

Queensland Treasury Response to Commonwealth Grants Commission Discussion Paper 2006/02:

Location Based Disabilities

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1 INTRODUCTION

Queensland supports the review of location based disabilities in order to ascertain whether these assessments can be simplified. There may be some impediments to determining high level disabilities and appropriately measuring them. It remains unclear whether it will be possible to collapse the disparate elements of the existing assessments into a smaller group of conceptually coherent assessments. Nonetheless, Queensland supports the Commission undertaking this work on the basis that it may lead to a credible synthesis which can improve transparency and simplicity.

A more practical outcome may be the re-examination and possible simplification of existing location based disabilities. Undertaking such a task would rely on the cooperation of states¹ and their willingness to provide the Commission with evidence of the impacts of location based disabilities. Queensland would not be averse to the removal of some disabilities from the Commission's assessments where it can be shown that either the conceptual case no longer exists or that clear evidence is not available to support a robust and reliable assessment of the impact of the disability.

2 APPROPRIATE LEVEL FOR ASSESSING LOCATION BASED DISABILITIES

A broad case supporting the existence of location based disabilities can be made by acknowledging that there are different levels of demand for state provided services depending on location, and that the cost of providing services does differ depending on where they are delivered.

In paragraph 35 Discussion Paper 2006-02, the Commission suggests that an examination of location based disabilities will depend on whether efficiency considerations are going to be taken into account in implementing equalisation. The Commission met with Heads of Treasuries in July 2006 to canvass a broad range of issues regarding the architecture of Horizontal Fiscal Equalisation (HFE), including whether the Commission should include efficiency considerations in its assessment processes. Based on the outcomes of this meeting, Queensland considers that the Commission will proceed on the basis that HFE does not require efficiency to be treated differently to the way it was treated in the 2004 Review. That is, the Commission will continue to assume that all States operate at the same (average) level of efficiency.

Some of the dot points in paragraph 36 of the discussion paper appear to identify issues relating to the extent or degree of location based disabilities, rather than identifying whether a conceptual case exists. Queensland recognises that a conceptually valid disability may not be assessed where there are insurmountable methodological or data issues. In this regard it is anticipated that many of the questions posed in paragraph 36 will become valid if the Commission decides the most appropriate approach to assessing location based disabilities is to simplify existing methodologies.

¹ States in this paper refers to States and Territories, unless stated otherwise.

3 SINGLE ASSESSMENT

While a single broad assessment of all location based disabilities would be the simplest approach, there are significant hurdles to adopting such an aggregate approach. The most significant of these is the disparate nature of location based disabilities, with one disability recognising the impact of a dispersed population and another attempting to measure the impact of congestion. Further, other drivers of the current location based disabilities include distance from supply, community size, socio-demographic characteristics and private sector wages.

If the aggregate conceptual case is made, the main impediment to pursuing a simple single aggregate assessment for all location based disabilities is identifying a single broad measure that incorporates the impacts of all of the location based disabilities.

Queensland supports further examination of the ABS spatial price index (paragraph 42), but considers it unlikely that the index will provide an appropriate measure of interstate differences in the cost of or demand for state government services. The index will represent supply costs but will also be influenced by the level of commercial competition in the sale of the products contained in the basket. It is not likely that the index will capture differences across Australia for the provision of a standard level of state government services. Other elements of location based disabilities such as availability of services in remote areas, area allowances and travel times will not be captured through a spatial price index.

Queensland supports the Commission exploring whether big cities, rural and remote areas have identifiable, different costs levels (paragraph 43). This approach appears to be similar to deriving a cost weight for urban, rural, remote, very remote areas which occurs in some of the Commission's existing assessments. However, a single cost weight for a type of region (say, remote) may not be able to accurately reflect the location based disabilities in different remote regions and could also inadvertently include an element of population characteristics that may more appropriately be assessed as (for example) a socio-demographic composition disability. Also, to the extent that some current location based disability assessment methods suffer from poor or unreliable data, the broad cost weight approach may be similarly constrained.

