development in a Free Market Economy: A Case Study of New Zealand', *Local Economy* 29, no. 4-5 (June 2014): 488-91, <https://doi.org/10.1177/0269094214535022>.
- 5 Manuel Trajtenberg, 'Can the Nelson-Arrow Paradigm Still Be the Beacon of Innovation Policy?', in *The Rate and Direction of Inventive Activity Revisited* (University of Chicago Press, 2012), 679-84, <http://www.nber.org/chapters/c12379>.
- 6 As highlighted in Julian Wood, 'Growing beyond Growth: Rethinking the Goals of Regional Development in New Zealand' (Maxim Institute, February 2017), 17-19, <https://www.maxim.org.nz/growing-beyond-growth/> the first major shift away from this place neutral policy occurred in the early 2000's with the desire to turn Auckland into a global economic hub or growth pole.
- 7 Dominique Foray, 'On the Policy Space of Smart Specialization Strategies', *European Planning Studies* 24, no. 8 (2 August 2016): 1431, <https://doi.org/10.1080/09654313.2016.1176126>.
- 8 Compliance costs are the costs of complying with government regulations, for example the costs of meeting tax regulations or statistical reporting requirements from Statistics New Zealand.
- 9 The previous National-led Government also, however, made some use of spatial regional development policy through the Regional Growth Programme, with the overall focus being on improving local knowledge through the generation of regional growth studies and regional action plans. In addition it created a number of regional research institutes and used the immigration points system to encourage regional migration.
- 10 The theoretical groundwork for these models has been outlined in Julian Wood, 'Growing beyond Growth: Rethinking the Goals of Regional Development in New Zealand' These "Circular and Cumulative Causation (CCC) models of regional growth were formalised by Dixon and Thirlwall in 1975 following on from earlier work of Kaldor in 1970 and Myrdal in 1957. See Robert J. Dixon and Anthony P. Thirlwall, 'A Model of Regional Growth-Rate Differences on Kaldorian Lines' *Oxford Economic Papers* 27, no. 2 (1975): 201-14; Nicholas Kaldor, 'The case for regional Policies,' *Scottish Journal of Political Economy* 17, no. 3 (1970): 337-348; and Gunnar Myrdal, *Economic Theory and the Underdeveloped Regions*, (London: 1957)."
- 11 Agglomeration is the effect that firm and worker concentration has on output; for more information see Stuart S. Rosenthal and William C. Strange, 'Evidence on the Nature and Sources of Agglomeration Economies', in *Handbook of Urban And Regional Economics*, vol. 4 (North Holland, 2002), 1082.
- 12 OECD, 'Innovation-Driven Growth in Regions: The Role of Smart Specialisation' (OECD, 2013), 18, <https://www.oecd.org/innovation/inno/smart-specialisation.pdf>.
- 13 Ron Martin and Peter Sunley, 'Path Dependence and Regional Economic Development', *Journal of Economic Geography* 6, no. 4 (2006): 399; Julian Wood, *Taking the Right Risks: Working Together to Revitalise Our Regions*, 2018, 4.
- 14 Fabrizio Barca, Philip McCann, and Andrés Rodríguez-Pose, 'The Case for Regional Development Intervention: Place-Based versus Place-Neutral Approaches', *Journal of Regional Science* 52, no. 1 (February 2012): 141, <https://doi.org/10.1111/j.1467-9787.2011.00756.x>.
- 15 Barca, McCann, and Rodríguez-Pose, 139 "whereby context here is understood in terms of its social, cultural, and institutional characteristics" .
- 16 See also the section on smart specialisation for a discussion of the role and benefits of multi-level governance within spatial regional development.
- 17 A potential example of this type of multi-level governance occurring in New Zealand came to light via personal discussions held within the review process for this paper with local and central government officials. The Canterbury Mayoral Forum initiative, supported by all South Island Mayors and Chairs, is to work together to develop a South Island Destination Management Plan that aligns with national tourism strategy. The interregional steering group includes senior central government officials and will work with a wide range of central government agencies including the: Department of Conservation; Ministry of Business Innovation and Employment; New Zealand Transport Agency; Tourism New Zealand; and Department of Internal Affairs.
- 18 Barca, McCann, and Rodríguez-Pose, 'The Case for Regional Development Intervention: Place-Based versus Place-Neutral Approaches'. Another example as outlined above may simply be that the local training institution has become disconnected from local employment opportunities and needs some additional transitional funding (that is not available via a simple per-student funding model).
- 19 This is not to say that raising the minimum wage so that employers to invest in more capital intensive production techniques is not a good thing, as this may actually improve local productivity and provide future employment resilience to a community over the longer term.
- 20 See Findings of MBIE Regional Economic Activity Reports cited in Julian Wood, 'Growing beyond Growth: Rethinking the Goals of Regional Development in New Zealand', 21.
- 21 Isabelle Sin and Steven Stillman, 'Economic Liberalisation and the Mobility of Minority Groups: Evidence from Māori in New Zealand', *IZA Journal of Migration* 5, no. 4 (December 2016): 2, <https://doi.org/10.1186/s40176-016-0049-z>.
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- 27 This wider discussion over the goals of regional development policy in New Zealand is still largely missing in action as New Zealand's attention has refocused on the delivery of the PGF.
- 28 Wood, *Taking the Right Risks*, 33.

29 Julian Wood, 'Growing beyond Growth: Rethinking the Goals of Regional Development in New Zealand', 25; P. Matanle and Y. Sato, 'Coming Soon to a City Near You! Learning to Live "Beyond Growth" in Japan's Shrinking Regions', *Social Science Japan Journal* 13, no. 2 (1 December 2010): 187–210, <https://doi.org/10.1093/ssjj/jyq013>; P. Matanle, 'Introduction: A Special Focus on Shrinking Regions', *Social Science Japan Journal* 13, no. 2 (1 December 2010): 183–85, <https://doi.org/10.1093/ssjj/jyq064>; Peter Matanle, 'The Great East Japan Earthquake, Tsunami, and Nuclear Meltdown: Towards the (Re)Construction of a Safe, Sustainable, and Compassionate Society in Japan's Shrinking Regions', *Local Environment* 16, no. 9 (October 2011): 823–47, <https://doi.org/10.1080/13549839.2011.607160>.

30 Julian Wood, 'Growing beyond Growth: Rethinking the Goals of Regional Development in New Zealand', 29–30.

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32 Wood, *Taking the Right Risks*.

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