



ACT
Government

Chief Minister, Treasury and
Economic Development

Mr Michael Willcock
Secretary
Commonwealth Grants Commission
Phoenix House
First Floor
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BRADDON ACT 2612

Dear Secretary

Michael

Thank you for your letter dated 1 December 2016 seeking the ACT's input into a work program for the 2020 Methodology Review.

The ACT supports the terms of reference and acknowledges the Commission has been asked to conduct a comprehensive review of methods to be used to calculate per capita relativities used to distribute the GST revenue among the States and Territories including recommend per capita relativities for 2020-21.

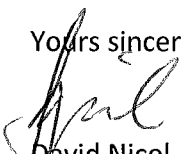
I agree consultation between all parties including the Commission, the Commonwealth Treasury and the States and Territories on the development of a comprehensive forward work program is essential to ensure we all manage our limited resources in the most efficient manner over the extended period of the Review. At the outset, I suggest that the Commission keep in regular contact with the Federal Treasury in designing the program, and monitoring its progression, to ensure the avoidance of clashes in the demands placed on the States and Territories in the federal financial relations sector.

In that context our views on a range of 2020 Review work program matters covered in the questions included in your correspondence is attached. Again as you sought our views on any other issues as well, we have also provided further insight into a number of matters we consider need to be addressed during the course of the Review.

From the ACT's perspective, the conduct of the 2020 Review will be coordinated by the Federal Financial Relations team in the Treasury headed by John Purcell, General Manager, with Doug Miller, Senior Manager, as the direct contact officer for the Review. I would ask that all matters be referred to the Federal Financial Relations team in the first instance as they will coordinate all ACT whole-of-government responses with the Commission.

I look forward to the Review progressing and the many opportunities it will present for connection between the Commissioners, Commission staff and ACT officers at all levels.

Yours sincerely


David Nicol
Under Treasurer

// January 2017

RESPONSE TO QUESTIONS RAISED BY THE COMMONWEALTH GRANTS COMMISSION (CGC)

Letter from CGC Secretary dated 1 December 2016

CGC Reference 2016/0100

Question 1.

Should the review begin with a reconsideration of 'whether the supporting principles the Commission uses to guide its work remain appropriate, including whether new principles should be adopted and whether different weights should be given to different supporting principles'?

ACT Response:

We consider how fiscal equalisation is currently defined and what is equalised (net financial worth) has stood the rigours of scrutiny since the last comprehensive methodology review was commissioned in 2005 and finalised in 2010. This Review facilitated the last major overhaul of both the definition and the underlying principles.

An independent review in the form of the GST Distribution Review subsequently endorsed these fundamentals and was carried forward into the shortened 2015 Review effectively unaltered:

- The GST Distribution Review agreed the current HFE system, requiring material equality and being guided by internally referenced principles and pillars, standards and capacities, is well established and internally consistent. In its view, it works satisfactorily under the current goal and definition of equalisation as currently set out.
- The Reform of the Federation White Paper encompassing a review of the HFE system did not lead to any justification for substantial change although it must be noted that the exercise did not come to fruition for other reasons.

In the absence of the Federal, State and Territory Governments reaching any degree of consensus on alternative interpretations of the existing definition of horizontal fiscal equalisation we would strongly argue the continued use of the same underlying assessment principles used in the 2015 Review to again guide parties through the 2020 Review.

Indeed, the 2020 Terms of Reference (ToR) speak only in terms of methodologies, not the re-examination of the definition itself.

In essence, methods, as far as practical and feasible, should:

- Reflect what States do.
- Be policy neutral in that an individual State should not be able, by its own actions, to directly influence its own share of the GST distribution.
- Capture as contemporaneously as reliable data will allow, the conditions in the States in the year the GST is distributed.
- Be derived in a practical way, as simply as possible, consistent with achieving horizontal fiscal equalisation and the quality of the available data.

We cannot identify any new principles that could be developed to further the exercise within the bounds of the existing HFE definition:

- Room for other goals within the system, such as providing incentives for general economic or State tax reform, or the efficient provision of services, interpersonal equity and locational efficiency have all been raised in the past and discarded on several different grounds.

The ACT does not see value in a reopening of these matters in this Review. There is considerable literature including the findings of the GST Distribution Review, itself on this issue.

These existing principles imply methods need to be developed that reflect State and Territory policy and practice in service delivery and revenue raising, and must prove resilient so that they continue to be relevant and appropriate as State and Territory policies change and as respective economic and social circumstances change. These are the fundamental pillars of the framework underlying the horizontal fiscal equalisation definition.