While there does not appear to be a simple measure that would account for the different types of location based disabilities, the approach proposed by the Commission is worth pursuing, and may lead to simplification of the Commission's assessment of location based disabilities. Queensland will closely examine any proposal for a single assessment for all location based disabilities presented by the Commission.

4 SEVERAL SIMPLER AND BROADER ASSESSMENTS

Queensland supports the Commission exploring further the possible sub-groupings listed at paragraph 45 of the Commission's discussion paper. These three subgroups cover differences in prices, costs and demand faced by state governments in delivering services. However, the Commission should be aware that the overarching aim of simplification may not be served by such sub-groupings, or simplification may come at the cost of reduced transparency and reduced acceptance of the Commission's outcomes.

Problems identified that could hamper a single assessment of location based disabilities are also apparent in the sub-groupings identified in the discussion paper, in particular the difficulty in addressing the dispersion/urban influences dichotomy.

Paragraph 48 of the discussion paper suggests the use of a spatial price index to measure interstate price level effects. As noted earlier in this submission, Queensland considers that the use of a spatial price index for measuring differences in prices faced by states in the provision of state government services would only be appropriate if these indexes were made up of a basket of those commodities which are directly linked to the provision of state government services. Even then Queensland doubts that a spatial price index would completely capture the impact of location based disabilities.

Queensland does not support the notion that diseconomies of scale, as highlighted in a U-shaped cost curve, is applicable in Australia. There is little reliable evidence to support claims that cities with populations greater than 3 million necessarily face higher costs in delivering services. The Commission's inclusion of an urban influences disability in only four assessment categories in the 2004 Review suggests that it is not a major cost driver in the provision of most state government services. Given the relative importance of this cost driver in the Commission's assessments to date, it is not clear why paragraph 47 implies that 'congestion' costs may in future be an integral part of a broader assessment of all location based disabilities.

The suggestion in paragraph 10 of the discussion paper that it is only the differences in the proportion of the population that live in a region that are important in determining interstate cost differences neglects the impact of different population characteristics. For example increased demand for state government school services in remote locations may result from the absence of a private sector alternative. Similarly, the proportion of a state's population living in remote areas may be the same as that for other states, but if the age profile is different (eg, with one having a larger proportion of school aged children), then the cost of providing the service will be different – with the resultant differential in fiscal needs.

Paragraph 49 of the discussion paper suggests that some of the investigation could revolve around finding out which of the determinants of location based disabilities are important. It may not be possible to do this while at the same time attempting to create broad groups of location disabilities. Each determinant is important because they identify one or more aspects of the causes of increased costs of or demand for state government services.

Preferably, Queensland supports the suggestion contained in paragraph 49 of the Commission's discussion paper, that is, a more useful examination of whether it is possible to use sub-groupings of location based disabilities is to assess whether they are conceptually justified and empirically feasible.

5 SIMPLIFICATION OF EXISTING ASSESSMENTS

The most pragmatic approach for the Commission to fulfil its aim to simplify its methods may well be for the Commission to re-examine and simplify the assessment of existing disabilities. While Queensland generally supports the Commission's top down approach, this approach may not be able to deliver simple, transparent, reliable and acceptable assessment methods for location based disabilities at a broader level than the current methods.

Queensland supports a complete examination of the existing location based disabilities, with a view to simplifying them, by:

- examining the conceptual basis for a disability;
- determining an appropriate methodology for assessing a conceptually valid disability; and
- finding and using accurate, reliable and comparable data in any assessment.

States which seek to have an existing location based disability retained should provide evidence, preferably empirical, of its existence to the Commission. Similarly, those states that seek to have an existing location based disability discontinued should provide evidence to the Commission that identifies problems with the conceptual basis of the disability, or its measurement.

The following comments outline Queensland's position in relation to various elements of the location based disabilities identified in the discussion paper.

