COMMONWEALTH GRANTS COMMISSION (CGC) 2015 REVIEW

UPDATE AND SUPPLEMENTARY ISSUES FOR THE 2015 REVIEW

STAFF DISCUSSION PAPER CGC 2014-03-S

NSW TREASURY COMMENTS

OCTOBER 2014

This submission responds to the Commonwealth Grants Commission's request for State comments on CGC Staff Discussion Paper 2014-03-S, *Update and Supplementary Issues for the 2015 Review*.

The 2015 Review Draft Report provided to States on 1 August 2014 contained a number of assessments in which the CGC had used 'placeholders' where assessments were still being developed or up-to-date data was not available. The *Update and Supplementary Issues* paper provides CGC staff proposals on developments in the assessments and data since the Draft Report.

In summary, NSW Treasury:

- is not convinced all issues relating to co-linearity in the school regression models have been resolved. We are concerned also that the 'fixed costs' measured by the government school model may cover more than service delivery scale
- considers CGC Staff conclusion that netting post-secondary education revenue off expenses is appropriate seems based on a materiality criterion, which if accepted could be relevant in other expense assessments
- is not convinced that the proportion of one-parent families with dependents in State populations provides a good indicator of the need to spend on 'other general welfare'. An amalgam of indicators identified by the CGC may provide a better indicator
- notes that the changes to the GST distribution outcomes of the Justice assessment resulting from updating SES weights indicate Horizontal Fiscal Equalisation is only ever a very approximate process. This suggests outcomes that are just as valid could be achieved using far less detailed, but simpler and more transparent, methods
- notes that further consideration of the treatment of Commonwealth education funding will be needed given uncertainty in arrangements beyond 2017 when Students First funding will end
- considers Option 3 (the actual 2013-14 National Health Reform (NHR) funding distribution) is the most appropriate treatment of NHR funding
- suggests that some Commonwealth payments to States the Commonwealth Government unilaterally ceased in its 2014-15 Budget could be regarded as major changes to

Commonwealth-State financial relations. Cessation of the payments should be backcast if, on an aggregate basis, including those payments in the assessment years materially changes some States' GST payments in 2015-16 when the payments will not be received

- notes that CGC Staff propose to use materiality as a criterion for deciding whether the CGC should exercise its discretion to change the treatment of Commonwealth facilitation payments from 'no impact' to 'impact'. Elsewhere problems are noted in applying materiality thresholds to individual Commonwealth payments – principally the incentive it provides for structuring payments to remain under thresholds
- suggests the Commonwealth payment for pay equity for the social and community services sector should have no impact on the relativities and
- notes the CGC Staff proposals in relation to
  - adjustments to June disaggregated estimated resident population data to make it consistent with December aggregate estimated resident population data
  - not backcasting Commonwealth payments commencing in 2014-15 and 2015-16
  - continuing the current treatment (impact on relativities) of Commonwealth payments for Water for the Future unless State information suggests some of the payments are for environmental purposes (for which no needs are assessed) and State policy plays no part in determining that purpose.

Changes to econometrics in Schools Education and Regional Costs

Staff intend to recommend the Commission:

- update the econometric model used in the schools regression to include the changes specified below.

Since the release of the 2015 Review Draft Report, the Commission has received the report from the consultant engaged to examine the econometric modelling used to estimate differences in spending on students with different characteristics using Australian Curriculum and Reporting Authority (ACARA) data. The Commission has also received 2012 ACARA data.

Staff propose to make a number of changes to the models estimated for government and non-government schools:

- moving to a model based on funding per student rather than funding per school. This allows students to be attributed to one of the ten Indigenous/socio-economic dummies without any co-linearity issues. In the schools based model, allocating each school based on geography-based Indigenous and non-Indigenous socio-economic indexes produced co-linearity issues which prevented use of the Indigenous SES weights in the Draft Report
- removing State dummies to better reflect what States collectively do

- including a variable that captures the fixed costs of schools rather than forcing the regression through the origin. This allows removal of the dummy identifying schools in Service delivery scale (SDS) areas
- including remoteness in the non-government schools model.

