STANDING COMMITTEE ON
ESTIMATES AND FINANCIAL OPERATIONS

INQUIRY INTO THE ROYALTIES FOR REGIONS POLICY

TRANSCRIPT OF EVIDENCE
TAKEN AT PERTH
MONDAY, 9 MARCH 2009

SESSION TWO

Members

Hon Giz Watson (Chairperson)
Hon Ken Travers (Deputy Chairman)
Hon Brian Ellis
Hon Sheila Mills
Hon Helen Morton

Hearing commenced at 3.17 pm

McLURE, DR MICHAEL
Senior Lecturer, Economics,
University of Western Australia Business School,
sworn and examined:

The CHAIRPERSON: Dr McLure, on behalf of the committee I would like to welcome you to the meeting. Before we begin, I am required to ask you to either take the oath or the affirmation.

[Witness took the oath.]

The CHAIRPERSON: Could you please state your full name, your contact address and the capacity in which you appear before the committee?

Dr McLure: My name is Michael Thomas McLure. My contact address is the University of Western Australia Business School. I appear in the capacity as an academic of that university.

The CHAIRPERSON: You would have signed a document entitled "Information for Witnesses". Have you read and understood that document?

Dr McLure: Yes, I have.

The CHAIRPERSON: The proceedings are being recorded by Hansard. A transcript of your evidence will be provided to you. To assist the committee and to assist Hansard, if you could please quote the full title of any document that you might refer to during the course of the hearing. Please be aware of the microphones and try to talk directly into the one closest to you. I remind you that your transcript will become a matter for public record. If, for some reason, you wish to make a confidential statement during today's proceedings, you should request that the evidence be taken in closed session. If the committee grants your request, any public and media in attendance will be excluded from the hearing. Please note that until such time as the transcript of your evidence is finalised, it should not be made public. I advise you the publication or disclosure of the uncorrected transcript of evidence may constitute contempt of Parliament and may mean that the material published or disclosed is not subject to parliamentary privilege.

Dr McLure, would you like to make an opening statement?

Dr McLure: Yes. Thank you. I see my participation in this committee meeting today to primarily answer any questions that occurred in considering my paper. I might just initiate the discussion by reiterating the two points that are of concern to me. I think that when a budget is being brought down, going from a circumstance where issues are not dealt with on a regional basis or a geographically defined basis to where they are being dealt with on a geographically defined basis, we have to ask ourselves carefully: do we consider the subglobal aspect or do we consider the budget in total? I think, with regard to the royalties for regions program, we are imposing a geographically-specific element in the budget, but it is subglobal—it is only dealing with part of the entire budget.

My central goal is to make sure that the reporting of fiscal arrangements is done on a global basis between the regions and the metropolitan area. The rationale there is so that discussions about the desirable level of cross movement of resources from one region to another are about policy and initiatives and not about facts. We do not have the facts available at the moment to know the net transfer of those fiscal resources from centre to regional, regional to centre. That is the rationale from the accountability side.

I am also concerned that we partially, I suppose, account for our assets in the balance sheet, which does not include the value of natural resources to the state. In effect, when we sell those resources, the value of our balance sheet would diminish. My suggestion is that we should be at least making sure that resources that come into the state in the form of royalties are allocated for capital purposes so that our notional, if you like—notion of our net balance sheet—shows no loss. The issue here is we do not have the capacity to value our stock of mineral resources and try and include a balance sheet which includes the value of natural resources. But as a sort of a minimum where we do have the information, I believe we should be looking at a requirement to make sure that there is no net depreciation in the state's assets, for current and future generations, and therefore allocate amounts to capital accounts rather than those funds be used for recurrent expenditures. That is, in a nutshell, my concern.

The CHAIRPERSON: Can I just clarify that for my own thinking—because the royalties reflect a return on a non-renewable resource, that that should then be expended on capital to kind of keep the notional capital equal?

Dr McLure: That is exactly right. I am suggesting that there is some notion of a stock of wealth that the community as a whole holds, some of it is in physical capital, or infrastructure and the like, and some of it is in natural resources, and that is the property of our generation and future generations. When part of that is depleted, be it even physical stock, or be it resources, there should be some attempt to make sure that the total stock itself does not decline over time. A requirement along the lines that I am suggesting, I think, would achieve that. I should also add that it is not an onerous thing, to the extent where that should be a minimum requirement. That is just maintaining stock of wealth that the state of Western Australia has at its current level and any forward looking view would actually be trying to increase the stock of wealth over time. I do not think what I am suggesting is even controversial; it is just a relatively conservative proposition.

