ACT
Government

AUSTRALIAN CAPITAL TERRITORY

Meeting with Commonwealth Grants Commission

Commonwealth Grants Commission 2015 Methodology Review

29 October 2014

**Chief Minister, Treasury and
Economic Development Directorate**

FACE TO FACE MEETING WITH THE COMMONWEALTH GRANTS COMMISSION

PHOENIX HOUSE, NORTHBOURNE AVENUE

5.00PM WEDNESDAY

29 OCTOBER 2014

ATTENDEE LIST:

Commonwealth Grants Commission:

Greg Smith	Chairperson
Glenn Appleyard	Commissioner
Ms Jennifer Menzies	Commissioner
Ms Patricia Faulkner AO	Commissioner
Dr Jeffrey Petchey	Commissioner
John Spasojevic	Secretary
Ms Catherine Hull	Assistant Secretary
Tim Carlton	
Tony Nichols	

Australian Capital Territory:

David Nicol	Under Treasurer
Karen Doran	Executive Director, Economic & Financial Group
John Purcell	Senior Manager, Federal Financial Relations
Doug Miller	Manager, Federal Financial Relations

Treasury

Chief Minister, Treasury & Economic Development Directorate

Australian Capital Territory Government

AGENDA

FACE TO FACE MEETING WITH THE COMMONWEALTH GRANTS COMMISSION

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PART A

1. Opening Comments.

PART B

2. Observations – Limited Review.

Themes:

I. Category Re-construction
   a. Urban Transport Summary

II. Capture of Indigeneity Costs

III. Discounting Assessments
   a. National Network Roads Summary

IV. User Charges

V. Equalisation Treatment of National Reforms
   a. NDIS Summary

PART C

3. Final Commission Reality Check.

4. Rolling Program of Review.

5. Enhancements to Final Report.

6. Clarification of what will be reported to States and Territories in November 2014.

7. Forward outlook for HFE including a more proactive engagement by the Commission in National Reform deliberations.

FACE TO FACE MEETING WITH THE COMMONWEALTH GRANTS COMMISSION

PHOENIX HOUSE

5.00PM WEDNESDAY 29 OCTOBER 2014

Agenda Item 1 – Introduction:

1. Thanked the Commission for the opportunity to meet for an open discussion on the state-of-play of the 2015 Methodology Review.

2. ACT commented favourably on the quality of the Commission and Staff papers released.

    - High quality and reflect well on the process oversighted by the Commission.

3. The ACT has provided the Commission with four submissions to date, all on time:

    - ACT strove to be inclusive of all line agencies while also keeping the Executive informed at every stage.
    - Hope this was a useful contribution to the process.

4. Reiterated the thrust of ACT's submission:

    - Articulated areas of the draft findings or options provided to-date that it opposed;
    - Provided views where the Commission has sought State views; and
    - Proposed some modifications or extensions to the Commission's approach.

5. Expressed intention today not to go into the specifics of these technical assessment issues:

    - Best left to our respective officials still engaged in further discussions.

6. Focused instead on some of the high-order issues of concern:

    - Relate to a number of themes that permeate through ACT submissions and highlighted in the commentary section of the final submission.

7. ACT sought some assurance that each one of them will be considered when finalising the report.

Agenda Item 2 -Observations – Limited Review:

Shortened 18 month review in hindsight has highlighted the fundamental challenge faced by the Commission in having, via the terms of reference, to deliver a report highly focused on particular assessments as priority issues:

- Inadvertently led, in our view, to a form of cherry picking via targeted terms of reference, regardless of all best efforts to avoid this outcome.
- On reflection partial selection of categories in a limited review timeframe does not lead to a balanced report – has the potential to produce a set of relativities that could have serious financial consequences for individual jurisdictions.

