Commonwealth Grants Commission — 2020 Review

CGC Draft Assessments Papers

Staff Research Paper – A Broader Assessment Approach

Commission Position Paper - The principle of HFE and its implementation

Submission by the South Australian Department of Treasury and Finance

September 2018

SOUTH
AUSTRALIA

Government of South Australia

Contents

INTRODUCTION

South Australia remains a strong supporter of horizontal fiscal equalisation (HFE) and the Commonwealth Grants Commission's role as the independent body responsible for developing the recommended GST distribution relativities to give effect to HFE.

South Australia provided its views on the principle of HFE and its implementation in July 2017 and now welcomes the opportunity to provide input into the consideration of specific issues under each of the Commission's assessment categories.

This submission provides South Australia's views on issues raised in Commission Staff Draft Assessment Papers distributed in April 2018. We also look forward to discussing these and other issues with the Commissioners during their visit to South Australia in September 2018.

In July 2018, the Commonwealth Government released the Productivity Commission's Inquiry Report into Horizontal Fiscal Equalisation (PC Report) that recommended a move away from current system of equalising states to the same standard to equalisation to a reasonable standard. South Australia believes that the Australian Federation is best served by having an equalisation system that has the objective of providing all states and territories with the fiscal capacity to provide services and associated infrastructure at the same standard.

The Commonwealth Government's interim response to the PC Report supports recommendations to significantly increase materiality thresholds and the use of broader/policy-neutral revenue and expenditure assessments. These recommendations are not supported by South Australia and represent a further move away from the equity objective of HFE. This issue is discussed further in the section responding to the CGC staff research paper – *A broader assessment approach*.

1. PAYROLL TAX (CGC 2018-01/02-S)

Staff propose to recommend the Commission:

- *retain the 2015 Review payroll tax assessment.*

South Australia supports continuation of the current assessment method for the payroll tax assessment. States' capacity to generate payroll tax revenue is dependent on the value of total remuneration for private sector and non-general-government employers, above a tax free threshold.

South Australia believes that the current data sources, Australian Bureau of Statistics (ABS) National Accounts data on Compensation of Employees (CoE), supplemented by other ABS data on wages and salaries to remove remuneration below the average threshold and general-government remuneration, provide a robust and reliable base for the Commission's assessment.

Treatment of diminishing thresholds

South Australia accepts that there are data limitations in undertaking an assessment that takes account of diminishing thresholds and supports the continuation of a single average threshold.

2. LAND TAX (CGC 2018-01/03-S)

Staff propose to recommend the Commission:

- *include all land based taxes in the Land revenue category, except those taxes deemed to be user charges*
  - *treat planning and development levies and Victoria's Growth areas infrastructure contribution as user charges*
- *include ACT replacement revenue in the category, provided the ACT can provide an estimate of the revenue*
- *include property based FESLs in the Land revenue category, insurance based FESLs in the Insurance tax category and motor vehicle based FESLs in the Motor taxes category.*

South Australia supports the overall position to include all land based taxes in the Land revenue category but does not support the proposal to exclude land planning and development levies.

South Australia considers planning and development levies to be more in the nature of a tax rather than a user charge. Accordingly, we believe that revenue from these levies and legislated contributions should be included in the land revenue category, not the Other Revenue category.

Victoria's *Metropolitan Planning Levy* is imposed on developers/individuals applying for a planning permit to develop land in metropolitan Melbourne. It is based on the estimated cost of the development and revenue raised is used to fund a Victorian Government agency, the Victorian Planning Authority. It is hard to see how this could be viewed as voluntary and it is unclear what specific services the person paying the levy receives. The levy is also not tied to the cost of the service provided. Using the

Henry Tax Review criteria, the imposition of this levy is not a “voluntary exchange” and is imposed using the “coercive powers” of the Victorian Government.

Victoria’s *Growth areas infrastructure contribution* is a one-off contribution payable on certain events associated with property development (transfers of title, subdivisions, application for building permits and significant acquisitions of land) in defined areas. Again, this legislated contribution does not appear to be voluntary, it is unclear what specific services the payer receives and it is imposed using the “coercive” powers of government.

South Australia supports the staff recommendation to include property based Fire and Emergency Services Levies (FESLs) in the Land revenue category, insurance based FESLs in the Insurance tax category and motor vehicle based FESLs in the Motor taxes category. This approach correctly considers the underlying nature and base for each FESL collection approach rather than grouping all FESLs together simply on the basis that the revenue is hypothecated to a particular service area. The proposed approach better captures each state’s capacity to generate FESL revenue.

Staff propose to recommend the Commission:

- *continue to use land values as the basis of the Land revenue capacity.*

South Australia supports the staff recommendation to continue measuring Land revenue capacity based on land values or adjusted land values. This is the basis on which states impose land-based taxes.

One state has previously argued that land values are policy influenced and that states change their land tax rates when land values rise faster than the community’s capacity to pay land tax. It has been suggested that states’ land tax policy changes over recent years illustrate that state taxes are more a way of taxing the capacity of the community as a whole.

While it is acknowledged that state policies can, to a limited degree, influence land values, South Australia is not aware of any evidence that would demonstrate that these state polices are so different that they have a material and differential impact on values. Investors influence prices as well. There appears to be no basis for applying any discount.

Current discount

In the 2015 Review, the Commission applied a 25 per cent discount to the assessment reflecting its concerns about the reliability and comparability of State Revenue Office (SRO) land value data. A key concern related to the reliability of Queensland’s data on the distribution of its taxable land holdings by value.

In the 2017 Update, Queensland provided new data based on a revised distribution of land values, which Commission staff considered to be more representative of Queensland’s property market and derived through an approach that is more consistent with that used by other states to estimate their value distributions.[1]

[1] Commission Staff Discussion Paper CGC 2017-01-S, *An additional new issue for the 2017 Update – Land tax assessment*

Given that the Commission now has more reliable data on which to base the Land Tax assessment, South Australia considers that the 25 per cent discount should be reduced or removed in light of the improved data.

Staff propose to recommend the Commission:

- *assess the Land tax component using adjusted land values*
- *adjust land values for*
  - *the scope of taxation, excluding land values relating to principal places of residence and land used for primary production, general government and charitable purposes*
  - *State policies on aggregation, including the treatment of jointly owned land, if it can be done reliably*
  - *the progressivity of Land tax*
- *not make a separate assessment of foreign owner surcharges, but allow the surcharges to affect the assessment through increased effective rates of tax.*

South Australia supports the staff recommendation to assess the Land tax component using adjusted land values to reflect the scope of taxation, exclude land values for principal places of residence, primary production, general government and land used for charitable purposes. South Australia also supports adjustments for aggregation to reflect that most states impose land tax on ownerships rather than individual holdings and we also support adjustments to reflect the progressivity of land tax rates.

Aggregation is an important factor in most states' land tax regimes and the impact of aggregation must be reflected in the Land revenue assessment. It is estimated that the abolition of aggregation would have resulted in a revenue loss of around $122 million in 2016-17 based on South Australian Department of Treasury and Finance estimates. This accounts for around a third of South Australia's private land tax revenue.

Progressivity of land tax rates is also a common feature of most land tax regimes and its impact must be reflected in the Land revenue assessment. The smaller states generally have lower per capita taxable land values in the higher value ranges where higher rates of tax are imposed. In the 2018 Update the value adjustments to reflect progressivity redistributed around $57 per capita or nearly $100 million to South Australia (per Table 5 in the Land revenue draft assessment paper).

The need to reflect aggregation and progressivity of tax rates leads us to support the continued use of State Revenue Office data in the Land revenue assessment. Alternative land value measures cannot provide the necessary data to reflect these factors.

South Australia supports the staff recommendation to allow the revenue from foreign ownership surcharges to affect the assessment through increased effective tax rates.

Staff propose to recommend the Commission:

- *assess other land based taxes using land values for residential, commercial and industrial properties.*

South Australia supports the staff recommendation to assess other land based taxes using values for residential, commercial and industrial properties.

Staff propose to recommend the Commission:

- *seek views from the Officer Working Party on which is the most appropriate source of land value data and what adjustments may be required to make States' measured tax bases comparable.*

South Australia supports the continued use of land value data sourced from State Revenue Offices as this is the only source of data that can reflect the actual land tax base in each jurisdiction.

The value of land in ABS National Accounts and from Valuer-Generals' data cannot identify ownerships relating to principal places of residence and cannot provide aggregated values by ownership. These are key features of land tax regimes and relevant data can only be provided by State Revenue Offices.

3. STAMP DUTY ON CONVEYANCES (CGC 2018-01/04 S)

Staff propose to recommend the Commission include in the category:

- *revenue from duties on the transfer of real and non-real property, including foreign owner surcharges*
- *an amount equal to the concessional duty provided to first home owners.*

South Australia supports the staff recommendation to include revenue from duties on the transfer of real and non-real property, including foreign owner surcharges and to include an amount equal to the concessional duty provided to first home owners.

In relation to first home owners, the proposed approach ensures that assistance provided is assessed in the same way, regardless of whether it is provided in the form of a grant or in the form of a concessional rate of duty.

South Australia acknowledges that a separate assessment of foreign owner surcharges would require significant additional information to be provided to Commission staff. Treating the surcharge like a progressive rate of tax reflects the impact of surcharge revenue without adding additional complexity to the assessment.

Staff propose to recommend the Commission:

- *assess stamp duty on conveyances using the value of property transferred*
- *adjust the value of property transferred:*
  - *to remove values relating to non-real property, corporate reconstructions and sales of major State assets*

> – *for the wider scope of unit trusts and commercial real property in selected States*
>
> – *for the progressivity of transfer duty*
>
> - *assess duty from transactions on non-real property, corporate reconstructions and sales of major State assets in the EPC component.*

South Australia supports the staff recommendation to assess stamp duty on conveyances using the value of property transferred. The value of property transferred is the most appropriate capacity measure that captures differences in states' revenue raising capacities and is less policy influenced. State Revenue Office (SRO) data is the only relevant data source for this assessment.

South Australia also supports the recommendation to adjust the value of property transferred to remove values relating to non-real property, corporate reconstructions, land rich transactions for listed companies and sales of major State assets and assess this revenue on an equal per capita basis. The removal of non-real property means that the property component capacity measure will be the value of real property transferred which is appropriate. Corporate reconstructions are more about reorganising assets than asset disposal so it is reasonable not to assess this revenue using a property component capacity measure. State asset sales are purely state policy decisions and do not have a direct relationship with real property transfers.

South Australia supports adjustments for the wider scope of unit trusts and commercial real property in selected states.

South Australia strongly supports the staff recommendation to adjust the value of property transferred to reflect the progressivity of transfer duty rates. There are substantial differences between states in the value distribution of transfers and allowing for these differences has a material impact on assessed revenue raising capacities.

> *Staff propose to recommend the Commission defer consideration of:*
>
> - *an elasticity adjustment until it has considered the consultant's report on elasticities.*

South Australia will consider the appropriateness of an elasticity adjustment when the consultant's report is made available to states.

4. INSURANCE TAX (CGC 2018-01/05-S)

> *Staff propose to recommend the Commission:*
>
> - *retain the 2015 Review insurance tax assessment, but include workers' compensation duty in the category and assess it using the general insurance base.*

South Australia supports retaining the 2015 Review insurance assessment approach but does not support assessing duty from workers' compensation premiums with general insurance revenue. Although a differential assessment is unlikely to be material, workers' compensation insurance arrangements (statutory obligations on employers based on payrolls) are different to most other forms of general insurance.

Workers' compensation duties should remain in the Other Revenue category and be assessed equal per capita.

