



AUSTRALIAN CAPITAL TERRITORY

Opening Submission to the Commonwealth Grants Commission 2015 Methodology Review

July 2013

**Chief Minister & Treasury
Directorate**

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Executive Summary

1. The ACT welcomes the opportunity to work once again with the CGC and other jurisdictions in prosecuting the 2015 Methodology Review. The request for an opening submission is appreciated.
2. In responding to the request, we have taken the approach that the 2015 Review should commence with the adoption of the 2010 Review methods and amend only where parties can provide compelling arguments that change is necessary. The GST Distribution Review, while comprehensive in its treatment of the issues, did not address detailed methodological questions and cannot be seen as a substitute for a Methodological Review. Therefore, the GST Distribution Review recommendations, while requiring treatment as issues of priority in the Terms of Reference, should not be seen as the starting point for the 2015 Review.
3. This submission provides our views on the:
 - Principles and architecture of horizontal fiscal equalisation;
 - Priority issues as outlined in the terms of reference; and
 - Other issues of priority for the ACT, including specific assessments and identifying assessments which should not change.
4. The submission adopts the basic premise that the 2010 Review should be seen as a hallmark report as it signalled a radically changing fiscal equalisation landscape. It effectively introduced a framework that recognised, in tandem with the growth in revenue capacity, the requirement to build infrastructure associated with population growth.
5. This recognition resulted from the reality that prior to that review, the two most populous States — New South Wales and Victoria — had above average fiscal capacities and together shared the cost of equalisation, while other States' capacities were judged to be below average.
6. What emerged and continues to this very day is a landscape whereby the two most populous States have moved closer to the average and the resource rich States headed by Western Australia continue to experience unprecedented strengthening of their fiscal capacities.
7. In our view, the Horizontal Fiscal Equalisation (HFE) system has proven that it could, and continues to, adjust dynamically to meet today's challenges and that of the future.

8. Importantly, and one the ACT considers has been understated by some parties, is the fact that not only did the 2010 Review change the equalisation landscape, it also achieved some landmark reforms in the process, resulting in simpler, more robust methods, using data in a manner consistent with their quality. It led to the inevitable change in a number of methods which remain sound and responsive in the main to changing State circumstances. With some improvements in the context of a shortened 2015 Review, the methods should be even more responsive to future change.
9. This stance, we consider, has been reinforced with the release of the GST Distribution Review Report prepared by Messrs Greiner, Brumby and Carter. We wholeheartedly agree with the Panel's conclusion that there was no consensus among the collective governments of Australia to pursue a different form of equalisation from that currently practiced. Their conclusion was predicated on the basis that all States and Territories should have equal capacity to provide services and infrastructure to their citizens, and the current HFE system was regarded as working effectively and not requiring major reform. Their conclusion that a prerequisite for any major reform would require a realignment of national tax bases and service responsibilities to significantly reduce the current level of vertical fiscal imbalance is again strongly supported.
10. Of fundamental importance to the ACT and one of importance to all parties to the 2015 Review is the fact that the Panel rather than pursuing fundamental change to the current system, instead opted to make a number of recommendations designed to:
 - Improve the understanding of the HFE system in Australia,
 - Increase the transparency of the process; and
 - Strengthen underlying governance arrangements.
11. We acknowledge while the Panel appropriately stopped short of making detailed recommendations on methodology, it did offer guidance on some methodological issues, particularly the treatment of Commonwealth payments to assist States' capital investment in nationally significant transport infrastructure and the current mining assessment.

Principles of HFE

12. It is against this background that the ACT submission contends that the current system of HFE has worked well, and that the fundamental principles, as stated in the 2010 Methods Review and reaffirmed in the CGC's latest Update, do not require change. We do not support any augmentation of the currently stated equalisation objective with other objectives. Accordingly, the CGC's approach to assessments should:
 - Reflect what States collectively do;

- Be policy neutral;
- Be practical; and
- Deliver relativities most appropriate to the application year.

Mining Revenue

13. The ACT supports the development of a new assessment of mining revenue to address the current design flaw in the two-tier approach to mining royalties. More broadly, any revised method of assessment should continue to fully equalise mining royalties, given the significance of this revenue source to State budgets.

Mining Expenditure

14. In relation to mining expenditure, the ACT does not support further allowances or disabilities being assessed for economic development. Infrastructure costs to support economic development, including mining, are already recognised in the capital assessment, as a result of the reforms to this assessment in the 2010 Review.

15. Recurrent costs for economic development are also part of assessments already, but treated on an equal per capita basis, and any differential assessment can only be based on identified drivers of expenditure which are consistent across States.

16. We also do not support the proposal of the GST Distribution Review that development costs relating to mining be netted off the revenue assessment. Such an approach would reduce the transparency and consistency of assessments, which treat revenue and expenses in separate categories.

Transport Infrastructure

17. The ACT considers that a more rigorous approach needs to be taken to defining projects of national significance for the purposes of assessing Commonwealth payments for transport infrastructure. We propose that such an approach focus on quantifiable, direct benefits which extend beyond the boundaries of the recipient State. In addition, the CGC's treatment of Commonwealth payments for transport infrastructure should align with that taken in the capital assessment i.e. the periods over which payments are assessed should be comparable.

Indigeneity

18. We accept the recommendation of the GST Distribution Review that Indigeneity continue to be assessed within HFE. Accordingly, we support completion of the work on

remoteness classification and Indigenous effects which had already been commenced by the 2015 Data Working Party. This work should include an assessment of the relative levels of disadvantage for differing types of Indigenous people, including whether those newly self-identifying in the 2011 Census have a different level of needs from those previously identifying as Indigenous. Any revised approach must ensure that there is no double-counting of the impacts of remoteness and other factors such as socio-demographic composition.

National Reforms

19. New national social reforms in disability services, education and health are transforming the landscape against which the CGC will carry out future assessment of needs and capacity, particularly in relation to the National Specific Purpose Payments (SPPs).
20. Given the recognition of specific cost drivers in the funding models being implemented under these reforms, the CGC will need to make some fundamental changes in its approach to expense assessments so as not to undo the effect of those models.
21. At the same time, it will need to continue to take into account relevant cost factors which are not part of the new funding models, as well as applying equalisation to Commonwealth payments for these reforms which are received as revenue. Our technical suggestions for addressing these matters are outlined in the submission.

Capital

22. The ACT supports examination of modifications to the capital assessment to smooth out volatility, as well as a comparison of the relative advantages and disadvantages of the current assessment approach and the alternative recommended by the GST Distribution Review. The adoption of a net worth approach to capital and investment expenses was a controversial aspect of the 2010 Review. This approach has, however, proven to be more responsive to the needs of faster growing States than the previous assessment method, and has simplified the assessment of returns on assets. At the same time it has increased the volatility of assessments.

Interstate Cost Differences

23. The ACT does not support subjecting interstate cost differences to partial equalisation on economic efficiency grounds (“spend gradient” concept) as it would represent a modification of the equalisation objective of the GST distribution system. Full equalisation of interstate costs must continue, provided that such differences are not susceptible to policy choice by States.

Materiality Thresholds

24. Any further increase in materiality thresholds is not supported. Materiality thresholds were adopted by the 2010 Review as a key method of achieving equalisation as simply as possible. Further increase in the thresholds, as recommended by the GST Distribution Review, would significantly reduce the accuracy and equity of assessments, and should not be pursued. The modelling of alternative thresholds undertaken by the CGC indicates that there would be random and varying effects on the distribution of GST among States, depending on which threshold levels are chosen. There are no impartial criteria against which such thresholds could be determined, thus leaving the issue to continuing contention between States.

National Capital and Cross-Border

25. We argue that:

- the approach taken to national capital allowances in the 2010 Review be reaffirmed; and
- the cross-border disability assessment be continued in its current form.

Socio-Economic Status

26. The ACT requests the CGC to adopt the alternative and more accurate measure (Socio-Economic Index for Individuals (SEIFI)) of socio-economic status for residents of the ACT. The standard measure of socio-economic status (Socio-Economic Index for Areas (SEIFA)) used in the assessments has significant deficiencies in measuring disadvantage in the ACT. Where low SES households are distributed fairly evenly across areas, as is the case in the ACT, rather than being highly concentrated in particular areas, SEIFI provides a more accurate measure of disadvantage.

Tax Reform

27. The ACT requests that tax reform be given a priority classification in the 2015 Review, in parallel to the 2014 Update process. We have proposed that the CGC examine incorporating tax elasticity effects into revenue assessments, to avoid penalising States that undertake tax reform.

Gambling Taxation

28. Finally, one item raised in the GST Distribution Review Report which causes the ACT concern is the suggestion that the gambling taxation assessment be re-examined.

29. We have reviewed all relevant research findings, which indicate a range of quite complex issues needing to be considered before a differential assessment of gambling could be carried out. We are not convinced that the available research provides clear direction as to the drivers of gambling expenditure and consider that the 2015 Review timeframe does not allow for parties to progress this matter.

30. Consequently, the ACT does not consider that gambling taxation should be accorded a high priority for review.

Other Views on all Assessments

31. To round off the discussion, the ACT's submission also methodically sets out our views on each of the CGC's current assessments and identifies those which we consider should, and those which should not, be examined as part of the 2015 Review, and the rationale for each conclusion.

1 Introduction

- 1 The ACT, in conjunction with other jurisdictions, has been invited to forward an opening submission to the Commonwealth Grants Commission (CGC) 2015 Review on the methodological approach to determining the per capita relativities to be used to distribute GST revenue among the States, the NT and the ACT¹ from 2015-16.
- 2 The request for submissions was accompanied by an associated 2015 Review Work Plan which *inter alia* requested jurisdictions to address how the principles and architectural issues associated with the equalisation principle should be defined and interpreted. Jurisdictions were also requested to identify other areas of the assessment framework that were not specifically identified in the Terms of Reference (ToR) within the constraints of a short review period.
- 3 The structure of the submission is: Chapter 2 identifies the key issues concerning the ToR; Chapter 3 addresses the key issues as to how the equalisation principle and the guidelines should be defined and interpreted in making decisions on assessment methods; Chapter 4 discusses each of the priority issues in the ToR; Chapter 5 discusses other terms of reference issues; and Chapter 6 discusses the ACT specific priorities for the 2015 Review.

2 Responding to the Terms of Reference

2.1 The context of the 2015 Review

- 4 The circumstances leading to the 2015 Review are not too dissimilar to what occurred post the 2004 Review when, following the release of that report, an internal review into the concept of HFE was commissioned by the then Ministerial Council on Federal Financial Relations.
- 5 The task was assigned to a Heads of Treasuries (HoTs) Working Group which led to ToR for the 2010 Review, with the CGC requested to again review the methods to be used to derive the relativities for distributing the GST among the States after 2009-10.
- 6 Importantly, the key features of the ToR asked for the assessment methods to be simplified, including through the aggregation of expense and revenue categories, the use of broader indicators of differences among the States and the application of materiality thresholds. Of note in the context of the 2015 Review is that the quality of data were also to be improved in calculating the relativities. In essence, the ToR was

¹ Referred to as the States from this point onwards unless otherwise indicated.

developed by the States through the HoTs Review, implying a high level of consultation and ownership by all parties.

- 7 The request was complied with and culminated in the release of the Report on *GST Revenue Sharing Relativities - 2010 Review* on 26 February 2010. This process followed the normal cycle of five year reviews of the underlying methods.
- 8 In a similar process to the 2004 Report, following the release of the 2010 Report and after much national deliberation, the Federal Government commissioned an independent review of the GST distribution to the States.
- 9 The objective, or focus of the review as announced, was to explore options that might lead to a simpler, fairer, more predictable and more efficient distribution of the GST to States, with a final report due by September 2012. The intention was then to request the CGC to update its methodology to reflect any agreed Review recommendations.
- 10 This process led to the 2013 Standing Council on Federal Financial Relations (SCFFR) meeting in Canberra on 3 April 2013 agreeing to an accelerated 2015 Methodology Review to address the bulk of the recommendations in the GST Distribution Review in an eighteen month period. Again the ToR for this 2015 Review have arisen from a subsequent independent review process, with the final ToR constructed by HoTs and endorsed by the SCFFR following extensive consultation.
- 11 These events to date reflect all parties acting as joint stewards of the system.

2.2 Terms of Reference for Commonwealth Grants Commission 2015 Methodology Review

- 12 The ToR require inquiry into and report, by 28 February 2015, on the methodological approach to determining the per capita relativities to be used to distribute GST revenue among the States, the NT and the ACT from 2015-16. A copy of the ToR is at [Attachment A](#).
- 13 The ToR in effect, contain instructions and guidance on how the task should be approached. In many respects a number of the provisions mirror the ToR provided for the 2010 Review.
- 14 This is not surprising as the CGC itself has stated on many occasions that the focus on simplification should be paramount. While there is always pressure to introduce greater complexity in an effort to more accurately reflect State differences, it is important that a balance be maintained between a comprehensive assessment of State fiscal capacities and an approach which is as simple and practical as possible.
- 15 In this context the ToR can be split into four components with the need to:

Component 1 (ToR Clause 1)

- Take into account the *Intergovernmental Agreement on Federal Financial Relations* (IGAFFR) (as amended), which provides that the GST revenue will be distributed among the States in accordance with the principle of HFE;
- Aim to have assessments that are simple and consistent with the quality and fitness for purpose of the available data;
- Ensure robust quality assurance processes; and
- Develop methods to appropriately capture the changing characteristics of the Indigenous population.

ACT Comment:

16 *We accept that the first three core items reflect similar requirements built into the 2010 Review hence, are not new problems for participants in the 2015 Review.*

17 *We argue that current assessments take into account the uneven distribution of Indigenous Australians and the higher expenditure States incur in providing services to these residents. The key to the 2015 Review will be for parties to clearly articulate any shortcomings, underpinned by quality data.*

Component 2 (ToR Clause 2)

18 In undertaking the assessments, the ToR must have regard to the recommendations of the final GST Distribution Review Report and in particular to:

- Consider the appropriateness of the current materiality thresholds;
- Consider the appropriateness of continuing to round relativities to five decimal places;
- Develop a new transport infrastructure assessment. This should include, if appropriate, a framework to identify payments for nationally significant transport infrastructure projects which should affect the relativities only in part and options for providing that treatment;
- Consider the use of data which is updated or released annually with a lag, or updated or released less frequently than annually;
- Examine the merits of adopting a simplified and integrated assessment framework;
- Investigate whether it is appropriate and feasible to equalise interstate costs on a 'spend gradient' basis;
- Develop a new mining revenue assessment; and

- Consider the appropriate treatment of mining related expenditure.

ACT Comment:

- 19 *This area of the ToR arises from the GST Distribution Review responding to a number of the large States' concerns, and is designed in the main to improve the transparency, simplicity, efficiency and stability of the system. We agree that these matters should be addressed although we contend that many have already been dealt with and it will be incumbent on those States wanting change to put before the review the evidence of any current shortfall in the process.*

Component 3: (ToR Clauses 3-6)

- 20 Taking into account the requirements of the IGAFRR, the assessments must be prepared on the basis that:
- National Specific Purpose Payments (NSPPs), National Health Reform (NHR) funding and National Partnership (NP) project payments should affect the relativities, recognising that these payments provide the States with budget support for standard state and territory services;
 - NHR funding and corresponding expenditure relating to the provision of cross-border services to the residents of other States should be allocated to States on the basis of residence;
 - NP facilitation and reward payments should not affect the relativities, so that any benefit to a State from achieving specified outputs sought by the Commonwealth, or through implementing reforms, will not be redistributed to other States through the HFE process;
 - General revenue assistance, excluding GST payments, will affect the relativities, recognising that these payments are available to provide untied general budget support to a State or Territory;
 - Those payments which have previously been treated as having no direct influence on the relativities continue to be treated in that way; and
 - Where responsibilities for funding and delivering aged care and disability services has not been transferred to the Commonwealth by a State under the NHR Agreement, these responsibilities will continue to be assessed as State services for that State.
- 21 Notwithstanding the above, with the exception of reward payments under NPs, the CGC is also given discretion to determine that it is appropriate for particular payments to be treated differently, reflecting the nature of the particular payment and the role of State governments in providing particular services.

- 22 Not surprising, given the evolving maturity of Federal financial relations, the assessments also need to consider the most appropriate treatment of disability services during the transition to DisabilityCare Australia (the National Disability Insurance Scheme) and once the full scheme is operating nationally.
- 23 Similarly direction is also provided to ensure that the GST distribution process will not have the effect of unwinding the recognition of educational disadvantage embedded in the National Education Reform Agreement (NERA) funding arrangements. As part of this process, the assessments should ensure that no State receives a windfall gain through the GST distribution from non-participation in NERA funding arrangements.

ACT Comment:

- 24 *In the main, these components of the ToR mirror the 2010 Review hence, we are comfortable with the requirements. It will be critical as part of the 2015 Review to assess what impact the introduction of major national social reform will have on equalisation particularly in the transitional years. A full account of the interplay is most important for all parties and governments to understand as these national reforms work their way to fruition.*

Component 4: (ToR Clause 8)

- 25 Finally, the 2015 Work Plan, developed in consultation with the Commonwealth and States, requests that a range of recommendations of the GST Distribution Review be given a priority with early consultation (including multilateral discussions) with the Commonwealth and States, namely:
- The proposed methodology to appropriately capture the changing characteristics of the Indigenous population;
 - The development of the new transport infrastructure assessment;
 - The development of the new mining revenue assessment;
 - The consideration of the appropriate treatment of mining related expenditure; and
 - The treatment of DisabilityCare Australia and NERA funding arrangements.
- 26 The reporting requirements see a draft report being provided for consideration by the SCFFR within 12 months from receipt of their ToR.