[3.20 pm]

The CHAIRPERSON: Although, of course, the challenge in that is that the natural resource is very hard to put a dollar value on, whereas an ore body is probably easier.

Dr McLure: Yes. I suppose implicit in what I have said is that the dollar value we put on the form of resource rent and royalties is their correct value. It is contendable that it is not the correct value —

The CHAIRPERSON: Especially when you look at forests.

Dr McLure: Yes, yes.

The CHAIRPERSON: But then that is another story.

Dr McLure: Yes.

Hon KEN TRAVERS: On that point, you suggested it would be quite hard to do that, but identifying the value just in terms of the royalty streams of the known reserves, could certainly be easily done, could it not?

Dr McLure: That would impose relative degrees of difficulty about the value. It assumes that the world price is a given price, which you generally do when a certain amount of quantity is tradable. If we were suddenly to trade large quantities, if we wanted to dispose of our entire stock of natural resources next year and replace it all with something else—I mean, it will not happen, but if it did—that would affect prices. So, when you get large variations of sales you are going to influence the world price.

Hon KEN TRAVERS: But a private sector organisation, a mining company, for instance, that has a mining lease, they will actually have carrying in their books the future value to the company of that lease. They will attach a value to that and that will be based on the current price and then they may hedge it a bit, but their accountants will go away and determine a value to be put in their books for that asset.

Dr McLure: In principle, could that be applied to the state's assets?

Hon KEN TRAVERS: And then the state would apply their share, which is effectively the royalty component from iron ore, the six—whatever it is—cents.

Dr McLure: I understand. Look, the issue I suspect for the state is that as prices fluctuate, its stock value—the value of its stock of natural resources—will go up significantly from one year to the next or down significantly from one year to the next. Ideally, when you are looking at this in the very long term, particularly from one generation to the next, you are trying to get some relatively stable value. What you are proposing could be done, I just have a concern about how fluctuations in those values from year to year due to international market values changing for minerals—how that could be managed in the public sector. It would just mean that the balance sheet would need to be viewed but there is a degree of volatility in it which is outside the government's control.

Hon KEN TRAVERS: But how do the companies put a value on it?

Dr McLure: Look, I do not know. I am not a —

Hon KEN TRAVERS: All right; sorry.

Just on the point that you are making, are you aware of the Alaska Permanent Fund?

Dr McLure: No.

The CHAIRPERSON: We will not ask you tricky questions on that then!

Hon KEN TRAVERS: Just in summary, as I understand it, that actually provides that 25 per cent of the royalties goes into a fund like a future fund, then only the profits of that fund are used; the actual asset base is separately maintained in perpetuity. Therefore, you cannot eat into the principle, only the annual —

Dr McLure: The earnings of it.

Hon KEN TRAVERS: — earnings.

Dr McLure: Okay. No, I am not aware of that fund.

Hon KEN TRAVERS: Would some process like that come anyway to meeting the sort of issues that you are addressing?

Dr McLure: It could be done in many ways. It could be done just through a requirement for the equivalent amount from the general government revenues to be allocated to capital equal to the sum value that is associated with the value of your royalties. Alternatively, you could establish a separate fund. There would be more than one way of achieving that end.

Hon KEN TRAVERS: Going back to your earlier comments in terms of allocating how it is spent in the regions versus the total budget, to get meaningful figures would you also, if you went down that path, have to go back at least a couple of previous budgets and go through and notionally allocate that so you actually get some sort of baseline so that you can record it into the future in a meaningful way?

