

EXPLORING THE FRONTIER OF HORIZONTAL FISCAL EQUALISATION AND REGIONAL DEVELOPMENT: *REGIONS AGAINST REGIONS?*

Dr Chris Berry
Manager, Local Government Structural Reform
Department of Local Government*

The views expressed in this presentation are the views of the author and do not represent the views of the Government of Western Australia or the Department of Local Government.

Overview

- allocation of GST grants to the States
 - impact of the State's mineral developments
- a 'plug' for WA's case
 - greater recognition of the infrastructure costs associated with mineral and gas developments
- regional dimension to assessing allocations
- Focus on the regional - allocation of grants to LG
 - impact on the Pilbara region
- Region against region?

Vertical fiscal imbalance and horizontal fiscal equalisation

- ◆ **VFI - financial resources of government don't match expenditure responsibilities**
- ◆ Commonwealth grants to States:
 - ◆ \$74B in 2007-08 (includes \$1.9b for LG)
 - ◆ includes \$42B in GST Grants
- ◆ averaging 50% of state revenue
- ◆ WA will receive \$3.3B in GST Grants
 - ◆ 8.1% (population share would be 10.2%)
 - ◆ Forecast to reduce to 5.7% by 2012-13
- ◆ **HFI - capacity differences among States (& LGs)**

The Commonwealth Grants Commission

- ◆ Recommends to the Commonwealth on distribution of GST revenue grants to the States
- ◆ HFE basis - definition

" State governments should receive funding from the Goods and Services Tax revenue such that, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the capacity to provide services at the same standard."
- ◆ Equalising fiscal capacity -
not performance or outcomes or regional services
- ◆ CGC review of relativities every 5 years, due 2010

The HFE Debate

- ◆ History of reinterpretation of HFE
- ◆ Judgements by CGC - States frequently disagree
- ◆ Independent assessment commissioned by NSW, Victoria and WA
- ◆ Review of Commonwealth-State Funding - reported in August 2002
- ◆ For WA, an opportunity to query if the large transfer of resources out of one of Australia's most prospective regions is inhibiting national development
- ◆ 2010 CGC Review

The Pilbara and the HFE Debate

- ◆ Massive resource development - huge private sector investment - also significant State government investment and assistance
- ◆ Remote region, distant from population centres, labour and services
- ◆ Significant benefits to the State, but high costs of development and on-going costs.
- ◆ WA Government and Commonwealth have benefited significantly from development.
- ◆ Development led to decline in WA funding share
- ◆ Q: is this outcome reasonable and sustainable for the national economy?

State Net Fiscal subsidies 2007-08

- ◆ WA Treasury analysis measures the fiscal subsidy WA provides to the Federation
- ◆ Total Commonwealth revenues derived from the State exceed total Commonwealth outlays
- ◆ Reflects WA's relatively higher tax contributions (esp. company tax) and relatively lower share of social security and health benefits and lower Commonwealth spending.

State Net Fiscal subsidies 2007-08

No ACT figure is provided in this table. "It is assumed that the ACT exists only to serve the federation and that if the federation was dissolved the ACT would cease to exist. Commonwealth expenditures and revenues attributed to the ACT have been allocated among the States according to population shares." (WA DoTaF)

2007-08	\$m	\$ per capita
NSW	4,637	668
Vic	607	115
Qld	-2,137	-504
WA	8,204	3,832
SA	-5,221	3,275
Tas	-5,221	-6,056
NT	-3,089	-14,214
Australia	0	0

WA case to CGC reviews

- ◆ WA accepts CGC role in redistribution
- ◆ Presented the case that CGC redistributes the returns without properly recognising the costs of development

WA case to CGC review:

Burrup example

- ◆ State investment **\$160M** - common user infrastructure: transport corridors, port, power, water
- ◆ Estimated income benefits to WA **\$450M**.
- ◆ CGC assesses only part of expenditure needs, *net loss* to State after redistribution to **\$60M**
- ◆ Other States fiscal benefit \$450M without investment or risk
- ◆ Commonwealth benefits directly \$600m, but its contribution is less than the State's