ACT Comment:

- 27 *We support the 2015 Work Plan with the ACT Treasury tasked with taking the lead role and the government assigning a priority to the task at hand.*

2.3 ACT overall response to the Terms of Reference

- 28 Given our general acceptance of the existing methodologies, which in our view have already been subject to rigorous scrutiny in the 2010 Review, a shortened review focussed on priority matters causes the Territory no discomfort.
- 29 The consideration of key priority issues provides the CGC with enough flexibility to consider, but not necessarily be locked into, recommendations on these and other wider issues, while at the same time noting the requirement for a draft report to be provided to the SCFFR in June/July 2014. Further advice will be sought from the CGC as the work program matures as to whether the draft report will contain recommendations or simply relate to progress achieved to date.
- 30 Ultimately, however, a revised approach to any of these tasks must be premised on ensuring that any new or changed assessment methodology is underpinned by data that are fit-for-purpose and of the best possible quality. The findings and reasons for decisions in the 2015 Review need to be accurate and transparent.

2.4 The Commission's 2015 Work Plan

- 31 Given the tight timeframe for the 2015 Review, we acknowledge that the work plan (see copy at [Attachment B](#)) differs quite substantially from past method reviews.
- 32 The program essentially assumes that much of the work of the 2010 Review will have to be preserved. As already stated, the attached plan requires an absolute need to focus on priority issues with limited scope to re-open a number of the outcomes of the 2010 Review:
- There will be limited opportunity for a staged format to be adopted built on a consultative and iterative approach that would normally provide States with several opportunities to contribute to the development of the final recommendations;
 - It will be very difficult or next to impossible to devise new assessment methods by starting with a 'clean slate' approach rather than the existing methods;
 - There will be limited opportunity to attempt further detailed top down approaches, where State expenses and revenues would be disaggregated into specific services and taxes;
 - There will be limited opportunity to explore the application of further broad indicators of the drivers of State expenses and revenues;
 - Introducing further detail, such as the impact of groups within State populations, will not be feasible in the absence of data to prove that it would materially improve equalisation and could be done reliably;

- Adopting new assessment guidelines with stronger reliability and materiality criteria than those already identified is not likely to be practical; and
- There will be no State visits which provide States with the opportunity for Commissioners touring jurisdictions to see first-hand the service delivery issues facing States.

33 From our perspective these limitations do not present any major concerns at this point. The strengths of the assessment framework arising from the adopted strategy in the 2010 Review should provide some confidence to all parties.

34 However, the magnitude of the task confronting all parties will not be fully known until the first milestone in the work plan is met, namely, States' submissions on the makeup of the review which are due by the end of July 2013.

35 In determining other issues of priority, we have prepared a matrix of the assessments (see Attachment C) on what might constitute areas to be/or not be examined. These include the deliberations of the 2015 Data Working Party. Some, but not all of this foreshadowed work, while appropriate for a full review, should now be re-considered as a lower priority order issue and should cease.

3 The Equalisation Principle and its Interpretation

3.1 The Equalisation Principle

36 In the early stages of the 2010 Review States were given opportunities to provide their views on issues such as: the objectives of the distribution of the GST; whether full or partial equalisation should be pursued; the implications of the emphasis on simplification; and how equalisation should be implemented.

37 It is very clear to us that there will never be absolute consensus on the continued appropriateness of distributing the GST solely on the basis of equalisation. However, as pointed out in the 2010 Report and repeated in the 2015 ToR, the IGAFRR, which all States signed, states the GST distribution is to be based on equalisation principles:

- The IGAFRR agreed by the Commonwealth and all State governments provides for the revenue collected from the GST to be used by the States for any purpose. It also says the GST is to be distributed among the States in accordance with the principle of HFE.

38 We contend that at its simplest, and as previously adopted in the 2010 Review, equalisation should aim to put all States on a level fiscal playing field. It must aim to ensure they all have the same fiscal capacity to provide services to their residents.

- 39 Further, determining a distribution of the GST that equalises State fiscal capacities should involve a comprehensive examination of the impact of State demographic, physical, and economic circumstances on the costs of providing the full range of State general government services and acquiring the associated infrastructure and the revenues they can raise. This approach should again be adopted in the 2015 Review to ensure all fiscal advantages and disadvantages of the States are taken into account.
- 40 We do not support any augmentation of the currently stated equalisation objective with other objectives. The 2015 ToR, the context in which they were developed and the IGAFRR all strongly imply the relativities to be recommended for 2015 should be based on a single objective, fiscal equalisation.
- 41 As stated before, the Territory considers that if governments wanted other objectives included they would have collectively expressed this through explicit ToR. This has not occurred and we suggest that there is no option but to use the 2010 principle of HFE as expressly set out in CGC Information Paper 2007/12 titled: *Principles, Interpretation and Scope of Horizontal Fiscal Equalisation*. The matter should not be re-opened in the context of the 2015 Review:

“State governments should receive funding from the pool of goods and services tax revenue 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.”

- 42 Indeed, this vexed question was again the focus of much deliberation in the recently completed GST Distribution Review in which it was asked *inter alia* to consider whether the distribution of the GST and the current form of HFE will ensure that Australia is best placed to respond to long-term trends and structural change in the economy.

- 43 The Panel noted:

“...as a general statement, the larger States favoured various ways to reduce the degree of equalisation, as well as various forms of less precise HFE, all potentially under the banner of moving from the present goal of providing ‘materially-the-same’ capacities to one of providing ‘comparable’ capacities. On the other hand, the smaller States do not favour a change, believing that the 2010 CGC review went as far as could feasibly be done without compromising equalisation too much.

In short, the four larger States see a move to comparable as a potential step on the path to less equalisation and therefore support it, while the four smaller States see

a move to comparable as a step on the path to less equalisation and therefore oppose it.”

- 44 The Panel also stated that it could see both groups of States’ points of view and went on to say:

“We understand that a change to ‘comparable’ is being urged by the large States as a step in the direction of an EPC distribution and that outcome is strongly opposed by the small States. Given our analysis..., it should be clear that we do not support changes in this direction on that basis. We simply do not see an EPC outcome as a viable short or medium term position.

Nevertheless, we are split on the question of whether to:

- *Change the wording to reflect the CGC’s current interpretation and practice of HFE (on the strict understanding that it does not signal a step to EPC), or*
- *Not change, as there is no demonstrated need.*

While we have been able to reach a unanimous view on the myriad of other issues considered during the course of the Review, this question alone has eluded consensus. As a result, we neither reach a finding in support of the status quo, nor recommend change, but leave that vexed matter to the wisdom of governments.”

3.2 The Equalisation Principle – ACT context

National Capital allowances

- 45 In the context of the ACT, and the *Australian Capital Territory (Self-Government) Act No. 106, 1988*, the application of the equalisation principle should also ensure that the Commonwealth conducts its financial relations with the ACT to ensure that the Territory is treated on the same basis as the States and the NT, while having regard to the special circumstances arising from the existence of the national capital and the seat of government of the Commonwealth in the Territory.

- 46 This is also required under the terms of the *Commonwealth Grants Commission Act 1973 (sub-section 5(1A))*:

- *“5. Meaning of special assistance*
 - *(1A) References in this Act to the grant of special assistance to the Australian Capital Territory shall be read as references to the grant of financial assistance to that Territory for the purpose of making it possible for that Territory, having regard to the special circumstances arising from the location in it of the national capital and the seat of Government of the Commonwealth, by reasonable effort, to function in respect of matters for*

which the Australian Capital Territory Executive has responsibility, at standards not appreciably below the standards of the States and the Northern Territory.”

- 47 This implies that, via the application of the principle of fiscal equalisation, recommendations in relation to ongoing national capital allowances outside the policy control of the ACT government should continue to be made.
- 48 In the 2004 Review (2005-06), the ACT received national capital allowances totalling \$25.5 million. In the 2010 Review (2008-09), an allowance totalling \$29.1 million was recognised. However, on a comparable basis - prior to indexation impacts – between the 2004 and 2010 Review the allowance was reduced by \$2.253 million.
- 49 In the 2010 Review, the national capital allowances were reviewed to ensure that they were consistent with all other assessments in terms of reliability, and that they were material.
- 50 The investigations indicated there was a strong conceptual case that most of the national capital influences continued to impose additional costs on the ACT, and that they could be measured reliably:
- Consequently, most of the allowances assessed in the 2004 Review have continued to be assessed. The Review accepted that 91% (\$23.2 million) of costs assessed in the 2004 Review (prior to indexing) should continue;
 - In the 2010 Review, four smaller allowances totalling \$2.253 million were discontinued, after evidence was collected and presented by other States, showing that in the case of low volunteer fire fighter numbers and counter-terrorism, all States faced these costs,.
- 51 The ACT also argued that the national capital allowances should be indexed annually so as to, at least in part, capture wages, rather than just the CPI index which significantly understates future costs. The 2010 Review agreed.
- 52 Against this background, the 2010 Review agreed to retain some previously assessed national capital allowances, but noted its opposition to reviewing the quantum of funding provided or entertaining any suggestion of new allowances. It was considered that as time elapses from the date of self-government, it would be reasonable for the number of national capital claims to reduce.
- 53 There was early agreement in the 2010 Review that this matter would not be re-opened, other than reviewing the existing allowances for consistency with the other assessments.
- 54 In light of the above comments in relation to the 2010 Review, we suggest a similar approach to national capital allowances be adopted for the 2015 Review.

Cross-border costs

- 55 In line with the 2010 Review, a cross-border disability was assessed on the net cross-border flow of services where there is a material level of extra costs that is not reimbursed by other States.
- 56 Three different approaches to assessing cross-border costs were adopted:
- When reimbursement arrangements exist there is no need to assess a cross-border allowance, such as in the case for hospitals where the bilateral agreement covers costs - under the National Health Reform funding arrangements;
 - Where reliable actual data on the cross-border use of services are available, they will be used. This is the case for:
 - Schools education, where the assessment uses data provided by the ACT on the actual numbers of NSW residents enrolled in ACT pre and post-compulsory school education services;
 - Post-secondary education, where the assessment uses National Centre for Vocational Education Research (NCVER) data on the net number of hours the ACT training system supplies to NSW residents; and
 - In other cases, the ACT used illustrative information for some services to mount a conceptual case that there are material levels of cross-border use of those and related services. In these cases a general method was adopted to allow for cross-border use of ACT services.
- 57 Similar to the National Capital allowances, a status quo approach is recommended for the 2015 Review, recognising that there is some growth provision via indexation built into the existing regime.
- 58 Importantly, the three methods also facilitate recognition of any improved data which might become available.

3.3 Supporting Principles

- 59 As discussed in the 2010 Report, the pre-existing principles used to help the interpretation and implementation of equalisation were reviewed with the focus centred around what States do and policy neutrality, and the balance between practicality and contemporary relativities.
- 60 We acknowledge there is scope for trade-offs between the principles hence, there has to be some flexibility between the application of the principles.
- 61 Indeed, there are no rules on how to decide the appropriate approach in all cases, nor is there an established hierarchy among the principles. We contend that each case

should be considered on its merits with a degree of judgment required at the end of the day in order to achieve the best overall result consistent with the aim of achieving fiscal equalisation.

62 The GST Distribution Review re-examined the supporting principles at great length and arrived at a number of findings which did not support a clear case for change and did not call for the adoption of alternative approaches.

63 We contend that the existing principles are more than adequate for the 2015 Review and should continue to be adopted without more time spent redefining possible alternative approaches. This would see the following approaches adopted:

- Reflect what States collectively do:
 - This principle means, as far as practical, that the assessments should reflect what States collectively do. It leads to the adoption of internal standards, which remove the need for judgments on what States could or should do;
- Are policy neutral:
 - Policy neutrality means policy differences between the States should not affect the recommended GST distribution. Policy neutrality is implemented by applying the same policies for delivering services and raising revenue to all States (that is, by applying average policies to all);
 - Pursuing policy neutrality by basing GST requirements on the average revenue collection and service provision policies of the States is a balanced and realistic approach, as it reflects what States do. It also prevents each State's own policies having an undue effect on its GST outcome;
- Are practical:
 - This means the assessments should be based on sound and reliable data and methods, be well constructed and be as simple as possible while also reflecting the major influences on State expenses and revenues. It recognises that, while State fiscal capacities are affected by a wide variety of factors, the suitability and acceptability of the recommended GST distribution may not be improved by including factors when sufficient data are not available to measure their effects or whose effects are small;
 - Importantly, this principle also reflects the emphasis in the 2015 ToR on simplification, reliability and materiality;
- Deliver relativities most appropriate to the application year:

- This means, as far as possible, that equalisation should reflect State circumstances in the year the funds are used but has and always will be constrained by the need for reliable data; and
- The averaging process is designed to smooth the effects of data irregularities and short term events thereby making State shares of the GST less volatile:
 - We value this approach over a more up-to-date assessment because it provides some stability in a major source of revenue, despite volatility in State own-source revenue, and endorse the adopted approach using data for the three most recent completed years.

3.4 The Assessment Guidelines

64 A major improvement initiated in the 2010 Review centred around the development of assessment guidelines to assist parties making decisions on assessment methods and determining which influences on State expenses and revenues should be included.

65 The assessment guidelines are summarised below:

- A category (expense or revenue) will be considered for separate assessment, if:
 - It is clearly a major State service or revenue source distinct from others;
 - It is affected by disabilities that are markedly different from those of other categories;
 - Data used to estimate the average expense or revenue are satisfactory;
 - It is expected that satisfactory assessments of disabilities can be made; and
 - The category is expected to be material; meaning, making a separate assessment rather than aggregating the service or revenue with broadly similar ones would redistribute more than \$30 per capita for any one State in the reference period.
- The CGC will include a disability in a category when:
 - A presumptive case for the disability is established; meaning, there is a sound conceptual case and sufficient empirical evidence of differences between States in the use and/or unit costs of services or in the capacities to raise revenues;
 - A reliable method has been devised that is conceptually rigorous, implementable and, where used, consistent with external review outcomes;
 - Data are fit for purpose (they measure what is trying to be measured), of suitable quality (implying the collection processes are appropriate and the data are comparable across States and over time and are not subject to large revisions) and from a reputable source; and
 - There is a material effect on the distribution of the GST — the disability redistributes more than \$10 per capita for any State in the reference period.

- Where a case for including a category or a disability is established but the CGC is unable to make a suitable assessment of its impact, the options are:
 - To discount the impact that has been determined; or
 - To make no assessment.
- Caveats:
 - The option chosen will reflect the specific circumstances of the assessment and will depend on: the strength of the conceptual case; the reliability of the method and data; the sensitivity of the assessment to the data used; and consistency with State circumstances. When the assessment is to be discounted, a uniform set of discounts is used, with higher discounts being applied when there is less confidence in the outcome of the assessment or more uncertainty attached to the information. The discounts range between 12.5 and 50 per cent.

66 This initiative was aimed at ensuring that the assessments achieved equalisation in a reliable and simple way, and was established in consultation with all the parties.

67 As expected, the materiality thresholds established by these guidelines are inevitably subjective with some parties at the time preferring lower thresholds while others preferred higher ones.

68 Indeed, the GST Distribution Review made a number of observations leading to a series of findings and recommendations on this issue, which are addressed later in this submission.

69 On balance, we contend that the levels adopted in the 2010 Review reflect a reasonable compromise between the requirements to avoid excessive detail and to recognise factors that have significant effects on State relative fiscal capacities. We propose that they should form the base for the 2015 Review.

4 Improving the system – Priority Issues in the Terms of Reference

4.1 Mining assessment

70 The ToR raise a number of issues with regard to the 2010 mining revenue and expenditure assessments, arising in the main from the deliberations of the GST Distribution Review and partly as a result of the assessment structure adopted in the 2010 Review.

71 The issues either directly or indirectly stem from the GST Distribution Recommendation 7.3 which is also referred to in the ToR:

- *“The Panel recommends that, in the ToR for the 2013 Update, the Commonwealth Treasurer direct the CGC to add an amount to its expenditure assessments equivalent to a 3 per cent discount of the mining revenue assessment in order to compensate for the fact that some mining related needs of the resource States are*

not fully recognised. This interim assessment should remain in place until the next methodology review is completed”.

- 72 The latter direction did not transpire as jurisdictions failed to reach consensus and the matter was deemed as one to be investigated as part of an overall review of the whole framework.
- 73 For our part, the ACT did not support the proposal. We could not agree to the concept that in effect would see development costs relating to mining netted off the revenue assessment:
- This would be contrary to the approach taken with all other assessments, which treats revenue and expenses separately, and does not attempt to hypothecate particular types of expenses to particular categories of revenue (for example, mining roads should continue to be treated as part of the roads expense category and business development costs as part of the services to industry expense category). This proposal would reduce the transparency and consistency of assessments. The only circumstance which might justify such an approach would be if the revenue could not be generated without that specific expenditure.
- 74 Regarding the ToR, we consider parties are directed to address three elements:
- concerns with the size of the redistribution from the assessment of mining revenue under equalisation - whether it is ‘fair’, and whether mining revenue should be equalised at all;
 - the two-rate structure of the current assessment of mining revenue which can have consequences for certain rate change decisions by States; and
 - whether mining related costs are adequately taken into account through equalisation.

Size of the mining revenue redistribution and equalisation

- 75 Due to the growth in mining over the last decade, the mining States have received, and are expected to receive in the future, substantial royalties. The resource-rich States of WA and Queensland have raised concerns with the amount of funding redistributed due to the equalisation system, and thus its fairness. This is particularly the case given its impact on the relativities.
- 76 This led to the resource rich States arguing for the removal, or partial removal of mining from HFE, and the GST Distribution Review being partially attracted to the Canadian model which discounts the extent to which mining revenues are included in the fiscal equalisation process.