5. MOTOR TAXES (CGC 2018-01/06-S)

Staff propose to recommend the Commission:

- *retain the 2015 Review Motor taxes capacity measures.*
- *present the assessment of stamp duty on motor vehicles transfers in the Motor taxes category.*

South Australia has no fundamental concerns with the Motor Taxes assessment and has no concerns with presenting the assessment of stamp duty on motor vehicle transfers in the Motor Taxes category.

South Australia is comfortable with Commission staff working with states to see if an updated split between light and heavy vehicles can be developed and whether vehicle transfer revenue can be split by value range to capture progressive duty rates.

6. GAMBLING TAXES (CGC 2018-01/07- S)

Staff propose to recommend the Commission:

- *continue to investigate a disaggregated gambling assessment based on HILDA data*
- *continue to investigate an aggregated assessment based on broad measures of gambling capacity*
- *pending the outcome of these investigations, assess gambling taxes EPC*

South Australia is keen for the Commission to undertake further work to determine if a differential assessment can be constructed for gambling revenue. A number of interested parties have publicly referred to the "non-assessment" (EPC assessment) of gaming machine revenue as a criticism of the current system of HFE. These interested parties have implied inconsistency by comparing the differential assessment of mining revenues to the "non-assessment" of gaming machine revenue. From a system presentation and integrity perspective, it would be beneficial if there was some form of differential assessment for gambling revenue if it can be demonstrated that the relative revenue raising capacities of the states differ.

In past reviews, the Commission has been unable to identify reliable drivers of an individual's propensity to gamble. Propensity to gamble appears to be driven by a complex interaction of factors that would include income, age, socio-economic background, ethnicity and local/ unique preferences. The impact of increased levels of online and overseas gambling further complicates the picture.

Commission staff have identified the collection of gambling related data from the Household, Income and Labour Dynamics Survey (HILDA) as being a potential data source for assessing the socio-economic characteristics driving people's propensity to gamble. Although Commission staff have identified limitations in this data source, it could be used to assist in the construction of a disaggregated assessment that includes socio-demographic characteristics (based on HILDA data), the number of people in age groups with a higher propensity to gamble and the number of people in income groups known to have a higher propensity to gamble.

Commission staff are encouraged to investigate such an option and also investigate aggregated approaches to see whether a differential assessment would result in GST distributions that meet the materiality criteria.

7. MINING REVENUE (CGC 2018-01/08-S)

Staff propose to recommend to the Commission that the Mining revenue category continue to comprise:

- *State royalty revenue*
- *grants in lieu of royalties*

and continue to:

- *use value of production as the capacity measure for mining revenue*
- *collect value of production data from states on a free on board basis*.
- *assess mining revenue capacity using a mineral by mineral approach.*

South Australia supports the staff recommendation to continue including all state royalty revenue and all grants in lieu of royalties in the Mining Revenue category. Royalty revenue represents the payments states collect in exchange for allowing private companies to extract mineral and petroleum resources within their borders. Grants in lieu of royalties are received under revenue sharing arrangements with the Commonwealth Government in respect to the exploitation of defined mineral and petroleum deposits. South Australia also supports the staff recommendation to continue assessing mining capacity using value of production.

South Australia is not aware of an alternative approach that would better achieve HFE outcomes than a mineral-by-mineral assessment. This approach is a better reflection of states' underlying mining revenue capacity and best reflects what states do.

Staff propose to recommend that, if a dominant State makes a discretionary change to its royalty rates, the Commission:

- *assess a portion of the revenue increase EPC*
- *use the formula (set out in Attachment A) to calculate that proportion*

As discussed by Commission staff in Research Paper CGC 2017-04-S, the Commission faces the challenge of balancing policy neutrality and reflecting what states do in the assessment of mining revenue, especially where production of a particular mineral is dominated by one or two states.

In its 2017 paper, *The Principle of HFE and its Implementation* (CGC 2017-21) the Commission proposed to address this issue by assessing mining revenue such that a state that dominates production of a given mineral and increases its royalty rate for that mineral will not lose more than half the additional revenue raised through HFE redistributions.

To achieve this, Commission staff have developed a formula that would assess a portion of the relevant increased revenue on an EPC basis to engineer an outcome that delivers the 50% outcome for a "dominant state".

South Australia acknowledges that of all assessments, mining revenue represents the most significant challenge to the policy neutrality principle. However, given the significant contribution of mining revenue to differences in state fiscal capacities, we do not support the application of any form of arbitrary discount.

One of the Commission's key considerations when evaluating a potential change to its assessment methodology is whether the change would produce an outcome closer to HFE than the current approach. South Australia does not believe that the proposed approach to effectively discount a portion of mining revenue increases for dominant states meets this benchmark.

Staff propose to recommend the Commission not make adjustments for differences in State:

- *development policies*
- *compliance efforts.*

South Australia supports the staff recommendation not to make adjustments for differences in state development policies and compliance efforts. It is not possible to identify revenue generated as a result of an above average effort in developing a state's economic base. There is no evidence that states with higher than average mining revenue capacity have achieved this as a result of their current or historical development policies. Introduction of a discount would penalise states with a lower than average revenue capacity which is primarily a function of a lack of mineral resources.

Staff propose to recommend the Commission:

- *assess revenue from banned minerals equal per capita, from the commencement of the 2020 Review*
- *apply this treatment to coal seam gas and uranium royalties*
- *present the banned minerals assessment in the Mining Revenue category.*

South Australia believes that a key strength of the current Mining Revenue assessment is that it is based on observed levels of production and policy decisions. The issue of how to treat banned minerals has grown in prominence due to some states' decisions to ban coal seam gas exploration and mining as well as long-standing bans on uranium mining in several jurisdictions.

Alternative estimates of revenue capacity would need to take into account factors such as extraction costs, commodity market conditions and other commercial and economic factors. Just because it is known that there is a resource deposit in a particular area, does not mean that it would be economically feasible to extract that resource. We are not aware of any reliable source of information for such an assessment.

South Australia therefore supports the staff recommendation to assess banned minerals, including coal seam gas and uranium, on an equal per capita basis.

8. OTHER REVENUE (CGC 2018-01/09-S)

South Australia agrees with Commission staff that there are no major issues with this assessment. Comments have been provided on gaming revenue in our response to the staff discussion paper CGC2018-01/07S – Gambling taxes.

9. SCHOOLS EDUCATION (CGC 2018-01/10-S)

Staff propose to recommend that the Commission:

- *use an appropriate regression model reflecting state funding models once further developed following consultation between staff and the states*
- *model student cost weights with a regression that predicts state government recurrent funding.*

In principle, South Australia supports the use of a regression model as the basis for assessing the cost of providing education services to different types of students. When underpinned by reliable, policy neutral data, an assessment based on a regression model recognises that the provision of the same standard of education services across states necessarily means that states need to dedicate more resources to disadvantaged students.

South Australia has no objection to the Commission investigating ways to improve its current regression model to enhance HFE outcomes. We look forward to consultations with the Commission regarding their proposed changes during the course of the 2020 Review.

Staff propose to recommend that the Commission:

- *net user charges off the state funded government school assessment.*

South Australia supports the proposal to net school education user charges against state funded government school expenses, as opposed to the current approach of assessing them on an EPC basis in the Other Revenue category. This proposal is consistent with South Australia's suggested treatment of user charges in the 2015 Review.

At the time, the Commission rejected this proposed approach, stating that:

> *"Student contributions are less than 2% of category expenses or about $30 per capita. South Australia said these amounts should be netted off expenses. We do not consider the drivers of spending and revenue to be the same and so we have not netted off the revenue."* – 2015 Review Final Report, Vol. 2, p.128

The drivers of education spending and revenue have not changed since the 2015 Review. Despite this, Commission staff now consider that netting off education user charges against expenses may in fact improve the overall assessment. It is therefore possible that, by the same token, netting off user charges in other categories could improve the Commission's assessments in those categories. On this basis, South Australia urges the Commission to revisit its treatment of all user charges.

Staff propose to recommend that the Commission:

- *use the Commonwealth's SRS to assess need for Commonwealth funded government schools;*
- *assess Commonwealth funding to non-government schools in the same way as for other Commonwealth payments that do not affect state shares of GST revenue.*

South Australia supports the continued use of the Commonwealth's Schooling Resource Standard (SRS) to assess need for the Commonwealth funded component of government schools. The SRS was introduced as part of the National Education Reform Agreement (NERA) to recognise the additional funding requirements of disadvantaged students. The Commission was required by the 2015 Review Terms of Reference to ensure that its assessments did not unwind the recognition of disadvantage embedded in the NERA.

Current school funding arrangements under the Commonwealth's *Quality Schools* program continue to recognise student disadvantage. On this basis, South Australia considers that the Commission should continue to use the SRS to assess needs for Commonwealth funding to government schools.

South Australia also supports the proposal to exclude Commonwealth funding for non-government schools from its assessments. The Commission's current approach of offsetting this funding with an equivalent expenditure amount is an unnecessary step that does not enhance the overall assessment system. South Australia agrees with Commission staff that it would be simpler to exclude this funding altogether, consistent with the treatment of other Commonwealth payments that do not affect the relativities.

Staff propose to recommend that the Commission:

- *continue the 2015 Review practice of using ABS data using splits of geographic distribution based on ACARA data.*

South Australia supports the continued use of ABS data on student numbers, split according to Australian Curriculum, Assessment and Reporting Authority (ACARA) data on student characteristics. We acknowledge that there is a slight timing difference between the two datasets but do not consider this to have a significant impact on the reliability of the Commission's assessments.

Staff propose to recommend that the Commission:

- *not incorporate students with a disability into the Schools education assessment unless it is clear these data are comparable across states.*

South Australia supports the proposal not to incorporate an assessment of students with a disability at this time, as there are still significant concerns about the comparability of the Nationally Consistent Collection of Data on School Students with a Disability across states.

Staff propose to recommend that the Commission:

- *use the actual numbers of government and non-government students in each state.*

South Australia supports the use of actual numbers of government and non-government students in its assessments. We agree with Commission staff that while there may be some policy influences on student numbers in government and non-government schools, there are also significant non-policy influences such as family incomes, remoteness and religion. Actual enrolment data remains the most appropriate basis on which to assess school education needs.

Staff propose to recommend that the Commission:

- *include transport of school children expenses with transport expenses and assess this using the same disabilities as those for the urban transport assessment.*

While South Australia acknowledges that there are concerns about the reliability of the data underlying the current student transport assessment, we do not support the proposal to assess these costs with urban transport expenses.

Commission staff have suggested three alternative approaches to assessing student transport expenses, which would entail:

- assessing student transport expenses on an EPC basis in the Other Expenses category
- grouping the expenses with school expenses and assessing them using the state funded school education disabilities
- grouping the expenses with transport expenses and assessing them using the urban transport assessment (Commission staff's preferred approach).

The approach preferred by Commission staff would likely result in an assessment that is biased towards urban student transport, despite the Commission finding in both the 2010 and 2015 Reviews that transport costs for urban and rural students were driven by materially different factors.

In any case, it is unlikely that the reliability issues associated with student transport data can be addressed by applying alternative disabilities to the data (whether they be disabilities for urban transport or for state funded schools). South Australia considers that the simplest and least subjective approach would be to assess student transport expenses on an EPC basis in Other Expenses.

10. POST-SECONDARY EDUCATION (CGC 2018-01/11-S)

Staff propose to recommend to the Commission:

- *retain the Indigenous cost loading but update the loading using State provided data reflecting current spending allocations.*

South Australia supports the staff proposal to retain the Indigenous cost loading and update the loading using state provided data reflecting current spending allocations. It is well established that states provide additional assistance to Indigenous students in form of supplementary services and fee concessions. In addition, most states include an Indigenous loading in their funding models.