NSW Treasury is concerned that changes to the model result in largely offsetting changes to the loadings for Indigenous and remote students. We are not convinced that all issues related to co-linearity have been resolved. The CGC explains that:

> The changes to the model have resulted in changes to coefficients for some variables. There were largely offsetting changes to the loadings for Indigenous and remote students. For example, the loading for a most disadvantaged, very remote Indigenous government student was changed from 142% (91% for Indigenous + 51% for very remote) to 135% (44% for most disadvantaged Indigenous + 91% for very remote). We understand that whether the high costs for remote Indigenous students are allocated to Indigeneity or remoteness is sensitive to the exact specification of the model. We would be interested in any information on whether that way the current model allocates these costs is consistent with State experience.[1]

The report on econometric work states that:

> Because of the inter-relation among the included explanatory variables, the effects of certain variables may be spread over a few related variables.[2]

NSW Treasury sees this as an issue for both the underlying data as well as the regression model specifications.

In New South Wales, the Resource Allocation Model (RAM) provides funding through three components: base, equity and targeted funding. Additional funding for remote schools and Indigenous students are independent of each other.

RAM funding for 'remoteness' is provided to schools through base funding allocations. Equity funding for Indigenous students funds students with the highest need at a higher rate per student. The rate per student increases based on the percentage of Indigenous student in the schools. However, no consideration is given to location in this loading.

NSW Treasury remains concerned with the underlying ACARA data. As raised in NSW Second submission to the CGC, NSW Treasury is not convinced that the ACARA data provides the nationally consistent data required to remove all uncertainty from the regression results.

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[1] CGC, *Update and Supplementary Issues for the 2015 Review*, Staff Discussion Paper CGC 2014-03-S, page 2.

[2] Gong, X., *Report on econometric work conducted by CGC*, page 2.
https://cgc.gov.au/index.php?option=com_content&view=article&id=196&catid=73

The CGC has not shown that the ACARA data has overcome aspects raised by Deloitte Touche Tohmatsu in the letter dated 21 February 2013, related to the 2011 calendar year financial data (provided using substantially the same methodology as used for the 2010 data).[3]

Cost weights

Given our concerns with the specifications of the regression model and the data, NSW Treasury is not convinced of the accuracy of the resulting cost weights.

NSW Treasury notes that student loadings for government and non-government students are now based on separate analyses of government and non-government school data from ACARA.

Service delivery scale

NSW Treasury notes the CGC's change in method to estimate service delivery scale (SDS) for schools means that fixed costs are not incorporated in the results of other variables.

However, NSW Treasury is not convinced that the 'fixed cost' per school estimate provided by the regression model is measuring SDS alone. SDS is supposed to account for the higher costs incurred in schools in small communities due to relatively higher staffing levels in those communities, given likely smaller class sizes. It is not clear that the fixed costs estimate per school from the regression is not picking up other elements of fixed costs.

Regional costs

The relationship between remote and Indigenous costs raises concerns for the accuracy of the regional cost factor if it is to be extrapolated to other expense categories. However, even if the regression results from schools were completely accurate, NSW Treasury does not support the extrapolation of econometric regression results from schools to other expense categories due to the absence of evidence that:

- the regional cost differential applicable to labour and other inputs in the delivery of school education are equally applicable to other services and
- the delivery of other services requires the same combination of inputs of labour and non-labour inputs as does the delivery of school services.

If the CGC extrapolates school regional costs to other categories, a high level discount of 50 per cent should be applied.

[3] Further detail can be found in NSW Second Submission to the CGC 2015 Methodology Review, pages 53-57

Post-secondary education user charges

> Staff propose to recommend the Commission:
>
> - net all post-secondary education user charges off the post-secondary education expenses rather than assessing them in Other revenue.

In the Draft Report, the Commission proposed to assess all revenues from user charges (both fee-for-service revenue and non-fee-for service revenue) equal per capita within the Other revenue category. This was because the CGC considered that:

> … it is likely the drivers of revenue are somewhat different to the drivers of expenses, and netting off revenue would be inappropriate. We have not identified any data source that would identify the revenue raised from different groups of students which we would require for a differential assessment of user charges.[4]

CGC Staff now argue that there is a strong conceptual case for netting fee-for-service revenue off post-secondary education expenses because:

- the revenue largely meets State spending on non-subsidised training hours which are provided on a commercial basis, so State provision of commercial VET services has no net impact on State fiscal capacities
- the socio-demographic pattern of hours used in the assessment does not include students enrolled in fee-for-service courses, so netting off fee-for-service revenue means that usage patterns and expenditure are comparable.