- 77 Regardless, the GST Distribution Review concluded that, while it agreed with the major resource States that there were specific problems with *how* mining revenue is currently equalised, it did not consider the case had been made that mining revenue should be treated differently to States' other own-source revenue².
- 78 We agree with this finding. All expenses, revenues and Commonwealth payments that form the adjusted budget should be included as assessments within the HFE framework as it is a comprehensive approach, it reflects what States do and removes the need for judgements as to what should be included in the adjusted budget.
- 79 In terms of the extent of the redistribution of funding from mining, it is noted that there are other assessments / disabilities that redistribute significant funding across States, such as Indigeneity and population dispersion. Indigeneity is similar to mining, as just as there is a wide disparity in the distribution of natural resources across States, there are significant differences in the proportion of Indigenous people in State populations across the States.
- 80 The mining redistribution, rather than being based on any subjective measure of 'fairness', or discount, should be considered in terms of the underlying parameters of the standard approach to revenue assessment that delivers full equalisation, that is:
- The actual revenues being collected;
 - The revenue base;
 - The average effective tax rate; and
 - The structure of the assessment.

Mining revenue – two-rate structure

- 81 Mining revenue is assessed in three components:
- High royalty minerals (royalty rates above five per cent) – minerals in this group are onshore oil and gas, export coal, lump iron ore and bauxite;
 - Low royalty minerals (less than five per cent) – the remaining minerals; and
 - Grants in lieu of royalties – assessed actual per capita revenue - WA receives a share of revenue from the North-West shelf and the NT receives a share of revenue from uranium mining.
- 82 Under the 2010 Review mining tax assessment, minerals are included in the *low group* when royalty rates are below 5 per cent, and are included in the *high group* when rates are above 5 per cent.

² GST Distribution Review Final Report, October 2012, p.109.

- 83 The 2010 Review assessment calculated that the average rate of royalties charged on all minerals in the high royalty group across all States, is around 7 per cent. While the average for minerals in the low royalty group is around 4 per cent:
- Because WA charges 4.7 per cent royalties on its fine iron ore,³ these minerals fall into the low royalty group and the amount of royalty revenue WA can generate from these minerals is assessed by multiplying the value of production by 4 per cent (the average rate for the low royalty group);
 - However, in June 2010 WA moved to increase the royalty rate from the existing 4.7 per cent to 5.625 per cent (an increase of roughly 1 per cent). Royalties charged on fine iron ore would then exceed the 5 per cent threshold and thus, would be assessed in the high royalty group:
 - In effect, this means the amount of royalty revenue WA could generate on its fine iron ore is assessed by multiplying the State's value of production by 7 per cent, rather than 4 per cent.
- 84 This gives rise to a scenario where for a 1 per cent increase in actual mining revenues received by WA, they lose 3 per cent through equalisation compared with the current assessment:
- WA notes that the decision to remove the concessional 3.75 per cent royalty rate effectively increased the basic rate to 5.625 per cent in June 2010, and led to the reclassification of iron ore fines from the low to high rate group with a consequential negative impact on WA's share in GST grants totalling \$1 billion, or an amount equal to about three times the additional royalty revenue raised at about \$300 million.⁴
- 85 We consider that there is a design fault with the current mining assessment whereby a State can lose more in GST funding than it gains from royalties ('over equalisation'), a matter addressed in the GST Distribution Review Report, but one also readily known to all interested parties.
- 86 To address 'over equalisation' occurring, this issue was effectively dealt with by incorporating quarantining provisions in Update Reports post the 2010 Review ensuring that iron ore fines did not move from the low royalty revenue group to the high royalty revenue group.
- 87 We consider that such a default mechanism should not be relied upon in the future to address deficiencies with any assessment.

³ This is the average royalty rate for iron ore fines as older companies were charged a concessional rate of 3.75 per cent and new companies were charged 5.625 per cent.

⁴ GST Distribution Review, WA Submission, October 2011, page 34.

- 88 It is noted that the WA Government has subsequently announced increases in its royalty rate on iron ore fines in two steps: to 6.5 per cent from 1 July 2012 and to 7.5 per cent from 1 July 2013.
- 89 The first rate increase affects 2012-13 data for the last year of the 2014 Update; while the second, the 2015 Review.
- 90 In the 2013 Update New Developments Paper, it was noted that because the treatment of mining royalties is under consideration by the GST Distribution Review, staff propose to recommend to the CGC that it consider how WA's changed royalty arrangements might be treated in the 2014 Update when the Government's response to the Review is known.
- 91 The GST Distribution Review's position is now known, and is being taken forward by governments in the form of the 2015 Methodology Review ToR, which request the 'development of a new mining assessment'. Unless the 2014 Update ToR direct the CGC how it is to respond to this issue, the decision will need to be canvassed with the States and worked through in the normal manner.
- 92 In responding to the ToR it is considered that any new mining revenue assessment needs to ensure that it is able to:
- Capture the variation in royalty rates across categories of minerals given the material impact this has on the GST distribution;
 - Capture the distribution of the types of minerals across States as this also has a material impact on the GST distribution;
 - Flexibly deal with royalty rate changes (up or down) for minerals without consequential over or under equalisation impacts; and
 - Be premised on reliable and comparable data across the States.

Mining related expenditure

- 93 Again, because the ToR require a reconsideration of the mining related expenditure assessment, it will be vitally important, as a first step, to review and understand the claims submitted to the GST Distribution Review Panel which led to their recommendation to discount the mining assessment by 3 per cent immediately.
- 94 The GST Distribution Review identified unrecognised annual mining costs for WA at between \$60m to \$120m comprised of:
- Mining industry support costs of \$30m to \$60m - directly linked to the regulation and management of new and ongoing mining projects, including environmental impact assessments, community consultation and infrastructure planning;

- Services and infrastructure for fly-in fly-out (FIFO) workers and drive-in drive-out (DIDO) workers of \$20m to \$40m; and
- Very high costs in WA's remote mining communities of \$10m to \$20m – due to the high demand for labour and housing with some government employee costs in remote locations.

95 It is important to note that the 2010 Review considered similar arguments but rejected them as they were either immaterial or already captured through the existing assessments. As an example of the latter, WA has cited the need to put in place common user infrastructure for mining projects, such as roads, however, these are for all intents and purposes captured in the roads category through the rural road length component.

96 Additionally, many of the infrastructure requirements supplied for mining projects, such as ports, electricity or water are provided by the private sector or are delivered by government with a large proportion, if not the total investment, recouped by way of user charges.

97 Hence, as a first step, costs will need to be reviewed in detail and parties to the 2015 Review will need to be convinced of the merits of the claims particularly:

- The large differences between the claims made by WA and the Panel's conclusions; and
- The lack of understanding on the methodology to derive the costs:
 - No estimate of the cost for mining industry support; and
 - No supporting information on the additional cost of each FIFO/DIDO worker.⁵

98 However, it would also be fair to say that better quality data is beginning to emerge particularly on the impact of the FIFO and DIDO work forces from a range of sources which should prove beneficial during the review.

99 The second element of the assessment to be explored relates to economic development expenses more generally.

100 WA has previously argued that resource-rich States are required to invest to promote development of their resources:

- Without recognition of the associated expenses incurred in promoting and supporting the underlying economic activity, WA has stated that the current

⁵ These views are based on those provided by GST Distribution Review as the information and data supplied by WA during the course of this Review were provided in confidence and unavailable to other parties.

assessment approach is inappropriate and asymmetrical as its mining revenues are equalised, but costs are not.

- 101 These economic development costs can be considered broadly in two categories: recurrent costs and infrastructure costs. Recurrent costs fall into the business development component of the services to industry category, which is currently not assessed differentially by the CGC. Business development represented about 2.7% of all State operating expenses at the time of the 2010 Review. Costs for infrastructure fall under the capital assessment.
- 102 The CGC examined this matter in the 2010 Review and found that there were significant disparities in the approaches States took in regard to promoting, attracting and growing business activity. This made it difficult to determine:
- Common State business development policies - they varied considerably between the States, which can be seen by the large differences in the expenses between the States; and
 - The underlying drivers of the expenses - given differing policy aims and how support could be provided:
 - Below average levels of business activity may indicate a disability as greater levels of effort are required to promote business; while
 - Above average business activity could also be seen as a disability given the need for greater investment and support.
- 103 Determining what the average policy was given the differing way States could provide business development assistance was difficult. This included, *inter alia*:
- Tax exemptions or concessions for revenue for specific activities;
 - Direct support for particular business or industries or projects; and
 - Planning, industrial, regulatory and other policies aimed at encouraging economic development.
- 104 Hence, given the overriding difficulty of consistently defining business development, and of measuring the underlying drivers in a reliable and policy-neutral way, the 2010 Review concluded that it was not possible to differentially assess business development expenses or offset them against revenues. It also concluded that it was not clear that a differential assessment of these expenses would make a material difference to the allocation of GST.
- 105 Finally, in relation to infrastructure costs to support economic development, we consider that the reform to the capital assessment undertaken in the 2010 Review

means that GST funding is already being redistributed to the mining States as a result of population growth:

- For example, in the 2013 Update, the investment and net lending assessments redistributed \$542 million to WA in 2011-12. The approach to the capital assessment, based on the up-front acquisition of capital, has effectively dealt with the issue of economic development as it takes into account the implications of growth for State investment.

106 Consequently, we consider that a case has not been made to recognise mining support costs or general economic development costs in addition to those already captured in assessments.

4.2 Commonwealth payments for the transport Infrastructure assessment including rail

107 The 2010 Review decision to equalise 50 per cent of the Commonwealth infrastructure payments for National Network Roads (NNR) on the grounds that it reflects the broader needs of the nation, rather than the circumstances of individual States,⁶ has received much comment and was the subject of much debate in the GST Distribution Review.

108 Some parties considered the decision to discount the roads network and not other forms of transport infrastructure to be inequitable particularly in light of the upcoming national spend on the rail network. This led to the GST Distribution Review recommending that all Commonwealth payments relating to NNR infrastructure and rail based transport infrastructure be identified with a blanket 50 per cent discount to be applied for the purposes of equalisation.

109 The GST Distribution Review saw potential in discounting capital payments for nationally significant transport infrastructure projects provided a workable process for identifying eligible projects could be developed.

110 This recommendation has been identified in the 2015 ToR as a priority item.

111 The ACT agrees in principle that there is a case for discounting Commonwealth payments for transport infrastructure, to the extent that there is an identifiable national benefit from such projects. The problem is the difficulty of implementing such discounting in a way which is fair and transparent. However, it should not be characterised as a “concession” – the payments should be fully equalised in respect of the benefits accruing to the recipient State.

⁶ Commonwealth Grants Commission Draft Report – Attachment 20, paragraph 76.

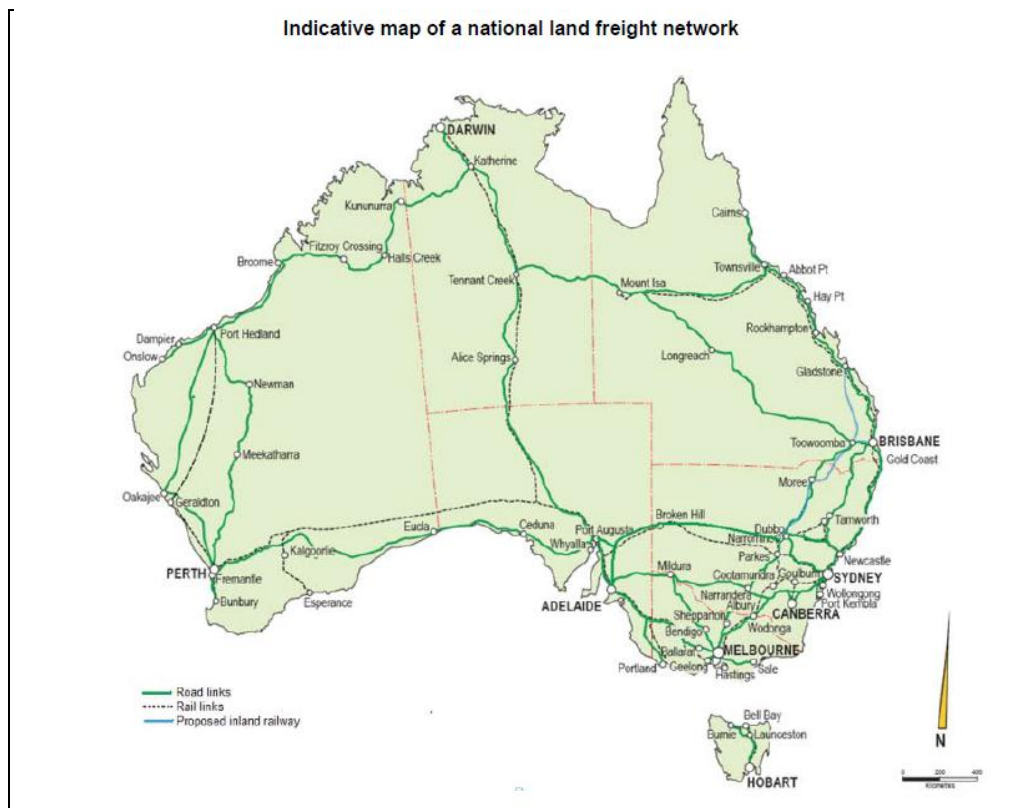
- 112 The issue for the 2015 Review is what criteria exist to identify the national benefits that accrue from increasing the efficiency of these transport networks, whether and by how much the discount should be applied to any assessment, and whether data exist that will allow a transparent application.
- 113 In setting about the task for the 2015 Review, parties will need to consider a broad range of issues before any decision on discounting of Commonwealth payments for transport infrastructure is warranted.
- 114 As a starting point, we consider that the two key components for consideration in the 2015 Review will be to review the 2010 Review decision on discounting and the current definition of what constitutes ‘nationally significant’ transport infrastructure:
- We understand that the 2010 Review rationale for equalising just 50 per cent of Commonwealth NNR funds was:
 - ‘Capital grants for NNR reflect the broader needs of the nation, rather than the circumstances of individual States’; and
 - There was a ‘need to develop an efficient national transport network to facilitate national economic growth and productivity gains in the long term.’⁷
- 115 In this regard, to date there has been no underpinning quantification that supports the discounting of NNR by 50 per cent. It is understood that in deciding on the level of discounting, the CGC chose from its uniform set of discounts with a higher discount being applied consistent with the highest level of uncertainty (50 per cent). This appears to have been undertaken without testing against other expert advice or evidence, such as the advice of Infrastructure Australia (IA).
- 116 In examining the degree of discounting for the 2015 Review, in addition to the other matters raised regarding national significance, the information collected from other bodies such as IA should be considered and taken into account in the decision making process.
- 117 What constitutes ‘nationally significant’, is broadly reflected in the extent of IA’s 2012 Infrastructure priority list and appraisals:
- “The 2012 infrastructure priority list includes \$76.53 billion of projects that will make a valuable contribution to addressing nationally significant issues.”⁸*
- 118 More specifically, ‘nationally significant’ could be defined as producing direct benefits to the nation that arise from an infrastructure project in question, for example when

⁷ Commonwealth Grants Commission Report on GST Revenue Sharing Relativities – 2010 Review, Volume 2, paragraph 53, page 444.

⁸ Infrastructure Australia, Fact Sheet – 2012 Infrastructure priority List and Appraisals.

the project improves freight corridors that link together as part of the national land freight network as proposed by IA.⁹

119 An indicative map of the national land freight network is provided below.



Source: Infrastructure Australia, National Land Freight Strategy Discussion Paper, February 2011.

120 IA has identified national land freight network projects that are ready to proceed including:

- Adelaide rail freight (Goodwood and Torrens junctions);
- Majura Parkway; and
- Pacific Highway.¹⁰

121 What does, and does not qualify as nationally significant transport infrastructure is subject to ongoing debate between the political parties at the State and Federal level in the lead up to the Federal election. The Opposition Leader, Tony Abbott has ruled out funding by a Coalition government of Brisbane's \$5.2 billion Cross River Rail and Melbourne's \$9 billion Metro projects on the basis that the Commonwealth should

⁹ Infrastructure Australia, National Land Freight Strategy Discussion Paper, February 2011.

¹⁰ Infrastructure Australia, National Land Freight Strategy Discussion Paper, February 2011, page 7.

not fund urban rail projects and that it was better to use Federal funding for national highways and rail freight, a position not shared by the Federal Government.¹¹

122 We consider that ‘national significance’ must be interpreted in a way which has a sound theoretical basis and is measurable, for example, *identifiable direct economic benefits which extend to other States and/or the Commonwealth, as against those accruing to the recipient State*:

- In this regard, IA notes that where governments invest in infrastructure assets, it is essential that they seek to achieve maximum economic benefits, determined through rigorous cost-benefit analysis.¹²

123 The benefits should be direct, that is, arise specifically from the infrastructure project, not indirect, for example, leading to productivity gains which produce higher Commonwealth personal income tax or company tax collections:

- Many other types of State expenditure (for example, on education and health) could be considered to have such indirect benefits – increasing human capital, thus enabling higher productivity and higher returns to Commonwealth taxes.

124 Direct benefits might include:

- Generating a flow of services to residents of at least one other State (for example, from an interstate rail or road link):
 - This cross-flow benefits approach would be consistent with the Asian Century White Paper and the view of the Commonwealth to work, including through IA and with States, to expand existing infrastructure plans by creating a long term national infrastructure strategy that focuses on cross-jurisdictional networks and projects of national significance;¹³
 - It is also consistent with IA’s approach when considering whether the Commonwealth is the appropriate level of government to fund a project as it considers, *inter alia*, whether ‘the project has spillover benefits that extend beyond the boundaries of a single State’;¹⁴
- Involvement of inter-State firms and/or workers in project management, design and construction.

125 If a common framework which determines what is or is not nationally significant is not adopted (such as the land freight network), we consider that the assessment of

¹¹ Abbott rejects urban rail funding by Coalition, The Australian Financial Review, Thursday 23 May 2013.

¹² A Report to the Council of Australian Governments - Infrastructure Australia – Advising Government on Australia’s Infrastructure, December 2008, page 66.

¹³ Australia in the Asian Century White Paper, Australian Government, October 2012, page 144.

¹⁴ A Report to the Council of Australian Governments - Infrastructure Australia – Advising Government on Australia’s Infrastructure, December 2008, page 74.

national benefits could only be done on a case-by-case basis. There is no sound basis for applying a single rate of discount to every project with some level of 'national significance'.