Dr McLure: I think that is correct. We need some sequence of events because we might have an abnormal year one year, but looking at an ideal, it would be appropriate to get the pre-royalties for regions period and post-royalties for regions period in a long enough time to know what that policy has actually achieved. That probably could be done. There are complexities with this, as I have sort of mentioned in my paper, that the first thing is the spill over effects. Any benefit that is provided in a region may have benefits for people in the metropolitan area and any benefit provided in the metropolitan area may well have benefits for people in regional areas, so there is a conceptual issue. However, I do not believe they are insurmountable; they have been fully faced by the state government in its own reporting on spill over effects between states, so I think those can be generally handled on a reasonable basis. Perhaps the grants commission's applications for doing it too is another complexity which the government is well-placed to deal with because data is collected by the Commonwealth Grants Commission through the state treasuries and the state treasuries know what that data is and how they use it to make their assessments. It should be feasible to break that down to regional and Perth areas to isolate the grants commission implications.

[3.30 pm]

I mean, of particular importance here is that when we talking about, say, revenues for regions, we should be allocating to the regions that part of the GST which is due to dispersion costs and costs that are high unit costs in dispersed areas, which the grants commission recognises and compensates the states for through increases in their GST share. Some of that GST should be allocated specifically to the regions for that reason. Similarly, when we look at our own revenue bases, some of our revenue bases may be above average and may need to be reduced. So those grants commission implications need to be accounted for, too. It is a technical thing, but it can be done, and it can be done relatively easily. The government has the capacity to do that.

Hon KEN TRAVERS: You have opened up a really interesting area that I think is a particular issue for Western Australia. To some degree, is not the cost of living factored in in other ways? For instance, housing prices are lower in regional areas than in metropolitan areas. Therefore, the higher cost of living in regional areas is actually compensated for by things such as cheaper housing, which is a big component of a person's expenditure. One of the problems for Western Australia on a national basis is that in areas such as Port Hedland there is also the secondary factor of supply and demand, which pushes prices up, yet it still may be a cheaper place to live than many areas on the east coast, where housing prices are higher, and people are paying more in GST because the cost of goods is higher. I do not know if anyone has ever done any economic modelling to see whether that is a factor. I am not explaining it very well, but you seem to indicate that you know what I am talking about.

Dr McLure: There are two points that probably need to be teased out. One is the impact on the distribution of the GST, which is related to costs faced by the government only. That is what the grants commission's modelling will do. The state government, in having to provide schooling in dispersed areas, has a disability dispersion, and the grants commission takes that into account when allocating the GST revenue. Over and above that is the general fact that GST will be paid in different shares across the states. The GST in Western Australia may be more than our per capita share because of the reasons that you are suggesting, where you have different costs, and the cost base will the base on which the GST is going to be paid. On that latter issue, I am not aware of anyone having done any work along the lines that you are suggesting. The grants commission itself implicitly assumes a per capita basis. That per capita share is a neutral amount, but we know that a greater amount of GST will be collected in Western Australia than its per capita share, reflecting greater activity, and possibly higher prices, too. I am not aware of anyone having done any modelling of that effect.

The CHAIRPERSON: You said that it is important that the net fiscal transfer between Perth and the regions be reported on. Can you elaborate on that? There is also an argument that that is a policy decision. Can you elaborate on why you think that is important?

Dr McLure: For me, the critical issue here is basic facts—and I consider that a fact should be reported on—because they help the policy position to be debated. No one person has the answer on what the policy position should be. That goes through a process that culminates in Parliament and in legislation. However, the discussion that leads to that is only effective when there is agreement on basic facts. At the moment, there is certainly no agreement on the basics facts as to who the net beneficiaries are in Western Australia of the fiscal decisions of government. I certainly do not know. I have heard many arguments put both ways. The problem is they are all partial arguments. You can think of many examples where Perth benefits from events in the country, and vice versa. That is important to me, because ultimately it affects the welfare of the community. Welfare economics, where I work, looks at what is the most important benefit for the community as a whole. It is not just gross state product maximisation. Usually there is an element of ethics in how it is distributed and where the benefits occur. The sorts of outcomes and processes that lead to that result will only work when there is transparency and disclosure of information. I think that is the problem with the current arrangement. It is arguable that this should be done even without royalties for regions. I say that because suddenly a new policy has been introduced which makes geographical region a policy criterion. If that is going to be a policy criterion, then I would argue that it should be done on a global basis across the whole state and not just for one particular policy, otherwise you will be in danger of misleading again by looking just at a partial picture rather than the whole picture.

The CHAIRPERSON: I just want to get your thoughts on this. If a key criterion is population, what other factors, if any, should be included in that to reflect disadvantage or special needs? Is there a formula that should be applied?