CGC Staff now consider assessing non-fee-for-service revenue on the basis of assessed hours is:

> … the most reliable and simple approach. It is not materially different to an assessment of non-remote, non-Indigenous and high SES students: those most likely to pay fees. It is more appropriate than the approach in the draft report...[5]

NSW Treasury agrees that if post-secondary education user charges revenue reflects exactly the same socio-demographic composition, cross-border and location disabilities as the post-secondary education expenses the simplest assessment method is to net off user charges from expenses.

However, CGC Staff have not provided enough information to make this conclusion. CGC Staff suggest fee-for-service revenue 'largely' meets State spending on non-subsidised training hours, without quantifying the gap. Non-fee-for-service revenue is said to be not materially different to

[4] CGC, *Draft Report*, page 179.

[5] CGC, *Update and Supplementary Issues for the 2015 Review*, Staff Discussion Paper CGC 2014-03-S, page 5.

an assessment of non-remote, non-Indigenous and high SES students, whereas the socio-demographic disabilities in the assessment give higher expense weightings to Indigenous and low-SES users.

Instead, the materiality of the impact (or lack thereof) of changing the assessment has been used to justify the change. If the criterion in expense assessments for netting off revenue becomes materiality it is possible other user charges in other assessments also could be netted off without material impact.

NSW Treasury would have preferred the CGC to provide a more detailed explanation as to why netting revenue from expenses is 'more appropriate' than the original proposal to assess revenue equal per capita under Other revenue.

NSW Treasury notes that the GFS concept of user charges excludes 'other revenue' and a few other minor adjustments. The National Centre for Vocational Education Research (NCVER) definition of 'other revenue' is not provided, though an Other revenue component is noted in Table 2 (page 5) of the Staff Discussion Paper. NSW Treasury considers that these elements of revenues should continue to be assessed equal per capita under the Other revenue category.

Low socio-economic status disability for Other General Welfare Services

Staff propose to recommend the Commission:

- use an up-to-date broad indicator of disadvantage such as the proportion of one parent families with dependents for the assessment of other general welfare services.

In the Other General Welfare sub-component of the General Welfare component of the Welfare assessment the CGC recognises low socio-economic status (SES) as an influence on the cost of providing services.

The CGC's standard approach in most other expense categories where low SES is assessed is to use a geographic measure of socio-economic status: an Indigenous specific Indigenous Relative Socio-Economic Outcomes (IRSEO) Index for Indigenous people, and a non-Indigenous Socio-Economic Index for Areas (NISEIFA) for non-Indigenous people. These indexes rank geographic *areas* according to relative socio-economic advantage and disadvantage.

CGC Staff consider using these geography-based indexes is not appropriate for Other General Welfare expenses. General welfare services are considered to be generally targeted at the 20 per cent of the *population* with the lowest SES, and some disadvantaged people live in non-disadvantaged areas.

The CGC therefore uses the relative proportion of people in the bottom quintile of the ABS's Socio-Economic Index for Individuals (SEIFI). In the 2015 Review Draft Report the CGC used as a placeholder SEIFI data from the 2006 Census, which would be updated when the 2011 Census data became available.

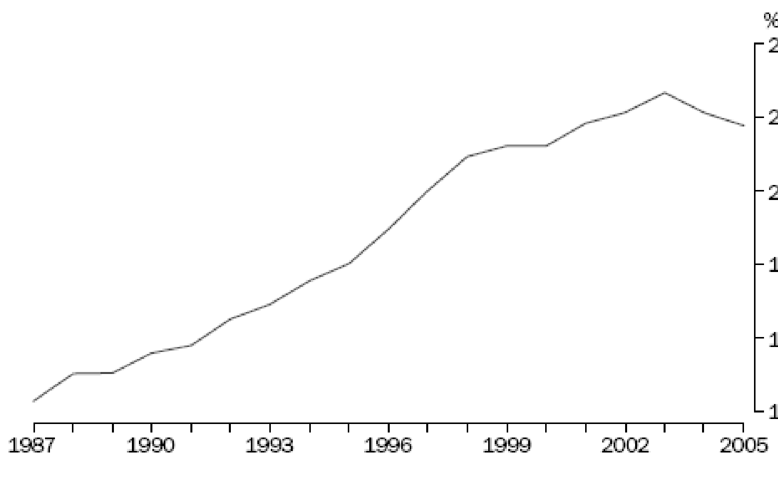
However, the ABS is not intending to update the SEIFI using 2011 Census data, nor is any alternative available in time for the 2015 Review. Commission Staff consider the 2006 SEIFI data too dated, given other indications from the 2001 census that the socio-economic status of State populations has changed.