Obviously, previous methods from the 2010 and 2015 Reviews will inevitably be reviewed and changed as a consequence of these new ToR. Any such changes again, should be driven in the main by the need to get the best available measure of innate fiscal capacities in conjunction with associated changes in the data that may come to light during the course of the Review.

Regarding the issue of weights being applied to the underlying principles, by their very nature, there is an implicit weighting built into the listing of the four principles as shown above in their order of importance but not in a quantitative sense.

We consider Principles One and Two above to be critical to the veracity of the HFE framework. One does not dominate the other and failure of a methodological approach to match either principle for a service would automatically rule it out of the proposed assessment framework:

- What States do is definable, not open to interpretation, and in the main reported in a transparent manner via the public record in the form of budgets, financial statements and backed up by the application of accounting standards with supporting underlying data.
- The achievement of policy neutrality defines the HFE exercise above that of all other data derived methodologies to measure fiscal capacity. It is the hallmark, or strength of the fiscal equalisation model unlike any other government derived assessments (e.g.: the Productivity Commission's *Report on Government Services*).

Principles 3 & 4 are subsidiary to the paramount objective of measuring capacity with contemporaneity being balanced with the practicalities of delivering well defined assessments in a simple practical manner. While greater simplicity would allow for a broader understanding of the system it is not always possible.

At the end of the day common sense and the application of broad judgement will determine any trade off between the four principles to ensure the acceptability of the final recommendations.

The degree of complexity of each assessment needs to be weighed against the impact of the category on the GST distribution – in general, assessments which redistribute smaller amounts of GST should have a simpler structure. The Table at Attachment A illustrates the current assessments in descending order of GST redistribution, with some accompanying suggestions as to how the complexity of each assessment category could be rated. Such a metric could assist in prioritising the effort of the Commission in reviewing assessment methodologies.

Broad measurements of this nature could be used by the Commission to assign some element of priority when determining the Work Program.

Question 2.

What is meant by a 'comprehensive review of methods'? Does this mean that once the supporting principles have been settled, the Commission should begin with a clean slate as it did in the 2010 Review and ask what functions and related transactions of State are relevant to their fiscal capacity, how they should be grouped for assessment purposes and how they should be assessed? Or should the Commission start with the present scope and structure of assessments and make adjustments consistent with the revised supporting principles?

ACT Response:

As noted above, we do not see value in the adoption of a new set of principles. Rather, we suggest the Commission start with a *status quo* approach - the present scope and structure of assessments and make adjustments consistent with the existing supporting principles throughout the course of the 2020 Review.

By implication, we do not consider that there is any benefit in the Review repeating the 2010 approach by the Commission of that time to a clean slate top down methodology.

In our view, the circumstances are quite different, with the intergovernmental sectoral environment somewhat more stable compared with the period during which the new *Intergovernmental Agreement on Federal Financial Relations* was being developed. The shortened 2015 Review directing its focus on a narrower range of the more contentious assessments arising from the independent GST Distribution Review has also lessened the requirement for a complete overhaul. Similarly, more productive annual updates have evolved with methodological issues addressed such as the recent wage cost assessment.

In a broader sense, the ACT has always accepted that at each methodology review, decisions on which assessments should be re-examined need to be made by the Commission, after consultation with the States and Territories. It should and must be the final arbiter.

In the past the Commission has regularly faced pressure to re-examine more assessments or disabilities than originally intended with the exception of the time deprived 2015 Review. This has resulted in virtually everything to some degree being reviewed to ensure non-favouritism.

Hence, if all assessments and disabilities, irrespective of their effect, or the likelihood that the underlying circumstances have changed, are re-examined in this upcoming 2020 review, it could result in a lack of focus.

All jurisdictions, including the Commission itself, have seen a decline in their respective available resources since the 2010 Review. It has been the ACT's experience that Reviews that cover all assessments and disabilities create large workloads for the Commission, the Commonwealth Treasury, and States and Territories with a limited return from all perspectives. We note the Secretary himself made this observation in his letter dated 8 November 2016 in which he outlined his observations from his meet and greet exercise:

- *"A theme common to most of my meetings was the pressure you are all under in maintaining your capability to respond on intergovernmental financial relations issues".*

More importantly, re-examining all assessments and disabilities must lead commentators within and outside the sector to question why this occurs - is it because they are all problematic, or need to be changed, hence raising doubt about past deliberations.