WA case: Ravensthorpe

- ◆ BHP Billiton Nickel Mine, south of Kalgoorlie
- ◆ \$2 Billion BHP Billiton investment
- ◆ Officially opened May 2008
- ◆ State investment **\$55M** :
 - ◆ transport, port, power, water
 - ◆ state royalties expected \$20M per annum
- ◆ Commonwealth investment **\$11m**
- ◆ Closed January 2009
- ◆ WA accepted the investment risk
- ◆ If it was successful, other States would have received the fiscal benefit without investment or risk

WA case to CGC review

- ◆ CGC processes create a disincentive for States to invest in projects that improve economic activity.
- ◆ Independent Review found this affects national performance - CGC redistributes benefits of economic development without sharing the costs ...
- ◆ “dulls incentives for growth promoting policies”

WA case to CGC review

- ◆ Gaps in CGC assessment of economic development costs needs to be addressed.
- ◆ WA suggests assessment of a standard rate of return on appropriate development activities

Other issues

- ◆ higher costs of providing water/power/sanitation/transport for sparse population
- ◆ infrastructure demands on fast growing economies
- ◆ needs for multi-user infrastructure
- ◆ need for subsidised services for regional development

WA case to CGC review

- ◆ Currently 90% of new royalties redistributed
- ◆ Other States argue WA would be the only winner from a change in CGC approach
- ◆ WA says it is not unreasonable that its costs be recognised
- ◆ CGC draft report for 2010 signalled some recognition of State capital requirements, but not economic development costs

Western Australian Infrastructure Fund

- Rudd Government election commitment.
- Fund to be established, using Commonwealth revenues from the Gorgon / Pluto gas projects.
- Used to invest in State economic and social infrastructure projects over the next 20 years.
- When fully operational, the fund would have Commonwealth contributions of up to \$100 M.
- Fund yet to be established....

The regional dimension

- ◆ current CGC system doesn't favour regions, people living in regions
- ◆ there are differences between levels of services in regions, differences entrenched in CGC model
- ◆ HFE about equity of States, not equity of people or regions
- ◆ Independent review
 - "remarkable that the current system emphasises the importance of horizontal equity yet does nothing to address disparities in access to services between regions within States"
 - "is it equitable for the CGC to compensate a recipient state for higher costs of delivering services in its capital than the average of state capitals, when the standard of non-metropolitan services is well below that level?"

The regional dimension: "Royalties for Regions" in WA

- ◆ Established at the end of 2008
- ◆ Commitment to return the equivalent of **25 %** of the State's mining and onshore petroleum royalties' revenue to regional Western Australia,
- ◆ \$619m in 2009-10
- ◆ Giving people in the Regions access to better services and facilities, support for the Regions to grow and develop, to continue to be seen as a world class location for resource development

HFE and local government

- ◆ Commonwealth funding \$1.9 billion in 2009-10
- ◆ Allocated through State Grants Commissions
- ◆ *Local Government (Financial Assistance) Act 1995* for the purposes of improving:
 - ...
 - “the capacity of local governing bodies to provide their residents with an equitable level of services ...”
 - Therefore, does address regional needs

HFE and local government

◆ National Principles

- ◆ effort neutrality
- ◆ minimum grants,
- ◆ other grant support,
- ◆ Aboriginal people and Torres Strait islanders
- ◆ the identified road component
- ◆ HFE: *" a basis that ensures that each local governing body in the State is able to function, by reasonable effort, at a standard not lower than the average standard of other local governing bodies in the State".*

Estimated 2009-2010 FAG Entitlements

2009/10 Estimated Entitlement	General Purpose ('000)	% share	Identified Road Funding ('000)	% share	Total ('000)	% share
New South Wales	433,719.9	32.6%	171,448.7	29.0%	605,168.7	31.5%
Victoria	330,233.7	24.8%	121,829.3	20.6%	452,063.1	23.5%
Queensland	267,457.2	20.1%	110,719.5	18.7%	378,176.7	19.7%
Western Australia	135,343.9	10.2%	90,354.8	15.3%	225,698.7	11.7%
South Australia	99,209.2	7.5%	3,247.9	5.5%	131,685.1	6.9%
Tasmania	30,748.0	2.3%	31,315.4	5.3%	62,063.4	3.2%
Northern Territory	13,596.7	1.0%	13,842.5	2.3%	27,439.2	1.4%
Australian Capital Territory	21,437.0	1.6%	18,948.6	3.2%	40,385.6	2.1%
Total	1,331,745.7	100%	590,934.7	100%	1,922,680.4	100%²⁰