CGC Staff therefore need an alternative measure of low SES status based on population. Staff considered, and rejected, household equivalised income based on the 2011 Census (it focusses on only one aspect of disadvantage), and measures of homelessness (numbers of people counted as homeless are subject to State policy influences).

Staff consider the proportion of one-parent families with dependents in State populations might provide a reasonable broad indicator of disadvantage and the need to provide other general welfare services, since these families tend to be higher users of welfare services such as temporary accommodation and other support services.

NSW Treasury is not convinced that the proportion of one-parent families with dependants in State populations provides a good indicator of the need to spend on other welfare. Chart 1 shows that one-parent families as a proportion of all families with children under 15 years increased from around 14 per cent in 1987 to around 22 per cent in 2005.

Chart 1: One-parent families as a proportion of all families with children under 15 years



Source: ABS, *Australian Social Trends 2007*, Cat.4102.0.

However, AIHW data shows a decline in recurrent spending for other welfare services on an annual average basis of -1 per cent over 1998-1999 to 2005-06.[6] If there was a strong correlation

[6] *AIHW, Welfare Expenditure Australia 2005–06, November 2007, Cat. HWE 38, p.18.*

between this family-type, level of disadvantage and use of general welfare services, more spending could be expected rather than less.

NSW Treasury suggests that an amalgam of the indicators suggested by CGC staff might provide a more multi-dimensional indicator of population disadvantage. This could be achieved by combining the indicators linked to income and family structure, though omitting homelessness if it is thought to be too influenced by State policy.

Otherwise, using IRSEO/NISEIFA as applied in other categories of expenses would at least provide a more consistent approach in the absence of any further supporting evidence from the Commission.

Revised weights for the Justice assessment

Staff propose to recommend the Commission:

- derive Indigenous use rates for police by adjusting the Australian Institute of Criminology (AIC) 2007 data based upon State provided data for 2010-11 to 2012-13 offenders
- continue to apply a 25 per cent discount to the specialized police-socio-demographic composition (SDC) factor
- derive Indigenous use rates for courts based upon State provided data for 2010-11 to 2012-13 on defendants
- fix the Indigenous use rates for the duration of the Review, unless a more current data source (such as updated AIC data) becomes available
- recognize socio-economic status (SES) in the Justice assessment based upon the index of Indigenous Relative Socio-Economic Outcomes (IRSEO) for Indigenous people and the non-Indigenous Socio-Economic Index for Areas (NISEIFA) for non-Indigenous people
- derive SES use rates for police and courts separately based upon State provided data for 2010-11 to 2012-13 for offenders and defendants respectively
- apply SES groupings based on the two most disadvantaged quintiles, the middle quintile and the two least disadvantaged quintiles
- apply the same SES groupings for police, courts and prisons
- apply the courts SES use rates in prisons
- fix the SES groupings and weights for the duration of the Review.

In the Justice assessment – with components for expenses on police, courts and prisons – the CGC recognises that certain population characteristics (Indigeneity, males aged 15-34 and people from low socio-economic status (SES) areas) affect the use and cost of providing services.

In the Draft Report the CGC used as placeholders SES weights from the 2010 Review. These weights were based on an SES distribution using the Socio-Economic Index for Areas (SEIFA),combined with data from States on offenders by location for 2005-06 and criminal court appearances for 2008-09, and, for police expenses, data from the Australian Institute of Criminology (AIC) 2007 *National Police Custody Survey*, for court expenses, ABS data on defendants with adjudicated outcomes, and for prison expenses, ABS data from *Prisoners in Australia* and Australian Institute of Health and Welfare data on persons in juvenile detention.

