



2010 Review

“Treatment of Commonwealth Payments”

Commission Position Paper 2009/03

Department of Treasury and Finance

November 2009

Tasmanian Position

- Tasmania supports the Commission assessing Commonwealth payments on a case-by-case basis according to the guidelines set out in Commission Position Paper 2009/03 and determining the treatment most consistent with maintaining the integrity of HFE.
- Payments that finance part of assessed state needs and impact on fiscal capacities should have an impact on state relativities.
- National Partnership reform payments will be the most difficult for the Commission to deal with. To be effective, untied reward payments will need to be treated so that they do not impact the relativities.
- Tasmania believes that Commonwealth payments through states to PTEs or direct to PTEs should impact on the relativities if the payment supports state-type activities. This is often clearly demonstrated through states requesting these payments from the Commonwealth and states jointly investing in projects funded by those Commonwealth payments.
- In respect of transport capital subsidies (or any other capital subsidy to PTEs), Tasmania believes that these needs have already been assessed through the net lending component of the Capital assessment. Through the net lending assessment, differential needs are recognised for state-held equity.
- With the “stock” produced by the capital subsidy having been distributed according to population growth, if the Commission were to also assess the “flow” of the capital subsidy through the Transport category (by population growth) this would be double-counting.
- This means that capital subsidies must be assessed EPC, and that the decision to do so is a deliberative one (because needs are already assessed). Further, because the decision must be a deliberative one, and needs are assessed, Commonwealth payments to PTEs must be allowed to impact on relativities, if the Commission is to allow certain payments to affect relativities in the investment component of the Capital assessment.

When Should Commonwealth Payments Affect the Relativities?

1. As a point of clarification, paragraph 9 of Commission Position Paper 2009/03, quotes Tasmania as encouraging the Commission to ensure that Commonwealth payments intended to respond to historical backlogs or unmet needs not affect the relativities.

2. This does not accurately reflect Tasmania's position. In our response to CGC Staff Discussion Paper 2009/01-S, we noted that the intent of some Commonwealth payments may be to assist states in achieving reform, or *overcoming* disadvantage. This is different to the intent of 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.
3. If such payments are allowed to impact the 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 socio-economic status disadvantage.
4. We made this theoretical point, but also discussed that in practice it is very difficult to determine what the true intent of the Commonwealth is in relation to a payment. It is unlikely that a Commonwealth Minister or agency would not believe that a Commonwealth payment is designed to address and overcome a problem and that it is simply providing support to a state.
5. In a number of instances, particularly in relation to Commonwealth payments to the education sector, Queensland has argued that the funding objective will not be achieved if funding to those recipient states is equalised away. Queensland has raised this issue in the context of Building the Education Revolution, Digital Education Revolution and Early Childhood Development NPs.
6. Tasmania does not agree with this position. Many of the "disadvantages" simply reflect a policy choice of a state not to have certain services, or levels of services over time. Any resultant effort by the Commonwealth Government to bring these services up to the national standard should impact on the relativities. This is because other states have expended resources over time to achieve and maintain a national standard (and these expenses would have been equalised).

The Use of Discretion

7. At a more general level, we support the Commission's use of judgement. We maintain that if Commonwealth payments are available for usual state functions, they should impact on the relativities.
8. However, Tasmania agrees with the position of the Northern Territory that untied reward payments should not impact on the relativities. "True" reward payments have their genesis in National Competition Policy payments, which were classified as general revenue assistance and were quarantined from the Commission's assessments. They are fully intended and paid as "bonus" transfers where states and the Commonwealth have deliberately entered into open arrangements to undertake difficult reform.

9. Unfortunately, a number of Commonwealth payments have been labelled as “reward” payments but their features are not that of a true reward payment. The *Intergovernmental Agreement on Federal Financial Relations* (IGA) is proposed to be amended to better specify all payment types, including reward payments.

Treatment of Commonwealth payments to PTEs

10. Tasmania supports the Commission’s inclination to treat payments through states to PTEs or direct to PTEs, on a case-by-case basis. We maintain that these payments should impact on the relativities if the payment affects state fiscal capacities and needs are assessed.
11. It is understood that the Commission is still considering the treatment of some Commonwealth payments in the context of its assessment decisions. They include payments for national network roads and rail infrastructure.
12. In the case of national network roads, Commonwealth payments facilitate the development of a national network, which makes the national transport task (with a heavy focus on export activity) easier and more efficient than would otherwise be the case. However, it also necessarily provides budget support for state services, the allocation of funding is policy influenced and the payments are for infrastructure from which recipient jurisdictions will benefit directly.
13. In the case of rail infrastructure, Commonwealth payments reduce state subsidy needs. Providing subsidies to transport providers is a normal state government activity, so any Commonwealth payment to a provider, even if it bypasses the General Government sector entirely, still reduces the call on a state government and, therefore, affects its fiscal capacity.

Capital Subsidy – Assessment of Needs

14. The Commission is reviewing the assessment of capital subsidies in the Transport category. Commission Position Paper 2009/03 (paragraph 23) suggests that if needs are assessed for capital subsidies, it is likely that related Commonwealth payments will impact the relativities. Tasmania supports this view.
15. Importantly, we believe that needs have already been assessed for capital subsidies through the net lending component of the Capital assessment. This is because capital subsidies to a transport PTE increases the PTE’s infrastructure assets and hence the value of state equity in the PTE sector. These transactions (between states and their transport PTEs) simply alter the “mix” or “composition” of all states’ net financial assets within the year.
16. Through equalisation, the Commission plans to assess net financial assets (reflected by an increase in PTE equity and a decrease in cash following a capital subsidy payment) using population disabilities in the

net lending component of the Capital assessment. Through that assessment, differential needs are recognised for state-held equity.