Staff propose to recommend to the Commission:

- *adopt the new category specific regional cost loadings and use them in the assessment on an undiscounted basis*

South Australia accepts that a regional cost loading is appropriate for this assessment and this is supported by the fact that most states apply remoteness loadings for training delivered by Registered Training Organisations (RTOs) located outside major cities. South Australia also accepts that a regional cost loading based on NCVER contact hours is more relevant to this assessment than loadings based on police and education data.

Staff propose to recommend to the Commission:

- *investigate if a qualification level loading should be included in the assessment to recognise that different level courses attract different subsidies.*

South Australia supports further investigation as to whether a qualification level loading should be included in the assessment. It has been established that there is considerable variation in the subsidies provided for different qualification level courses.

Staff propose to recommend to the Commission to:

- *not include a State course mix disability because States are unlikely to be able to provide the necessary cost data and there is potential for State subsidy policies to influence the course mix.*

South Australia believes that a state's industry mix does materially influence overall subsidy levels. A state's industry profile does affect the types of courses students choose to complete and therefore influence the level of state subsidies. It is understood that determining the extent to which the industry mix influences each state's spending would require data on state spending by field of study. Although previous attempts to collect this data have been unsuccessful, it may be worth retesting whether reliable data is available as not including the impact of industry mix would appear to be a short-coming of the current assessment.

Staff propose to recommend to the Commission:

- *not investigate a disability based on the sector of training providers because most States provide the same subsidy to all providers regardless of sector, and the mix of public and private providers is highly policy influenced.*

South Australia is comfortable with the staff recommendation not to investigate a disability based on whether training providers are in the public or private sector. Most states provide the same subsidies regardless of sector and it is a policy decision whether specific courses are provided by public or private training providers.

Staff propose to recommend to the Commission:

- *make a data adjustment to ensure only fee-for-service revenue is netted of expenses, if it is material.*

South Australia is comfortable with the staff recommendation to make a data adjustment based on NCVER VET finance data to ensure only fee-for-service revenue is netted off expenses, if material.

11. HEALTH (CGC 2018-01/12-S)

Staff propose to recommend that the Commission:

- *consider retaining the direct approach to assess all components of health expenses in the 2020 Review rather than reverting to a subtraction approach because the direct approach utilises reliable data to directly assess state health spending and focuses on what states do while appropriately recognising the influence of the non-state sector; and*
- *not scale the outcomes of the direct assessment method based on a very broad interpretation of what constitutes state-like services.*

South Australia supports the staff recommendation to retain the direct approach to all components of the health assessment and not revert back to the subtraction method.

The Commission adopted the subtraction method in the 2010 Review for the community and health services categories as a practical way to address a lack of administrative data on the use and cost of state services provided, and due to there being a relatively large and mature non-state sector providing state-like services.

The subtraction approach assumed that state provided services and state-like services provided by the non-state sector were fully substitutable. The greater the levels of non-state sector provision of state-like services, the lower the level of state service provision.

The Commission has noted that considerable judgements were required to in order to determine the scope of state-like services. Assessments were based on a range of data with varying degrees of quality.

With the introduction of the National Health Reform Agreement and the establishment of the Independent Hospital Pricing Authority (IHPA) in 2011, new usage and activity data collections commenced. Data was now collected for admitted patients, emergency departments and non-admitted patient services.

With the availability of new data, the Commission was able to construct an assessment based on direct data in the 2015 Review. The impact of the non-state sector was reflected in the assessment through a non-state sector adjustment reflecting different levels of state-like service provision in similar regions between states. The scale of the non-state sector adjustment was based on the proportion of total State spending affected by State-like service provision. In addition, the SDC assessment recognised that there were lower levels of State-like service provision with increasing remoteness, which leads to an increase in the use of similar State services.

For the 2015 Review, the Commission was of the view that although the direct approach was not perfect, it represented an improvement over the subtraction approach.

Although there are issues with both assessment methods, South Australia believes that the direct method is conceptually superior to the subtraction approach. The subtraction approach (proposed by Western Australia):

- effectively broadens the scope of equalisation beyond state health services to equalisation of community spending on “medically necessary services”; and
- assumes 100% actual substitutability for all services considered potentially substitutable.

The subtraction approach discussed in the Western Australian paper proposes that the health assessment should be weighted or scaled with an aim to equalise community spending on all medically necessary services regardless of the sector providing the services. This position is not consistent with the objective of HFE and the Commission’s supporting principles. The scale of needs must relate to the level of State spending. HFE is about equalising states’ fiscal capacities. It is not about equalising total community spending, including individual spending.

The initial step in a subtraction approach requires a determination of the substitutability of health services. An assumption that 100 per cent of potentially substitutable services are actually substitutable is incorrect and does not reflect reality. “Potential substitutability” and “actual substitutability” are different things. As discussed in the assessment paper, the range of potentially substitutable services is reduced by income and co-contribution constraints (e.g. for dental services) preventing a significant proportion of the population from accessing non-state services. Ignoring this factor, through adoption of a 100% substitutability assumption makes the assessment less reflective of what state services are actually provided and what services are being equalised.

The Western Australian paper also does not provide information on how a subtraction approach could be implemented using existing available data.

Staff propose to recommend that the Commission:

- *continue to use IHPA’s NWAU data for the SDC assessments of admitted and ED services because the data provide a reliable basis for measuring the material factors which influence state spending on these services; and*
- *use IHPA’s NAP NWAU data for the SDC assessment of NAP expenses instead of admitted patient separations because the data should be sufficiently reliable by the 2020 Review and it will provide a better measure of the material factors which influence state spending on NAP services.*

South Australia supports the continued use of IHPA's national weighted activity unit (NWAU) data to assess sociodemographic composition (SDC) disabilities in the Admitted Patients and Emergency Department (ED) components, as this is the most reliable and readily available source of data for the Commission’s purposes.

In the 2015 Review, the Commission considered that IHPA's NWAU data on non-admitted patients (NAP) was not a sufficiently reliable source for assessing SDC disabilities, and used admitted patient NWAUs as a proxy. South Australia agrees with Commission staff’s view that the quality of IHPA's NAP data has improved since the 2015 Review and supports the use of this data to assess NAP SDC disabilities in the 2020 Review.

Staff propose to recommend that the Commission:

- *investigate whether sufficiently comparable and reliable administrative data on community health services are available from states to build a national SDC profile for community health services; and*
- *in the absence of suitable data, staff will consider whether ED triage category 4 and 5 remain the best proxy for measuring the SDC disability for community health services.*

South Australia supports the Commission investigating the availability of suitable data for the development of a national SDC profile for community health services. We are comfortable with the Commission using ED triage categories 4 and 5 as a proxy in the event that a suitable alternative data source is not available.

Staff propose to recommend that the Commission:

- *note the changes to IHPA's adjustments for 2018-19 NWAU data, which will affect the assessment for the first time in the 2020 Review;*
- *ensure all hospital remoteness and SDS costs for small rural block funded hospitals are recognised in the SDC assessments for hospital services (admitted patients, ED and NAP);*
- *take steps to ensure that the proxy indicator used in the SDC assessment for community health adequately recognises remoteness and SDS costs; and*
- *re-test the materiality of splitting remote and very remote areas in the SDC assessments.*

South Australia notes the location adjustments for acute admitted patient services and ED services included in the National Efficient Price specification for 2018-19 and notes that these adjustments will affect the Commission's assessments from the 2020 Review onwards.

South Australia has no objection to the Commission ensuring that remoteness and SDS costs for small rural block funded hospitals are recognised in the SDC assessments. We look forward to the outcomes of the Commission's consultations with IHPA on this issue during the course of the 2020 Review.

Similarly, South Australia is comfortable with the Commission ensuring that remoteness and SDS costs are adequately captured in the Community Health assessment.

In the 2015 Review, the Commission decided to combine remote and very remote NWAUs in its SDC assessments, as disaggregating them was not material. South Australia supports the Commission re-testing the materiality of a split remote and very remote assessment in the 2020 Review.

Staff propose to recommend that the Commission:

- *re-test the materiality of splitting the older age group (75+ years) to have a 75-84 years age group and an 85+ age group.*

South Australia supports the Commission investigating the materiality of splitting the

75+ years age group into a 75-84 years and 85+ years age group. As South Australia has previously indicated, there are likely to be material differences in the service delivery needs and associated costs of people aged 85 years and over, compared to people aged below 85.

Substitutability

Staff propose to recommend that the Commission: • *continue to recognise the influence of the non-state sector on admitted patient expenses using a direct assessment approach;* • *confirm the level of substitutability and data used to calculate the non-state sector adjustment after staff analysis has been completed and states have been consulted;* • *investigate if there are any new studies examining the relationship between GP and state provided ED services to support or otherwise indicate a different level of substitutability for ED services; and* • *investigate to what extent private ED services are substitutable with state ED services;* • *confirm the current level of substitutability for NAP using the same approach used in the 2015 Review;* • *investigate if service bundling or non-state allied health services have any implications for state provided NAP services;* • *re-estimate the substitutability level for community health using a bottom-up approach which examines each major service area on a case by case basis; and* • *investigate if bulk-billed GP benefits data, which is currently being used to estimate the availability of non-state community health services, is the best available indicator for this purpose.*

South Australia is broadly comfortable with the Commission's current approach to assessing the influence of the non-state sector on health service delivery needs, including the substitutability factors currently applied to the Admitted Patients, ED, NAP and community health components. Notwithstanding this, we support the Commission undertaking work to enhance its current approach and look forward to the Commission's further consultations on its findings during the course of the 2020 Review.

Cross-border service use

Staff propose to recommend that the Commission: • *note that the current arrangements ensure that states are reimbursed for the cost of providing hospital services to residents of another state;* • *review the approach to the cross-border assessment for community and other health services as outlined in the Staff Draft Assessment Paper CGC 2018-01/25-S.*

South Australia notes that the Commission currently applies cross-border adjustments to actual National Health Reform funding payments to ensure that any funding to a state for health services provided to non-residents does not affect the relativities. South Australia supports the continuation of this adjustment, to ensure that the Commonwealth contribution received by a state for treating non-residents is not redistributed through the Commission's assessments.

Staff propose to recommend that the Commission:

- *retain the current method for assessing non-hospital patient transport expenses but collect new data to benchmark patient transport expenses and re-calculate the remote patient cost loading.*

South Australia supports the current method for assessing non-hospital patient transport expenses. We note that Commission staff intend to collect data similar to that collected in the 2015 Review, to allow the benchmarking of the relevant costs to GFS data and to recalculate the remote patient cost loading for the 2020 Review. South Australia looks forward to the Commission's consultations regarding the preliminary outcomes of this exercise.

Other health expenses

Staff propose to recommend that the Commission:

- *consider whether expenses for pharmaceuticals, medical aids and appliances and health administration not elsewhere classified (n.e.c.) should be included in the community and other health component or admitted patients.*

South Australia supports the Commission investigating whether expenses relating to pharmaceuticals, medical aids and appliances and health administration n.e.c. should be assessed in the Admitted Patients component rather than Community and other health. Our preliminary view is that Admitted patients would be a more intuitive place in which to assess these expenses, given the strong link between the hospital services assessed in Admitted Patients and the need for pharmaceuticals, medical aids and medical appliances. There is also a strong conceptual case that the majority of health administration costs relate to the delivery of hospital services.

Staff propose to recommend that the Commission:

- *consider options for deriving annual estimates of ED and NAP expenses.*

The Commission currently splits non-admitted patient expenses into ED and NAP on a 50/50 basis, due to a lack of reliable data to otherwise split these expenses in the 2015 Review. Commission staff consider the availability of new data may allow it to now better estimate ED and NAP expenses, either through the use of NAP NWAU data or GFS and AIHW or National Hospital Cost Data Collection data.