Dr McLure: Within the regions in general?

The CHAIRPERSON: I assume that to use population as a stand-alone criterion is too crude, because you might have a population in Mt Barker that is very well off as opposed to a population in Warburton that is not so well off.

Dr McLure: It would depend on whether it is recurrent or capital expenditure. I am arguing that it should be capital. Before I came to this meeting, I had a look at the mid-year review of the state government, and I noted that about half of the funds that are allocated will be allocated for recurrent expenditure. Of those funds that have been allocated for recurrent expenditure, if it is deemed that education is a priority, you would not look just at population shares but you would look also at relevant population shares in the relevant age group. You would look at other factors as well to see whether there is a disadvantage associated with that. You would look at all the things that the grants commission takes into account; that is, where the dispersion and the low numbers need to be compensated for in additional funds. It is the same with health. You would look at the relevant age groups for which a higher degree of care is required. Not everyone across a certain age range will need the same level of service, but the older people are, the more likely it is that they will need a greater level of care. So you would start from a basic position of looking at the relevant populations where the health demands are the greatest, and you would then start adding secondary criteria, such as the relationship between health provision in Perth and in the regions. For example, if the people in a region are flown to Perth for treatment, you would not be compensating the region. However, if you decide that it is appropriate that the people in a region are treated in the region, close to their families, then that would be reflected in the cost model. The region size would also be relevant. My preferred position, though, as I have said, is that these funds should be allocated for capital. I say that given that the government has decided that half of these funds will be allocated to capital and half will be allocated to recurrent expenditure. My preferred view is that there should be something in the strategic framework of government that requires capital expenditure in total not to drop below the total level of royalties that are collected in the state. Therefore, it may not come directly from the royalty stream because it has been committed under royalties for regions for recurrent expenditure in regional areas, but at least it should be allocated from other parts of the budget.

I should indicate—I am not sure of the proprieties, so you can advise me—but this for me started with a letter that I wrote to the Premier, and the Premier wrote back. If you think it is appropriate, I am happy to give you a copy of the Premier's reply, because it is a very considered one.

The CHAIRPERSON: That was one of my questions, actually!

Dr McLure: I have brought copies for everyone, so I can distribute those.

[3.40 pm]

The CHAIRPERSON: Thank you.

Dr McLure: In brief, two major points are made. Basically, the Premier has declined my suggestion and supported it on the basis of two arguments. The first one is to say that to report on a regional basis to show the net fiscal flow between Perth and the regions goes beyond the warrant of government. He thinks it is not necessary for government to do that and suggests that perhaps this could be done as an academic exercise because it might have interest to the community, but not be done as a public reporting process. My response to that is that I am sure there would be interest in the academic community to doing that sort of thing, but we do not have the data. The only people who will have data on the allocation of particular government funds across regions on the expenditures side will be government. The second point I would make is that the greatest level of expertise in dealing with the types of adjustments which are associated with the grants commission exercise are clearly within the state Treasury. They regularly make submissions to the Commonwealth Grants Commission and are very well regarded around Australia—that is the group that operates out of the WA Treasury. The actual expertise for this is largely within government. Two things: one, academics do not have the information; and, two, the actual practical knowledge is located in government. And I suppose, thirdly, the whole point of this is an argument about not just something for academic merit; it is an argument about what is good public policy reporting. To have good debate and to make informed decisions, the management of government needs certain information—and that is my rationale.

The second point which is made, which is a very interesting point, is that the value of mining royalties to Western Australia, after you take account for the Commonwealth Grants Commission effects, is about $1 billion. I cannot remember which year; I think it was current year 2008-09.

The CHAIRPERSON: Yes.