Unintended Impacts of Category Re-construction:

- The unintended consequence, whereby proposed category amalgamations and changes to the scope of assessments have altered the standard budget, and thereby adversely impact on jurisdictions, not by design, but as a consequence.
    - Should be re-examined with a view to ameliorating the direct impact to reduce volatility. The ACT has proposed phasing-in of the urban transport stock assessment over three years.
- *(Proposed changes to category structures such as the incorporation of urban transport and public housing PNFCs into the assessments while not adding undue complexity and better capturing what States do – the move of these services and assets from net financial worth to expense and infrastructure categories does impact the relevant standards dramatically).*

URBAN TRANSPORT STOCK ASSESSMENT – HIGH PRIORITY FOR ACT

- In the 2015 Review the Commission is expanding the scope if its assessments to include the operations and capital requirements of urban transport Public Non-Financial Corporations (PNFCs).
    - The methodology applied to transport PNFCs in previous reviews was only to assess subsidies provided by, and dividend returns to, the General Government sector.
- The new approach has brought $70 billion of urban transport infrastructure assets into the assessments, which produce a redistribution of $474 million of GST.
- The ACT will lose about $110 million in GST under the new infrastructure assessment, compared with a loss of $32 million in the 2014 Update. This is a deterioration of $78 million in the ACT's GST position.
    - Large shifts will also occur for some other States e.g.: -$219 million for QLD and +$182 million for the NT.
- Assessment of State needs for urban transport infrastructure is based on econometric modelling by the Commission. The model is impacted heavily by the data from the small number of large cities in Australia.
    - Alternative forms for the model based on the same data appear to give significantly different outcomes for State needs. These alternatives have not been adequately evaluated by Commission staff.
- Actual asset values used in the modelling vary widely across the State capitals as a proportion of

replacement values (from 40% up to 87%).

  - While the mix of asset types and ages may vary between cities, it could be expected that cities of similar sizes would have similar ratios of actual to replacement values. This casts doubt on the consistency of asset valuations.

- Given the concerns about the accuracy of the modelling and the robustness of asset valuations, and the impact of a change of this size on State Budget planning, the ACT view is that:

  - the provisional 50% discount applied by the Commission should be retained in the final Report; and

  - the revised assessment should be phased in over three years rather than impacting fully in the first application year.

Capture of Indigeneity Costs:

- The challenge for the Commission going forward from this point is to ensure that the equalisation process tied to the GST pool does not over compensate for the Indigeneity factor when other funding sources are taken into account.
  - A holistic approach required to the financing of this sector – understood CGC Staff are still struggling with capturing the source and use of funds in this field.
- The risk of a double count or failure to appreciate the quarantining aspect will need a reality check in the remaining timeframe.

Discounting the Assessments:

- The ACT response in a number of categories refers to what we deem an inconsistent application of the principle of discount particularly in the Services to Industry category and the discount for roads stock disabilities in the Infrastructure category.
  - The ACT proposes removal of the 50% discount for national network roads as lacking basis in evidence and inconsistent with treatment of other transport modes.

NATIONAL NETWORK ROADS DISCOUNT – HIGH PRIORITY FOR ACT

- The Commission currently excludes 50% of Commonwealth payments for national network roads (NNR) from equalisation.

  - The basis for this exclusion is that there are significant spillover benefits to other States (and/or the Commonwealth) from these roads.

- The 50% figure is based on judgement. No quantitative evidence appears to have been used to determine this figure.

  - There are models which could potentially be used to measure these spillover benefits (e.g.: the Wider Economic Impacts model).

  - Any benefits would need to be assessed net of user charges, as these capture such benefits.

- The National Land Transport Network, as defined by the *Nation Building Program (National and Land Transport) Act 2009*, includes railways and inter-modal transfer facilities.

  - However, the Commission does not make any allowance for spillover benefits of railways or other elements of the national network i.e.: 100% of any Commonwealth payments for these purposes are equalised.

- The Commonwealth Treasurer recently issued a letter indicating supplementary Terms of Reference for the 2015 Review will be issued which require the Commission to apply a 50% discount to payments from the Commonwealth for major roads under the Infrastructure Growth Package.
    - This decision lends weight to the view that Commonwealth payments for major roads outside the scope of that package should be subject to full equalisation.
- The ACT’s preferred approach is that each major road project be examined on a case-by–case basis to assess spillover benefits, however:
    - Unless a robust method for assessing these benefits can be developed, there should be no discounting of Commonwealth payments for roads.
- An Infrastructure “road map” is attached which highlights how equalisation will be applied to the full range of infrastructure payments in the Commonwealth Budget.