Maintaining a degree of consistency in the GST shares between jurisdictions continues to be a stated long sought after goal of all governments. This underlines the importance of maintaining some degree of stability in assessment methods between Reviews.

Question 3:

Reviews have generally been conducted using an iterative process, with the Commission taking the lead in defining HFE principles and assessment methods, followed by the States providing feedback on the proposed approaches, leading to amended Commission views and so on. Should this review adopt the same iterative process or do States consider alternative approaches, for example with States taking a lead role in some instances, for example the development of assessments, would result in an improved HFE outcome?

ACT Response:

The ACT supports the adoption of the iterative process with the Commission taking the lead in defining the supportive principles and assessment methods.

Following receipt of the ToR we would suggest the Commission:

- Convene a preliminary conference of the interested parties to discuss the terms of reference and the procedural arrangements for the inquiry.
- Subsequently develop a timetable in the form of a draft work program covering *Inter alia*, receipt of written submissions and rejoinder submissions; and
- Hold a subsequent conference to allow each of the parties to respond to the submissions and evidence presented by other parties.

We also would look forward to the Commission visiting each jurisdiction and conducting hearings on their submissions. This latter role could also coincide with the Commission conducting inspections in each State and Territory of selected government services premised on their submission claims.

In that context, we question the notion that a State or Territory should take a lead role in some instances, for example, in the development of assessments:

- While it has always fallen on the ACT to individually prosecute its case for certain characteristics unique to the Australian Capital Territory, namely, National Capital and cross border claims, it has done so in the context of a framework provided by the Commission itself and not one designed by the Territory.

We view the Commission itself, as the independent body with the full time resources at its disposal to deliver its report to the Government via ToR given to it. Consultation should be a key factor but not necessarily at every point, or step along the way. Ownership and direction of the program is the responsibility of the Commission.

By its nature these assessments involve significant potential revenue gains and losses for individual jurisdictions. We consider it would involve a significant conflict of interest for any jurisdiction asked to lead on the development of assessments.

Question 4:

Are there particular issues States would like to see the Commission explore?

ACT Response:

The key to the ACT's response to this question relates to the initiative commenced by the Secretary of the Commission requesting comments from us on a series of staff research papers dealing with the full range of State and Territory services and supporting revenue measures.

We understood these research papers were intended to provide the foundation for the Commission to embark on this review of the underlying methodology and saw them as representing the critical first step in the process – the building blocks in the sense that they represent the Commission staff understanding of the operation of the respective areas of State activity and were seeking State comments that improve their understanding of State operations.

We found the papers to be highly informative, constructive and well researched and consider they provide an excellent depth of comparison between jurisdictions. Equally, on receipt we set about the important task of authenticating via our respective line agencies, all references to the ACT regarding the accuracy of the issues raised, in order to capture the full extent of service delivery observations and developments contained therein:

- We also requested their comments on the questions raised in each of the papers on their findings.

In referring the papers back to the Commission, we overlaid our final returns with other technical methodological comments underpinning the HFE framework we deemed necessary. A full compilation of the ACT's areas of interest can be taken from the papers currently referred back to the Commission, as well as future papers on other assessment categories we expect to follow.

We understand further papers are to be issued, and in that context we will complete the analysis which should give a good insight to what areas the ACT deems essential to review. Short of completing that analysis we have no direct areas of concern that we would wish to single out at this point of the Review.

Question 5:

Most States have said they would encourage the Commission to visit their State for discussions on a range of matters. Would you want the Commission to visit your State during the review? When during the review would you want the Commission to visit and what is the rationale of this timing? How would the Commission expect to gain guidance in the development of its methods through a visit to your State?

ACT Response:

The ACT supports the Commission visiting all jurisdictions during the course of the Review.

A snap shot of Commission reports for past reviews in 1993; 1999; 2004 and 2010 shows that all reported that workplace discussions had proven to be extremely valuable to the work of the Commission. In effect, the feedback from all parties was that workplace discussions allow Commission members to witness first hand disabilities experienced by, and the relative revenue capacities of, the States and Territories which gives them a basis on which to exercise judgement when required.

The fact that such visits/discussions have not occurred since 2008 [2010 Review], or some 9 years ago is partly responsible, in our view, for the loss of general knowledge and understanding of the process at all levels which was heavily criticised in the GST Distribution Review resulting in a range of recommendations which we note, have yet to be acted on by any party.