South Australia supports the Commission considering the suitability of the available data for deriving annual estimates of ED and NAP expenses.

User charges

> *Staff propose to recommend that the Commission:*
>
> - *continue to offset all user charges against expenses to maintain simplicity and because:*
>   - *fully compensable patients have no effect on state fiscal capacities and it is appropriate to remove these expenses from the assessment; and*
>   - *only the residual cost of private patients in public hospitals affect state fiscal capacities and the NWAU data used in the SDC assessment recognises that private patients in public hospitals are less costly.*

South Australia supports the offsetting of user charges against expenditure in the Health category, provided expenses continue to be assessed on the basis of the direct method.

Category structure

> *Staff propose to recommend that the Commission:*
>
> - *consider assessing all hospital services in a single component if IHPA's NWAU data for NAP services is considered sufficiently reliable by the time of the 2020 Review.*

South Australia considers that an aggregate "hospital services" assessment encompassing admitted patients, ED and NAP expenses should only be considered if it can be established that NAP NWAU data is sufficiently reliable for use in the Commission's assessments. We also note that there may be limited simplicity gains from the Commission staff proposal, as a single hospital services assessment would still require separate analysis of the three component service categories.

Other issues considered

> *Staff propose to recommend that the Commission:*
>
> - *not include a cost adjustment for culturally and linguistically diverse (CALD) patients because any additional costs for CALD patients compared with non-CALD patients appear to be small.*

South Australia accepts the Commission staff proposal not to include an adjustment for CALD patients on the basis of data reliability concerns. We note the outcomes of the IHPA study discussed by Commission staff, which found that there is no nationally consistent indicator for identifying CALD patients, there are reliability concerns about current costing data, and that the additional cost of CALD patients compared to non-CALD patients would likely be immaterial. On this basis, South Australia considers that no CALD adjustment should be applied in the Health category until the data issues highlighted above, including the materiality of a CALD assessment, are addressed.

12. WELFARE (CGC 2018-01/13-S)

Staff propose to recommend the Commission:

- *retain the current assessment methodology for family and child services but stay in contact with the AIHW on developments concerning their unit record database, including whether data might become available for New South Wales and a possible CALD and/or disability measure.*

South Australia is generally comfortable with Commission's current assessment approach that recognises the impact of differences in age, Indigenous status, socio-economic status (SES) and remoteness on the cost of providing family and child services. The assessment is based on a reliable data source being Australian Institute of Health and Welfare (AIHW) child protection data. As noted by Commission staff, the inclusion of disaggregated New South Wales data by SES and region in the AIHW Child protection Australia publication would represent a significant improvement to the overall coverage of the data in this report.

Staff propose to recommend the Commission:

- *merge States' residual aged care expenses with other general welfare expenses and assess them using a general low SES measure.*

South Australia supports the staff proposal to merge residual aged care expenses with other general welfare expenses and assess them using a general low SES measure. This simple approach would remove the need to have a separate sub-category for aged care and reflects the expected reduction in the scale of states' expenditure on aged care services.

Staff propose to recommend the Commission:

- *assess NDIS expenses APC at full implementation in the 2020 Review, subject to decisions on this issue taken in the 2019 Update.*
- *re-allocate non NDIS expenses to the other general welfare component and assess them using the same measure of low SES as that used for other general welfare expenses after the full implementation of NDIS, subject to decisions on this issue taken in the 2019 Update.*

South Australia supports assessment of state NDIS contributions on an Actual Per Capita (APC) basis at full implementation. As contributions to the NDIS will be based 2011 Census data until the 2021 Census becomes available, the change in population shares will have a material impact on GST distributions. It is acknowledged that adjustments will be required to a simple APC assessment to account for the Western Australian NDIS-like model. During the transition period we are comfortable with the back-casting arrangements.

South Australia supports the staff recommendation to reallocate non-NDIS disability expenses to the other general welfare component and use the same measure of low-SES as that used for other general welfare expenses upon full implementation of the NDIS.

Non-NDIS expenses incurred by states post full implementation of the NDIS are likely to be in gap areas where there is no NDIS coverage but identified community need for the continuation of certain services. An assessment based on the number of people in low SES groups appears to be an appropriate basis for assessing these expenses.

It is noted that the potential redistributions noted in the staff paper for the proposed assessment approach for non-NDIS expenses are likely to be overstated in the context of future application as the scale of non-NDIS expenses post full NDIS implementation is likely to decline.

Staff propose to recommend the Commission:

- *retain the current assessment methodology for concessions.*
- *retain homelessness related expenses within the other general welfare component of the Welfare category.*
- *if the ABS updates SEIFI, use it to measure needs for other general welfare expenses. If an updated SEIFI is not available for the 2020 Review, use the relative proportions of State populations in the bottom quintile of the 2016 Census individual income.*
- *assess revenues from user charges on an EPC basis in the Other revenue category.*

South Australia is comfortable with the staff proposal to retain the current assessment methodology for concessions. The proportion of pensioner concession and healthcare card holders in each state is the appropriate driver for a differential assessment.

South Australia also supports retaining homelessness related expenses in the other general welfare component of the Welfare category. Homelessness services are broader than just the provision of social housing and it is appropriate to use a low SES measure as the basis for assessing needs.

South Australia notes that the ABS is considering updating the socio-economic index for individuals (SEIFI) with 2016 Census data and that Commission staff propose to recommend use of the update data if it is available for the 2020 Review.

As user charges are not significant in proportion to total welfare related expenses, South Australia is comfortable with assessing them in Other Revenue on an EPC basis.

13. HOUSING (CGC 2018-01/14-S)

Staff propose to recommend to the Commission:

- *agree to develop an approach which scales the more detailed Census data to accord, to the extent possible and appropriate, with available AIHW data for each State on households in State housing (public housing plus SOMIH) and community housing (mainstream community housing plus ICHOs).*
- *agree to staff undertaking further investigations into the possible scaling of Census rent data to accord with available AIHW data.*

South Australia appreciates that there are material differences between AIHW data on households in social housing and social housing data published by the ABS that has been sourced from Census data collections.

A decision was made in the 2015 Review to use Census data because that data was considered to be more comprehensive for community housing and have better coverage of Indigenous status households. Commission staff believe that the 2016 Census data continues to provide consistent and comprehensive data on the characteristics of social housing households. However, the 2016 Census data does appear to understate the number of community housing households, especially for Indigenous communities.

The AIHW data appears to provide a more accurate count of the total number of social housing dwellings, especially for Indigenous community housing. However, Commission staff note that there are some significant data gaps for some states and there is limited dissection of socio-economic characteristics for certain community housing areas in some states.

Commission staff propose to use AIHW data for the total number of social housing dwellings and use ABS Census data to determine the socio-economic characteristics (income, Indigenous status and remoteness) of social housing households. It is also suggested that ABS Census data provides a more comprehensive breakdown by rent range allowing rents to be taken into account in the housing revenue assessment.

The staff recommendation requires scaling of the ABS Census data up to the AIHW number of social housing households and it is proposed that this be done in every update as the AIHW data is available annually. Commission staff acknowledge that this approach will result in the socio-demographic characteristics applying to households in the Census data also being applied to the additional households required to match the AIHW social housing count.

South Australia notes the Commission staff recommendation but would like to examine the “combined” data, including characteristics (when available) and the distribution impacts of using this approach compared to either solely using Census or AIHW data before providing a position on the proposed approach.

States are welcome to develop a case for the assessment of the impact of land prices on the costs of providing housing services. *Staff propose to recommend the Commission:*

- *not pursue a differential assessment of housing related land costs because recurrent expenses would not be affected by land prices and net investment in land is too small for an assessment to be material.*

South Australia supports the staff recommendation not to pursue a differential assessment of housing related land costs as recurrent expenses would not be affected by land prices and net investment in land is too small for an assessment to be material.

Staff propose to recommend the Commission:

- *not pursue a separate assessment of affordable housing because State expenses are likely to be small.*

South Australia is comfortable with the staff recommendation not to pursue a separate assessment of affordable housing. It is accepted that there is no readily available, nor reliable, information on state spending on affordable housing programs and these expenses are likely to be relatively small.

> *Staff propose to recommend the Commission:*
>
> - *retain the EPC assessment of FHOGs and stamp duty concessions expenses.*

South Australia supports the staff recommendation to retain the EPC assessment of First Home Owner Grants and stamp duty concession expenses. It is accepted that a differential assessment or an actual per capita assessment would not be material.

> *Staff propose to recommend the Commission:*
>
> - *agree to update the Indigenous cost weight and the location factor using the latest available data.*

South Australia notes that the Commission intends to update the Indigenous cost weight and location factor using more recent state data.

14. SERVICES TO COMMUNITIES (CGC 2018-01/15-S)

> *Staff propose to recommend that the Commission:*
>
> - *split the utilities component into electricity subsidies and water subsidies, recognising that average subsidies for these services are likely to be different;*
> - *update the split between electricity and water subsidies annually using data already available from the states.*

South Australia supports the proposal to split the utilities component into electricity and water subsidies. This is in line with South Australia's recommended approach in the 2015 Review and would take into account the different drivers of electricity and water supply costs and subsidies. We also support the Commission updating the split between electricity and water subsidies using the latest available state data to support the contemporaneity of the assessments.

Electricity subsidies

> *Staff propose to recommend that the Commission:*
>
> - *determine at what point full cost recovery for electricity services is not feasible;*
> - *differentially assess electricity subsidies which are the result of unavoidably high costs recognising that subsidies vary by community size and remoteness area;*
> - *not differentially assess electricity subsidies when the decision to not fully cost recover is due to state policy choice.*

South Australia supports the Commission considering the most appropriate way to assess electricity subsidies. South Australia has provided data to assist this process and we look forward to further consultations regarding the Commission's preferred approach.

Water subsidies

Staff propose to recommend that the Commission: • *determine at what point full cost recovery for water services is feasible;* • *not differentially assess water subsidies when the decision not to fully cost recover is due to state policy;* • *differentially assess water subsidies which are the result of unavoidably high costs.*

South Australia supports the Commission investigating the most appropriate way to assess water subsidies. A key theme for South Australia in this regard is the assessment of water quality and availability as a factor that influences the cost of providing water and the resulting need for subsidies.

In the 2015 Review, the Commission decided not to assess the impact of water quality and availability on water subsidy needs, due to a lack of suitable data. This was despite the Commission having previously found a conceptual case that:

> *"…under average policy, the smaller communities in poor water [quality] areas, outside highly accessible regions, are the most likely to receive subsidies and to drive state needs."* – CGC 2010 Review Final Report, Vol. 2 p.297

The Commission applied a 25% discount to its water subsidy assessment to reflect data quality concerns.

While South Australia recognises that the available data is not ideal, the conceptual case for assessing the influence of water quality does exist and should be assessed. In South Australia's case, the State is heavily reliant on the Murray River for water, which presents some significant cost and supply security issues, as the River is slow flowing, saline, turbid and subject to shortages created by upstream use (and misuse). The reliance on the Murray River for country water supplies leads to considerable investment in water treatment facilities, driving up costs and, in effect, the subsidies provided to residents accessing this water.

Community development and amenities

Staff propose to recommend that the Commission: • *expand the scope of Indigenous community development expenses to include general revenue grants to local councils with a predominantly Indigenous population because the driver of these expenses is communities with a significant Indigenous population;* • *collect data from the states for Indigenous community development expenses to evaluate the quality of GFS data and to decide the best approach for estimating annual component expenses;* • *assess Indigenous community development expenses in a separate component of the Services to Communities category to improve transparency and simplify the assessment;* • *continue to use the Indigenous population living in these communities as the disability for the Indigenous community development component, and*

> *applying wage costs and regional costs disabilities;*
> - *continue to define discrete Indigenous communities as SA1s with populations that are more than 50% Indigenous.*

South Australia does not object to the proposal to expand the scope of assessed Indigenous development expenses to include grants to local councils with a predominantly Indigenous population; and will endeavour to provide the data required to assist the Commission in developing an assessment.