ACT UNDERSTANDING
PAYMENTS TO SUPPORT STATE INFRASTRUCTURE SERVICES
2014-15 FEDERAL BUDGET PAPERS

National Partnership Payments ($million)	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**Proposed CGC Treatment**
Infrastructure Investment Programme						
Black Spot projects	64.5	60.0	60.0	60.0	60.0	For State roads 100% equalised (a)
Bridges renewal programme		60.0	60.0	60.0	60.0	For State roads 100% equalised (a)
Heavy vehicle safety and productivity	40.0	48.0	40.0	40.0	40.0	100% equalised
Improving the national network	0.8					
Investment						
Rail	332.7	353.7	124.2	23.5	24.6	100% equalised
Road	4,279.6	3,005.9	3,973.4	5,311.6	2,780.0	50% equalised - national network
Off-network projects						
Rail	89.6	115.9	219.0	160.1	3.0	100% equalised
Road	404.8	556.4	354.3	395.4	222.6	100% equalised
Supplementary	7.5					
Roads to Recovery	373.2	349.8	349.8	349.8	349.8	For State roads 100% equalised (a)
Infrastructure Growth Package						
Asset Recycling Fund						
Asset Recycling Initiative		335.0	1,278.0	1,285.0	1,007.0	Excluded - supp. terms of reference
New investments		201.7	1,010.1	969.2	519.3	50% equalised - supp. terms of reference
Western Sydney Infrastructure Plan		103.0	210.2	351.6	530.9	50% equalised - supp. terms of reference
Other Projects						
Building Australia Fund						
Rail	1,128.0	331.0	232.1			100% equalised

Road	72.0	48.1				100% equalised
Centenary of Canberra 2013 -						
a gift to the national capital		10.0				Excluded - terms of reference
Community Infrastructure Grants -						
Glenbrook precinct upgrade	0.8					100% equalised
Interstate road transport	77.0	77.0	77.0	77.0	77.0	100% equalised
Latrobe Valley economic diversification	2.4	5.4	3.1			State component 100% equalised, local component excluded.
Liveable communities	9.5					State component 100% equalised, local component excluded.
Local Government and Regional Development -						
infrastructure employment projects	1.6					Excluded - local government
Managed motorways	20.8	9.4				100% equalised
Murray-Darling Basin regional economic						
diversification programme	10.0	32.5	30.5	24.7		100% equalised
Townsville Convention and Entertainment Centre	5.0					Excluded - local government
Total	**6,919.8**	**5,702.8**	**8,021.7**	**9,107.9**	**5,674.2**	

Notes:

(a) All payments for State roads equalised, but any for local roads will be excluded.

User Charges

- Suggest the draft report suffers from the lack of a common policy approach across expense assessments to the treatment of user charges:
    - ACT's view is that user charges should, in general, be netted off related expenses at the national level, without a differential assessment, as they are driven by cost and reduce the call on State budgets.

Equalisation Treatment of National Reforms:

- While Commission has made a good first attempt at applying an equalisation approach to the national reforms underway in the Health, Education and Disability sectors ACT contends there remain scope for further change:
    - ACT has been a key player in a number of these reforms and has led the way on some aspects – we consider some aspects have not been duly recognised in the draft assessments:
        - Treatment of NDIS during the Transition phase is a particular concern as the Commission's proposed approach does not recognise the actual costs faced by the ACT.

TREATMENT OF NDIS TRANSITION – HIGH PRIORITY FOR ACT

- The Commission proposes to assess State needs[1] during NDIS Transition according to States' proportions of the total number of people who are expected to be entitled to a support package when the scheme is fully implemented.
    - This approach does not recognise States' actual expenditure needs during Transition (2016-17 to 2018-19).
    - Because the ACT's share of the total eventual number of participants is estimated to be 1.1%, the ACT would be assessed as having an expense requirement of only 1.1% of the national total during the entire Transition.
        - This grossly under-represents the ACT's actual NDIS expenditure.
- The Commission considers that NDIS participant numbers during Transition are significantly influenced by State policy decisions about the trial sites. <u>WE DISAGREE</u>.
    - The trial numbers and cohorts determine the starting point for Transition in each State.
    - However, the size and type of trial sites was determined by the Commonwealth in consultation with States. These were not a matter of individual State policy decisions.
        - We have provided documentary evidence to Commission staff to support this (see attachment) since release of the draft report and provision of our final submission.
- The ACT has by far the largest trial site of any State in proportion to its population. It will have close to its full participant number signed up to NDIS by the start of Transition.
    - As costs for each State in Transition are determined by actual participant numbers in the State, the ACT will have much higher costs than other States as a proportion of population.
- The Commission's proposed assessment method would assess most of the ACT's requirements during

[1] Assessed differences (also known as "needs"): the financial impact on a State's budget of its disabilities. They are measured, for example, as the difference between assessed expenses and average expenses. Assessed differences can be either positive or negative.