Dr McLure: Virtually, that says that Treasury has the capacity to take the raw revenue figure and readily adjust it to an amount, after an adjustment for GST; so that is an interesting figure. Then the comment is that, well, the state government as a whole is already spending well and truly above that. It will spend $2.5 billion; therefore it is not necessary to have this requirement for funds to be allocated to capital along the lines that I am suggesting. My response to that is that that is it in aggregate, but you should also look at the regions versus the metropolitan area; you might not get that result when you look at the regions versus the metropolitan area. It may well be that in the regions, less is being spent than what is appropriate or the other way around. I do not know the answer. The second thing is that capital is a notoriously lumpy item in government. When I look at the mid-year review, it may well be that the budget is showing real long-term concern with the credit rating staying at AAA because of the high level of debt that is going to occur in the next few years—going beyond the 47 per cent limit that is shown as part of their fiscal strategy. When times get tough, it is likely that capital is going to get pared back to try and maintain things like credit ratings. So, although for the moment, there is a very clear balance in favour of capital outlays that need not be the case. And the last point is one that I made earlier. This is just the minimum. This is just maintaining a stock of wealth of the state; it is not growing it over time. The government, I mean, ideally, should have in their fiscal strategy, along with low taxes and expenditure growth at a certain rate, some guide to having the balance sheet grow at a certain rate so that there is a benefit, a growth in the government, going through for people across different generations. And that would not be picked up in the process. So, I acknowledge all that is in the Premier's letter; it is all very considered and worked through. I just still have not changed my mind after considering the views that the Premier put.

Hon KEN TRAVERS: What is your understanding of the term "retained royalties"?

Dr McLure: Okay; it means when we get a certain quantity of royalties, a good portion of that, the majority of it, is redistributed to other states by our GST revenues being reduced. So, what I am calling "retained royalty" or what the Premier is calling "retained royalty" is the royalty that is left after our GST has been reduced for our high levels of royalty collections.

Hon KEN TRAVERS: I am asking you because my understanding is that it may be one billion this year, but because there is a lag time in that, part of our problem is that in four years' time our GST payments will be reduced because of the royalties we are receiving now, even though our royalties may be reduced at that time as well, if there is a downturn in global production. So, that one billion is in this year, and that one billion could potentially be redistributed over the next four or five years—couldn't it?

Dr McLure: To answer, firstly, I did not do the calculations so I am not aware of the total basis for what the Premier has done. But what I would expect that they would have done is the grants commission reviews and gets to calculate royalties which apply in year one, which is based on an average from seven years ago to two years ago, so it is a five-year average, and then apply it. So what you are saying is there is a long lag between what the grants commission assesses and when those relativities apply to distribute the GST among the states. But what has changed essentially, is the size of the GST pool. The GST pool would have risen over time. You could look at the amounts of what they call revenue needs—Western Australia would have negative needs from minerals because it has a greater capacity to raise revenue than elsewhere—as applied to that five-year period and then see how the average pool of GST grants has changed from one year to the next, and then apply it—net that off the total amount of royalties in any one year. That would be how I would have calculated it, but I am not sure that that is what was done in the Premier's office.

Hon KEN TRAVERS: Theoretically, you could end up with the scenario in the next four or five years where although you may have retained royalties of one billion this year, over the next four or five years you could end up, in theory, with a negative where you are actually losing $200 million per year, through that lag effect.

Dr McLure: Yes; it is a legitimate concern that Australia is going to have been in the greatest boom it has ever had in my lifetime and when it is possibly in the greatest bust is when the relativities will apply from the boom in that period. So you are right. There is a time-lag issue and how it needs to be worked through. What will apply in a few years' time will be based on an average in the past. There is an adjustment, which is the one I described as the pool in the GST changes from the average period in the grants commission's assessment to the current period, but that does not take into account the actual change in the structure of economic activity that has occurred in that period—which is why there is the difference.

Hon KEN TRAVERS: And from your understanding, is there any mechanism for them to identify, if royalties just completely crash, and readjust those figures or are they, under the current formula, always required to have that two and seven-year —

Dr McLure: Not to my knowledge—under the current conditions, that is it. Extraordinary times, sometimes, lead to extraordinary results. That would be something discussed at COAG or, unless you were the council dealing with the allocation of GST —

Hon KEN TRAVERS: But it is not that extraordinary because royalties are one of those things; I mean, commodity prices have traditionally been highly cyclical in their nature. We are going through potentially extraordinary times, but even without that the cyclical nature of royalties would still potentially leave you to have one year of net "retained royalties" and then, over the future, a negative "retained royalties" figure.

Dr McLure: If the average is over a five-year period, which it is, then those swings and roundabouts from one year to another will be okay and cancelled out. The danger is where you have an out-of-phase that has occurred over—that is, when the current phase over five years is different to the phase that occurred seven to two years ago; when one is up and one is down. It is a very particular set of circumstances that require a very bad outcome. So, five good years from seven years ago to two years ago, followed by five bad years from now to the year out, is a potential scenario for where we are at the moment, but it is not a regular potential scenario.