CGC Staff noted in the Draft Report that the weights would be updated using more recent State supplied data for the period 2010-11 to 2012-13, other updated data, and separate Indigenous and non-Indigenous SES weights calculated using the Indigenous Relative Socio-Economic Outcomes (IRSEO) Index for Indigenous people and the non-Indigenous Socio-Economic Index for Areas (NISEIFA) for non-Indigenous people. The *Update and Supplementary Issues* Paper provides the outcomes of that updating and separate Indigenous and non-Indigenous SES weighting.

NSW Treasury notes the updating generally produces lower weights for Indigeneity – reflecting the lower proportion of Indigenous offenders amongst total offenders – and for low SES – reflecting the change in the SES groupings, with the middle quintile forming the 'middle' SES grouping in the 2015 Review, rather than the middle three quintiles as in the 2010 Review.

For the 2012-13 assessment year, the changes produce a substantial redistribution of GST payments for some States: the Northern Territory's GST payments 'need' is reduced by $66 million ($277 per capita) and Tasmania's reduced by $22 million ($43 per capita) and Western Australia's 'need' is increased by $33 million ($13 per capita) and Victoria's by $70 million ($12 per capita).

NSW Treasury considers these changes indicate that Horizontal Fiscal Equalisation is a very approximate process, heavily dependent on the data available and how it is used. This suggests that outcomes achieved using less detailed but far simpler and more transparent methods could be just as valid.

Adjustments to June disaggregated estimated resident population (ERP) data

Staff propose to recommend the Commission:

- adjust disaggregated 30 June estimated resident populations in proportion to match 31 December State population totals for each assessment year.

Staff require estimated resident populations (ERP) to be disaggregated according to different characteristics. such as age, sex, Indigenous status and location, so national costs calculated for different population groups can be distributed across the States according to State shares of that population group.

Conceptually the disaggregated populations should add to equal total State populations. However, the CGC uses total populations as at 31 December each year – the mid-point of each year – to calculate per capita averages, while disaggregated population data are available only for 30 June each year.

Staff propose recommending the Commission adjust 30 June ERPs so the total population for each State matches the 31 December State totals. This is the same as applying disaggregated 30 June population shares to total populations as at 31 December.

NSW Treasury notes this proposal.

Backcasting Commonwealth National Specific Purpose and National Agreement Payments (SPPs)

Changed Federal financial arrangements affecting the year in which relativities are to be applied (the application year) are backcast into the years on which the calculation of the relativities are based (the assessment years), provided the changes are major, the application year outcomes are reliably known and the outcomes that would have applied in the assessment years can be reliably estimated. This ensures that the relativities are calculated on a basis most appropriate to the year in which they will be applied.

For example, when funding for National Agreement payments was phased over several years to an equal per capita (EPC) distribution under the 2008 Intergovernmental Agreement, the distribution that would apply in the application year (an increasing percentage EPC and a decreasing percentage based on historical shares) was backcast into the assessment years.

- Commonwealth payments for Skilled Workforce Development, Affordable Housing and Disability moved to a completely EPC distribution in 2014-15, so an EPC distribution was backcast for these payments in the 2014 Update and this will continue in the 2015 Review.
- However, with further changes since 2008 in Commonwealth-State funding arrangements for health and education, the distribution to States of these Commonwealth payments is moving away from equal per capita and issues arise in relation to how these payments should be backcast.

Students First

The 2015 Review Terms of Reference direct the Commission to ensure that the GST distribution process will not unwind the recognition of educational disadvantage embedded in the National Education Reform Agreement (NERA). Commonwealth funding related to the NERA is now referred to as Students First.

NSW Treasury notes that to meet this condition, the 2015 Review Draft Report outlined that the impact on State fiscal capacities of:

- Commonwealth payments for government schools under the Students First program would be the difference between:
    - what States receive in each of the assessment years (backcast using the distribution in 2015-16) and
    - what they would have received had the Commonwealth funds been distributed among States only on the basis of the Student Resource Standard (SRS) amounts for different students and the numbers of such students in each State in 2015-16.
- Commonwealth payments to non-government schools will have no impact.

The Commission has decided that the treatment of Commonwealth payments for government schools is necessary because States have negotiated different levels of base funding, which should be the subject of equalisation.