5.1 Isolation

Queensland supports the examination of the conceptual basis for the current isolation disability, and considers that the methodology and data used to support the existing assessment also require close examination.

Queensland accepts at a broad level the conceptual case that there may be additional costs incurred by some states due to distances of those State capitals from primary sources of supply - primarily the Australian south eastern seaboard. However, the underlying assumption used in the assessment of the disability that Sydney, Melbourne and Brisbane are the sole sources of supply for other States is questionable.

This underlying assumption also implies that Brisbane does not source its goods from anywhere else but Brisbane - similarly for Sydney and Melbourne. While this assumption might be largely valid, there would equally be many examples of where this would not be valid, for example Brisbane has no local motor vehicle assembly plants and has to import vehicles from Melbourne, Sydney, Adelaide and overseas.

While Western Australia, the Northern Territory and Tasmania, are relatively isolated from the south eastern seaboard of Australia, they need to provide tangible evidence of the impact of such isolation. Perth and Darwin in particular are closer to lower cost Asian markets than the South-Eastern States. The completion of the Adelaide to Darwin railway means that supplies coming from overseas may be travelling from the north of Australia to the south. Further, it is difficult to understand how Adelaide (730 kilometres from Melbourne) can have an isolation factor when Brisbane (930 kilometres from Sydney) does not.

Paragraphs 60 and 61 highlight the need for reliable data from the states on isolation costs. Queensland understands that the current isolation assessment uses limited and relatively outdated data from two states, mainly the Northern Territory and Tasmania, which is then used as the basis for estimating costs for other states. This is hardly ideal, and Queensland is concerned that the data used in the assessment do not accurately represent isolation disabilities, if they exist at all.

States that seek to make a better case for an isolation disability should identify the costs due to isolation based on the costs above the Australian average costs, not merely the costs associated with freighting goods or obtaining in their state. If states suggest there is a wage component to isolation costs, the Commission may need to establish whether these costs are already accounted for in the dispersion and input cost disabilities.

On this basis, the relationship between isolation costs, population and distance, identified in paragraphs 58 and 59 and Figure 1, is more likely to reflect historical judgements by the Commission, than to demonstrate a real and measurable relationship.

Overall, Queensland considers that there is a relatively weak conceptual basis for an isolation disability. The current assessment has serious methodological and data issues which, if not resolved, suggest that it may not be appropriate to continue assessing this disability beyond the 2010 Review.

5.2 Dispersion

A robust conceptual basis for the existence of a disability due to a dispersed population has been established and accepted for some time. The readily available and reliable empirical evidence supports the conceptual case and allows the Commission to apply a sound methodology to the assessment of the disability. However, Queensland acknowledges that there may be ways to simplify the methodology for the dispersion assessment in the 2010 Review.

The current method of assessing dispersion relies on three broad variables:

- The size of a state's population residing in rural and remote communities;
- The distance between these communities, the capital city and large regional centres; and
- The additional costs identified as dispersion related.

Queensland supports an examination of a simpler assessment framework which accounts for all of the variables outlined above. Omitting any one of them would lead to an assessment that does not reflect the dispersion-related needs of states. On that basis, Queensland does not support the use of Local Government Areas (LGAs) instead of Census Collection Districts (CDs), the use of remoteness measures alone or the use of population density as a broad measure.

Changing from CDs to LGAs would not simplify the assessment of the dispersion disability and would decrease the robustness of the assessment. Notwithstanding that LGA's are a construct of state legislation, and are therefore subject to policy choices of state government, in reality they differ significantly in both geographical and population size – both within and between states which could reduce the quality of the assessment. Broader geographical areas, such as LGAs, may not accurately reflect differences between rural and remote populations.