The CHAIRPERSON: While we are dealing with the response you received from the Premier, I noticed that you also copied your letter to the Leader of the Opposition—am I correct?

Hon KEN TRAVERS: Treasury.

The CHAIRPERSON: I must remind myself who it was. It was the Leader of the Opposition and also to the Leader of the National Party. Did you receive responses?

Dr McLure: I received a response from the Leader of the National Party expressing his interest. I did not receive a response from the Labor Party.

Hon KEN TRAVERS: Just out of fairness, did you receive one from the Leader of the Greens?

Dr McLure: I received an invitation to submit something to this committee!

Hon KEN TRAVERS: That was a cross-party invitation—that one!

[3.50 pm]

The CHAIRPERSON: You said in the paper that great care will be needed to ensure that the operational details of the royalties for regions program is sustainable in the sense that it does not deprive future generations from sharing the benefits of WA's current royalties. You touched on that a bit, but could you elaborate a little bit more on that?

Dr McLure: Okay. It goes back to the point I made in the very opening comment that the stock of wealth of the state is the stock for now and for all generations. It is the community's over time. If one generation is to treat the next equitably in an economic sense—and it is a narrow economic sense which I mean here—then it is an obligation for us to make sure that any stock of wealth that we consume in one form or another is replaced by another stock of equal value. Economists generally would not say we do not do anything; we just have to retain it as it is, and you can transform it how you like as long as the aggregate value that is passed from one generation to the next does not diminish. My concern with the royalties for regions program is that part of it is being spent not on recurrent, so there is a potential for it to diminish. It is a fair point the Premier makes—that the total expenditure is higher than what royalties for regions is. It is a valid point, but I still think that over time, that will not necessarily be the case because there is no fiscal framework requirement for this to be maintained. I also firmly believe that documentation of these things is appropriate and useful for reflection that this is what we have done with our royalties; this is where it is.

The other point which I make is that royalty values typically appreciate over time in real values. If you put money into a port, it will typically depreciate fairly quickly if it is being used. There needs to be a record of this over time so that if things are depreciating and there is actually a real decline in values, you have the records which will show you and make remedial action as you go. If you do not have records and you just assume that we are going to allocate a certain amount to capital and there is no framework within which that amount is allocated, there is a risk of not identifying problems that can occur in terms of intergenerational equity.

The CHAIRPERSON: And is the problem solved if the fund was used only for capital rather than recurrent expenditure, apart from the comment you just made about the depreciation of certain capital assets?

Dr McLure: I think so, but I am sympathetic to the view that the demands—I suppose this is the policy context within which all this occurred and the demands for regions is not only for capital; it is for recurrent expenditures as well. If the royalties for regions scheme is to be set up that way and it has a recurrent element and a capital element, I believe there needs to be some requirement within the state budget somewhere that says at least the equivalent of what is spent under royalties for regions on the current exercise should be spent on capital areas elsewhere. I do not even think it would matter which area. It depends on where the priorities of the government of the day are. It may be in the metro area or it may be outside the metropolitan area.

The CHAIRPERSON: I am wondering about that comparison between the capital value of, say, the ore body in the ground versus the capital that you might then convert it into. You could do a dollar sum, but I guess there are other values as well. Is a sports stadium as valuable as a hospital, even though they might actually cost the same thing to —

Dr McLure: To the community.

The CHAIRPERSON: Yes, in pure dollar terms.

Hon KEN TRAVERS: A sports stadium is better for your health!

The CHAIRPERSON: Yes, that is probably true.

Hon BRIAN ELLIS: That could be debated.

The CHAIRPERSON: You usually die in hospital; that is the trouble!

Hon BRIAN ELLIS: You are meant to be going there for your health!

Dr McLure: I suppose that comes to the heart of how does the government allocate its priorities, which is a broader question —

The CHAIRPERSON: And complicated.

Dr McLure: — which probably goes beyond this, I suspect.

The CHAIRPERSON: Yes; I was not really expecting a definitive answer. It is just interesting how do you value that?