- 126 The 'three tailed' test ('direct', 'economic benefits' and 'extended to other States') is important. Not all projects that are nationally significant and deliver economic benefits should be included as they may be limited to just one State, and may not interrelate with a network across Australia, such as the national land freight network.
- 127 Alternatively, an option for the 2015 Review to consider might be to exclude all such payments from equalisation. However, this has serious equity implications. If they are for projects which generate an ongoing flow of services to State residents, which would normally be supplied by State governments, then the payments should be equalised fully (that is, to the full extent to which the benefits accrue to residents of that State):
- The benefit calculation should be discounted for costs recovered by user charges.
- 128 There are strong arguments for allowing all tied Commonwealth payments to impact on the relativities fully, and this may be the most practicable approach to take as it would ensure that:
- The equity within the system is retained, particularly if there is difficulty in quantifying the extent of the discount that should be applied; and
 - Administrative costs are minimised, given the complexity in applying a framework to assess which 'national projects' should be discounted, and to what extent.
- 129 The Commonwealth Treasury has noted that the allocation of Commonwealth infrastructure payments should be considered in totality and over time and that continuing the current arrangements will ensure that Commonwealth infrastructure funding is distributed equitably amongst jurisdictions.¹⁵
- 130 The Review should also consider the timeframe within which equalisation of Commonwealth payments for transport infrastructure should be applied. This should align with the approach taken to the capital (investment) assessment, which is discussed later in this submission. That is, if capital is to be assessed in the year/s in which the investment occurs, then the Commonwealth payments should be assessed fully in the year/s in which they are received. On the other hand, if capital is to be assessed over the life of the asset, then the Commonwealth payments should also be assessed in that way.

¹⁵ GST Distribution Review – Interim Report, page 89.

4.3 Capturing the changing characteristics of the Indigenous population

131 The redistribution of GST revenue that occurs as a result of differences between the proportions of Indigenous people in States' populations (Indigeneity) is a vexed issue and remains so in the lead up to the 2015 Review:

- The 2010 Review assesses Indigeneity in seven of the 14 expense assessment categories predominantly in the social services assessments, education, health, justice services, welfare and housing and services to communities. Indeed, Indigeneity has the biggest influence on GST distribution on the expense side, and the second largest overall, after revenue from mining royalties.

132 The ToR for the 2015 Review ask the Commission to develop methods to appropriately capture the changing characteristics of the Indigenous population. This reference is aimed at addressing:

- The apparent inability of the current 2010 Review framework to adequately capture Indigeneity costs overall ; and
- Concerns that there are differences between States in the relative disadvantage suffered by their indigenous residents which are not reflected in the current assessments.

133 These issues have been exacerbated by the latest estimates of Indigenous population numbers published by the Australian Bureau of Statistics (ABS) based on the 2011 Census, which show a significant increase in people identifying as Indigenous and a change in the proportions of Indigenous people between States, with significant increases in those States with the lowest proportion of Indigenous people:

- The estimates of Indigenous population for June 2011 based on the 2011 Census were applied by the CGC in the 2013 Update:
 - These estimates differed substantially from the previous June 2011 projection derived from the 2006 Census. In particular, there was a large increase in self-identification in NSW and Victoria.
 - This led to a significant redistribution of funding across States (the most affected was the NT, with a loss of \$121m in GST) as a result of:
 - the reduction in the shares of the Indigenous population for various States; and
 - the 18% increase in the national estimate of Indigenous people, causing a downward revision to average spending per Indigenous person, and thus a redistribution of GST toward States such as Victoria (and the ACT) with a relatively small Indigenous population.

134 Hence, it is not surprising that a number of State submissions (including the ACT's) to the GST Distribution Review advocated the removal of Indigeneity from HFE on the basis that more needed to be done to address entrenched disadvantage, and that HFE did no more than give States the capacity to provide the average level of services:

- The current system of fiscal equalisation is one based on average spending across all States, with the 2010 Review assigning each State the average capacity to address disadvantage. It makes no assessment of what needs to be spent to tackle any particular disadvantage:
 - It does not provide sufficient funds to 'fix' any particular disadvantage. To achieve above average spending, any additional funding must be external to the equalisation process.

135 Other parties claim that ABS population estimates undercount their Indigenous population and that the 2010 Review wrongly assumes that Indigenous persons are equally disadvantaged across the nation in comparable areas, with WA claiming, for example, that its Indigenous people in fact suffer higher disadvantage noting:

- The 2010 Review incorrectly assumes that Indigenous persons are equally disadvantaged across the nation in comparable areas; and
- WA Indigenous people are considered to suffer higher disadvantage relative to Indigenous in other States (reflecting in part the higher incidence of recent separation and dislocation), as shown by their hospital use, their higher funding in the State education budget and their higher imprisonment rates. WA's derived additional cost of \$300 million assumes a 20 per cent increase in the Indigenous cost weight for WA.¹⁶

136 A further problem perceived by some parties is an apparent overlap in the 2010 Review between Indigeneity and remoteness influences in the form of population dispersion assessments, with WA claiming that its costs relating to providing services in remote areas are higher than in most States. This is attributed to poor data and to costs in remote areas varying widely depending on economic circumstances.

137 Against this background, the GST Distribution Review reached a view that Indigeneity should continue to remain in the HFE system. It also acknowledged that where additional measures are required to overcome the disadvantage experienced by some Indigenous communities, they would be best undertaken outside the HFE system¹⁷.

138 The *Report on GST Revenue Sharing Relativities – 2013 Update* also noted that the 2011 Census highlighted the changing characteristics of the Indigenous population and

¹⁶ GST Distribution Review – Interim Report, March 2012 page 124.

¹⁷ GST Distribution Review Final Report, October 2012, page 149.

that developing methods to capture these changing characteristics should be accorded a priority hence, the inclusion in the 2015 ToR.

139 As a starting point, we agree that Indigeneity be assessed for the 2015 Review. The 2015 ToR and deliberations at government level confirm this approach.

140 The challenge for all parties in implementing the ToR arises from the lack of clearly defined data which has hindered, and continues to hinder, development of a specific methodology which captures the essence of disadvantage:

- The GST Distribution Review perceived the problem to be that the current assessments do not directly or separately measure the overall difference between spending on Indigenous and non-Indigenous people to determine the estimate of the redistribution:
 - They contend that the current approach whereby an estimate is derived by assigning non-Indigenous cost weights and/or spending levels to Indigenous people in each expenditure category, with all else unchanged, then comparing the resulting GST redistribution with the GST redistribution from the actual assessments leads to inaccuracies.
 - The ACT does not necessarily share this view – we consider that the separate category assessments, assuming data are reliable and fit-for-purpose, are able to accurately capture disabilities faced by States in providing services to the Indigenous population including demand for, and cost of providing, services for Indigenous people, which vary across the services in question.

141 As a way forward, one avenue open to the 2015 Review, and also aired by the GST Distribution Review, is to again explore whether assessments could be framed to more directly measure needs due to disabilities than the category of spending approach currently adopted.

142 We do note that a working group of officials has commenced the task of exploring possible measures via the 2015 Data Working Party (DWP) - see Attachment C. The outcome of two specific projects on hand, while difficult to progress because of data constraints, might facilitate further deliberations:

- ‘Remoteness Classification’ – use of different models as the basis of a remoteness index to classify where people live; and
- The ‘Indigenous Effects Project’ - whereby the group is examining how it can assess the relative levels of disadvantage for differing types of Indigenous persons without double-counting aspects of disadvantage – this project could focus on the change in the number of persons self-identifying in the 2011 Census as Indigenous,

which may suggest that those newly self-identifying do not have the same level of needs as those who have always self-identified as Indigenous.

143 In progressing this latter work, we consider the overriding consideration or guideline should be premised on:

- Examining the attributes of the population and whether the newly identified people have characteristics/needs that are reflective of the rest of the Indigenous population;
- The reasons for the differential pattern of Indigenous population growth across States between 2006 and 2011; and
- Whether the assessments are still valid for the newly self-identified population.

144 Any revised approach must also ensure that there is no double-counting of the impacts of remoteness and possibly other factors such as socio-demographic composition, which are already catered for as disabilities in the CGC's assessments.

145 But it must be said, the overriding difficulty confronting all parties, and one recognised by the GST Distribution Review, is that any more comprehensive assessment of Indigenous costs and cost weights can only increase complexity and could also quite possibly lead to further claims of false precision.

4.4 Treatment of new national social reform – DisabilityCare Australia, National Education Reform Agreement and the National Health Reform Agreement

General

146 The new national social reforms in Disability Services, Education and Health are transforming the landscape against which the CGC will carry out future assessments of needs and capacity, particularly in relation to the National Specific Purpose Payments (SPPs). Prior to these reforms, the main direction of change, under the principles of the IGAFRR, was the progressive move of all SPPs to an equal per capita basis of distribution. The new reforms will replace this approach with funding models based on individual need, with an underlying assumption that the CGC should not seek to overturn or alter these models through its own assessments. The Disability reforms in particular take a new direction by establishing a national fund, to which all jurisdictions will contribute, and a national system of individual assessments of need, thereby removing the case for equalisation of payments or expenses on a State by State basis.

147 We have provided more detailed analysis of the possible impacts of the Disability and Education reforms on HFE at [Attachment D](#).

Disability Services

- 148 A new assessment will need to be developed for Disability services to cater for the implementation of DisabilityCare Australia (the National Disability Insurance Scheme (NDIS)). Disability services currently forms part of the Welfare and Housing category, comprising around 30% of expenditure under that category.
- 149 The Inter Governmental Agreement for the NDIS Launch (Clause 31) provides that the additional Commonwealth funding for the Launch (first) stage will not impact on State GST shares. The Launch period runs from July 2013 to June 2017.
- 150 During the Transition stage, which applies in 2017-18 and 2018-19, we understand that jurisdictions will move to a contribution arrangement based on the percentage of the total number of expected clients in each State who are taken into NDIS. This is likely to require a 'blended' assessment, comprising a component similar to the current Disability Services assessment for that percentage of State services being provided to clients under the current arrangements, and an NDIS-based assessment for that percentage of State services being provided to clients participating in NDIS. The latter component of the assessment is assumed to be equal per capita, as discussed below.
- 151 Full implementation of NDIS, which occurs in July 2019, involves State contributions to a national funding pool on a per head of population basis. All expenditure will be managed by the national authority, DisabilityCare Australia, so there will be no direct State expenditure on these clients. Our assumption is that the State funding contributions to the national pool should be treated on an equal per capita basis, as this would reflect State needs. The Commonwealth contribution would no longer be part of State budgets (involving a wind-down of the current Disability SPP) and would not form part of assessments. This wind-down process should also occur for Commonwealth payments to States under the NP on Transitioning Aged Care and Disability Services for use of specialist disability services by older people.
- 152 Some component of the current Disability Services assessment may need to be retained for any services which are not replaced by the NDIS.
- 153 We also consider that the Disability Services assessment should not create a windfall gain in GST on transition for any State not participating in NDIS. One option is to assess any non-participating State on the basis of the payments they would have made if they were participating. Although this treatment would not give such States any GST above an EPC level (and thus be in line with the treatment of participating States), there would be a gain compared with the State's previous GST allocation if it had been receiving a below-EPC share of GST under the current assessment.

Schools Education

- 154 The Schools Education assessment will be fundamentally transformed by the National Education Reform Agreement (NERA) and the associated implementation of the Schooling Resource Standard (SRS) for school funding. The new arrangements are to come into operation from the start of 2014, so will have an impact even prior to the completion of the 2015 Review.
- 155 The Commonwealth has issued a position paper stating that the loadings for disadvantage under the SRS model are not to be unwound by the HFE assessment (as per Clause 76 of the NERA), that is, the disability assessment would align exactly with the loadings for educational disadvantage under the SRS. However, the paper also states that the base funding under SRS would be subject to equalisation under the normal CGC processes. Given that this is intended to be the basic level of funding required by all students, we assume that it would be treated under HFE by equalisation solely on a per head of student population basis. Thus, although it would result in redistribution of GST compared with an EPC distribution, it would align closely with the use of actual enrolments in the current Schools Education assessment. The Commonwealth paper does not address the treatment of the Commonwealth payments on the revenue side of assessments – in the absence of other guidance, the assumption is that these payments would be equalised in accordance with the CGC’s standard methods.
- 156 The NERA (Clause 77) also requires the CGC to ensure that there is no windfall gain in GST for any State which does not sign up to NERA. The Commonwealth position paper does not provide any guidance as to how this might be handled under HFE, stating that the mechanism should be determined as part of the upcoming 2015 Review.
- 157 There are perhaps two main options for how this assessment could be handled. The first option assumes that all States have signed up to the NERA and are receiving the funding they are entitled to and making the expenditure they are required to under NERA. Under this option, non-participating States would gain GST, compared to the current assessment, if the SRS formula gives them a higher funding need than the current School Education assessment, and/or if they currently receive below an equal per capita share of the Schools SPP. An alternative option is to carry out separate assessments for participating and non-participating States. This would involve applying a lower (non-NERA) dollar standard of expenditure and funding to non-participating States. Such an approach would prevent any redistribution of GST towards non-participating States, compared with the current allocations.

Hospital Services

- 158 The IGAFRR (Clause D66) provides that National Health Reform (NHR) funding is to be treated by inclusion, recognising that these payments “provide the States and Territories with budget support for providing standard state and territory services”.

This is reinforced by the National Health Reform Agreement (NHRA), which states (Clause B14), in relation to the determination of the national efficient price, that the Independent Hospital Pricing Authority (IHPA) “should not seek to duplicate the work of the Commonwealth Grants Commission in determining relativities”.

- 159 However, an exception is made in both agreements for cross-border services, for which NHR funding and corresponding expenditure are to be treated as not affecting GST relativities (IGAFFR sub-clause D66 (a) (i); NHRA sub-clause A88(c) and Clause A89). We consider that quarantining of cross-border funding (and expenditure) from equalisation is appropriate because it recognises that equitable treatment should be on the basis of user populations, not resident populations. Cross-border impacts would still need to be considered under HFE for non-hospital-based health services, such as community health.
- 160 The 2013 Update Report (Chapter 4, para 96 (p.57)) also made a distinction between the base and growth funding in the NHR payments, noting that in 2013-14 the National Health Reform base (our emphasis) funding will move to a 100 per cent EPC distribution. While this implies a potentially different treatment between the base and growth NHR funding, no such distinction appears to be made in the IGAFFR, nor does the NHRA make this distinction in relation to treatment by the CGC.
- 161 While it seems clear that HFE should continue to equalise both expenditure and Commonwealth payments under the NHR arrangements, consideration would need to be given to the factors taken into account by the IHPA in determining the efficient price. These factors include (NHRA Clauses B3g, B13) ‘loadings’ for hospital type and size; hospital location, including regional and remote status; and patient complexity, including Indigenous status. The IHPA must take account of these where they involve “legitimate and unavoidable variations in wage costs and other inputs”.
- 162 Consideration would need to be given to, as in the case of the SRS (though with the discretion to decide either way), whether these loadings should replace assessment of relevant disabilities or be over-ridden by such assessments. While there may be some overlap with the current Admitted Patient Services assessment of location costs, the IHPA approach does not appear to cater for the socio-demographic composition (except as far as this is represented by patient complexity) or administrative scale factors, which are the other main factors in the CGC’s assessment. The wording of the NHRA seems to envisage that the CGC would continue to carry out its own assessment of such disabilities.

5 Improving the system – Other Issues in the Terms of Reference

5.1 Capital assessment (Simplified and integrated assessment framework)

163 The 2010 Review made a major change in the treatment of State infrastructure needs. For the first time it adopted a net worth approach to assessing capital needs, and included assessment of financial as well as non-financial assets. Prior to this, it had applied a debt charges approach to capital needs, which in effect recognised the cost of capital as an ongoing operating cost. This was similar to the approach applied to depreciation, which was recognised as the ongoing operating cost (reduction in value) of existing, as distinct from new, capital assets:

- The 2004 Review had changed the approach to depreciation from a separate assessment category to incorporation in the relevant expense categories which were affected (transport, school education, admitted patients etc).

164 The move to a net worth approach, and to include financial as well as non-financial assets, extended the scope of assessments to elements of State balance sheets, beyond purely their operating statements. This can be considered as to some degree increasing the complexity of the assessments. However, at the same time it enabled assessments to focus on the change in net worth in a single year, and by equalising net worth, enabling returns on assets to be assessed EPC, thus greatly simplifying the data requirements for the assessments.

165 A crucial impact of this change was that it recognised capital needs fully in the year in which the investment occurred, rather than spreading it out as an operating cost over the life of the asset. This approach has both advantages and disadvantages. On the plus side, it caters better for States with greater needs for investment due to population growth and economic development, giving them greater budget flexibility by making the adjustment to assessed needs and thus GST distribution up-front. On the minus side, it increases the volatility of assessments, moving widely varying amounts of GST between assessment years. The amount of GST redistributed by the investment assessment during the three most recent assessment years varied from a low of \$542m to a high of \$1,002m.

166 The GST Distribution Review recognised that the “up-front” approach to capital assessment adopted in the 2010 Review was a contentious matter, with some States considering that the method adopted was too complex. The Panel’s proposal for a simplified and integrated assessment framework is discussed in more detail later in this section.

167 The most obvious and distinct alternative to the up-front approach would be to adopt fully an operating cost approach to investment, with the holding costs (depreciation and cost of capital) of assets and earnings on investments being fully accounted for in

the expense and revenue assessments. Such an approach would also have to be applied to Commonwealth payments for infrastructure, with some form of amortisation of the payments over the life of the asset. This approach has some additional complexities in terms of the data required to support the assessments, including consideration of issues such as determining the user cost of capital. However, it also has advantages in smoothing out volatility in impacts on GST distribution.