The Draft Report states that:

> This approach means we do not 'unwind' the recognition of educational disadvantage embedded in the NERA funding for government schools, but we do 'unwind' the different transitional paths States have agreed to in bilateral agreements with the Commonwealth, and differential Commonwealth funding proportions.[7]

This treatment increases the complexity of the assessment. Further complexity is created by uncertainty around the Commonwealth funding arrangements beyond 2017, when Students First funding will end. NSW Treasury expects close consultation with the CGC as details of funding from 2018 are determined so that they can be incorporated into the 2015 Review methodology.

National health reform funding

Staff propose to recommend the Commission:

- Backcast the National Health reform funding using the 2014-15 National health Reform distribution in MYEFO, adjusted for cross-border payments.

There are two key issues that the Commission needs to decide in this Review on the appropriate treatment of National Health Reform (NHR) funding to the States:

- how to give effect to the terms of reference requirement to allocate NHR funding on the basis of residence

[7] CGC, *2015 Review Draft Report*, page 161

- whether, and how, the NHR payments should be backcast in this review.

The *Update and Supplementary Issues* paper suggests the following options in response:

- Option 1: use the out-year estimates for 2015-16 from the 2014-15 Commonwealth Budget, and make an adjustment for cross-border use. The cross-border estimate would be derived by indexing the 2013-14 estimate or using Treasury's estimates if available

- Option 2: if the first approach were not deemed sufficiently reliable, the Commission could use a similar approach for 2014-15, from estimates published in the 2014-15 MYEFO

- Option 3: use the 2013-14 distribution as published in the Commonwealth's 2013-14 Final Budget Outcome, with an adjustment for cross-border. This is not materially different from an EPC distribution, but the Commission notes that this is conceptually more valid.

NSW Treasury does not support Option 1 given the uncertainty about the level of hospital activity assumed by the Commonwealth in its 2014-15 Budget projections. As shown in Table 1, these assumptions include annual growth of up to 20 per cent for some States.

Table 1: Growth in Commonwealth Health funding to the States

Year	Budget presentation	NSW %	VIC %	QLD %	WA %	SA %	TAS %	ACT %	NT %	AUS %
2013-14	EPC (less cross border)	7.77	7.27	12.83	13.57	7.08	15.17	-0.29	0.07	9.18
2014-15	EPC + actual growth	9.82	8.22	9.75	11.42	8.39	6.22	10.07	19.39	9.50
2015-16	EPC + actual growth	9.59	8.09	9.59	11.22	8.20	6.21	9.99	17.61	9.33

Source: 2014-15 Commonwealth Budget Paper No.3

Staff propose to recommend the Commission adopt Option 2 which is to backcast funding using the 2014-15 NHR distribution in MYEFO, adjusted for cross-border payments. This is preferable to Option 1 as the 2014-15 NHR figures in MYEFO are likely to be updated using several months of actual activity data which should be more accurate.

In the 2014 Update, the Commission considered whether to backcast the NHR funding based on the 2014-15 distribution. Most States argued that backcasting the NHR funding would be based on unreliable data. As such, the Commission concluded the 2014-15 NHR funding distribution should not be backcast as it could not be done reliably.

NSW Treasury considers Option 3 (actual 2013-14 NHR funding distribution) is the most appropriate treatment of NHR funding given it is robust and recognises that public hospital funding will be on an EPC basis from 2017-18. This is consistent with the outcome under Option 3 which is not materially different from an EPC distribution and would not require any backasting.

If the Commission adopts Option 2, NSW Treasury agrees that this would require backcasting, if materially different from an EPC basis, due to interstate differences in the level of hospital activity.

Treatment of Commonwealth payments not made in the application year

Staff propose to recommend the Commission:

- only consider backcasting payments not made in the application year when they are the result of major change in Commonwealth-State financial arrangements
- not backcast any of the payments made in the assessment years but not made in the 2015-16 application year because their cessation is not the result of major change in Commonwealth-State funding arrangements.

In the Draft Report, the Commission said it would consider whether Commonwealth payments made in the assessment years for the 2015 Review (2011-12 to 2013-14) but not made in the application year (2015-16) should be removed from the assessment years. This might ensure that the relativities better reflected fiscal arrangements that would apply in the application year.