17. At the same time, the capital subsidy will also show up in the capital subsidies component of the Transport category, usually as recurrent expenditure. This is despite net financial assets remaining the same (as the capital subsidy simply changes the composition or mix between cash and equity).
18. The net lending component of the Capital assessment distributes the “stock” arising from the capital subsidy according to population growth, therefore, if the Commission also assesses the “flow” of the capital subsidy in the Transport category (by population growth), this would be double counting.
19. Put another way, by equalising the value of states’ equity in the net lending assessment, the Commission is, by extension, equalising the infrastructure held by PTEs, including transport operators. Any population dilution effects on PTE-owned infrastructure are, therefore, captured in the net lending assessment.
20. In this way, disabilities relating to the need to provide capital subsidies to a PTE may have already been fully met, so a deliberative assessment of any capital subsidies to the PTE sector is entirely appropriate.
21. The capital subsidy transactions, although flowing through the operating statements, essentially leave state balance sheets unchanged. That is, they do not impact the fiscal capacities of the states.
22. Tasmania believes that an EPC assessment in the Transport category will allow the Commission to recognise the related Commonwealth payments provided to the states, but not double up on disabilities (with the expenditure associated with these Commonwealth payments already recognised through the Capital assessment).
23. An EPC assessment of transport capital subsidies maintains symmetry with the treatment of investment in the General Government sector. Had the capital subsidies been used to invest in transport infrastructure within the General Government sector, then the resultant assets would still have appeared in the balance sheet, the difference being that they would appear as physical assets rather than financial assets, and would be reflected in the investment component of the Capital assessment rather than the net lending component.
24. One potential area of criticism is that, unlike the investment assessment, there are no disabilities applied in the net lending assessment (other than population growth). If there are other disabilities that affect subsidy needs, such as socio-demographic composition, these would not be captured. However, the Draft Report clearly notes that “only the change in state populations is considered to affect state net lending requirements” (paragraph 57 of Attachment 20 “Capital”).

25. Tasmania recognises that the size of the redistribution from allowing some Commonwealth payments in this area (for example, those funded by the Building Australia Fund) is likely to be very significant. While this is an issue, it should not be one that influences how a decision based purely on principle is made.
26. There is also a need to keep in mind the symmetry of impacts in the investment part of the Capital assessment. Through the Commonwealth's fiscal stimulus package, very large increases in state General Government capital expenditure will occur nationally over the next few years (with 2009-10 being particularly significant).
27. Tasmania will receive a considerably large share relative to its population share of the Building the Education Revolution and Social Housing components of the Commonwealth's Nation Building and Jobs Plan.
28. Therefore, there is likely to be a very significant impact on Tasmania's relativity when the relevant years (particularly 2009-10) enter into the Commission's assessments. This is because not only will the stock of General Government capital be vastly increased (therefore resulting in a much greater redistributive impact), but Tasmania's share of payments that finance that capital spending will also compound the impact on Tasmania's relativity.
29. We do not argue, however, that in principle, these payments should not impact on the relativities. They are clearly for state type services.
30. We ask, however, that the Commission treat all Commonwealth payments consistently, and that the decisions that it makes with reference to those payments that find their way to PTEs be treated the same as those that find their way to the General Government sector.
31. We also question the notion that if the Commission cannot assess needs, that the Commonwealth's payments must reflect need. Just because the Commission cannot assess needs, nor does it mean that the Commonwealth does so. There is no difference in the Commonwealth's capacity to judge states' needs for, say schools and social housing, compared with transport infrastructure.
32. This is now a moot point, however, given the above discussion that needs are indeed being assessed for PTEs through the net lending assessment.

Comments on Particular Commonwealth Payments

33. The following comments relate to specific Commonwealth payments in Attachment C of Commission Position Paper 2009/03. For Table C1:
 - Remote Indigenous Housing – Tasmania does not agree that this is a purchase by the Commonwealth. The NP is no different to other NPs for indigenous disadvantage. States do have policy influence.

This view is supported by Commonwealth Treasury advice to Commission Staff concerning payment classification under the IGA. In that regard, Remote Indigenous Housing is classified as an NP project payment under NPs relating to affordable housing.

- Strengthening Tasmania – the program description requires clarification. The payment is aimed at strengthening Tasmania’s economy and building a better community through various sporting and community facility upgrades and initiatives. The Low Head historic precinct, to which the Commission Position Paper 2009/03 refers, is only one of many such initiatives.

In 2008-09, a payment of \$2.5 million was for the Launceston City Council (\$1 million for an aquatic centre); the Burnie Council (\$1 million for lawn bowls, soccer and cricket facilities); and the Devonport Council (\$0.46 million for bowls and tennis projects and gym equipment at a recreation centre).

34. As a point of clarification, footnote (a) to Table C3, which relates to the Digital Regions Initiative payment should note “includes payments *through the state* to local governments”, rather than “includes payments direct to local governments.”

Backcasting

35. The Draft Report articulates the intention of the Commission to backcast major changes in federal financial relations unless the terms of reference direct it not to, or it cannot be done reliably,
36. Tasmania supports this approach and believes that backcasting the changes in the distribution of National SPPs will produce relativities that better reflect the circumstances of the year they are to be used.