



Australian Government

Commonwealth Grants Commission

**REQUEST FOR INFORMATION ON ECONOMIC
DEVELOPMENT NEEDS FOR THE 2010 REVIEW**

**STAFF DISCUSSION PAPER
CGC 2007/25-S**

JULY 2007

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BACKGROUND

- 1 At the July 2006 meeting with HoTs, the Chairman informed the States that he had asked staff to bring forward a paper on economic development. Western Australia had raised the issue briefly in its introductory remarks.
- 2 In the 2004 Review, Western Australia sought to have the Commission recognise an asymmetry in the calculation of relativities, where revenue capacity was fully equalised, but a range of State expenses which they considered contributed or related to that revenue capacity was not.
- 3 Western Australia was concerned about the mining sector where mining royalties were redistributed without there being adequate recognition of the expenses undertaken by the State in developing those revenues. Such an approach, it argued, created a disincentive for the State providing assistance for future projects that would increase the State's economic activity.
- 4 The Commission decided in the 2004 Review to assess such 'economic development' expenses equal per capita. The Commission considered that such expenses were policy driven and that underlying disabilities could not be established. There was a dissenting view by Commissioner Wiltshire who considered that some adjustments were both desirable and feasible.

STATE VIEWS

- 5 Western Australia has again raised the issue of economic development needs in its submission on other issues of importance. It argues that assessing such needs are essential for comprehensive equalisation to occur and that these needs are of particular importance to it. It notes that it has:
 - a young developing economy with much of its endowment (both natural resources and proximity to international markets) still relatively untapped, in terms of both direct exploitation of resources and the scope for viable value added activity as population size grows.
- 6 It notes that economic development is facilitated through:
 - the provision of public services (for example, education and health), public infrastructure (for example, roads, hospitals and schools) and support for essential services in remote areas (for example, electricity and water); and
 - direct assistance to industry through geological mapping, multi-user infrastructure assistance and primary industry research.
- 7 Western Australia argues that, as in other areas of spending, the assessment task is to identify the underlying drivers of need for industry development spending. It said that the Commission could either:
 - identify industry development spending and include it all in the Services to Industry category and develop a policy neutral disability factor assessment for this spending.

The size of natural endowments and population location characteristics could be used;
or

- discount the revenue assessments (preserving symmetry between the scope of expense equalisation and the scope of revenue equalisation).

- 8 In addition, Western Australia is concerned that the Commission's current methods do not remove the impact on revenue bases of differences between States in their economic development policies. It recognises that may be too difficult and says that a practicable alternative may be to use broader indicators of revenue bases that are less policy influenced than the bases themselves. Alternatively, the revenue bases could be discounted, in the same way that the Commission presently discounts policy affected expense factors.
- 9 Western Australia says that it will further consider these issues in its September submission.

COMMISSION VIEW

- 10 The Commission proposes to pursue its normal approach to decide how economic development influences will be treated in the 2010 Review. The Chairman, in his discussions with HoTs in early 2007, explained the Commission's broad approach and suggested that the treatment of economic development in the 2010 methodology be placed on the agenda for the HoTs meeting in November 2007. HoTs accepted this approach.
- 11 The Commission has not reached any decisions on how, if at all, an assessment of economic development expenses will be incorporated into the 2010 methodology. However waiting until after the HoTs meeting to collect data and State views on the technical aspects of possible approaches will unnecessarily constrain the time in which to develop suitable methodology.
- 12 This paper sets out how economic development issues could be reflected in the 2010 methodology, seeks from the States technical inputs on these approaches and data that would be needed to implement them.

POSSIBLE APPROACHES

- 13 The Commission recognises that all States pursue economic development policies. Those policies can work through State expenses, revenue and capital expenditure. Regardless of whether it was assessed on the revenue or expense side of the budget, it would be desirable for the approach to economic development to have the same impact on the HFE distribution. This argues for considering the role of economic development expenses in all three broad areas.

Expense assessments

- 14 Economic development needs may differ because States have different resource endowments and economic structures which require different per capita expenses for development or support. To develop an assessment of State expense needs, it would be necessary to consider

what economic development policies States are pursuing. The Commission considers that it would be possible to assess economic development needs in one category or as a disability in a number of categories.

- 15 **A separate category.** As proposed by Western Australia, the Services to industry category could be expanded to cover all State expenses on economic development and an appropriate assessment constructed. This would require:
- a definition of what would be included in the new category. We would welcome views on what a workable definition might be.
 - data. We would welcome information on how much States have expended on economic development in recent years. Information on how these expenses are accounted for in the GFS framework is also required¹.
 - views on potential disabilities and indicators to reflect those in the assessment.
- 16 **As a disability in existing categories.** We would welcome views on which categories States consider are materially impacted by this disability, how the disability would be measured and data to support that view. For example, Western Australia has noted a range of ways in which economic development is facilitated. Not all expenses would occur in the Services to industry category, and some may be in the Roads, Transport and the Services to communities category (water, sewerage, electricity).

Revenue assessments

- 17 Economic development can also be pursued through revenue concessions, either on the rate or on the base. States with greater economic development needs may be required to offer more concessions. If this is the case, then an adjustment to the rate or the base should be made to reflect this.
- 18 We seek State information on the extent of their concessions, by revenue source and if they are provided through variations to rates or through the tax base. This information will enable the materiality of these concessions to be measured and shape any subsequent assessment.
- 19 We also seek State views on how revenue assessments could be modified to incorporate an economic development disability.
- 20 Western Australia has raised concerns about the policy neutrality of revenue bases with respect to State economic development policies. We seek State views on whether revenue bases are policy neutral and, if not, how any non-neutrality could be measured and incorporated into the 2010 methodology.

¹ Note that information on economic development expenses in the Services industry categories is being collected in a Commission survey.

Capital

- 21 The Commission is yet to decide how capital needs should be incorporated into the 2010 methods. However, States could give effect to their economic development policies through capital provision. We seek information on the extent to which this has occurred, how that has happened and the expense areas in which it has occurred; for example, road infrastructure.
- 22 We also seek views on how an economic development disability might be incorporated into an assessment of spending on new capital.

CONCLUSION

- 23 The Commission proposes to discuss with HoTs whether and if so, how, an assessment of economic development needs should be undertaken in the 2010 Review. The information sought in this paper will be used to inform the discussion with HoTs in November. If the Commission is persuaded that a conceptual case for an assessment exists, it will then use the assessment guidelines to decide if a reliable assessment can be made. Evidence of materially different needs and a reliable method of assessing them would be required.