Local Government (Financial Assistance) Act 1995

- ◆ Reviewed by CGC in 2000
- ◆ Findings included in terms of reference of the current House of Representatives Standing Committee on Economics, Finance and Public Administration Inquiry into Local Government and Cost Shifting (the Cost Shifting Inquiry).
- ◆ Inquiry Proposed a simplified formula, centralised allocation (i.e.. Worked out in Canberra)

Minimum grant requirement

- ◆ Requirement that councils not get less than 30% of what would have been allotted had funding been distributed solely on population basis.
- ◆ 2008/2009 WA: 31 councils received minimum grants (\$19.02 per capita).
- ◆ Accounted for \$30.8m of the \$136m equalisation funding pool (and 75% of the State population).
- ◆ Conversely, majority of funding (\$105m) is distributed to the remaining local governments, mainly in non-metropolitan areas, with 25% of the population.

Minimum Grant Councils 2007-08

	Minimum Grant Councils	% Population
NSW	21	25.3%
VIC	7	14.5%
QLD	2	36.7%
WA	31	75.3%
SA	21	55%
TAS	1	10%
NT	1	35.8%
ACT	NA	-
Australia	84	31.9%

Addressing regional needs

- ◆ Financial assistance grant system for local government goes a long way to addressing regional needs, for local governments in regional areas are generally big winners.
- ◆ In particular, the four Pilbara local governments are recipients of equalisation grants, reflecting their relatively **weaker** capacity to raise revenue and higher operating costs relative to State averages.

Western Australian Group Shares of FAGs 2009/2010

Region Shares	Population 2008	Total GP Grants 2009/10	% of state total	Grants per capita 2009/10	% of state total
GASCOYNE	9,668	6,617,510	0.40%	\$684.48	4.90%
GOLDFIELDS-ESPERANCE	58,074	9,445,911	2.70%	\$162.65	7.00%
GREAT SOUTHERN	57,439	6,630,644	2.60%	\$115.44	4.90%
KIMBERLEY	34,185	13,778,159	1.60%	\$403.05	10.20%
MID WEST	53,741	15,430,814	2.50%	\$287.13	11.40%
PEEL	99,252	4,768,028	4.60%	\$48.04	3.50%
PERTH	1,587,278	32,231,920	73.10%	\$20.31	23.80%
PILBARA	45,983	10,523,271	2.10%	\$228.85	7.80%
SOUTH WEST	152,087	9,632,011	7.00%	\$63.33	7.10%
WHEATBELT	73,490	26,285,595	3.40%	\$357.68	19.40%
TOTAL	2,171,197	135,343,863	100%	\$62.34	100%

Pilbara local government rate revenues and FAGs 2007/2008

	Residential rates	Commercial rates	Industrial rates	Mining rates	Pastoral rates	Total rates	Total FAGS
Ashburton (S)	2,389,715	581,487	191,034	943,060	166,266	4,425,157	3,793,915
East Pilbara (S)	1,789,415	195,298	339,972	2,240,232	233,070	4,797,987	4,464,194
Port Hedland (T)	6,186,608	1,751,300	771,389	527,725	48,405	9,370,030	2,388,182
Roebourne (S)	6,816,002	2,063,045	914,506	428,743	59,607	10,281,903	3,300,467
Pilbara total	17,181,740	4,591,130	2,216,901	4,139,760	507,348	28,875,077	13,946,759

- Agreement Acts limit rates payable on most major mining and industrial developments
- Shires generate more rates from residential sector than rest combined.
- Kmart biggest ratepayer in Shire of Roebourne – despite \$Billions of industrial infrastructure on Burrup.
- Councils are recipients of significant FAGs, when they would be minimum grant councils if all developments and infrastructure were fully rateable.