NSW Treasury agrees that the same principles that are applied in the decision whether to backcast changed Commonwealth-State financial arrangements in the application year to the assessment years should also apply to the decision whether to backcast ceased payments in the application year to the assessment years.

We agree cessation of the payments should be backcast into the assessment years only where the cessation is the result of major changes to Commonwealth-State financial relations. We agree that many of the payments ceasing in 2015-16 do not meet this criterion.

- Some of the ceasing infrastructure payments were for time limited projects and have been replaced by payments for new projects.
- Some of the payments were due for expiry on dates established in the agreements, even though their non-replacement by other payments makes continuing service provision by States of services provided under the agreements difficult.
- Many of the payments were treated so that they had no impact on the relativities.

NSW Treasury considers that whether overall Commonwealth funding of the States has increased or decreased should not influence the decision. It is not overall amounts of Commonwealth funding that influences the GST distribution but rather the distribution of the Commonwealth funding between the States. That funding in the normal course of events, if not the result of major changes in Commonwealth-State funding arrangements, would not impact on the relativities until it is taken into the assessment years.

However, in its 2014-15 Budget the Commonwealth unilaterally terminated funding for some national partnership payments in advance of scheduled expiry dates. For example:

- the Preventive Health National Partnership was not due to expire until 30 June 2018. The non-reward and non-local government elements of the payments impacted on the relativities in the 2014 Update
- the National Partnership on Certain Concessions for Pensioner Concession Card and Seniors Card Holders was not due to expire until 30 June 2016. It provided payments in two components: under a 1993 agreement whereby the Commonwealth and the States agreed that certain concessions would be provided by the States to all Pension Concession Card holders without discrimination between cardholders, in return for indexed Commonwealth funding; and the second relating to the Commonwealth's contribution to the provision by State governments of Designated Public Transport Concessions to all Australian Seniors Card holders using public transport services, irrespective of the Senior Card holder's state of residence which commenced in 2008-09 as a Commonwealth initiative. Total payments in 2013-14 were $292 million,[8] and in the 2014 Update the payments impacted on the relativities.

Such changes could be regarded as major changes to Commonwealth-State financial relations. Cessation of the payments should be backcast if including those payments in the assessment years materially changes some States' GST payments in 2015-16 when the payments will not be received.

In line with the Commission's decision in the Draft Report not to adopt a materiality threshold for individual Commonwealth payments, materiality should be assessed in relation to the total impact of ceased Commonwealth payments regarded as major changes to Commonwealth-State financial relations.

Treatment of other Commonwealth payments

Staff propose to recommend the Commission:

- only exercise its discretion in relation to the treatment of Commonwealth payments where doing so will make a material change at the proposed disability materiality threshold and the impact can be assessed reliably.

[8] Commonwealth Government, *Final Budget Outcome, 2013-14,* Table 40, p. 74.

The CGC is directed to treat some Commonwealth payments in particular ways: terms of reference can direct that particular payments not affect the relativities.

The *Intergovernmental Agreement on Federal Financial Relations* notes that National Partnership facilitation and reward payments should not affect the relativities but gives the CGC discretion, on a case by case basis, to treat any payment differently if it considers that such treatment is more appropriate. Terms of reference for the 2015 Review remove this discretion for reward payments.

CGC Staff propose to recommend the Commission only exercise its discretion where doing so will make a material change to the GST distribution at the proposed disability materiality threshold ($30 per capita) and the impact can be assessed reliably.

Staff note that it is often difficult to distinguish between project and facilitation payments. Staff propose to treat all payments as project payments unless informed otherwise.

NSW Treasury interprets these advices/proposals/intentions to mean that generally:

- facilitation payments will not impact on the relativities
- the CGC will treat all payments as project payments, unless it is informed the payment is a facilitation payment. The presumption is that project payments will impact on the relativities, provided the payment meets the proposed general guideline for deciding treatment, i.e. the payment supports State services for which expenditure needs are assessed
- if informed a project is a facilitation payment (which would generally not impact on the relativities), the CGC could use its discretion to change the treatment (i.e., have it impact on the relativities) provided that changing the treatment would be material and the impact can be assessed reliably, and the payment meets the general guideline of supporting State services for which expenditure needs are assessed.