South Australia is comfortable with the proposal to assess Indigenous community development expenses in a separate component if the Commission considers that this will improve the transparency of the assessment. We are also comfortable with the proposed definition of a discrete Indigenous community and the use of Indigenous population in these communities as the disability for the Indigenous community development assessment.

Other community development and amenities

> *Staff propose to recommend that the Commission:*
> - *continue to assess community amenities expenses EPC;*
> - *assess other community development expenses EPC because these services apply to all communities including discrete Indigenous communities;*
> - *continue to apply wage costs and regional costs disabilities to other community development and community amenities expenses;*
> - *include other community development and amenities expenses in the Other Expenses category because this is where most other state expenses which are assessed on the basis of population are classified.*

South Australia supports the assessment of community amenities and other community development expenses on an EPC basis, and the inclusion of these expenses in the Other Expenses category. We however oppose the proposal to apply wage cost disabilities to these expenses.

South Australia has long-standing and well documented concerns about the wage costs assessment (discussed in detail in the Wage Costs section of this submission). On this basis, we do not support the application of this disability (at least in its current form) to any assessment until the fundamental issues associated with it have been resolved.

Environmental protection

> *Staff propose to recommend that the Commission:*
> - *continue to assess environmental protection expenses EPC because it is not practical to disaggregate expenses or possible to identify a single broad indicator for assessing spending on this function;*
> - *continue to apply a wage costs disability;*
> - *consider applying the regional costs disability to some or all environmental protection expenses, especially in light of changes to the scope of these*

> *expenses, which now include national parks and wildlife expenses;*
>
> - *include environmental protection expenses in the service expenses component of the Other Expenses category because this is where most other state expenses which are assessed on the basis of population are classified.*

South Australia accepts that it is difficult to develop a robust differential assessment for environmental protection given the broad range of activities undertaken by states in this area and is comfortable assessing environmental protection expenses on an EPC basis. We do not support the application of a wage costs disability to these expenses.

South Australia supports the Commission considering whether a regional costs disability would be appropriate for some (not all) environmental protection expenses. We note that while regional costs were assessed for national park and wildlife expenses in the 2010 Review (then assessed under Other Expenses), this was not the case for other environmental protection expenses. South Australia does not believe there is a case for changing this approach in the 2020 Review.

South Australia does not object to the assessment of environmental protection expenses under Other Expenses.

User charges

> *Staff propose to recommend that the Commission:*
>
> - *include all user charges for the activities covered by the existing Services to Communities category in the Other Revenue category and assess them on an EPC basis.*

As indicated earlier in this submission, South Australia considers that the Commission should review its approach to assessing all user charges.

Other issues considered

> *Staff propose to recommend that the Commission:*
>
> - *not assess the effect of the non-state sector on the level of electricity, water and wastewater subsidies;*
> - *not assess the effect of the non-state sector on the provision of environmental protection services because it is impractical to develop an assessment.*

South Australia is comfortable with the proposals not to assess the effect of the non-state sector on utilities subsidies and environmental protection expenses.

15. JUSTICE SERVICES (CGC 2018-01/16-S)

> *Staff propose to recommend the Commission:*
>
> - *further develop a model incorporating socio-demographic drivers of offences and geographic based model of cost per offence*

South Australia accepts that the current “population-based” assessment for police services should be reconsidered as it is based on significant Commission judgement (50% of police resources dedicated to community policing and the other 50% dedicated to crime), uses offender numbers to determine resource use and uses some base data that is now quite dated.

Commission staff are now seeking to develop an assessment using offender data and police cost data to determine a cost per offence for different regional areas and for Indigenous and non-Indigenous offenders. This approach could remove the need for the judgement-based estimate of the split between community and specialised policing as this is reflected in the cost data.

South Australia is happy for Commission staff to further develop a new assessment model for police services and will consider the results of the model when it is available.

Staff propose to recommend the Commission:

- *divide legal service expenses into those associated with criminal matters and all other legal services*
- *assess criminal legal matters using use rates based upon State data on the Indigenous status, SES and age characteristics of criminal court defendants*
- *not apply any cost-weights to population groups.*

South Australia is comfortable with the staff proposal to divide legal services into those associated with criminal matters and all other legal services. South Australia is also comfortable with the recommendation to assess criminal legal matters using use rates based upon state data on Indigenous status, SES and the age characteristics of criminal court defendants.

Staff propose to recommend the Commission:

- *retain the 2015 Review method used to assess Prisons.*

South Australia is comfortable with the staff recommendation to retain the 2015 Review assessment approach for prisons.

Staff propose to recommend the Commission:

- *apply the wage costs assessment in the Justice category*
- *retain the 2015 Review method for regional costs and service delivery scale*
- *assess the influence of the use of AFP officers by the ACT on police expenses.*

In relation to the application of the wage cost assessment, please refer to comments in the Wage Cost assessment of this submission. South Australia supports the other staff recommendations to retain the 2015 Review method for regional costs and service delivery scale. South Australia notes the recommendation to assess the influence of the use of AFP officers by the ACT on police expenses.

16. ROADS (CGC 2018-01/17-S)

Road length

Staff propose to recommend that the Commission:

- *consider whether it should adopt a new approach to measuring state road length in a way that more closely reflects the actual length of roads that states manage and, if so, to:*
  - *use state actual road networks adjusted to ensure the inclusion of roads commonly classified as state roads and the exclusion of roads commonly classified as local roads to reflect average policy;*
  - *as a fall-back, retain the mapping algorithm approach with changes to incorporate all connections between urban centres, connections to smaller population centres and connections to certain areas of significance; and*
- *provide a draft data request to states by early 2019 to see whether states can provide road length information based on the definitions and formats set out in the Austroads Standard.*
- *retain the definition of urban areas as UCLs of more than 40 000 people;*
- *as a fall-back, continue to use urban population as a proxy measure of urban road length needs.*
- *ensure that the local roads component includes only expenses related to maintenance of local roads in areas of states where there is no local government (unincorporated areas) or where there is insufficient population for the local government to support road maintenance; and*
- *update the estimates of local road length using actual road length in unincorporated areas and sparsely populated areas.*

In principle, South Australia supports the use of actual rural, urban and local road length data in the Commission's assessments, subject to the fitness of this data for the Commission's purposes. Actual road data, if robust, would better reflect the service delivery task faced by the states than the use of proxies such as urban population or a synthetic road network.

South Australia would therefore welcome the work proposed by Commission staff in this regard. We however note that the proposed timing of the draft data request (early 2019, with a final data request presumably being provided soon after that) may leave insufficient time for the states to effectively participate in this process and for the Commission to consider the states' positions before delivering the Draft and Final Reports of the 2020 Review.

South Australia also supports the proposal to review the expenses included in the local roads component to ensure that only the relevant expenses are included.

Road use – traffic volume and heavy vehicle use

Staff propose to recommend that the Commission:

- *retain the current methodology for calculating urban and rural traffic*

> *volume;*
> - *treat light commercial vehicles as passenger vehicles because they do not fit the definition of heavy vehicles;*
> - *combine rigid and other trucks, and buses into an 'other heavy vehicles' class; and*
> - *not pursue the issue raised by the ACT.*

South Australia supports the current methodology for calculating urban and rural traffic volume, which is based on vehicle kilometres travelled data from the Bureau of Infrastructure, Transport and Regional Economics. South Australia also accepts the proposed adjustments to the assessment of heavy vehicle use.

The ACT has indicated that information on state spending on urban roads suggests that states with higher urban areas per capita generally appear to spend more per capita in those areas than states with lower urban areas per capita. We note and accept Commission staff's analysis of state road expenses data, which shows that this is not the case in three states (Western Australia, South Australia and Tasmania). On this basis, South Australia supports the recommendation not to pursue this issue further.

Bridges and tunnels

> *Staff propose to recommend that the Commission:*
> - *agree to staff considering options for a bridge and tunnel factor based on state spatial data; and*
> - *if no satisfactory options are found, reallocate bridge and tunnel expenses and investment to the relevant urban and rural road components and apply the disabilities for those components.*

South Australia supports the Commission staff considering options for a bridge and tunnel factor based on state spatial data. We however have concerns about the proposed fall-back option of assessing bridge and tunnel expenses and investment using the urban and rural roads disabilities. Such an approach would effectively assume that the factors driving the construction and maintenance costs of bridges and tunnels are the same as those driving the cost of roads.

In the absence of compelling evidence to support this assumption, South Australia considers that the Commission should continue the current EPC approach in the event that it is unable to develop a differential assessment based on state spatial data.

Other services

> *Staff propose to recommend that the Commission:*
> - *remove the Other Services component from the Roads category and reallocate other services expenses to the other components of the Roads category on a proportional basis and apply to them the component disabilities.*

South Australia supports the proposal to reallocate the expenses currently assessed under to the Other Services component to the other components of the Roads category on a proportional basis and assess them using the relevant component disabilities. This approach would be consistent with the treatment of similar expenses in other expense categories.

National Network Roads

Staff propose to recommend that the Commission:

- *defer a decision on the treatment of Commonwealth payments for investment on national network road and rail projects until state comments on the issue have been received and examined.*

South Australia supports the principle that where a Commonwealth payment relates to a road (or rail) project that addresses both national and state tasks, a portion of that payment should not affect the relativities. In our view, the issue that needs to be considered is the development of a framework that clearly defines the criteria for this treatment as well as the proportion of each eligible payment that will affect the relativities.

In the 2015 Review, South Australia suggested that a simple test for partial assessment could be whether Commonwealth payments to a particular state involve the provision of services to residents and businesses in multiple states. Some rules of thumb may be needed to avoid excessive complexity, and fine tuning of the national benefit proportion, but the appropriate concept for some payments appears to be one of 'proportional exclusion' to the extent there are direct spill-over benefits to multiple states.

Physical environment

Staff propose to recommend that the Commission:

- *not pursue the development of a physical environment assessment for road maintenance expenses.*

South Australia agrees with Commission staff that attempts to measure the impact of the physical environment on road maintenance expenses are unlikely to yield an outcome materially better than past attempts.

Location factor

Staff propose to recommend that the Commission:

- *continue to apply the wage costs factor to all components of the Roads category; and*
- *continue to apply the regional costs factor to the rural roads component.*

In principle, South Australia supports the application of the regional cost factor to the rural roads component. We do not, however, support the application of a wage costs disability to these expenses.

User charges

Staff propose to recommend that the Commission:

- *continue to assess roads user charges on an EPC basis in the Other Revenue category.*

As indicated in our responses to the Schools Education paper, South Australia considers that the Commission should revisit its treatment of all user charges, given that Commission staff have indicated that – in respect of schools education at least – user charges are better assessed by netting them off the related expenses (despite the Commission's view that the drivers of expenses and user charges are different).

17. TRANSPORT (CGC 2018-01/18-S)

Staff propose to recommend the Commission:

- *retain the current general approach to the assessment of recurrent and infrastructure urban transport expenditure because the conceptual case that city population is a major driver of net expenses and assets for public transport systems is strong and supported by data.*

Staff propose to:

- *provide the report on stage 2 of the consultancy to States for comments. After receiving those comments, staff will develop assessment proposals for net expenses and investment for the Commission.*

South Australia continues to have concerns about the conceptual validity of the Transport assessment. The assessment is based on population being the main non-policy influenced driver of urban transport expenses and that per capita net expenses increase with urban centre population size.

