



**Response to
Staff Discussion Paper
CGC 2009/01-S**

**Treatment of Commonwealth
Payments to the States**

Department of Treasury and Finance

April 2009

1. Tasmania generally supports the proposals on the treatment of Commonwealth payments in the Staff Discussion Paper. In particular, we agree that:
 - HFE should be the predominant principle used in determining the treatment of all Commonwealth payments to the states;
 - generally speaking, payments that finance part of assessed state expenses and impact on fiscal capacities should have an impact on state relativities;
 - the Commission should recognise the impact of out-of-scope payments where these have a material effect on state fiscal capacities; and
 - backcasting should apply to reflect the major changes to payment arrangements agreed under the new IGA.
2. Tasmania considers that National Partnership reform payments will be the most difficult for the Commission to deal with.
3. Project payments are relatively straightforward and we agree that they should affect relativities in most cases (i.e. they should be treated by 'inclusion'). The vast majority of payments in existence prior to the November 2008 COAG meeting have simply been reclassified as NP project payments (from SPPs) and should, in general, continue to be treated by the Commission on the same basis as they have historically been treated.
4. NP reward payments are intended to reward states who achieve specified reforms. To be effective, these payments will need to be treated so that they do not affect the relativities (i.e. they should be treated by 'exclusion'). Otherwise, states who receive these payments would lose a part of them to states who do not receive them, so that the incentives for reform may be lost. This treatment is consistent with the past treatment of National Competition Payments.
5. We agree with the comments in the paper that some NP facilitation payments will affect state fiscal capacities and should, therefore, affect relativities. While the Intergovernmental Agreement on Federal Financial Relations sets the default position for NP facilitation payments to exclusion, in practice, it is likely that most NP facilitation payments will meet the criteria for the Commission to exercise its discretion and treat them by inclusion.

6. There are likely to be some facilitation payments that are genuinely intended to achieve reform, and situations where 'including' these payments might interfere with these reforms. This is particularly likely to be the case where a facilitation payment is made to only a limited number of states, or where there are large differences in state per capita shares of a particular payment. This would suggest that the intent of the payment is to assist particular states in achieving reform, or *overcoming* disadvantage. This is a different intent to the Commission's assessments, which simply aim to allow states to deliver an average level of services *taking into account* their relative disadvantages (or advantages), not to overcome them.
7. If such payments are allowed to affect relativities, the recipients of these payments will effectively lose any financial advantage and will not be able to achieve the reform without sacrificing service delivery elsewhere. This could be a major issue in overcoming indigenous or low SES disadvantage.
8. However, distinguishing the Commonwealth's intent with regard to particular payments is likely to be very difficult in practice. Most Commonwealth Ministers and their departments would likely argue that all payments made to a particular state (or states) are designed to improve services and address disadvantage particular to that jurisdiction, rather than simply being general support for state-type services. Given the likely ambiguity in most instances, in the interests of equalisation, the Commission should act conservatively and use its judgement where appropriate to limit the opportunity for states to avoid having a particular payment 'equalised away' by having it labelled as a reform payment, or distributed differentially.
9. Therefore, Tasmania supports the Commission using its discretion and treating all NP payments on a case-by-case basis.
10. Where the Commission decides that a Commonwealth payment should not affect relativities, we are not particularly concerned about how it achieves this (e.g. whether through old-fashioned 'exclusion', or APC or EPC assessments) as long as the outcome is the same.