Dr McLure: I think there is probably an implicit assumption in my work that we have got the values right; that is, the value that we charge for a royalty reflects its social and economic value to the community, which would include an environmental value. Where there are traded goods and there is no environment then, usually, the market price is a pretty good indicator of the social price if there are no distribution concerns. But where there are traded goods and an environment as well and there is no marketing in environment, there are all sorts of imperfections that can occur. Government, in trying to set policy for the appropriate royalty rates, would be considering what is the appropriate social return the community needs, which would include that environmental part. They may get that wrong, because it is a difficult question and it is not something I have gone into to say whether the current spread across the royalty regime is correct. It is a legitimate question. It is just something which is at least as big as, if not bigger than, the royalties for regions program in itself. You could be fair to note that that is a weakness, if you like, in my paper in that I have made an assumption and I have not stated it; it is an implicit assumption. But if it is wrong, it means the intergenerational equity argument will be distorted by it because we are losing values to something which we do not currently account for.

Hon KEN TRAVERS: I guess my only final question was: in all of that, too, does there not need to be some assessment, if you are trying to make rational decisions about your allocation of your resources and your assets, about whether the spatial distribution of your economic infrastructure or your government structure is still rational? There are large parts of the state where we are still supporting communities and if you were designing them from the ground up today, you would not design them in that way, because there has been a range of changes in terms of the ability to travel, the communications ability, even the threshold that you need to provide services. Whether or not you need to actually do some structural adjustment to make those more rational, and I do not mean that in a —

Dr McLure: This comes down to history versus theory almost; does it not? Our economic development did not start with some plan and a theory; it emerged on a haphazard basis. There is simply no simple answer. For example, servicing many remote Aboriginal communities on a per capita basis for education would be just enormously expensive compared to in Perth. Do you do it? Yes, because there are other considerations. How you arrive at when you make the decision to support a community that is remote or whatever and/or not to support it, these are difficult questions and that comes to the heart of what you are saying. If you did it from a whiteboard from day one without history, you would not have it along the pattern that you currently have.

Hon KEN TRAVERS: In fact, I saw a quote from the Treasurer saying that he had been to the Kimberley and there were a number of Aboriginal communities that were uneconomical and that there would have to be some sort of rationalisation. I wonder why we look at that about an Aboriginal community, but you can make that same argument about a whole range of other communities which are called towns. Are you devaluing the asset even though you may spend $2 million on a new nursing post? It may not have that value immediately the day you open it if it is not servicing a reasonable population, and you need to try to have some process for determining that.

Dr McLure: I understand exactly what you are saying. The inputs into a decision of a government to do it are many and varied, and, on economic grounds, many times you would not make them, but on a broader range of criteria you do. The grants commission has a simple solution; because it is trying to compare across all states, it just says that if state governments do it then it is fine. If there is a high-cost provision to remote communities in the north of Australia—say, the Northern Territory, Queensland or Western Australia—that is standard policy. It assesses it on that basis. That is probably some indication that there is a social norm applying across Australia and it just accepts it as a social norm, not trying to rationalise what has led to that.

Hon KEN TRAVERS: Do you know if the Local Government Grants Commission process has that same approach?

Dr McLure: I do not. I have not studied the Local Government Grants Commission. I know generally what it does, but the methodology it employs, I do not know.

The CHAIRPERSON: I have a final question on the proposition of doing your accounting on geographical regions. Are you aware of examples of where that has been done?

Dr McLure: No, I am not, and I have given some thought to that, because obviously it is easier to learn from another jurisdiction. I think what is occurring here is that, in a policy sense, being geographic is to my knowledge unique, so what has occurred in that proposal is me trying to think through to the best of my ability what is the logical consequence of it. It is not by looking at models that exist in other parts of the world.

The CHAIRPERSON: So to your knowledge, this is a unique experiment in that regard?

Dr McLure: To my knowledge, it is. I should say that I am primarily a historian of economic ideas; I am always interested in public policy, but it is not my primary research. I did some work but could find nothing that was comparable.

Hon SHEILA MILLS: It is probably just call politics; that is what it is!

Dr McLure: Yes!

The CHAIRPERSON: Thank you very much for your attendance this afternoon. It has been very useful.

Dr McLure: Thank you; it has been a pleasure to be here and I am delighted to have been asked.

Hearing concluded at 4.00 pm