Although there is clearly some relationship between subsidies and city size, it is not clear that this assumption is valid when cities grow beyond a certain size. For very large urban areas, public transport demand generally increases as road congestion and road travel times increase. The increased passenger demand increases the revenue generating capacity and utilisation of public transport systems in larger cities. To some degree this mitigates the costs associated with expanded public transport networks.

For the urban transport assessment, Commission staff use a regression analysis to estimate, in cities with populations over 20,000, the average relationship between per capita net transport expenses and city populations. This analysis has produced an upward sloping curve. The average relationship has been applied to the size of each city with over 20,000 people in each State and the results summed to derive assessed net expenses.

Although this analysis is supported by multiple data points for smaller urban centres, in the Australian context, there are only two large city data points to confirm or support the position that transport subsidies increase indefinitely with city size.

Australia's two largest cities, Sydney and Melbourne have a similar population but Sydney's per capita net transport expenses between 2009-10 and 2011-12 were almost double that of Melbourne. Both Brisbane and Perth had higher per capita subsidies over the same period. It appears that it is the influence of one data point, Sydney, that is driving the proposition of subsidies increasing with city size. Without Sydney, subsidies would level out at populations around 1 million to 1.5 million.

South Australia recognises that for completeness Sydney has to be part of the regression analysis and also to be consistent with the “what states do principle”. However, it is clear that for the two large cities, either Sydney is a high cost outlier or Melbourne is low cost outlier. Whichever is the case, this disparity should be sufficient evidence to question an assessment based on urban centre size alone.

It seems apparent that other factors are driving urban transport subsidies and the Commission have correctly engaged a consultant to investigate whether the current assessment approach should incorporate population characteristics, urban form and topography.

Should the consultant’s report fail to provide a robust way to incorporate these factors into the urban transport assessment, South Australia believes that the Commission should consider moderating the distributional impact of this assessment due to the lack of conclusive data on urban size being the main driver of subsidies.

Staff propose to recommend the Commission:

- *retain the 2015 Review definition of urban areas: ABS UCLs contained within SUAs*
- *include all SUAs in the assessment of urban transport because most of them have public transport services.*
- *decide whether or not some satellite cities should be amalgamated with their principal city based on the results of the analysis using the two quantitative criteria proposed by the consultant.*

South Australia is comfortable with the staff proposal to retain the 2015 Review definition of urban area, a position supported by the consultant engaged by the Commission to review the Transport assessment.

South Australia notes the staff recommendation to broaden the scope of urban areas included in the assessment from Significant Urban Areas (SUAs) with a population above 20,000 to SUAs with a population of above 10,000 people. This expanded scope will result in an additional 41 SUAs being incorporated into the assessment and reflects the finding that most urban centres with populations over 10,000 provide some form of public transport service.

South Australia generally supports the criteria recommended by the consultant to determine whether a satellite city should be amalgamated with their principal city. This criteria is as follows:

- A public transport travel time threshold of 120 minutes between the principal and satellite city centres in morning peak hours be applied. This threshold indicates the maximum commute travel time between the principal and satellite cities.
- The proportion of inter-city commute trips is greater than 5 per cent of satellite intra-city commute trips. This criterion indicates a minimum level of labour market integration between the principal and the satellite city.

South Australia is not convinced that using a benchmark based on the proportion of inter-city commute trips being greater than 5 per cent of satellite intra-city commute trips indicates labour market integration and therefore inclusion in the principal city transport network. A benchmark as low as 5 per cent means that vast majority public transport commute trips are intra-city implying that the vast majority of public transport users are employed or engaged in activities in the satellite city. South Australia suggests that for the sake of prudency, the Commission should consider a more conservative inter-city commute threshold like 10 or 15 per cent.

Staff propose to recommend the Commission:

- retain the 2015 Review assessment of non-urban transport services, which is based on State shares of population outside capital cities.

South Australia is comfortable with the staff recommendation to retain the 2015 Review assessment of non-urban transport which is based on state shares of population outside of capital cities.

18. SERVICES TO INDUSTRY (CGC 2018-01/19-S)

Staff propose to recommend the Commission:

- *continue to assess business development expenses EPC.*
- *continue to apply the wage costs disability to State business development expenses.*
- *continue to recognise that there are minimum fixed costs associated with the normal range of business development activities States perform.*

South Australia is comfortable with the staff recommendation to assess business development costs on an EPC basis. It is accepted that there this no reliable evidence to support the view that particular industries have a need for higher or lower state-funded development expenditure.

South Australia does not support the application of a wage costs disability to state business expenses but we do support the proposal to continue to recognise that there are minimum fixed costs associated with the normal range of business development activities states perform.

Staff propose to recommend the Commission:

- *use State data on business development expenses and GFS data to estimate business development and regulation expenses for agriculture and other industries.*
- *continue to assess agriculture and other industries regulation separately because the way States regulate these sectors is different, but only if a separate agriculture assessment remains material.*
- *send draft data requests for agriculture and other industries in May 2018.*
- *send final data requests to the States in September 2018 to collect the final data for three financial years from 2015-16 to 2017-18.*
- *retain the business development and regulation weights obtained from data for 2015-16 to 2017-18 for the period of the 2020 Review.*

South Australia is comfortable with the staff recommendation to use state data on business development expenses and GFS data to estimate business development and regulation expenses for agriculture and other industries.

South Australia supports the staff recommendation to continue to assess agriculture and other industries separately due to the way states regulate these sectors is different. It is accepted that regulation of agriculture differs from other industries due to the food safety and biosecurity arrangements which exist for agricultural products. This assessment is, however, subject to meeting the materiality thresholds.

South Australia will complete all necessary data requests to update weights for the 2020 Review period.

Staff propose to recommend the Commission:

- *continue to differentially assess industry regulation expenses because the size of the regulation task for industry is related to the size of the sector.*
- *use information from State line agencies to inform the decision on the relevant drivers of State spending on industry regulation.*

South Australia supports the staff recommendation to continue to differentially assess industry regulation expenses as the size of the regulation task for industry is related to the size of the sector. It is acknowledged that significant judgement has been used in the past to determine the level of influence for each driver (e.g. number of businesses, value of production and population). Accordingly South Australia supports Commission staff seeking further information from state line-agencies to inform decisions on the relevant drivers of state spending on industry regulation.

Staff propose to recommend the Commission:

- *not use a regression approach to determine drivers and associated weights due to the nature of the available data and initial regression results lacking statistical significance.*

South Australia accepts the analysis undertaken by Commission on the regression proposal put forward by Western Australia and supports the staff recommendation not to pursue this approach.

Staff propose to recommend the Commission:

- *continue to assess planning and regulation expenses for major infrastructure projects in the Services to industry category using State shares of private non-dwelling construction expenditure as the disability*
- *collect data from States to update the current spending estimate.*

South Australia notes that the assessment of state spending on planning and regulation for major infrastructure projects exceeds the materiality test (for two states in 2018 Update). We support a re-examination of states expenditure in this area to reconfirm whether this assessment should continue.

Staff propose to recommend the Commission:

- *not remove R&D expenses identified in the new COFOG-A classification from the relevant functions on simplicity grounds, unless it is material.*

South Australia notes the staff recommendation not remove R&D expenses identified in the new COFOG-A classification from the relevant functions on simplicity grounds, unless it is material.

Staff propose to recommend the Commission:

- *deduct all user charges from expenses because most relate to regulation activities and the same disabilities apply to expenses and revenue*
- *collect data on State agricultural levies to confirm they are not material.*

South Australia supports the staff proposal to deduct all user charges from expenses and supports the collection of data on agricultural levies (including voluntary levies) for further analysis.

Staff propose to recommend the Commission:

- *retain the administrative scale assessment for the category but re-estimate the costs using the approach outlined in Staff Draft Assessment Paper CGC 2018-01/25-S, Administrative scale.*

South Australia supports the staff recommendation to retain the administrative scale assessment for the Services to industry category but we will reserve our position on an appropriate quantum until after the revised Administrative scale assessment has been further developed.

19. OTHER EXPENSES (CGC 2018-01/20-S)

Natural disaster relief

Staff propose to recommend that the Commission:

- *continue to assess natural disaster relief expenses on an APC basis;*
- *not make an assessment for natural disaster mitigation expenses, due to the difficulty in obtaining expense data and identifying a reliable driver;*
- *continue to make adjustments to the adjusted budget to ensure:*
  - *natural disaster relief expenses under the NDRRA framework are only assessed once;*
  - *net natural disaster relief expenses funded from local government revenue are not included in the assessment because they do not affect a state's fiscal capacity;*
  - *Commonwealth NDRRA assistance payments through states to local government (for example, for roads) are not included in category expenses.*

South Australia supports the continued assessment of natural disaster relief expenses on an actual per capita (APC) basis, as states are subject to the same eligibility requirements under the Natural Disaster Relief and Recovery Arrangements (NDRRA), including the requirement for adequate insurance arrangements.

South Australia supports the proposal not to make an assessment for natural disaster mitigation expenses. We note the difficulties highlighted by Commission staff with regards to obtaining expense data and identifying a reliable driver. In addition, we consider that, as states are required under the NDRRA framework to implement natural disaster mitigation strategies, any effects of such strategies (or lack thereof) would be captured in the net expenses incurred by states (which are assessed APC by the Commission).

South Australia supports the Commission continuing to apply adjustments to the adjusted budget in respect of long term natural disaster reconstruction expenses, expenses funded from local government revenue and Commonwealth NDRRA payments through states to local governments.

Capital grants to local government for community amenities

Staff propose to recommend that the Commission:

- *cease assessing the capital grants to local governments for community amenities component because the driver of this spending is unclear.*

South Australia has no objections to the proposal to cease assessing capital grants to local governments for community amenities.

National parks and wildlife services

Staff propose to recommend that the Commission:

- *not assess national parks and wildlife services, due to uncertainties surrounding the policy influences and difficulty in obtaining reliable data to measure cost influences and expenses.*

South Australia supports the proposal not to develop an assessment for national parks and wildlife services. We agree with Commission staff that it would be difficult to identify the relevant expenses and cost drivers, as GFS data combines national parks and wildlife expenses with other environmental protection expenses.

Other issues including location

Staff propose to recommend that the Commission:

- *include most state expenses which are assessed EPC in this category;*
- *continue to apply location disabilities to the same expenses as the 2015 Review.*

South Australia does not object to the proposal to include most state expenses which are assessed EPC in this category, as this would be a presentational issue with no impact on assessed fiscal capacities. We however note that, as was the case with the Commission's decision in the 2015 Review to assess all administrative scale costs in this category, concerns may be raised about reduced transparency within individual expense categories.

South Australia's position on the application of location disabilities is discussed in detail in the *Wage Costs* and *Geography used by the Commission* sections of this submission.

20. PHYSICAL AND FINANCIAL ASSETS (CGC 2018-01/21-S)

Staff propose to recommend the Commission:

- *separately assess investment in all category and component service areas*

South Australia is open to Commission staff undertaking further analysis on a functionalised assessment. It is acknowledged that the other assets category accounts for around 44% of the stock of physical assets and it is the aggregation of assets from ten different assessment categories. A functionalised assessment would appear to make it easier and more transparent to identify all expenditure needs for each category, both recurrent and investment. However, such an approach is likely to increase the complexity of the assessment and may require further data. Upon further analysis becoming available, South Australia will finalise its position on functionalisation.