Transition under the non-NDIS component of the assessment. This currently redistributes about $30 million in GST away from the ACT.

  - The ACT's increased costs of about $20 million a year (net of the Medicare Levy surcharge offset) during Transition are not recognised by the Commission's proposed method.

- The ACT requests that the Commission adopt an actual per capita assessment of State NDIS expenses during the Transition period i.e.:
  - The assessed expense for each State is set equal to its actual expense. This method is used when, in the Commission's judgement, the policies of all States are the same and any differences in expenses per capita are due to differences in State circumstances.

Change to measuring Average Policy – 'What States collectively do':

- The Commission decision to change the approach for deciding what to bring into the equalisation framework under the principle 'What States collectively do' to determine average policy has triggered the requirement to reflect the ACT's tax reform agenda in the revenue assessments framework:
  - The decision to consider any tax imposed or service provided by any State to be part of what States do collectively, hence average policy, in our view now requires the Commission to make a differential assessment of general rates as part of the Land Tax assessment.
    - All States would be assessed against the broader tax base (i.e.: including owner occupied residences) but the effective rate would be affected only by the additional revenue generated in the ACT.
  - The ACT would continue to be assessed for its capacity to raise conveyancing duty against its property sales transactions base, with the effective rate depending on national average revenue from this tax.

Agenda Item 3 - Final Commission Reality Check:

ACT Submission signalled if the indicative results were to follow through to the final report this would have serious consequences for the Territory's forward Budget Program:

- The formulaic approach underwriting the implied results presented to the Commission by the Staff requires 'a reality check' as an essential final step in the review.
- Such a judgement, supported by sound reasoning and focused on achieving the HFE objective, is an essential part of the Commission response to the terms of reference.

Agenda Item 4 - Rolling Program of Review:

ACT Rejoinder Submission of January 2014 proposed an end to the traditional five yearly review cycle premised on a changing federal financial relations environment in which equalisation, in our view, must play a more prominent role:

- Methods will need to change more quickly than under the five yearly review processes.

- Recognise the potential volatility consequences but could lead to broader acceptance of HFE by stakeholders in the longer run.
- A number of the individual assessments are identified in the final submission that should be further examined, but timing of implementation should be tailored to minimise large variations in GST distribution outcomes among States.

Agenda Item 5 - Enhancement to Final Report:

Acknowledged the final report will require extensive explanation of the underlying reasons causing any redistribution at both the aggregate level and the specific jurisdictional level:

- Something akin to the jurisdictional specific approach adopted in Annual Update reports of late would be highly beneficial.
- We also flagged a more fundamental form of reporting that captures the history of some major assessments over a time period instead of the obligatory movement from one methodology to the next:
    - For instance, a 20 year timeframe explaining the mining assessment might prove a very useful contribution to the ongoing debate as to how equalisation accommodates changing cycles.

Agenda Item 6 - Clarification of what will be reported to States and Territories in November 2014:

Our understanding is the Commission will review the draft report in light of State comments in their final submissions and report back to all parties *"if significant changes are made to the draft report",* as required under the terms of reference.

Agenda Item 7 - Forward outlook for HFE including a more proactive engagement by the Commission in National Reform deliberations:

The ACT in its rejoinder submission also invited commentary from the Commission on the future of HFE in light of some parties' continued call for the dismantling of the HFE concept by moving the GST distribution to one premised on a population share basis:

- We continue to see merit in this request as we enter the development phase of the White Papers on Federation and Tax Reform.

We consider the Commission could play a more leading role in providing advice and direction on how equalisation might accommodate changed roles and responsibilities in service delivery and what revenue treatments could apply.

The WA proposal (in its final submission) for instance provides the Commission with some flexibility within its current terms of reference to engage in a wider discussion on how equalisation might change from one premised on actual outcomes to one focused on projections to address the issue of contemporaneity.