- 168 Another aspect to consider is the need for an assessment of financial assets as well as non-financial assets on a capitalised basis, or whether their assessment should revert simply to an operating cost approach of recognising borrowing costs and dividends/earnings. However, it could be argued that if a capitalised approach to non-financial investment is appropriate, then using the same approach for financial assets would be more consistent and allow greater flexibility for State choices in their investment decisions. The capitalised approach also aligns with the full equalisation of Commonwealth payments for infrastructure in the year in which they are made.
- 169 The key disability used in the investment and net lending assessments is relative population growth – that is, a disability is assessed for States with above average population growth. This has the effect of anticipating States’ needs for new infrastructure as they arise, rather than taking account of them in arrears, as the conventional assessment approach does. While the ACT recognises the merits of this approach, we have previously raised concerns that other aspects of faster growth (e.g.: revaluation effects), which are not taken account of, may reduce State needs. However, the CGC was not able to find evidence to support this contention. Nevertheless, given the very large redistributive impact of the population growth factor (\$620m in the investment assessment and \$241m in the net lending assessment in the 2010 Review), it would be appropriate to review all aspects of the drivers of capital needs.
- 170 The other disabilities currently applied to the investment assessment, for use and cost factors, appear to be appropriate and reasonable.
- 171 The GST Distribution Review identified the treatment of subsidised Public Trading Enterprises (PTEs) as another area of concern in relation to the capital assessment. In the 2010 Review, the CGC adopted a subsidy based approach to recognising needs for PTEs. Differences in State holdings of PTE equity appear to be largely a matter of State policy and the CGC was not able to determine any basis for a rate of return disability.
- 172 Clearly, inclusion of the assets of PTEs in assessments would involve a major increase in scope and complexity of equalisation beyond the General Government Sector, and should not be considered. However, subsidies to, and dividends from, PTEs should be treated equitably. Currently, the assessment approach assumes that States hold the same share of their financial assets in different asset classes, with average rates of

return calculated for each asset class. On the assumption that States have flexibility to determine their investment strategies, this is a reasonable approach.

- 173** The GST Distribution Review claimed that equalisation of States' net financial worth in the net lending assessment "imposes a constraint on the recognition of capital needs for subsidised PTEs". The Panel were concerned that this would mean that the capital needs of subsidised PTEs may not be fully recognised. However, the net lending and investment assessments are not intended to equalise the capital needs of PTEs, and to attempt to do so would be to greatly extend the scope of equalisation beyond the General Government Sector. The main concern should be that HFE assessments do not create distortions in capital investment decisions relating to PTEs.
- 174 The GST Distribution Review identified some problems with the net investment assessment. The first of these was that the assessment of net investment and depreciation appears to involve a double count. This is because, under an up-front, capitalised approach to assessing investment, depreciation of an asset should be incorporated into its initial valuation. We agree that the retention of depreciation costs as a recurrent expense should be reviewed if the capital assessment is to continue on an up-front, capitalised basis. The second problem identified by the Distribution Review was the volatility caused by applying current period capital stock disabilities to the large stock of physical assets. We agree that this is a concern and that consideration should be given to methods which smooth out such impacts.
- 175 Although the GST Distribution Review proposed a return to a net operating statement framework, it said that the population growth needs assessment should be retained. It appears that their intention was that the current investment assessment (net worth based) be retained, while reverting to an operating statement approach for net lending. This approach would introduce inconsistency between the treatment of physical and financial investments, but it is not clear whether there would be any unintended consequences of such a change e.g.: whether it could give rise to distortions in State investment decisions.
- 176 The GST Distribution Review also proposed that the revised assessment framework should include the net operating deficits of subsidised PTEs including depreciation and before subsidies. This approach involves a different, but similarly extended, approach to the current net worth method in intruding into the operating statements of State PTEs. Its merits are unclear, though it would mean incorporation of larger costs in the assessments where the government subsidies do not fully cover the PTE operating deficits. We assume that the Distribution Review did not intend that equalisation should be applied to PTEs, which would add another layer of complexity to the investment/lending assessments.
- 177 The Final Report of the GST Distribution Review also seems to be recommending the adoption of a hybrid model, combining elements of both the capitalised and holding

cost approaches. It states that “the largest component of the current capital assessment is retained” (presumably referring to the investment assessment), but that “a user financial cost of capital element ‘scales up’ the depreciation assessment” – which implies the use of a holding cost/expensed approach in relation to these costs.

178 While we agree with the Panel that an operating statement framework is more accessible and familiar than a net lending framework, and would tend to be more stable and predictable, we do not consider it has more transparency. Moreover, the Panel’s proposed modification to the operating statement framework would appear to make it more complex and less accessible than previous approaches based on this concept. However, the ACT considers that the Methodology Review should include a more substantive analysis of the capital assessment model proposed by the GST Distribution Review and a comparison with the current model to clarify the relative advantages and disadvantages of each.

5.2 Location costs - Equalise Interstate costs on a ‘spend gradient basis’

179 The GST Distribution Review under the heading of reporting on ‘greater stability of GST shares and methodology improvements’ recommended:

*“That the CGC investigate whether it is appropriate and feasible to equalise interstate costs on a ‘spend gradient’ basis. This investigation should occur in the context of the assessment of other cost disability factors including costs of remote locations, and administrative scale”.*¹⁸

180 The current methodology adopts the principle that differences in fiscal capacity on the expenditure side of State budgets can arise from demand (use) factors or from cost factors. We note that the factors relating to cost of service provision (interstate wage levels, administrative scale, population dispersion) redistribute around \$3.95 billion of GST, compared with demand/intensity of use factors (Indigeneity, socio-economic status, non-State service provision, population growth) which redistribute about \$5.01 billion.¹⁹

181 In the context of location costs, currently two types are equalised:

- intrastate costs, which reflect differences in the number of high cost locations within States; and
- interstate costs, which reflect the fact that some States face higher costs predominantly because of higher wage costs compared with other States.

¹⁸ GST Distribution Review, Final Report, October 2012, page 15.

¹⁹ Report on GST Revenue Sharing Relativities – 2013 Update, page 75.

- 182 Administrative scale costs are also equalised. This relates to the fixed costs of State governments arising from the existence of States (which are unaffected by population settlement patterns.)
- 183 Evidence tabled at the GST Distribution Review by some jurisdictions suggested that there should be full equalisation for costs, including for diseconomies of small scale and remoteness (on a stratified spend gradient basis), but only partially for interstate wage levels.
- 184 In reviewing the evidence contained in the referenced material made available to the GST Distribution Review, it does not appear to us that the term ‘spend gradient’ is used. However, it seems that the concept is that regions across States could be stratified by cost, with equalisation occurring at the stratum level. The meaning of this concept needs to be clarified.
- 185 Nevertheless, there is clearly an option put forward by some parties that expenditure on high cost inputs should in some way be ‘economised’, that is, reduced on economic efficiency grounds, because social demand for government services is, at least to some degree, sensitive to costs (a government focussed on economic efficiency in theory would provide lower levels of service in high wage areas where it is more expensive to provide government services).
- 186 The argument is that full equalisation acts as an incentive to move to high cost areas and/or reduces the incentive to move to low cost areas.
- 187 The GST Distribution Review went further and suggested that such an approach for interstate costs would align with the treatment of intrastate costs, on the grounds that it is recognised that States can, and do, provide lower levels of service in high cost locations.²⁰
- 188 There is also significant concern by some parties that some costs, in particular wage costs, are partly under the policy control of States, and that equalisation should not reward inefficient service provision by State governments. However, the evidence previously considered indicates that there is a strong correlation between public and private sector wages across States, leading to the conclusion in the 2010 Methods Review that: *“the influence of location on wages is beyond the control of States and presents a conceptual case for making an interstate wage assessment.”*²¹ We support this conclusion.
- 189 The argument for partial equalisation of cost differences rests on economic efficiency grounds, and would apply even under the assumption that such costs are not to any degree under the control of States. However, this introduces an element of trade-off between equity and efficiency into the CGC’s assessments, and represents a move

²⁰ GST Distribution Review Final Report, October 2012, page 102.

²¹ Report on GST Revenue Sharing Relativities – 2010 Review - Volume 2, Chapter 24, page 501.

away from the single objective of HFE. As stated elsewhere in this submission, we do not support such a weakening or modification of the HFE objective.

190 Full equalisation of interstate costs does not require that each State provides the same level of service to all locations within the State – this is in any case outside the scope of HFE, which aims to equalise fiscal capacity at the State level. In conjunction with the intrastate costs assessment, it gives each State equal capacity to provide the same standard of service to comparable locations as other States.

5.3 Materiality thresholds

191 As foreshadowed earlier, the 2010 Review adopted materiality thresholds as a way of achieving simplicity whilst still achieving equalisation.

192 We consider that the materiality mechanisms have already, after detailed review, been pursued to their reasonable limits and pursuing this line further, by implementing a fourfold increase in the materiality thresholds as recommended by the GST Distribution Review,²² would reduce the accuracy and equity of assessments. Accordingly, it should not be given a high priority.

193 Moreover, there has been little rigour provided in terms of empirical evidence used to support the Panel’s recommendations.

194 If the 2015 Review was to re-open this issue, the following principles would need to be considered:

- Balancing the goal of achieving simplicity while ensuring that equalisation (accurate assessment of States’ disabilities) is achieved;
- How effective the other approaches, for example, aggregation and the removal of factors based on unsatisfactory data and methods, have been in achieving simplicity;
- The equity requirements and the arbitrary nature of thresholds in their effect on per capita redistribution of GST among States; and
- Justifying any increase in the materiality thresholds by way of quantified evidence.

195 Finally, rather than using broad-based mechanisms which are arbitrary and blunt to achieve simplicity, we recommend that each category be considered on a case by case basis.

196 Indeed, we contend that the 2015 Review’s time would be better spent re-examining a number of the complex expenditure assessments which could be undertaken more simply, while noting that this should not be at the expense of equalisation.

²² GST Distribution Review, Final Report October 2012, Recommendation 3.1 on materiality thresholds, page 11.

6 Improving the system – ACT specific priorities for the 2015 Review

6.1 Use of Socio-Economic Index for Areas

197 The 2010 Review continued to recognise that differences between the States in the socio-economic profile of their populations had substantial effects on their relative fiscal capacities. States with higher proportions of their populations with a lower socio-economic status (SES) were assessed as having to incur above average expenses per capita.

198 The most common approach used to measure the number of low SES to date was to base the calculation of low SES persons on the Australian Bureau of Statistics' Socio-Economic Index for Areas (SEIFA) using the Index of Relative Socio-economic Disadvantage (IRSD).

199 In a similar vein to the arguments put to the GST Distribution Review by some jurisdictions that their Indigeneity costs are not fully recognised due to population undercounts and insufficient recognition of higher costs, we contend that the adopted index is failing to capture the true extent of socio-economic disadvantage in the ACT:

- It significantly understates the Territory's low SES numbers within the assessments.

200 Early work was undertaken by the 2015 Data Working Party (DWP) process which undertook a project on capturing persons of low SES and Indigenous effects using ABS SEIFA data. The project was aimed at determining whether SEIFA was the best measure to continue assessing persons of differing SES. A 2015 DWP paper noted the:

"... most viable approach to assessing SES is to use the ABS SEIFA [Index of Relative Socio-economic Disadvantage (IRSD)], and while a number of criticisms have been made of this indicator, these are largely unfounded, and SEIFA should be considered a reliable and robust approach to assessing socio-economic status".²³

201 However, the results of work undertaken by the ABS on an ACT Socio-Economic Index for Individuals (SEIFI) and SEIFA data Analysis Project quantified the relative socio-economic disadvantage hidden by SEIFA:

- At the suburb level, the SEIFA IRSD only identified 0.2% of the total ACT population as falling into the most disadvantaged 20% of Australians, or approximately 712 individuals; and
- By contrast, SEIFI IRSD data identified that 12.6% or 28,639 of ACT residents aged 15 to 64 falls into that same cohort.

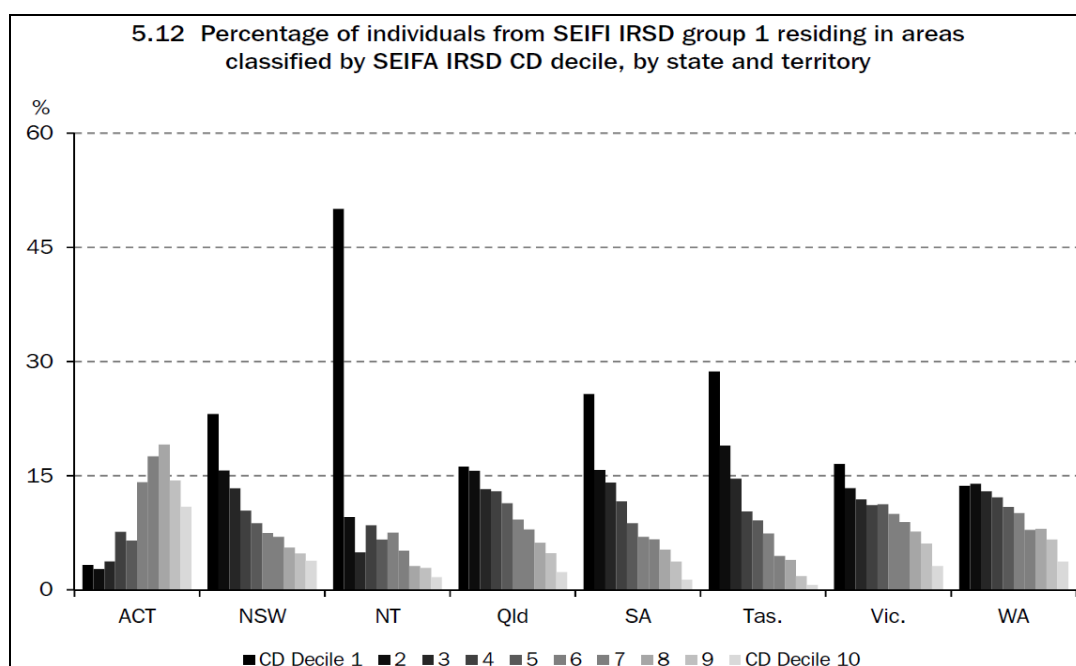
²³ Commonwealth Grants Commission, Next Review – Measuring Socio-Economic Status, (Paper prepared for the Data Working Party of 30 August 2012), Staff Discussion Paper CGC 2012-03, page 1, August 2012.

202 The impact of the undercount of low SES persons is material. Analysis of some of the assessments in which SEIFA is used – schools education and admitted patients - suggests that using SEIFI would result in a material redistribution of GST funding to the Territory assessments in the order of \$12.7 million, or around \$36.51 per capita.²⁴

203 We contend that the levels of disadvantage are masked by SEIFA because of the greater diversity of the socio-economic composition of the areas in the ACT, with a relatively low proportion of the most disadvantaged people residing in areas with high levels of disadvantage, and a relatively high proportion of the most disadvantaged people residing in less disadvantaged areas.

204 Under SEIFA’s averaging effects, the ACT’s disadvantaged population residing in less disadvantaged areas is treated as being similar to the rest of the population. The averaging effect of SEIFA masks the relative disadvantage of individuals living in Canberra’s socio-economically diverse neighbourhoods. The result is that only a fraction of the ACT’s actual level of disadvantage is captured:

- As seen in the following chart, Canberra’s most disadvantaged residents living in deciles 6-10 are effectively ignored as they differ from the average of what occurs in the other States.



Source: ABS, SEIFA: *Getting a Handle on Individual Diversity within Areas*, 1351.0.55.036, page 31.

205 We understand that the SEIFI offers an alternative for use in the category assessments as the ABS has published SEIFI data for all States from the 2006 Census data.

²⁴ Based on the 2010 Review assessment methods and data using a number of caveats / proxies to calculate these figures.

Alternatively SEIFI could be used only for the ACT given it is the State heavily affected by the averaging effects of SEIFA.

- 206 A number of ACT directorates, including Justice and Community Safety, Health and Community Services are now using SEIFI data to assist in the identification of low SES persons located throughout Canberra.
- 207 In this context the ACT Project represents a major contribution towards ensuring that adequate and effective services are provided to ACT residents. Through SEIFI analysis, directorates are now looking to ensure that the provision of services is comprehensive and better targeted towards their client population.
- 208 When looking at the best measure of low SES for the States, the 2015 Review should consider:
- How differences between the States in the socio-economic profile of their populations are best captured;
 - Which measures should be used to accurately assess the low SES populations – such as SEIFA for the majority of States and SEIFI for the ACT;
 - The reasons why SEIFA may not be applicable for the ACT’s circumstances and capturing its low SES persons accurately;
 - The extent of diversity that exists between the most disadvantaged populations within States; and
 - Where the most disadvantaged cohort of the population lives across States.

6.2 Tax reform

- 209 The 2012-13 ACT Budget Paper No 3, (page 45) provides a path for reform titled ‘A Fairer, Simpler and More Efficient Tax System: 5-Year Plan’. It is predicated on phasing out taxes on property and insurance transactions in a staged approach. A summation of the reform package and changes of interest to the CGC (impacts on its revenue assessment categories) is provided at [Attachment E](#).
- 210 This reform would normally have been addressed in the proposed *Report on GST Revenue Sharing Relativities 2014 Update* for application in the 2014-15 year.
- 211 However, we contend that this matter, with consequential GST distribution effects flowing from tax reform, should be accorded a priority classification in the 2015 Review in parallel to the 2014 Update process, given the significance of the decision by the ACT to proceed with such a package on a unilateral basis.
- 212 The implementation of the reform package, should, in effect, be seen as a test case for both State tax reform and the ability of HFE to accommodate such an initiative. In

response to the findings of the GST Distribution Review on this issue, the ACT proposes that any unintended impediments to tax reform due to consequent changes in GST shares could best be addressed by modification of the existing revenue assessments using elasticity adjustments (discussed later).