The ACT would suggest that the first order issues should rest on defining the scope and coverage of the review, the degree to which the principles of fiscal equalisation should be applied, and other aspects on which there could be expected to be general agreement between the parties. This could then be followed by those elements of the inquiry which deal with specific issues and require more extensive discussion and consideration by the parties (as referenced in answer to Q3).

Question 6:

A draft report will be part of the process. In recent reviews the Commission has produced this in the June of the year before the final report. This gives the Commission sufficient time to develop well considered methods, the States time to comment on the proposed assessments and the Commission time to react to those comments, including advising States of any major changes since the draft report. Do you have any particular views on this process?

ACT Response:

Again the ACT supports the proposal for the Commission to issue a draft report a year ahead of the final report to Government. From our experience, this early indication of where the assessment framework changes are heading allows Treasuries to brief their respective Governments of the likely longer term outlook thus ameliorating any sudden shocks. It also allows jurisdictions to better target their resources to areas in the draft report causing them the most concern in the lead up to the final recommendations.

However, that said, we strongly recommend that the draft report include draft relativities to ensure all governments are briefed from the same report card. Past attempts to avoid specific draft relativities have led to highly tensioned discussions in the respective intergovernmental fora with each jurisdiction interpreting Commission findings differently. This is both unnecessary and only adds to the confusion and criticism of the process. A no win situation in a highly political environment.

That said the jurisdictions must also accept that any draft relativities are exactly that – draft with all the necessary caveats attached.

Question 7:

What other types of meetings should be held between the Commission and State representatives, Commission staff and State representatives? For example, should there be a multilateral meeting between the Commission and Heads of Treasury to discuss the supporting principles and how they might interact? Could third parties, such as academics, play a role at such a gathering? Should there be meetings between State and Commission staff to help States understand the assessments set out in the draft report?

ACT Response:

The makeup of the intergovernmental sector has changed remarkably since the last full review which commenced in 2005 culminating in the 2010 Report. The maturity of COAG and the role of the Council on Federal Financial Relations have undergone change with the bulk of national funding agreements negotiated through the former forum with Treasuries playing a supporting role.

This has seen the development of other fora who may wish to be involved in the Review including the Council of the Australian Federation (CAF), COAG Senior Officials (SOM) and of course Council on Federal Financial Relations (CFFR), Heads of Treasuries (HoTs) and in more recent times HoTs Deputies.

The roles and interest of these bodies in the review will need to be addressed upfront. In effect, it is difficult to see the Review conducted in the Treasury space alone, a marked change in circumstances from the 2010 Review.

At a more local level, in a policy sense, the ACT will be looking to engage the ACT Government more directly in deliberations including the potential for the Commission to address members of the ACT Legislative Assembly in some shape or form, if the latter deem it appropriate, on progress with the Review and/or opportunity for the ACT's elected representatives to address the Commission on issues they deem relevant. We would view this as part of restoring the integrity of the HFE process.

From a direct meeting perspective, the ACT would see the Deputy HoTs forum as the body charged with liaising directly with the Commission during the course of the Review. It is important that deliberations be pitched at this level. Past experience with meetings between the Commission and Heads of Treasuries for instance, have not always had the desired outcomes due to the limited exposure by the latter to the complexities underpinning the framework. Deputy HoTs should be the focal point for all deliberations and would be better equipped to offer more insight to the process.

The ACT would expect and be very mindful that the Commonwealth Treasury also play a much more proactive role during the review and not adopt hands off *modus operandi* as has been our observation in more recent times. Ownership of the Review process should rest with all nine governments in parallel with the Commission taking the lead role as referred to earlier.

Again, the specific types of meetings have already been referenced in the ACT's response to Question 3 which by implication would/could involve third parties including academics if the circumstances deem it appropriate.

OTHER ISSUES

The ACT would also take this opportunity as offered in the Secretary's letter to respond to a number of the issues raised by the same in an earlier letter dated 8 November 2016 regarding his observations from the meet and greet he conducted with all jurisdictions, which for the record, we appreciated and found to be most productive.

The Commission also has capacity to offer some development assistance to your staff.

While the offer from the Commission is commendable, the ACT is inclined not to support any prolonged dedicated training program at the expense of getting on with the task at hand if that is the implied intention.

What States do and need, by way of training and/or refreshing seminars etc. is a matter best left to each jurisdiction who should engage with the Commission as they see fit as offered by the Secretary:

A dedicated training program as a preamble to the development of a Work Program is a hindrance to the task on hand and overrides the effort some jurisdictions have, and continue to input into, the What States Do – exercise which we understand was designed to inter alia provide the starting point.