Interstate comparisons

	Population 2008	General Purpose Grant per capita	Road Grant	Total Grant
Ashburton (S)	6,604	450.15	1,101,288	4,074,047
East Pilbara (S)	7,597	394.13	1,381,543	4,375,756
Port Hedland (T)	13,375	143.2	598,367	2,513,685
Roebourne (S)	18,407	128.88	648,335	3,020,683
Broome (WA)	15,386	158.69	672,472	3,114,054
Charters Towers (Q)	12,506	368.81	2,103,762	6,716,055
Katherine (NT)	9,912	64.52	543,826	1,183,331
Broken Hill (NSW)	20,001	190.46	421,280	4,230,597
Kalgoorlie-Boulder (WA)	31,716	29.34	1,313,011	2,243,597
Mount Isa (Q)	21,570	95.88	1,144,072	3,212,151
Swan Hill (V)	21,765	161.78	1,623,016	5,144,249
Alice Springs (NT)	27,481	32.22	830,716	1,716,170
Whyalla (SA)	22,801	188.66	327,955	4,629,627

Reasons for grant differences?

Local Government	Area (Sq. Km)	Road Length	Rawlinson's Construction Index	Index of Socio-Economic Disadvantage (ABS SEIFA) (2006)	Accessibility and Remoteness Index (ARIA)
Ashburton (S)	105,647	2554		1063	11.4957
East Pilbara (S)	378,533	3039		936	11.6046
Port Hedland (T)	11,844	919	145	988	9.7447
Roebourne (S)	15,196	900		1033	9.8545
Broome (WA)	56,000	848	155	928	10.7461
Charters Towers (Q)	68,388	4359	120	933	4.5509
Katherine (NT)	7,421	173	142	958	6.8922
Broken Hill (NSW)	170	211	127.5	912	3.4331
Kalgoorlie-Boulder (WA)	95,228	1330	125	1007	9.8242
Mount Isa (Q)	43,343	1179	145	975	8.8347
Swan Hill (V)	6,116	3096	102	959	3.702
Alice Springs (NT)	327	246	116	1002	6.1739
Whyalla (SA)	1,026	273	113	887	2.9406

Conclusion

- Place for FAGs to address vertical and fiscal imbalance
- Role of CGC is accepted, but
- ... WA calling on the CGC to make fair recognition of its development costs as well as its revenues
- Mixed blessings in grant arrangements for the regions

Viagra to counter funding cut

CONCERNED about the static or shrinking population of your town(s)? Mayor Elcio Berti could well have the answer. As mayor of the small town of Bocaiuva do Sul (population 10,000) in southern Brazil, he is determined to boost its population. No matter what it takes.

Last November he tried to forbid the sale of condoms and the contraceptive pill. "But they said my condom ban was unconstitutional and a health risk

so I have to think of an alternative," said the enterprising mayor. Has he ever. In July of this year he decided on another tactic: supplying free Viagra to the men of the town.

What is driving his worship to such extreme lengths (no p[un intended)? If he encourages the town's people to procreate, he says, the population will increase and so the town will receive bigger government handouts.

As matters now stand the town has been told by the state government that

it is likely to suffer a 33 per cent funding cut, a decision the mayor insists is linked to the town's static population.

"Expenses are going up and revenue is falling," explained Mayor Berti. "There is nothing else I can do but turn to Viagra."

He plans to spend \$60,000 on 1000 boxes of the drug, but has run into a couple of obstacles. One is that he has been told he cannot spend public money in this way. The other is the reaction from the town's would-be recipients. "At the end of the day he is calling us flaccid," said one outraged local.

Undaunted, the mayor says he will pay for the Viagra and distribute it personally. He said he knew 90 per cent of the townspeople and so didn't expect to get any amorous

freeloaders from adjoining towns.

But this is proving easier said than done. When he contacted the Viagra distributors they told him that he could buy only three packets, the limit for one person. The only way to buy more is through Brazil's health service which is against his idea.

Even if Viagra did not help grow the town to 12,000, the mayor said his plan would still have been worth it because the publicity it gained was drawing attention to the plight of small towns throughout Brazil which are losing their populations to the cities. The problem is compounded by the state giving this as a reason to slash its Municipal Participation Fund which results in reduced levels of service - and further depopulation. ■

Council-run