213 The taxation reform plan is designed to be revenue neutral overall with the distributional impacts ameliorated through improving the progressivity of the revenue replacement base (General Rates), and utilising the concession system. The main measures are:

- Abolishing Duty on Insurance policies over five years;
- Phasing out Conveyance Duty over 20 years;
- Abolishing commercial Land Tax and combining it with commercial General Rates;
- Making General Rates more progressive;
- Making residential Land Tax more progressive; and
- Reducing the amount of Payroll Tax paid by businesses.

214 The interplay between tax reform on a unilateral basis and potential impacts of the HFE system was an important consideration of the ACT Taxation Review Panel. The Panel recognised that national consensus on pursuing structural tax reform, while inevitable, would take time. Therefore a package was designed to provide a basis for the transition.

215 The ACT Taxation Review Panel noted:

- *“The CGC revenue assessments were an important consideration for the Panel. This includes potential second round effects that could occur due to reforms to existing taxes, although these effects should not be a barrier to reform”.*²⁵
- *“For example, removing or reducing inefficient taxes will have benefits for the Territory economy and community. However, the Territory’s GST entitlements could be adversely affected through a redistribution of the revenue gains, or higher revenue raising capacity assessment due to improvement in economic efficiency”.*²⁶

216 The Taxation Review Panel responded with two specific recommendations to the ACT Government which effectively suggested that Commonwealth support should be sought to ensure that the taxation reforms were not encumbered by unintended penalties through the HFE process.

²⁵ ACT Taxation Review, May 2012, page 28.

²⁶ ACT Taxation Review, May 2012, page 30.

- 217 The Panel also made mention of the GST Distribution Review and in particular, the expansion of the original ToR in November 2011 to include recommendations on incentives and disincentives to improve the efficiency of State taxes:
- The views of the ACT Panel were that the expanded ToR sought to address a concern raised by its own Review, as well as others, that HFE should not be a disincentive to State tax or economic reform.
- 218 This concern was subsequently taken up in our submission to the GST Distribution Review's Supplementary Issues Paper of December 2011 in which the key question was asked of all parties - *Does HFE provide a disincentive for States to undertake State tax reform?*
- 219 In general, we stated that major State tax reform is likely to be pursued through national agreements and common time frames across States. In such circumstances, HFE would not be a disincentive for tax reform. However, we suggested that it was possible that HFE does provide a disincentive if a State sought to pursue major reform of its own accord. We concluded that this could occur through a redistribution of the revenue gains; or a higher revenue raising capacity assessment due to improvement in economic efficiency following reducing or abolishing an inefficient tax.
- 220 The GST Distribution Review subsequently examined these concerns and agreed that it was vital for all levels of government to pursue a tax system that favours broadly based taxes with fewer exemptions over narrow and distortionary transaction based taxes. It suggested that ideally, this would occur on a multilateral basis — amongst the States and including the Commonwealth — but it would not be a bad thing if some States chose to take a leadership role²⁷.
- 221 The Review Panel addressed the first order effects of unilateral tax reform on GST distribution (i.e. immediate redistribution of revenue gains) in its Second Interim Report, Table 3.1 (page 30), reproduced below. The table shows the direct effects of a unilateral increase in tax rate (or coverage) for each of the major categories of State own-source revenue, in terms of the percentage of additional own source revenue which is lost (or gained) in GST. For the State implementing the change, the net budget impact is the sum of the change in own source revenue collections and the change in GST share. For the remaining States, the net budget impact is simply the change in GST share.
- 222 The report concluded that most changes in tax policy have little direct effect on GST shares. For the ACT, there would be only a small direct effect from tax increases in any of the major categories of revenue.

²⁷ GST Distribution Review Final Report, October 2012, p.142.

Table 3.1: Effect on GST payments of a unilateral tax increase relative to change in tax amount, 2010-11 (a)

%	NSW	VIC	QLD	WA	SA	TAS	ACT	NT
Mining revenue	18.58	24.28	-8.30	-41.84	4.27	1.65	1.61	-0.27
Payroll tax	-1.58	0.01	2.00	-3.28	1.78	0.73	0.17	0.16
Stamp duties	-1.75	-3.77	2.41	-0.07	2.35	1.01	-0.40	0.22
Land tax	0.80	-0.86	-1.35	-3.49	2.72	1.22	0.65	0.31
Motor taxes	3.65	-0.93	-0.26	-2.57	-0.06	-0.11	0.20	0.08
Insurance tax	-3.38	1.68	0.73	0.13	0.02	0.50	0.16	0.15
Other revenue (b)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Notes: These figures show a one year GST effect and ignore any potential elasticity effects or the impact of value distribution adjustments within assessment categories.

(a) If States decrease their tax rates or coverage the size of the effect would be the same, but the signs reversed.

(b) Where any source of revenue is not differentially assessed, increasing revenue collected from that source will have no impact on any State's GST share.

Source: CGC 2012 Update, Secretariat calculations.

223 However, the greater concern is the second order effects (i.e. elasticity effects) of such tax changes. Elasticity in this context refers to the responsiveness of the underlying activity being taxed to the rate of tax. The GST Distribution Review recognised our concerns in relation to capturing tax elasticity effects. It concluded that HFE did not take into account the effect of a State's tax rates on the size of its tax base. It acknowledged that adjustments had previously been made to some revenue assessments to take into account elasticity effects, but this was discontinued because of the lack of a reliable measure and by implication, something that may be reconsidered in a future methods review.²⁸

224 While the ACT accepts the leadership role in State tax reform, we argue that we should not be penalised through the loss of GST as a result of the impact of reform on our tax base. In our view, the elasticity effects will have a relatively significant impact

²⁸ GST Distribution Review, Second Interim Report, June 2012, page 31.

on our share of GST as we move to abolish several inefficient taxes on a unilateral basis over a period of time.

- 225 In particular, the progressive reduction of conveyance duty is likely to increase the level of turnover in the housing market. Analysis carried out by the Henry Review (*Australia's Future Tax System*) indicates that the marginal welfare loss of conveyancing duty is around 34% (as a percentage of revenues raised). The Report also quotes research by Leigh (2009) which found that a 10 per cent increase in the level of stamp duty reduces the numbers of properties exchanged by 4-5 per cent.²⁹ Given the significance of conveyancing duty as a source of State revenue, the GST effect of a large reduction in, or abolition of, this tax could be very substantial.
- 226 It is our contention that the 2015 Review should re-examine the issue of elasticity adjustments to assessments of revenue raising capacity. This should be preferred to other approaches which might be adopted to address the question asked by the GST Distribution Review: "How could an alternative form of GST distribution be designed that would remove (or at least reduce) this effect?".
- 227 The GST Distribution Review – Second Interim Report provided some suggestions as to alternative approaches to incorporation of elasticity effects.³⁰ The two possible methods they suggested were:
- Assessing the revenue raising capacity of a State that abolishes a tax as if it had no capacity to raise revenue from that tax – or recognising a diminished capacity; or
 - Assessing a State's revenue raising capacity for tax to be abolished on the basis that what they actually raise from that tax represents their capacity - an actual per capita (APC) assessment.
- 228 The ACT does not support either of these suggestions because they are ad-hoc rather than structural solutions to the problem, and would have the effect of rewarding states for reducing their tax effort. We agree with the view expressed by the GST Distribution Review that consideration of the GST effect of reduction or abolition of inefficient taxes should also consider the effect of any increase in replacement taxes³¹. That is, States should not be rewarded by a gain in GST simply for lowering their overall tax effort. However, tax reform which shifts effort from less efficient to more efficient taxes will, in general, mean shifting from taxes with high elasticity to those with low elasticity. The net effect would therefore be to increase the overall size of a State's tax base, and thus its revenue raising capacity. This would be best assessed through an elasticity adjustment.

²⁹ Australia's Future Tax System, Part 2, Volume 1, p.255.

³¹ GST Distribution Review, Second Interim Report, June 2012, page 32.

229 The revised approach to assessing revenues is important as it would ensure that the ACT's tax reform package remains revenue neutral. This is the stated policy goal of the package – 'Reforms have been funded through General Rates to ensure revenue neutrality overall, while preserving capacity for government services and ensuring future generations do not bear the higher economic costs of an unfair and inefficient tax system'³². The ACT is not seeking a windfall gain from any revised GST arrangements.

6.3 Gambling taxation

230 Prior to the 2010 Review, the revenue raising capacity of the States was based on 50 per cent of gross household disposable income (GHDI) as a proxy for the propensity of State populations to gamble.

231 Queensland, South Australia and Tasmania argued for a differential assessment of gambling revenue during the 2010 Review. This was on the grounds that substantial revenues were collected and there were differences in the capacities of States to collect this tax.

232 The 2010 Review ceased a differential assessment of gambling on the basis that a reliable assessment could not be developed. The main reason for this was that it was not possible to construct policy neutral proxies that capture the underlying factors that drive gambling expenditure. Another reason was that the literature indicates that personal income is not a good guide to gambling expenditure (although it provides limited guidance on which socio-economic and behavioural factors are relevant).

233 However, it was noted by the GST Distribution Review that further submissions on the treatment of gambling revenue would ordinarily be reviewed by the CGC in the course of its regular methodology reviews. It did not rule out the assessment of gambling tax on a differential basis.

234 Given the difficulties in reliably measuring the underlying factors driving States' gambling expenditure, we supported an equal per capita (EPC) assessment in the 2010 Review. We continue to support that position for the 2015 Review.

235 The issue of determining the drivers of individuals' propensity to gamble is a contentious matter to assess with a range of complexities. It is difficult to derive a policy neutral gambling tax assessment without a substantial amount of effort being dedicated to the task. Our view is that:

- The gambling issue is complicated and there are likely to be inter-relating factors driving differences in States' revenue raising capacities;

³² ACT Budget 2013-14, Budget Paper 3, page 95.

- It requires dedicated research into the drivers of the propensity of individuals to gamble which are difficult to determine; and
- One or two high level proxies are not able to capture the drivers of gambling adequately.

236 In terms of proxies, we do not consider that the use of The Queensland Government Report *An analysis of relationship between gambling activity, socio-economic, demographic and density indicators*, 2007, which we understand was a driving force behind the GST Distribution Review Panel’s deliberations, is sufficient for the purposes of the gambling assessment. The analysis represents a single report that claims that urban concentration (and larger venue size) drives higher electronic gaming machine (EGM) metered win (more difficult to generate income in more remote areas), rather than socio-economic and demographic factors, which is contrary to a range of other evidence:

- The Queensland report suggests that the only significant demographic or socioeconomic variable in the study is persons aged between 18 to 24. This contrasts with many other national and State studies which indicate that age, sex, Indigeneity, and socio-economic status measures such as educational attainment and income all affect the propensity of individuals to gamble.

237 The contention that revenue generation from gambling in more remote areas is more difficult is questionable, given that Productivity Commission analysis has highlighted that 70.1% of non-gamblers live in metropolitan areas, compared with a population share of 64.7% living in metropolitan areas, while conversely, 29.9% of non-gamblers live in regional/rural areas, compared with a population share of 35.3% living in regional/rural areas.³³

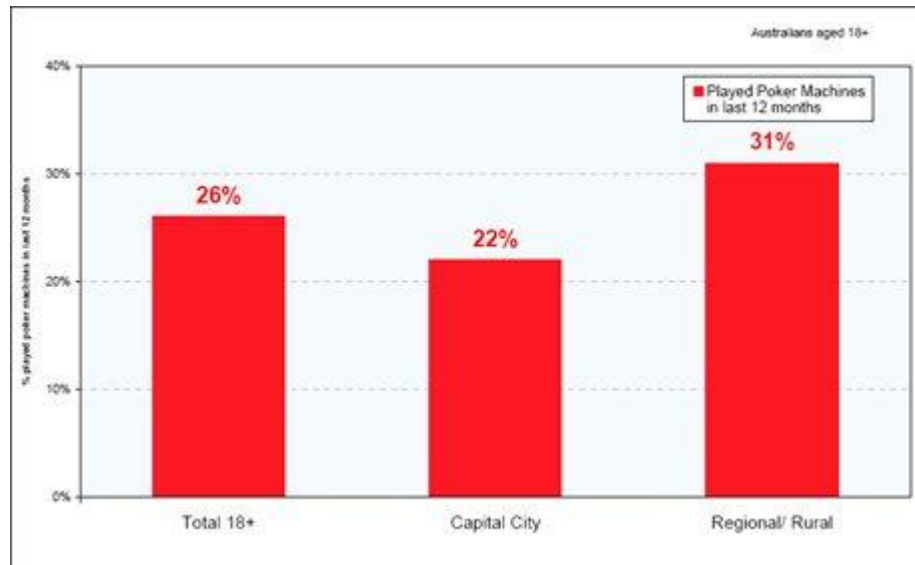
238 This finding is also consistent with the latest information from the March 2012 Roy Morgan Gambling Monitor which shows that Australians who live in regional or rural areas are more likely than capital city dwellers to have played poker machines in the last 12 months. 31% of Australians living in regional or rural areas played the pokies in the last 12 months, compared to only 22% of capital city dwellers.³⁴

³³ Productivity Commission, *Australia’s Gambling Industries*, Inquiry Report, Volume 1, 1999, Table 3.4, page 3.19.

³⁴ Roy Morgan, *Regional/rural residents more likely to play pokies*, 14 May 2012. See:

<http://www.roymorganonlinestore.com/News/Regional-rural-residents-more-likely-to-play-pokie.aspx>

Incidence of playing Poker Machines (last 12 months)



Source: Roy Morgan Single Source, April 2011 – March 2012.

- 239 Australians living in regional or rural areas are also more likely to place a bet, buy a lottery or scratch ticket, and play Keno at a club, pub or casino. The reason for this is that regional and rural residents are more likely than capital city dwellers to go to pubs and hotels for a drink or meal and to catch up with friends - and many play the pokies while they are there.³⁵
- 240 There is also evidence that suggests rural and remote residents participate in a range of forms of gambling in relatively high numbers given that, for example, Aboriginal people describe gambling as a way of socialising, to relieve boredom and loneliness.³⁶
- 241 The Queensland analysis also fails to take into account the large numbers of domestic and international tourists that visit Queensland's highly accessible Local Government Areas such as the Gold Coast, Cairns and the Sunshine Coast. Where large numbers of tourists congregate, it is natural to expect more entertainment facilities to be present. Accordingly, it is not surprising to see that the higher density of electronic gaming machines on the Gold Coast generate higher revenues than areas that do not experience a similar volume of tourists. We would argue that jurisdictions with a high volume of domestic and international tourists have a greater capacity to raise gambling tax revenue.
- 242 Finally, in our view the Queensland analysis also focuses solely on poker machines and is thus limited in its scope of gambling revenues. While poker machines are available in pubs and clubs throughout Australia, there is now proliferation of interactive gambling products such as internet gambling and telephone betting, which means that consumers no longer have to leave home to gamble. This means that rural residents

³⁵ Roy Morgan, Regional/rural residents more likely to play pokies, 14 May 2012.

³⁶ Gambling and Aboriginal people. See: <http://www.creativespirits.info/aboriginalculture/people/gambling-and-aboriginal-people>

are able to access a wide range of forms of gambling, and the assumption that revenue generation in more remote areas is more difficult does not necessarily hold for these types of gambling.

243 The Henry Review also notes that different forms of gambling are patronised by persons of differing socio-economic status, which leads to spending on particular forms of gambling being less evenly distributed than spending on gambling as a whole. For example, participation in casino gaming and sports wagering is strongly biased towards young single men, while lotteries and the largest form of gaming, EGMs, are disproportionately patronised by low income people.³⁷

244 Issues that would need to be considered in any differential assessment of gambling would include:

- Propensity of individuals/State populations to gamble:
 - There are different drivers for the different forms of gambling, such as age, level of education and income, which may / may not be necessarily consistent across all States;
- The relative importance of the different forms of gambling:
 - Need to consider the relative size of revenues from the different forms of gambling;
- The contribution of interstate and international tourists to gambling turnover:
 - In its submission to the Productivity Commission, the Burswood Casino estimated that 50 per cent of its gambling revenue was from high rollers;³⁸
 - It was estimated that in 1998, the interstate and international share of casino expenditures in Melbourne was 48 per cent;³⁹
 - The ABS estimated that, in 1997-98, overseas visitors accounted for \$536.5 million (or 25 per cent) of casino revenue;⁴⁰
 - Australian casinos obtained nearly 20 per cent of their gaming revenue from international VIP programs in 2008-09;⁴¹
- Access to gambling:

³⁷ Australia's Future Tax System, Report to the Treasurer, December 2009, Part 2 Detailed Analysis, Volume 2 of 2, page 466.

³⁸ Productivity Commission 1999, Australia's Gambling Industries, Inquiry Report, page 5.

³⁹ The National Institute of Economic and Industry Research, 2000, page 70.

⁴⁰ Productivity Commission 1999, Australia's Gambling Industries, Inquiry Report, page 5.35.

⁴¹ Gambling, Productivity Commission Inquiry Report, Volume 1, No. 50, 26 February 2010.

- Some forms of gambling may be more accessible than others, such as internet gambling; lotteries; or race betting by mobile phones; and
- Leakage due to online gambling:
 - The relationship between gambling expenditure by residents of a State and the revenue raised in that State has been weakened with the growth in online gambling by interstate and international residents.

245 We again contend that time does not allow for this matter to be progressed within the constraints of the 2015 Review.

Attachment A – 2015 Methodology Review Terms of Reference

I, Wayne Maxwell Swan, Deputy Prime Minister and Treasurer, pursuant to sections 16, 16A and 16AA of the *Commonwealth Grants Commission Act 1973*, refer to the Commission for inquiry into the methodological approach to determining the per capita relativities to be used to distribute Goods and Services Tax (GST) revenue among the States, the Northern Territory and the Australian Capital Territory (collectively referred to as the States) from 2015-16. The Commission should provide its final report to the Commonwealth and States by 28 February 2015.