NSW Treasury is concerned with materiality being used as a criterion for deciding the treatment of Commonwealth payments. As the CGC noted in the Draft Report, it decided not to adopt a materiality threshold for Commonwealth payments in the 2015 Review.[9] The CGC noted that if a materiality threshold were applied to Commonwealth payments, it should be applied in the same way the materiality of disabilities is judged – in aggregate. The CGC also noted State concerns that a materiality threshold applied to Commonwealth payments could result in funding arrangements being developed and structured in a manner to remain under the threshold.

It is not clear how these issues with applying materiality thresholds to individual Commonwealth payments could be overcome in determining whether the CGC should use its discretion to change the treatment of individual facilitation payments.

[9] *CGC, 2015 Review Draft Report, pp. 53-54.*

Treatment of Commonwealth payments commencing in 2013-14

Staff propose to recommend the Commission:

- adopt the treatment of each Commonwealth payment commenced in 2013-14 as set out in Table B-1 of Attachment B.

NSW Treasury notes the proposed treatment of payments indicated in Attachment B, Table B-1 of the *Update and Supplementary Issues* paper.

NSW Treasury disagrees with the proposed treatment of the payment for pay equity for the social and community service sector. Staff propose that the payment impact on the relativities.

In the 2014 Update Commonwealth payments in 2011-12 and 2012-13 for pay equity for the social and community services sector were treated so that there was no impact on the relativities. This was because payments were to third parties and had no impact on State fiscal capacities. The funding covered the Commonwealth's share of the wage increases in the social and community services sector arising from Fair Work Australia's decision on 1 February 2012 to grant an Equal Remuneration Order in the sector.

We acknowledge that under the proposed change to the CGC's criteria for determining treatment of Commonwealth payments the payments support the provision of State services for which needs are assessed. However, if the payments have no actual impact on State fiscal capacities – with the payment as revenue exactly offset by State payments to third parties – we see no reason for the payment to be reflected in States' GST 'needs'. We note that it is proposed that Commonwealth payments for non-government schools, which are also for State services for which expenditure needs are assessed but are to third parties, will continue to have no impact on the relativities.

Treatment of Commonwealth payments commencing in 2014-15 and 2015-16

Staff propose to recommend the Commission:

- not backcast Commonwealth payments commencing in 2014-15 and 2015-16 as set out in Table B-2 of Attachment B because they are not the result of major change in Commonwealth-State financial arrangements.

We expect terms of reference for the 2015 Review will require the Commission to ensure the Infrastructure Growth Package, payments from the Asset Recycling Fund have no impact on the relativities. The Commission will act accordingly.

NSW Treasury notes that Staff propose not to backcast payments indicated in Attachment B, Table B-2 of the *Update and Supplementary Issues* paper, because they are either:

- not the result of major change in Commonwealth-State financial arrangements
- information for backcasting is not reliable or
- Staff understand that an amendment to the 2015 Review terms of reference will direct the Commission to ensure certain payments have no impact on the relativities.

Water for the Future

Staff propose to recommend the Commission:

- retain the current approach to all three components of the program unless data and other information from the States can establish that environmental spending is now the main purpose of the third component of the program and that the interstate pattern is not overly influenced by State policy.

Commonwealth payments to States under the National Partnership (NP) on Water for the Future have in the past been allowed to affect the distribution of GST payments because, though some payments are for environmental protection for which State needs are not assessed, the majority of payments are related to urban and rural water supply projects for which needs are assessed. Data allowing disaggregation of the payments into those for environmental purposes and those for water supply was not available.

Commonwealth Budget papers now divide the components of the former Water for the Future NP into three payment components relating to:

- national urban water and desalination plan
- national water security plan for cities and towns and
- sustainable rural water use and infrastructure.

CGC Staff consider the first two components are clearly related to urban water services for which needs are assessed, so should impact on the relativities.

CGC staff note evidence from South Australia and the Commonwealth Department of the Environment suggesting the third component contains projects relating to urban water, rural irrigation and protection of the environment.

The CGC has asked States for information on the purposes and funding of projects covered by the sustainable rural water use and infrastructure component. Staff propose to continue the current treatment of the payments unless State information indicates that protection of the environment is the main purpose of the third component and that this is not the result of State policy choices.

NSW Treasury notes the proposal and will provide any available information on NSW spending under this component of the NP.