Staff propose to recommend the Commission:

- *remove three year averaging of stock disabilities.*
- *capture the change in circumstances through the use of category specific growth measures, where methods can be developed and reliable data are available. If no alternative measure is available, use total population growth as a proxy.*
- *where population growth is used, specify change in population levels, rather than births, deaths and net migration, as the measure of population growth*
- *where there are considered to be additional stock requirements not captured by the growth indicator, use the assessment year's stock disability for both opening and closing stocks.*

It is acknowledged that the averaging of stock disabilities can reduce the alignment between changes in disabilities and changes in population. However, the averaging process does reduce volatility. South Australia is happy for Commission staff to undertake further analysis on the volatility implications of removing averaging for the states to consider.

The use of category specific growth measures assumes that the functionalisation proposal is adopted. If the functionalisation option is adopted, it would be a logical step to explore category specific growth factors and not just use population growth.

Staff propose to recommend the Commission:

- *not consider differential assessment of investment in land for any category other than roads*
- *assess the suitability of recurrent disabilities in assessing capital stock needs when assessments are further progressed*
- *consider whether to assess depreciation expenses with net investment expenses in an assessment of gross investment*
- *continue to assess the impact of population dilution on net financial assets, remove the 12.5% discount and not recognise any other disabilities.*

South Australia notes the staff recommendations but would prefer to provide comments on the proposals listed above when Commission staff have further developed their alternative assessment options. This will allow the interaction of the various proposals to be examined from a broader perspective rather than looking at specific changes in isolation.

Staff propose to recommend the Commission:

- *retain the 2015 Review method of assessing capital costs through a combination of construction cost indices and recurrent cost factors.*

South Australia is comfortable with the staff recommendation to retain the 2015 Review method of assessing capital costs through a combination of construction cost indices and recurrent cost factors.

21. WAGE COSTS (CGC 2018-01/22-S)

Staff propose to recommend that the Commission:

- *retain its approach to estimating differences in wage costs using the 2016 Update econometric model, updated with new CoES data each year.*
- *update the wage proportions of service delivery expenses based on GFS expense data in the review, but not update these proportions in subsequent updates.*

South Australia continues to hold concerns about the conceptual validity of the wages assessment. The assessment is based on the following key assumptions:

- Private sector wage movements in a state are a good proxy for public sector wage movements.
- Public sector wages are predominantly influenced by wage movements in local or regional labour markets.
- Comparability of public sector workers across jurisdictions.

The National Institute of Labour Studies in their 2016 report *Public-private sector wage differentials in Australia: What are the differences by state and how do they impact GST redistribution decisions (*NILS Report) provided sufficient evidence to question these underlying assumptions and moderate the distributional impact of the wage cost assessment.

Private sector wage movements *in a state are a good proxy for public sector wage movements*

The wage cost assessment seeks to reflect divergences between underlying public sector wage levels between states and territories but is influenced by inter-jurisdictional differences in the skills and experience of staff chosen to deliver comparable services (i.e. policy choices).This has led the Commission to base its assessment on comparable private sector employees as an indicator of the differences in wages that would need to be paid to public sector workers in each state. This approach is valid so long as there is a strong relationship between public and private sector wages.

Whilst private sector wage movements are an influence on public sector wages, this influence alone is unlikely to reflect movements in the wages for the majority of public sector employees (e.g. nurses and teachers). With some minor exceptions in highly specialist fields, state and territory governments are not forced to pay private sector wages. Wage outcomes reflect movements in job specific labour markets (national markets) and fiscal strategies in each jurisdiction.

The NILS report concluded that *"wages in the private sector appear to be more sensitive and responsive to pressures from the market. But these pressures also have the expected effects on the public sector, though moderated in timing and perhaps also in degree"*.

In other words, movements in private sector wages alone do not fully reflect the, triggers, timing and magnitude of movements in public sector wages.

Public sector wages are predominantly influenced by wage movements in local or regional labour markets

The Commission has held the view that public sector wages are predominantly driven by regional labour market influences with national wage pressures being less of a driver. South Australia has consistently argued that regional labour market factors may have some impact on public sector wages but that for the majority of public sector employees, wage movements/outcomes are strongly influenced by what happens in other jurisdictions.

In public sector wage negotiation processes (especially for teaching, nursing and police) relevant unions refer to interstate wages as a key justification for pay rises and changes in working conditions. Unions, like the Australian Education Union, maintain wage comparison charts on their websites to allow their members to observe wage rates and movements in other jurisdictions.

The Commission has previously undertaken comparisons of wage levels for nurses, police and teachers and have observed differences for what appear to be the same level of employee. These observed wage differentials are more likely to be the result of differences in responsibilities, differences in employment status (e.g. tenure), timing differences from when pay adjustments take effect, the impact of non-wage benefits and other policy choice differences.

The NILS Report provides support for the view that public sector wages are influenced as a result of competitive pressures from public sector wage outcomes in other Australian jurisdictions. The Report noted that states compete in two labour markets simultaneously i.e. local labour markets and a national labour market. NILS concluded that states*"…also compete with public sectors in other states, and this leads to some convergence in public sector wages across the country"*.

In its staff discussion paper, reference is made to analysis that showed 60 per cent of the people joining state public sectors between 2006 and 2011 come from the private sector, while only 3 per cent moved from another state public sector. South Australia also does not believe that this is strong evidence that the impact of competition for labour from other sectors in a state is stronger than the impact of a national labour market for state public sector employees. The physical movement of people across state borders is not an indicator of the influence that interstate wage levels can have on wages in a particular jurisdiction.

Comparability of public sector workers across jurisdictions

South Australia has previously expressed concerns about the true comparability of employees across jurisdictions. Jurisdictions with larger labour markets can offer greater and more diverse employment opportunities than smaller jurisdictions. This can lead to highly skilled and ambitious individuals leaving smaller jurisdictions and moving to the larger cities. Governments in larger jurisdictions may have access to a labour supply that is relatively more productive compared to smaller jurisdictions.

The NILS Report considered that the human capital composition (education and qualifications) of public sector workforces varied between jurisdictions. This raises the issue that workforce compositional differences will lead to differences in the standard or quality of services provided between jurisdictions.

To conclude, South Australia believes that sufficient evidence was provided in the NILS Report to support the Commission reducing the distributional impact of the wage cost assessment.

22. GEOGRAPHY USED BY THE COMMISION (CGC 2018-01/23-S)

Staff propose to recommend the Commission:

- *continue using ABS remoteness areas geography across all categories*

South Australia notes that Commission staff have investigated the possible use of the Modified Monash Model (MMM) for assessing remoteness. The MMM was developed by the Department of Health (Commonwealth) to better recognise and understand the challenges in attracting health workers to remote and smaller communities. The MMM attempts to improve the categorisation of metropolitan, regional, rural and remote areas according to both geographical remoteness and town size. Analysis was undertaken by Commission staff that compared cost/remoteness relationships using both the MMM and ABS standard remoteness areas (current remoteness data source) for schools and hospitals. This analysis did not demonstrate that the MMM was a better proxy of state spending than ABS remoteness areas data. The MMM appears to add additional complexity (a further two remoteness categories) without materially improving understanding of the cost/remoteness relationship. Based on this analysis South Australia supports the staff recommendation to continue using ABS remoteness areas geography across all categories.

Staff propose to recommend the Commission:

- *develop a regional costs assessment using data from schools, police, post-secondary education and hospitals.*
- *test whether there are significant differences in the cost gradients between these services and, if not, use a single measure for all categories.*

South Australia supports the staff recommendation to develop a regional cost assessment using data from schools, police, post-secondary education and hospitals. South Australia is also open to Commission staff testing whether there are significant differences in the cost gradients between region-affected services and whether a single measure for all categories could be used.

Staff propose to recommend the Commission:

- *send a data request to States for current data on State spending by region by service*
- *continue applying a regional cost disability to services where a conceptual case has been identified.*

South Australia believes that a conceptual case exists for regional costs being recognised in all of the categories identified in the 2015 Review. These include post-secondary education, housing, welfare, services to communities, justice, roads, transport, services to industry, other expenses, depreciation and investment.

South Australia is comfortable with Commission staff seeking data on state spending by region and service and continuing to apply a regional cost disability to services where a conceptual case has been identified.

Staff propose to recommend the Commission:

- *look into the merits of IRSEO+ as a better measure of Indigenous SES once this becomes available.*

South Australia is comfortable with Commission staff looking into the merits of IRSEO+ as a better measure of Indigenous SES once this becomes available.

Staff propose to recommend the Commission:

- *continue to use SEIFA and NISEIFA for the total and non-Indigenous population, respectively*
- *maintain 2015 methods for Service delivery scale*
- *maintain 2015 methods to measure Interstate non-wage costs.*

South Australia supports the staff recommendation to continue to use SEIFA and NISEIFA for the total and non-Indigenous population respectively and maintain 2015 methods for both service delivery scale and the measurement of interstate non-wage costs.

23. ADMINISTRATIVE SCALE (CGC 2018-01/24-S)

Staff propose to recommend that the Commission:

- *retain the 2015 Review definition of administrative scale.*

South Australia supports the current definition of administrative scale. We do not believe there is a compelling case for the Commission to pursue the issues around economies or diseconomies of scale raised by New South Wales and Western Australia.

Staff propose to recommend that the Commission:

- *to the extent possible, re-estimate administrative scale expenses for each expenses category using the bottom-up and top-down approaches.*

South Australia supports the proposal to re-estimate administrative scale expenses using the bottom-up and top-down approaches. South Australia has long considered that the current quantum, based on data from the 1999 and 2004 Reviews, needed to be recalculated as it no longer provided an adequate reflection of non-scale related costs faced by the states. We therefore welcome the work being undertaken by the Commission in this regard.

Staff propose to recommend that the Commission:

- *continue to adjust the ACT's scale expenses to reflect its minimal spending needs for Indigenous communities, non-urban transport, primary industries, and mining and mineral resources other than fuels;*
- *decide whether to retain the adjustments for the Northern Territory based on state-provided evidence about the existence of dual service delivery models.*

South Australia supports the Commission applying its judgement regarding adjustments to the administrative scale costs of the ACT and the Northern Territory.

Staff propose to recommend that the Commission:

- *re-estimate the proportion of administrative scale expenses to which the wage costs factor should apply through the collection of state data on the proportion of wage related expenses for head office functions and whole of state services such as Treasuries, for all the Commission's categories.*

South Australia supports the re-estimation of the proportion of administrative scale expenses to which the wage costs factor is applied, and will endeavour to provide the required information through the Commission's data request processes.

Staff propose to recommend that the Commission:

- *keep the administrative scale expenses up to date in updates following the 2020 Review by indexing them using the ABS State and Local Government Final Consumption Expenditure (SLGFCE) deflator.*

South Australia supports the Commission continuing to index administrative scale costs using the ABS's SLGFCE deflator, as it is a readily available index that reflects changes in state costs.

Before making a recommendation to the Commission:

- *staff seek state views on whether administrative scale expenses should all be included in a component of the Other Expenses category or separately identified in each expense category.*

South Australia is comfortable with the presentation of administrative scale costs either as a component of Other Expenses or in each expense category. It would be fairly simple to access this information from the Commission's publications and assessment system regardless of how it is presented.

24. OTHER DISBAILITIES (CGC 2018-01/25-S)

Cross border

Staff propose to recommend the Commission:

- *retain the 2015 Review approaches to cross-border disabilities for schools, post-secondary education, roads and hospitals.*
- *retain a cross-border assessment for community health expenses.*
- *collect updated evidence on cross-border use of ACT community health services by residents from New South Wales and use of New South Wales community health services by ACT residents.*
- *not apply a cross-border factor to residual State disability expenses, other general welfare expenses and recreation and culture expenses, unless the ACT provides evidence of significant cross-border use and that use leads to identifiable costs for the ACT.*
- *consider whether a community health specific method could be assessed to measure a cross-border factor or whether the general method, subject to a review of the proportion of the population from surrounding areas who are considered to use ACT services, should continue.*

South Australia supports the staff recommendations in relation to the assessment of cross border disabilities.