1. In preparing its assessments the Commission should:
 - a) take into account the Intergovernmental Agreement on Federal Financial Relations (as amended), which provides that the GST revenue will be distributed among the States in accordance with the principle of horizontal fiscal equalisation;
 - b) aim to have assessments that are simple and consistent with the quality and fitness for purpose of the available data;
 - c) ensure robust quality assurance processes; and
 - d) develop methods to appropriately capture the changing characteristics of the Indigenous population.
2. In undertaking its assessments, the Commission should also have regard to the recommendations of the final report of the *GST Distribution Review* (October 2012) to:
 - a) consider the appropriateness of the current materiality thresholds (Recommendation 3.1);
 - b) consider the appropriateness of continuing to round relativities to five decimal places (Recommendation 3.2);
 - c) develop a new transport infrastructure assessment. This should include, if appropriate, a framework to identify payments for nationally significant transport infrastructure projects which should affect the relativities only in part and options for providing that treatment (Recommendation 6.1);
 - d) consider the use of data which is updated or released annually with a lag, or updated or released less frequently than annually (Recommendation 6.2);
 - e) examine the merits of adopting a simplified and integrated assessment framework (Recommendation 6.3);
 - f) investigate whether it is appropriate and feasible to equalise interstate costs on a 'spend gradient' basis (Recommendation 6.4);
 - g) develop a new mining revenue assessment (Recommendations 7.1 and 7.2); and

- h) consider the appropriate treatment of mining related expenditure (Recommendation 7.3).
3. The Commission should prepare its assessments on the basis that:
 - a) National Specific Purpose Payments (NSPPs), National Health Reform (NHR) funding and National Partnership (NP) project payments should affect the relativities, recognising that these payments provide the States with budget support for providing standard state and territory services;
 - i. NHR funding and corresponding expenditure relating to the provision of cross-border services to the residents of other States should be allocated to States on the basis of residence.
 - b) NP facilitation and reward payments should not affect the relativities, so that any benefit to a State from achieving specified outputs sought by the Commonwealth, or through implementing reforms, will not be redistributed to other States through the horizontal fiscal equalisation process;
 - c) general revenue assistance, excluding GST payments, will affect the relativities, recognising that these payments are available to provide untied general budget support to a State or Territory;
 - d) those payments which the Commission has previously been directed to treat as having no direct influence on the relativities continue to be treated in that way. Where those payments are replaced, the treatment of the new payment should be guided by subparagraphs 3(a) – (c) and paragraph 4, unless otherwise directed; and
 - e) where responsibilities for funding and delivering aged care and disability services has not been transferred to the Commonwealth by a State under the NHR Agreement, these responsibilities will continue to be assessed as State services for that State.
 4. Notwithstanding subparagraphs 3(a) – (c), with the exception of reward payments under NPs, the Commission may determine that it is appropriate for particular payments to be treated differently, reflecting the nature of the particular payment and the role of the State governments in providing particular services.
 5. The Commission will consider the most appropriate treatment of disability services during the transition to DisabilityCare Australia (the National Disability Insurance Scheme) and once the full scheme is operating nationally.
 6. The Commission will ensure that the GST distribution process will not have the effect of unwinding the recognition of educational disadvantage embedded in the National Education Reform Agreement (NERA) funding arrangements. The Commission will also ensure that no State or Territory receives a windfall gain through the GST distribution from non-participation in NERA funding arrangements.

7. The Commission will consult regularly with the Commonwealth and States as it considers these terms of reference.
8. The Commission will develop a work program, in consultation with the Commonwealth and States, which sees the matters outlined in paragraphs 1(d), 2(c), 2(g), 2(h), 5 and 6 being progressed as a priority and subject to early consultation (including multilateral discussions) with the Commonwealth and States.
9. The Commission should provide a draft report for consideration by the Standing Council on Federal Financial Relations within 12 months from receipt of these terms of reference.
 - a) Should the Commission expect to make significant changes following consultation on the draft report, further consultation with the States on those changes will be required.

Attachment B – Work Plan for the 2015 Methodology Review

2015 REVIEW PROGRAM

Date	Event
2013	
End July	State submissions due on the following: <ul style="list-style-type: none"> • principles and architecture (similar to Chapter 3 of 2010 Review report); • priority issues as outlined in the ToR; • other issues of priority for States, including specific assessments and identifying expenses which should not change.
12-14 August	Bilateral meetings with HoTs/Treasurers to discuss State submissions. 2 hour meetings for each State.
End October	CGC send to States: <ul style="list-style-type: none"> • Commission views on principles and architecture; • staff views on priority issues and changes to assessments.
End November	CGC staff meetings with State officials to discuss issues.
2014	
End January	State submissions due on October papers: <ul style="list-style-type: none"> • principles and architecture; • priority issues and changes to assessments.
21 June	CGC release draft report
June/July	Consideration of draft report by Standing Council on Federal Financial Relations
June/July	CGC staff meetings with State officials to discuss draft report
August	State submissions due on draft report
August	Potential HoTs meeting to discuss draft report
End November	CGC to consult with States if significant changes are made to the draft report as required by the ToR
End December	Final State comments due on proposed changes to draft report
2015	
28 February	Release of final report

Attachment C – Views on the Commission’s assessments requiring examination in the 2015 Methodology Review

Views on the Commission’s current assessments

246 The following list summarises the ACT’s views on the Commission’s current assessments and whether or not they require examination and review as part of the 2015 Methodology Review.

ACT views on examination of the Commonwealth Grants Commission assessment methods for the 2015 Methodology Review

Assessment	Examination required X No examination required -	Rationale for change / no change
Payroll Tax	-	<ul style="list-style-type: none"> The revenue assessments were thoroughly reviewed in the 2010 Review as part of the simplification process. Circumstances have not changed hence, no need for review.
Land Tax	-	
Stamp duties on conveyances	-	
Insurance Tax	-	
Motor Taxes	-	
Mining Revenue	X	<ul style="list-style-type: none"> Priority issue in 2015 Review ToR – develop a new mining revenue assessment (Rec 7.1 and 7.2) and consider the appropriate treatment of mining related expenditure (Rec 7.3)
Other Revenue	-	<ul style="list-style-type: none"> Continue EPC assessment, no rationale for change.
Schools Education	X	<ul style="list-style-type: none"> The treatment of the National Education Reform Agreement is a Priority issue in 2015 Review ToR.
Post-secondary Education	-	<ul style="list-style-type: none"> Circumstances have not changed that would require a major overhaul of the assessment.
Admitted Patients	-	<ul style="list-style-type: none"> Major drivers of needs have not changed – do not consider this to be a priority issue.
Community and Other Health	-	<ul style="list-style-type: none"> Community and Other Health assessment is well grounded and captures the impact of the relative amount of Commonwealth and private sector service provision on

		<p>State government service delivery requirements.</p> <ul style="list-style-type: none"> • Circumstances have not changed that would require a major overhaul of the assessment.
Welfare and Housing	X	<ul style="list-style-type: none"> • The treatment of DisabilityCare Australia is a Priority issue in 2015 Review ToR
Services to Communities	-	<ul style="list-style-type: none"> • Circumstances have not changed that would require a major overhaul of the assessment.
Justice Services	-	<ul style="list-style-type: none"> • Circumstances / data have not changed that would allow major overhaul of the assessment e.g. proportion of spending on police forces aimed at reducing crime and proportion ensuring public safety.
Roads	X	<ul style="list-style-type: none"> • While not a Priority issue in 2015 Review ToR, may be impinged by the Priority issue on transport services – need to reconsider 50% equalisation of national network roads funding.
Transport Services	X	<ul style="list-style-type: none"> • Priority issue in 2015 Review ToR – develop a new transport infrastructure assessment (Rec 6.1).
Services to Industry	X	<ul style="list-style-type: none"> • Economic Development to be considered in the context of the mining assessment which may impinge on the Services to Industry category.
Other Expenses	-	<ul style="list-style-type: none"> • Most functions provided to the whole State population – circumstances have not changed.
Infrastructure – Investment and Depreciation	X	<ul style="list-style-type: none"> • Issue in 2015 Review ToR – examine the merits of adopting a simplified and integrated assessment framework (Rec 6.3).
Net Lending and Interest and Dividend income	X	
Administrative Scale	-	<ul style="list-style-type: none"> • Quantum of fixed costs may have changed, however, not a priority issue. • Consider this aspect in next Review when there is more time to permit a survey to be developed consistently across States that

		adequately captures scale costs.
Location Costs	X	<ul style="list-style-type: none"> Issue in 2015 Review ToR– investigate whether appropriate and feasible to equalise interstate costs on a ‘spend gradient basis’ (Rec 6.4).
Indigeneity	X	<ul style="list-style-type: none"> Priority issue in the 2015 Review ToR – develop methods to appropriately capture the changing characteristics of the Indigenous population.
Socio-economic Status	X	<ul style="list-style-type: none"> ACT priority to the use the Socio-economic Index for Individuals to capture the ACT’s low SES persons rather than the Socio-economic Index for Areas which undercounts numbers.
Service Delivery Scale	-	<ul style="list-style-type: none"> No significant changes in SDS expected. Not a major factor in terms of GST redistribution.
Cross-border costs *	-	<ul style="list-style-type: none"> No additional significant claims. Growth in population surrounding ACT region will capture additional costs.
National Capital Influences	-	<ul style="list-style-type: none"> No additional significant claims.
Native Title and Land Rights	-	<ul style="list-style-type: none"> APC assessment will pick up additional costs.

Views on the Commission’s Data Working Party Projects

- 247 Our views on key projects progressed to date by the Data Working Party are provided below. In light of the tight timetable, we suggest that four of the eleven projects should cease.
- 248 If projects are not listed they are deemed to be projects that should cease, or are projects that have already ceased.
- 249 In this context the Data Working Party should be ceased as a discrete stream of activity and addressed in the 2020 Review if considered to be a matter of priority then.

ACT views on progressing Data Working Party Projects

Project	ACT Comment	Rationale for ceasing / progressing project
Administrative scale project: survey being designed to allow quantum of administrative scale expenses to be recalculated.	CEASE PROJECT. Pushed for fixed information and communication technology costs to be captured.	<ul style="list-style-type: none"> • Time does not permit a survey to be developed consistently across States that adequately captures scale costs. • Given the importance of this matter leave until next Review when time permits and index only.
Roads (physical environment) project: Consultancy on physical environment (PE) on road construction, State buildings and similar infrastructure being undertaken.	CEASE PROJECT. Argued for consultancy to consider depreciation costs to be offset by natural disaster costs (assets replaced earlier) and insurance which mitigates PE costs.	<ul style="list-style-type: none"> • Cease project if consultancy unable to deliver clear and fit-for-purpose information / data to enable an assessment of the physical environment to be progressed as this has been a contentious and difficult matter to address in the past. • Cease project if depreciation costs and Government insurance are not addressed as genuine issues as part of the physical environment factor.
Urban transport project: CGC has undertaken a State data request that will be used to update the urban cost model.	PROGRESS PROJECT. Differing public transport patronage levels will affect urban transport subsidies.	<ul style="list-style-type: none"> • Progress project if data from the States are reliable and fit-for-purpose as States have already returned data to the CGC. • Time would permit updating of the urban cost model and this matter relates to a priority issue in the 2015 ToR.
Road length project: CGC is undertaking a spatial questionnaire to determine what States can provide in terms of spatial data sets for roads to determine if spatial provided road length is suitable for the roads assessment.	PROGRESS PROJECT. Spatial data may provide better more accurate outcome than current algorithm approach.	<ul style="list-style-type: none"> • This interrelates to a priority issue in the 2015 ToR – discounting of ‘nationally significant’ transport infrastructure.
Low SES project (use of ABS SEIFA data): CGC intends to use SEIFA as it currently does. CGC considers ACT individuals are still advantaged relative to other States.	PROGRESS PROJECT. To pursue with CGC, ABS and CSD. It is noted that SEIFA understates (masks) the ACT’s actual numbers of low socio-economic status (SES) persons	<ul style="list-style-type: none"> • This is a priority issue (see above).

	as SEIFI indicates the ACT has much higher levels of low SES.	
Indigenous effects project: CGC is examining how it can assess the relative levels of disadvantage for differing types of Indigenous persons without double-counting aspects of disadvantage.	PROGRESS PROJECT. This will lead to a redistribution of funding amongst the States.	<ul style="list-style-type: none"> • ‘Capturing the changing characteristics of the Indigenous population’ is a priority issue.
Gambling revenue project: CGC looking at approaches to assessing propensity to gamble.	CEASE PROJECT. Argued that States’ prevalence reports clearly show that age, Indigeneity, education levels and income are important drivers for the different forms of gambling.	<ul style="list-style-type: none"> • This is a contentious and difficult matter to assess with a range of complexities involved in trying to capture individual’s propensities to gamble. • In this context this project should be ceased and considered in the 2020 Review if considered as a matter of priority then.
Cultural and linguistic Diversity (CALD) project: CGC analysing whether CALD hospital separations data for NSW and Victoria is material.	CEASE PROJECT Unknown if NSW and Victoria have provided CALD data.	<ul style="list-style-type: none"> • This project is not considered to be a matter of priority.
Urbanisation project: CGC considering urban influences (‘big city effects’) which reflect higher service costs, such as due to complexity, congestion or require extra or higher standard infrastructure not required in smaller cities.	CEASE PROJECT. It is noted that a roads urbanisation factor and low throughput in specialty services for admitted patients are issues of importance from a Territory perspective.	<ul style="list-style-type: none"> • Cease project as States have been given the opportunity to bring forward arguments and data but have not done so. • This is not a priority task.
Water and Wastewater project: Data request sent out to select States (Qld, WA, SA and NT) seeking information on water subsidies in rural and remote areas.	PROGRESS PROJECT. The services to community’s assessment are negative for the ACT.	<ul style="list-style-type: none"> • Progress project if data from the States are reliable and fit-for-purpose as States have already returned data to the CGC. • Time would permit updating of the water subsidies if work is minimal.

<p>Remoteness Classification: Use either ARIA or SARIA as the basis of a remoteness index to classify where people live.</p>	<p>PROGRESS PROJECT. Discussion Paper arrived 26 April 2013 – to be reviewed</p>	<ul style="list-style-type: none">• Remoteness is a key factor for the CGC's assessments and should be considered, including the move to ARIA.
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Attachment D – HFE Impact of National Social Reforms

NATIONAL DISABILITY INSURANCE SCHEME – APPLICATION OF EQUALISATION

Key Principles in the draft Heads of Agreement

Clause 25: The ACT and the Commonwealth agree that the Commonwealth Grants Commission Methodology Review, agreed by the Standing Council on Federal Financial Relations (SCFFR) on 3 April 2013, should:

- a. determine the most appropriate treatment of disability services in the period during the transition to the NDIS as well as the treatment once the full scheme is operating nationally; and
- b. give priority to determining the appropriate treatment of the NDIS to allow SCFFR to consider the issue at the time the draft report is received.

Provisions of the Intergovernmental Agreement for the NDIS Launch

Clause 31: For the purpose of the Commonwealth Grants Commission determining Goods and Services Tax (GST) revenue sharing relativities, all jurisdictions agree that the additional Commonwealth funding contribution for the first stage of an NDIS will not impact on State GST shares. This Clause will be reflected in any relevant Terms of Reference issued by the Commonwealth Treasurer to the Commonwealth Grants Commission.

The CGC proposes that the Launch phase be treated as a trial for the purposes of HFE (i.e.: any payments and expenditure associated with it would not be equalised). This phase starts in some States (NSW, Vic, SA, Tas) from July 2013 (in ACT from July 2014) and runs until June 2016. A review and evaluation of the Launch is to be completed by May 2016 and this will form the basis of States moving into the full scheme.

The Transition phase to the full scheme then commences from July 2016 and runs to June 2018, with a progressive build-up of client numbers during this period. The full implementation then commences from July 2018.

The Terms of Reference for the CGC's 2015 Methods Review state that the Commission "should consider the most appropriate treatment of disability services during the transition to DisabilityCare Australia (the National Disability Insurance Scheme) and once the full scheme is operating nationally".

Notes on Current CGC Assessment

- Disability Services is part of the Welfare and Housing category assessment.
- Disability Services comprises 31% of all State welfare and housing expenses (but only 22% in the ACT).

Disabilities (Cost drivers) Assessed:

- Socio-demographic composition – based on numbers of Disability Support Pension (DSP) and Carer Allowance recipients – CGC regards these as a good indicator of usage of State disability services.
- Service delivery scale – allowance for increased cost of service delivery to small population centres.
- Location – allowance for different labour and other input costs depending on location.
- Cross-border – allowance for use of services by out-of-State residents (ACT only).
- Administrative scale – allowance for minimum level of administration required in each State.
- Native title and land rights – allowance for costs incurred as a result of native title and land rights provisions.

Issues for consideration by the CGC:

When to implement blended assessment – depends on percentage of potential clients included in NDIS – or a user-weighted percentage of States in transition.

The Commonwealth paper of 10 April 2013 presented to the NDIS Funding and Governance Working Group gives a range of options for applying HFE during the Launch and Transition phases – the presentation below is based on the most likely of these.

Actual per capita is considered to be the same as equal per capita in the context of NDIS, as the formula for contributions is EPC and common for all States, with no scope for policy choice.

NDIS involves separate Commonwealth and State contributions to a single national fund, so there will no longer be a Revenue assessment (no Commonwealth payments to States).

Phases of the NDIS & Likely CGC Treatment

Pre Stage 1 – Trials

Trials are currently underway in various States. These are to test particular elements of the NDIS support services and/or in relation to particular segments of the client population. These would either be completed by June 2013 or be subsumed into the Launch phase, which begins in most participating States from July 2013.

Expected CGC Treatment:

Expenditure assessment: Trial expenditure and funding not included (2013 Update decision). Current assessment methodology continues.

Revenue assessment: Assessed EPC. No GST impact as SPP already on 100% population share basis.

Result: No change from current GST impact.

Stage 1 – Launch

Commences from 2014-15 in the ACT. Other jurisdictions commence from 2013-14. Inclusion of a small percentage of clients nationally, but most potential clients in the ACT included. Ends June 2016.