Remoteness measures, such as the State based Accessibility/Remoteness Index of Australia (SARIA), may be useful in simplifying the assessment framework for the dispersion disability. Sole use of a remoteness measure may not accurately reflect dispersion costs. Similarly, the use of population density as a sole measure of dispersion may not be accurate. Population location (how widely dispersed) and population density are elements of why a state may face increased cost in providing services, but another vital element is the distances

between communities outside capital cities and major regional centres. It may be possible to simplify the dispersion assessment by using a cost weight for areas (incorporating distance) and a measure of remoteness.

Queensland supports the Commission exploring the idea of a simple empirical model with the main variables including populations in rural and remote communities and the distance from the states capital cities or major service centres (paragraph 74).

Queensland supports the Commission re-examining the impact of ICT on the costs of and demand for state government services. However, it is useful to recall several points from the 2004 Review that may not have changed, including:

- in many cases where ICT has been introduced, it has not replaced existing services, but enhanced them – for example, access to a central police data base in a remote community;
- as more sophisticated services are made available through the use of ICT, community expectations increase;
- there are very few instances where services can be solely delivered through ICT – regardless of communications technology, hospitals, schools and police stations (and associated staff) are still required;
- the advantages of providing remote access services are often offset by set up costs and the technical expertise required by both the sender and the receiver.

There is no evidence to suggest that the introduction of communications technology in any sector has served to ameliorate the disabilities associated with dispersion. As a consequence, there is no evidence to suggest that the conceptual basis for this disability has been eroded by the introduction of ICT.

5.3 Urban Influences

Queensland supports examining the conceptual justification for recognising urban influences in the 2010 Review. However, the inability of states which claim to be affected by this disability to provide clear and compelling evidence suggest that it may not be appropriate to continue assessing this disability beyond the 2010 Review.

There is insufficient evidence to demonstrate the existence of diseconomies of large scale in Australia, particularly to the extent asserted by New South Wales and Victoria. Also, the argument in relation to greater complexity of service provision for large cities, such as Sydney and Melbourne, has not been clearly demonstrated or measured. However, if an urban influences disability is to be assessed, the measurement of its impact would need to reflect reality. For example:

- The use of capital city population size assumes that urban influences only affect capital cities and not large regional towns. There are instances where some states' large regional towns are larger than other states' capital cities.
- The use of states' shares of population that is urban or capital city based will indicate there are more urban influence needs in Canberra than there are in Brisbane. Yet the population of Brisbane is greater than that of Canberra.
- There is no evidence that a centre with a population of say 3 million people has greater urban costs of a centre with a population of say 2 million people. An assessment based on population size would need to be carefully examined to ensure it reflected a real disability.

6 USE OF EXTERNAL EXPERTISE

Queensland recognises the benefits of using external expertise, where it is appropriate to do so. There do not appear to be any areas at this point of the 2010 Review that require the use of external experts. There may be more scope for the use of external experts as the Commission formalises its assessment categories and the methods it proposes be used in the 2010 Review.

Queensland considers that external experts should not be engaged to determine assessment methods, but rather to provide advice and guidance on whether the methods proposed and data to be used are robust and reliable. Commission staff are better placed to identify and develop new assessment methodologies because of their greater expertise in the field of applying the HFE principles.

External experts in fields such as statistical analysis or public policy rarely have detailed knowledge of or experience in the field of HFE, which can limit the usefulness of their reports where they are asked to develop new, or test the validity of existing, assessment methods.

Queensland does not wish to nominate an external expert to undertake work on location based disabilities at this time.

7 CONCLUSION AND FURTHER WORK

Queensland generally supports the top down process the Commission proposes to use to simplify location based disabilities, as it is consistent with the approach being used to determine the appropriate assessment categories for the 2010 Review.

However, it is not clear to Queensland how the disparate elements of the existing location based disability assessments can be addressed in broader assessments. A more practical outcome may be the re-examination and possible simplification of existing location based disabilities. Queensland supports the Commission seeking simpler assessment methods, and recognises that simpler assessments are likely to require better evidence from states that seek to have the disabilities recognised.