National Capital Allowances

Staff propose to recommend the Commission:

- *discontinue all the planning allowances unless the ACT can make a case for their continuation.*
- *retain the police allowance and the 2015 Review method for calculating it and assess it as a separate factor in the Justice category.*

South Australia supports the staff recommendations in relation to the assessment of National Capital Allowance disabilities.

Native title and land rights

Staff propose to recommend the Commission: • *continue to assess the native title component of the Native title and land rights assessment on an APC basis, subject to State views on alternative assessments.* • *decide on whether land rights expenses should be assessed for all States and, if so, how, after collecting State expenses on land rights.*

South Australia supports the staff recommendation to continue to assess the native title component of this category on an APC basis. The alternative assessment approach put forward by the ACT does not capture all the drivers of expenditure. South Australia is open to assessment options that do not require the annual collection of data from the states. However, native title expenditure for South Australia has been relatively volatile in recent years making reliance on a single year's data (or historical average) potentially non-representative for application in future years.

25. STAFF RESEACH PAPER – A BROADER ASSESSMENT APPROACH (CGC 2018-02-S)

Broader assessment approaches have been considered and rejected by the Commission and other review processes on a number of occasions since the introduction of the current comprehensive equalisation system.

The Commission has considered two broader revenue assessment approaches in its research paper – a macro approach and a global approach.

The macro approach involves using a single broad indicator for each revenue category (e.g. value of land for land revenue and private sector wages for payroll tax). The adoption of one unadjusted or broad measure of tax capacity for each category would not reflect the true nature and scope of the relevant tax base. Such measures would not reflect the existence of thresholds (wage thresholds), common exemptions (e.g. principal places of residence), land value distribution variances between jurisdictions and would potentially apply non-representative capacity measures to aggregated revenue categories like other revenue.

Adoption of a global revenue assessment, with one broad indicator determining the capacity for all revenue categories, is a more extreme approach and would result in an assessment of revenue capacity that is based on a single driver/measure that has little or no connection or relevance to the actual capacity to generate taxation revenue.

No one indicator can be used as a proxy driver for assessing all state taxes and revenues, as noted by Walsh (2011)[2]:

[2] C Walsh, The Equity Case for Equalising Fiscal Capacities: Rationales, value-judgements, compromises and their implications, A discussion paper prepared for the Department of Treasury and Finance, Government of Victoria, September 2011, page 15.

> *"….it is sometimes suggested that revenue-raising capacity assessments should be based on global or macro measures such as household incomes. The major problem with this suggestion is that it confuses households' capacity to pay with States' capacities to raise revenue, in two senses. First, if the tax bases actually available to the states are not related to incomes, nor will be their actual capacity to raise revenue from them. Second, and perhaps even more significantly, household incomes or any other reasonably measurable macro indicator would, at best, capture only the capacity of States to raise revenue from residence-based taxes. It would not reflect any differences in different States' relative capacities to raise revenue from source-based taxes."*

South Australia is opposed to the use of all forms of broad revenue assessment as they do not reflect what states do and would produce outcomes that are inconsistent with the equalisation objective.

The use of broader indicators to measure revenue capacity would produce extreme winners and losers and move away from true equalisation without achieving any significant simplification to HFE arrangements and to federal financial relations more broadly. We do not in any way support the concept that gross simplification is a higher order priority than accuracy of assessments.

Similarly, South Australia is opposed to the replacement of existing expense assessments with broader "proxy" based assessment approaches. The Commission has investigated a number of expense "proxy" approaches including assessments being based on subsets of existing expense assessments, subsets of state attributes, regressions of state actual expenditure, national government expenses and past expense assessments.

The GST distribution implications from the options modelled by the Commission vary significantly. The variations range from negative redistributions of close to $4000 per capita (2015-16 impact for the Northern Territory using a national government expense approach) to positive redistributions of over $150 per capita (2015-16 impact for Queensland using subset of state attributes approach). There is no consistent pattern or direction common to all the options.

All of the options considered have the same underlying problem – they do not accurately reflect the drivers of state expenditure. As a result, the selection of any "proxy" option would be arbitrary and not be consistent with the equalisation objective.

Commission staff have also considered an expansion to its current approach to simplification – the use of materiality thresholds. The current general materiality threshold of $30 per capita could potentially be increased resulting in revenue and expense categories dropping out of the assessment process. Increasing the materiality threshold to $100 per capita would remove seven expense disabilities and three revenue disabilities. An increase to $200 per capita would increase these numbers.

South Australia recognises that materiality thresholds are necessary to ensure that assessments are focused on the main drivers of revenue capacity or the main drivers of state expenditure and are an effective way of simplifying assessments. However, there comes a point where thresholds levels can undermine the equalisation objective. The threshold levels modelled by Commission staff, $100 per capita and $200 per capita would clearly undermine this objective.

South Australia supports the Commission's position of increasing the materiality threshold for disability assessments from $30 per capita (from the 2015 Review) to $35 per capita to reflect price and wage movements.

26. REVIEW QUALITY ASSURANCE STRATEGIC PLAN (CGC 2018-03-S)

South Australia is generally comfortable with the proposed Quality Assurance Strategic Plan.

Under *Objective 2: Transparent and appropriate reporting of methods, decisions and results*, we would like the reference to providing a draft report to states on the Commission's preliminary decisions on assessments to also include an undertaking to provide the estimated GST redistribution impacts (compared to the 2019 Update) for each proposed method change and for each assessment category.

27. THE PRINCIPLE OF HFE AND ITS IMPLEMENTATION (CGC 2017-21)

Objective of HFE

South Australia supports the Commission position to retain the current definition of the Horizontal Fiscal Equalisation (HFE) as being:

> *State governments should receive funding from the pool of goods and services tax such that, after allowing for material factors affecting revenues and expenditures, each would have the fiscal capacity to provide services and the associated infrastructure at the same standard, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency.*

Should the Commonwealth decide in the future to provide states and territories with funding in addition to the GST pool in response to the PC Report recommendations, the definition should refer to both *funding from the pool of goods and services tax* and the additional funding.

This definition supports a "full" model of equalisation rather than a form of "partial" equalisation. Full equalisation should be the objective as it attempts to replicate how a unitary system of government would treat its citizens in the absence of state and territory borders.

South Australia agrees with the Commission that the use terms such as "similar" or "acceptable", when referring to standards of service, would not lead to a simpler or more transparent assessment framework. Conversely, it would complicate the assessment process as any deviation away from the "same" objective would require justification and explanation.

The words *'after allowing for material factors'* adequately allow the Commission to resist excessive or inappropriately detailed assessments where required.

Supporting principles

Role of supporting principles

South Australia supports the Commission position to retain the existing supporting principles, not introduce new principles and not to introduce any form of ranking or weighting.

Ranking or weighting of principles would unnecessarily complicate assessments. It would be difficult to get consensus among the states about the appropriate weightings for each supporting principle. In most instances, the Commission's current methodology achieves an appropriate balance between the supporting principles.

"What states do"

South Australia supports the Commission's position to retain the "what states do" principle as the basis for category assessments and the Commission's preference for internal standards.

Internal standards ensure that assessments reflect what states actually do and effectively removes the need for the Commission to make judgements on what states *could* or *should* do. It focuses assessments on activities or services actually provided by states and territories and allocates GST revenue accordingly.

The use of any form of external standard would require significant judgement and would increase overall complexity. External standards have been proposed by some as a way to use the GST distribution mechanism as an incentive to achieve particular efficiency goals or policy objectives. The Commission has correctly formed the view that the achievement of HFE should not be compromised by expanding the objective of the GST distribution arrangements. Other policy objectives should be pursued outside the HFE system.

The use of external standards raises a number of concerns, including impeding states' sovereignty and undermining the untied nature of states' allocations of GST revenues. In addition, determining how external standards are derived would be an ongoing area of contention and it would be difficult to achieve agreement on national or state benchmarks that would drive the external standards. As states differ in the scope and quality of services provided, it would be difficult to determine appropriate service delivery baselines without penalising or over-rewarding jurisdictions.

The Commission has stated that they would only consider the use of external standards in circumstances of extreme policy non-neutrality and where another suitable resolution cannot be found. South Australia does not believe that there are currently any circumstances that warrant the use of external standards.

Policy neutrality

South Australia supports the Commission view that adoption of broad indicators, particularly for revenue assessments, would not necessarily result in an improved HFE outcome.

Western Australia has proposed the use of broad indicators, in particular, a global revenue assessment. Although this has been presented as a way of addressing policy neutrality concerns, expectations of a more favourable GST outcome is more likely to be the main driver behind this proposal.

South Australia is opposed to the use of broad indicators where they do not reflect what states do. The use of broader indicators to measure revenue capacity would result in arbitrary winners and losers, is unlikely to achieve any significant simplification and would come at the expense of a less equitable and efficient HFE outcome.

For each major revenue item (payroll tax, land tax, conveyance duty, motor vehicle taxes) there is no one independent indicator or statistical collection that can capture the drivers of taxation revenue and changes in the bases that are actually taxed.

It would be inappropriate, for example, for the assessment of conveyance duty needs to be based solely on land values (and disregarding transaction volumes) or the assessment of payroll tax needs based on household income data (disregarding thresholds and exemptions).

Practicality

South Australia supports the Commission position that recognises while State fiscal capacities are affected by a wide variety of factors, an improved HFE outcome may not be achieved by including factors when sufficient data are not available to measure their effects or where effects are small.

Although practicality can limit the extent to which the Commission can achieve full fiscal equalisation, it reflects the reality of not always having reliable or fit-for-purpose data available for all assessment components.

South Australia supports the Commission using the most reliable, fit-for-purpose data in its assessments but acknowledges that the Commission will often have to exercise judgement when such data is not readily available.

Contemporaneity

South Australia notes that the Commission has not settled its position on changing the size of the assessment period (currently three years) and agrees with the Commission's reluctance to use states' or independent estimates/forecasts of revenues and expenditures in the application year.

South Australia is comfortable with the Commission's current approach to contemporaneity and continues to believe that three year averaging is a practical, reliable and stable assessment approach. While we are not opposed to the Commission exploring a shorter assessment period (less than three years) we would ask that volatility and predictability implications of any potential change are taken into account.

Implementation issues

Discounting assessments

South Australia is comfortable with the Commission's discounting framework and generally supports the Commission using its discretion to determine the levels of the discounts applied in specific cases. However, as discussed in our earlier submission, South Australia would encourage the Commission to review the discounts applied in the Land Tax and Wage Costs assessments.

Materiality thresholds

Refer to the *Broader assessment approach* section for comments on materiality thresholds.

Quality assurance

South Australia notes the work that the Commission is doing on the 2020 Review Quality Assurance Strategic Plan.

Backcasting

South Australia is generally supportive of backcasting major changes in Commonwealth-State relations. However, backcasting should only be undertaken when the Commission is satisfied that reliable estimates of all relevant factors (including costs, activity levels, participation rates) are available, and a genuine step change is occurring in the application year in respect of the roles and responsibilities of Commonwealth and State Governments.

Treatment of other Commonwealth payments to states

South Australia supports the Commission's current approach to assessing Commonwealth payments to the states i.e. payments which support state services, and for which needs are assessed, will have an impact on relativities. In adopting this principle, the Commission should retain its discretion in determining the treatment of each payment in a manner that most closely achieves HFE.

The assessment guidelines

South Australia is comfortable with the Commission's proposed assessment guidelines.

South Australian Department of Treasury and Finance
September 2018