Expected CGC Treatment:

Expenditure assessment: IGA provision applies, so current assessment methodology continues. Additional expenditure on Launch sites not included in assessment.

Revenue assessment: Assessed EPC. Additional payments for Launch sites not included in assessment. No GST impact as SPP already on 100% population share basis.

Result: No change from current GST impact.

Stage 2 – Transition

Applies in 2016-17 and 2017-18 (though Vic and Qld will be in Transition for 2018-19 as well). Potential clients are progressively brought into the scheme.

Expected CGC Treatment:

Expenditure assessment: Blended assessment comprising current assessment and NDIS assessment; weighted according to number of clients nationally in each type of program (NDIS or non-NDIS) and average spending on each program. NDIS component would take account of users by State, but not local cost drivers (as contributions based on national average costs).

Revenue assessment: Assessed EPC. No GST impact as SPP already on 100% population share basis.

Result: As the CGC has described it, this assessment would be based on users, rather than contributors, but not on other cost factors such as service delivery scale and location. The overall effect depends on the weight of the user factor (essentially the socio-demographic factor) as compared with the other factors. States which currently gain GST (above EPC) through the local cost drivers would lose GST, and vice versa. The user factor would have a similar impact to the current assessment, provided that the DSP population distribution

across States aligns closely with the distribution of NDIS client numbers. Given the extra funding being put in during this period, the GST allocation impact will also be greater than under the current assessment.

Stage 3 – Full implementation

Applies from 2018-19 in most States, including ACT, but Vic and Qld do not start full scheme until 2019-20. All potential clients included in the scheme.

Expected CGC Treatment: Expenditure assessment only. Assessed equal per capita. If the CGC treatment of Transition is as suggested above, there could be a major step-change on full implementation, from a user-based to a contributor-based assessment. States previously receiving above an EPC allocation will lose GST; those previously receiving below an EPC allocation will gain GST.

Result: Basis of assessment is the same as basis of contribution, so GST allocation is equal per capita.

Notes on the National Disability SPP

1. The current Disability SPP goes to 100% population share allocation from 2013-14.
2. During the Launch and Transition periods there will be a progressive shift of Commonwealth funding from the SPP into NDIS, in accordance with the number of clients moving from non-NDIS to NDIS services (as well as an overall increase in funding, and new clients brought in who were not previously accessing support). During the Launch this will mean States making repayments of SPP to the Commonwealth based on the number of NDIS clients in their jurisdiction.
 - a. As the SPP will in any case be allocated 100% EPC at the start of this process, this will not impact on GST allocation.
3. It is not clear whether there will still be a National Disability SPP once NDIS is fully implemented as there could be some residual programs/services which will not be incorporated in NDIS.

Note on National Partnership Payments (NPPs)

The only NPP in the Disability area is Transitioning Aged Care and Disability Services. This NP rationalised funding for these services so that all costs for the aged (over 65) are borne by the Commonwealth and all costs for younger people are borne by the States. Funding for this NPP continues throughout the current Budget period (i.e. to 2015-16 inclusive).

The element of this which affects disability services is additional Commonwealth payments to States for use of specialist disability services by older people (over 65).

As with the Disability SPP, the provisions in the Launch IGA and Bilateral Agreements include repayment from States to the Commonwealth of amounts from this NPP which relate to clients transferred to NDIS.

The Specialist Disability Services component of this NP is currently treated by the CGC as having no impact on relativities. It is assumed that this treatment would continue.

States Not Participating

The CGC has indicated that the Disability Services assessment for any State not participating in NDIS would be based on the payments they would have made if they were participating. It is not clear whether these States would still receive SPP payments for services moving to NDIS in participating States.

Expected CGC Treatment:

Expenditure assessment: Assessed equal per capita, assuming a State contribution to NDIS equal to the standard State contribution (48.6% of total costs) per head of population.

Revenue assessment: Assessed EPC. No GST impact as SPP already on 100% population share basis.

Result: Basis of assessment is the same as basis of contribution, so GST allocation is equal per capita. Any non-participating State receiving a below-EPC share of GST under the current assessment would gain GST.

NATIONAL EDUCATION REFORM AGREEMENT – APPLICATION OF EQUALISATION

Key Principles in the ACT Heads of Agreement relating to CGC Treatment of NERA Payments (key terms in bold)

Clause 23: Consistent with provisions 76 and 77 of the NERA, the ACT contribution is provided on the basis that, for the purposes of the Commonwealth Grants Commission (CGC) determining Goods and Services Tax (GST):

- a. The Commonwealth Treasurer will ensure that the GST distribution process will not have the effect of **unwinding** the recognition of **educational disadvantage** embedded in the NERA funding arrangements; and
- b. The Commonwealth Treasurer will instruct the CGC to ensure that no State or Territory will receive a **windfall gain** through the GST distribution from **non-participation** in NERA funding arrangements.

These provisions are common to the NSW and ACT Heads of Agreement.

The Commonwealth has included these clauses in the Terms of Reference for the CGC's 2015 Methods Review.

Impacts of the NERA on the CGC's Assessment Process

The NERA has two key impacts on the CGC's Assessment of GST:

Replacement of the current Schools Education assessment with an assessment based on the Schooling Resource Standard (SRS) – see below for details.

A (large) increase in the dollar standard in the Schools Education assessment. This increases the weighting of the Schools Assessment in the overall determination of States' relativities.

Funding Provisions in the ACT Heads of Agreement (Clauses 16 to 19)

1. From 1 January 2014, the ACT will contribute its existing funding for schools and schools systems. This equates to \$483.7 million in 2014. This contribution will be escalated by 3 per cent per annum from 2015.

Expected CGC Treatment: Expenditure assessment. Equalise, using the SRS as the basis for assessment of disabilities (SRS is average policy). Base funding would be equalised according to actual student enrolments.

Result: Replaces redistribution impact of current GST allocation with redistribution based on the SRS.

2. In addition, the ACT will also contribute \$21.5 million over six years (2014-2019) of the additional investment required to transition schools and school systems under the SRS toward the SRS over this period.

(This funding will be largely to the Catholic school system, which is below SRS; while independent schools are over the SRS.)

Expected CGC Treatment: Expenditure assessment. Equalise, using the SRS as the basis for assessment of disabilities (SRS is average policy). Replaces current Schools Education assessment. Base funding would be equalised according to actual student enrolments.

Result: Redistribution of GST based on the SRS. States making policy choice to fund above the SRS requirement would receive no additional GST.

3. From 1 January 2014, the Commonwealth will contribute its existing funding for education equating to \$231.6 million in 2014. This contribution will be escalated by 4.7 per cent per annum from 2014 to 2015 and yearly thereafter.

Expected CGC Treatment: Revenue assessment. Equalise, on an equal per capita basis.

Result: No impact on GST allocation – CGC currently assesses Commonwealth payments on an equal per capita basis.

4. In addition, the Commonwealth will also contribute \$16.1 million over six years (2014-2019) of the additional investment required to transition schools and school systems under the SRS toward the SRS over this period.

(This funding will be largely to the Catholic school system, which is below SRS; while independent schools are over the SRS.)

Expected CGC Treatment: Revenue assessment. Equalise, on an equal per capita basis.

Result: GST is distributed away from States which receive a share of additional Commonwealth funding greater than an equal per capita allocation, and towards States which receive a share of additional Commonwealth funding less than an equal per capita allocation.

Possible Issue for CGC: Could the above treatment of revenue be regarded as “unwinding” ? – because the additional Commonwealth payments are used to transition schools from below SRS up to the SRS standard.

But unwinding applies only to “educational disadvantage” – this is recognised in the Expenditure assessment.

And expenditure disabilities such as educational disadvantage are not considered by the CGC in its Revenue assessments.

Notes on Current CGC Assessment:

1. There is no separate assessment for pre-school education needs as the CGC was not able to obtain reliable data. However, pre-school expenditure is included in the assessment for school education expenses. (Developments associated with the Early Childhood Education NP may change this, as substantially better data collections are likely in future).
2. The non-government component of the National Schools SPP is assessed actual per capita by the CGC, for both expenses and revenue. This is because States have no flexibility in how this money is spent. That is, the expenses and revenue are considered to have no effect on State fiscal capacities.
3. There is also State-funded support to non-government schools which is assessed differentially by the CGC.

Notes on the National Schools SPP

1. From Jan 2014, Commonwealth funding for government schools will replace the government schools component of the SPP and will be known as Commonwealth NERA funding (NERA Clause 74).
2. Non-government school funding from the Commonwealth will still be passed through State governments (NERA Clause 70). *(Not clear whether this will still be called SPP funding).*
3. In 2013-14, 80% of the government schools component of the SPP is distributed by student enrolment numbers and 20% on a historical basis.

**CURRENT SCHOOLS ASSESSMENT vs SCHOOLING RESOURCE STANDARD
(SRS)**

Usage & Cost Factors	Current Assessment	SRS
<u>Enrolments (User Numbers)</u>		
Compulsory	Actual enrolments (little/no policy influence)	Actual enrolments (per student basis of funding)
Pre-compulsory	Assessed enrolments – based on average participation rates across States	Actual enrolments (per student basis of funding)
Post-compulsory	Assessed enrolments – based on population plus an SES adjustment	Actual enrolments (per student basis of funding)
<u>Cost Factors (student-based)</u>		
Indigeneity	Assessed – using State data on costs per indigenous student.	Percentage loading based on ATSI status - varies depending on percentage of ATSI students in a school.
Low English Fluency	Not part of Schools Assessment (assessed in Other Expenses – based on CALD data).	Percentage loading for low English language proficiency – up to a capped amount.
Low SES	Assessed – uses SEIFA classification and State data on costs.	Percentage loading based on SEA (socio-educational advantage) quartiles – varies depending on percentage of low SES students in a school.
Remoteness (of students)	Not assessed – covered by service delivery scale and location.	Not covered.

Usage & Cost Factors	Current Assessment	SRS
Disabled Students	Not assessed – reliable data not available, but cost data suggests not materially different from general population distribution.	Percentage loading per student with disability.
Non-government students (1)	Assessed – costs based on State data (about 17% of per student cost for government students).	Adjusted for “capacity to contribute” based on SES score of school – public contribution ranges from 20% to 90% of base per student amount.
Transport costs	Assessed – based on State data/survey.	Not covered.
<u>Cost Factors (school/State-based)</u>		
<u>Location</u>	Assessed for regions within States (costs per <u>employee</u>).	Percentage loading based on ARIA (Accessibility/Remoteness Index of Australia) classification of the (school ?).
<u>Service delivery scale (2)</u>	Assessed based on State staffing and cost data by location.	<u>Size of school</u> – dollar loading for small schools, on a sliding scale.
<u>Administrative scale</u>	Assessed – same amount per State.	Not covered.

Notes:

1. SRS model implies greater State funding of non-government schools and greater Commonwealth funding of government schools, in proportionate terms, than under the previous arrangements. The overall impact is difficult to assess at this stage.
2. Size of school is assumed to be a rough proxy for service delivery scale.

Windfall Gain Issue – Likely CGC Treatment

Participating States have an interest in ensuring that the GST treatment of the NERA funding arrangements does not result in a gain for non-participating States that would offset (partly or fully) their loss of additional Commonwealth funding.

Expenditure Assessment – Option 1

- Treat the SRS as average policy.
- Assume all States sign up to NERA and are spending what is required under SRS.
- Participants and non-participants are treated as one group (one assessment).

Outcome: Non-participating States would gain GST if the SRS formula gives them a higher per capita funding need than the current CGC assessment for School Education.

Any gains (or losses) are magnified by the higher dollar standard.

Expenditure Assessment – Option 2

- Carry out separate assessments for participants and non-participants:
 - Higher dollar standard would apply to participants as it includes the additional expenditure to reach the SRS level.
- Apply the SRS to both groups as the basis of assessment:
 - But for non-participants it would be as proportions of a lower dollar standard.

Outcome: Non-participating States as a group do not gain GST.

Some GST would be redistributed within the group – to the extent that the SRS formula differs from the current CGC assessment for School Education.

Revenue Assessment – Option 1

- Assume all States sign up to NERA and are receiving what they are entitled to under NERA/SRS.
- Participants and non-participants are treated as one group (one assessment).

Outcome: Non-participating States would gain GST if they currently receive below an equal per capita share of the Schools SPP - the higher dollar standard under SRS gives them a bigger relativity.

Revenue Assessment – Option 2

- Carry out separate assessments for participants and non-participants:
 - Higher dollar standard would apply to participants as it includes the additional Commonwealth funding.
- Both groups would be assessed on an equal per capita basis.

Outcome: Non-participating States as a group do not gain GST.

No GST would be redistributed as it is already distributed equal per capita.

Attachment E – Tax Reform in the ACT

250 In the 2012-13 Budget, the ACT Government announced the intention to undertake substantial tax reform through ‘A fairer, simpler and more efficient taxation system – 5 Year Reform Plan’ (the Taxation Reform Plan). The Taxation Reform Plan seeks to simplify the overall taxation system. The 2012-13 Budget and the 2013-14 Budget have begun phasing in the changes described below. Of interest to the Commission is the:

- abolition of duty on general insurance over five years by 20 per cent, starting from 2012-13 (Insurance Tax revenue assessment);
- abolition of duty on life insurance over five years by 20 per cent, starting from 2012-13 (Insurance Tax revenue assessment);
- phase out of conveyance duty over twenty years, starting from 2012-13 – the changes in rates and thresholds are detailed in the table below (Stamp Duties on Conveyances revenue assessment);
- abolition of Commercial Land Tax on 1 July 2012 and combined with commercial general rates (Land Tax revenue assessment); and
- reduction of Payroll Tax by increasing the payroll tax threshold from \$1.5 million to \$1.75 million from 1 July 2012 (Payroll Tax revenue assessment).

Conveyance Duty Rates and Thresholds

CURRENT SYSTEM		TAX REFORM					
Thresholds (\$)	Rate (%)	Thresholds (\$)	2012-13	2013-14	2014-15	2015-16	2016-17
Up to 100,000	2.0						
100,001-200,000	3.5	Up to 200,000	2.4	2.2	2.0	1.8	1.48
200,001-300,000	4.0	200,001-300,000	3.75	3.7	3.5	3.0	2.5
300,001-500,000	5.5	300,001-500,000	4.75	4.5	4.15	4.0	4.0
500,001- 1,000,000	5.75	500,001-750,000	5.5	5.0	5.0	5.0	5.0
		750,001-1,000,000	6.5	6.5	6.5	6.5	6.5
Above 1,000,001	6.75	Above 1,000,001	7.25	7.0	7.0	7.0	7.0

251 The revenue will be replaced through:

- increased General Rates on Commercial land from 1 July 2012 (Other Revenue assessment);
- increased General Rates on Residential land from 1 July 2012 (Other Revenue assessment); and

- one-off increase for year ending 31 March 2013 to the Utilities (Network Facilities) Tax to reflect land value appreciation, then annual increase by wage price index (no impact on assessments).

252 The 2012-13 Budget reforms of note are:

- extension to the General Rates Rebate for pensioners, veterans and concession card holders commencing 1 July 2012 (Other Revenue assessment);
- General Rates Deferral Scheme commencing 6 June 2012 (Other Revenue assessment);
- Duty Deferral Scheme commencing 6 June 2012 (Stamp Duties on Conveyances revenue assessment);
- expanded Home Buyer Concession Scheme commencing 6 June 2012 (Stamp Duties on Conveyances revenue assessment); and
- extended Pensioner Duty Concessions Scheme commencing 6 June 2012 (Stamp Duties on Conveyances revenue assessment).

253 The 2013-14 Budget continued implementation of the Taxation Reform Plan by:

- a further reduction in conveyance duty rates, including the implementation of a flat rate of 5.5 per cent on properties over \$1.65 million, as per the table below (Stamp Duties on Conveyances revenue assessment):

		Conveyance Duty Rates				
2012-13	Threshold	2013-14	Reduction	2014-15	2015-16	2016-17
2.4	Up to \$200,000	2.2	0.2	2.0	1.8	1.48
3.75	\$200,001 to \$300,000	3.7	0.05	3.5	3.0	2.5
4.75	\$300,001 to \$500,000	4.5	0.05	4.15	4.0	4.0
5.5	\$500,001 to \$750,000	5.0	0.5	5.0	5.0	5.0
6.5	\$750,001 to \$1,000,000	6.5	0	6.5	6.5	6.5
7.25	\$1,000,001 to \$1,649,999 ¹	7.0	0.25	7.0	7.0	7.0
7.25	\$1,650,000 and above	5.5 ²	1.75 ²	5.5 ²	5.5 ²	5.5 ²

Notes:

1. From 5 June 2013, the abolition of conveyance duty on large properties above \$1.65 million will be accelerated – this is a 2013-14 Budget tax reform initiative.
2. The 5.5 per cent rate is a flat rate.

- a further reduction in duty on insurance policies from 8 per cent to 6 per cent, and duty on life insurance from 4 per cent to 3 per cent (Insurance Tax revenue assessment);
- a concession on payroll tax for the employment of school leavers with a disability (Payroll Tax revenue assessment);

- introducing changes to the Land Rent Scheme to provide improved access to housing for low to medium income households, by retargeting eligibility requirements (Stamp Duties on Conveyances revenue assessment);
- retargeting the First Home Owner Grant to new and substantially renovated properties from 1 September 2013, with the value of the grant increased from \$7,000 to \$12,500; and
- a further expansion to the Home Buyer Concession Scheme, increasing the income eligibility from \$150,000 to \$160,000. The property threshold up until which the full concession is available will increase from the 25th to the 40th percentile, providing full duty up to a property valued at \$425,000 and a partial concession for property valued up to \$525,000 (Stamp Duties on Conveyances revenue assessment).

254 Each year the Government will announce a rolling five year strategy for tax reform. This will be announced later in 2013 and will propose conveyance rates for 2017-18, which does not form part of the forward estimates.