Also, the ACT's experience with the 'Assessment System on Line' has been fraught with difficulty both in the software supporting the system and the complex nature of the system which makes it unusable for our needs in most circumstances. Access to the odd data set has assisted the ACT but any modelling we do primarily rests with our own spread sheeting. Unless a State officer is using the system constantly, there is limited chance the system will be used effectively hence dedicated training workshops are of little value.

We believe the What States Do papers could also form a useful basis for discussion through a series of telepresences with all jurisdictions. To manage workload demands on your staff, we propose scheduling teleconferences on these papers after Update 2017 has been finalised.

The ACT does not place a high priority on this proposal.

As already discussed in answer to Question 4, we have, and will continue to do so with the remaining papers when they are issued, identified the areas that we consider warrant further consideration in the 2020 Review. If all jurisdictions were to do the same, such a discussion would be unworkable.

We see the task on hand for the Commission to now decipher the main points raised by jurisdictions which would help determine a draft Work Program for all to consider and then consult as alluded to in earlier questions.

In discussions with staff from each of your departments, there was also general endorsement of our proposal to set up a data working party. In the 2015 Review Report (Volume 1, Table 5, page 13) the Commission listed a number of areas where it considered work on improving data for assessments could be usefully undertaken. We will be in contact after the 2017 Update with staff views on these areas and seeking State involvement in a Data Working Party through 2017.

The ACT did not support this proposal and continues to advocate against its adoption. Our direct experience with a similar tasking in a past Review was overwhelmingly unproductive from the point of what was not achieved and the resources devoted to it.

While the list of areas for further work mentioned above has some value in considering priority areas for the next Review, it should not be considered as defining a way forward in settling a Work Program for the 2020 Review. Pursuit of improved data should be done individually as part of any specific assessment review, but in the totality of an assessment framework prioritised against other assessment tasks.

We recommend that the Commission reconsider this proposal.

The need for re-building confidence in the HFE System.

We consider this requires a firm commitment by all parties to the Review upfront to do more in explaining/defending and re-establishing some degree of integrity in the process:

- More about increasing our collective efforts by publically explaining what the Commission via the ToR is now being asked to do in the 2020 Review, how it currently does it, and how it will go about the task passed to it, including reporting its results whilst proactively addressing any public misrepresentations along the way.

Essentially, we are seeking certainty underpinning the system to be re-established which should be built into the Work Program and opened up for discussion.

Consulting Role in Commonwealth-State Relations.

During the 2020 Review, we expect that a number of developments will occur in National Agreements underpinning Federal-State relations particularly in the health and education sectors.

We view the Commission also playing a role in facilitating policy analysis [on request] in collaboration with central agency officials (1st Ministers and Treasuries) tasked with implementing national reform in the major areas of State service delivery:

Commission observations and in some instances ongoing analysis of the options under investigation for their impact on the existing equalisation framework and consequential redistribution impacts for GST.

This role would also assist the Commission itself in adapting the relevant assessment framework under review.

Federal Financial Relations

ATTACHMENT A

GST REDISTRIBUTION BY CATEGORY

Category	Revenue/Expense	GST Redistributed (\$m)
Mining revenue	Revenue	6,042
Other expenses	Expense	1,640
Health	Expense	1,626
Payroll tax	Revenue	1,440
School education	Expense	1,327
Stamp duty	Revenue	1,322
Investment	Expense	915
Justice	Expense	907
Services to communities	Expense	848
Depreciation	Expense	801
Transport	Expense	748
Roads	Expense	697
Welfare	Expense	621
Land tax	Revenue	422
Motor taxes	Revenue	312
Services to industry	Expense	269
Housing	Expense	186
Insurance tax	Revenue	171
Net borrowing	Revenue	95
Post-secondary education	Expense	58
Total Revenue	Revenue	7,679
Total Expenses	Expense	8,084
Grand Total		8,029

Notes:

- Expense includes Investment and Depreciation.
- Commonwealth payments not included.

COMPLEXITY OF ASSESSMENTS

Complexity is found in two main components of assessments: 1) Methodology and 2) Data.

Possible criteria for determining the degree of complexity of assessments by category are indicated below:

Methodology

- Number of components/streams (i.e.: different methodological approaches for subsets of the assessment).
- Number of variables where regression models are used.
- Number of different disabilities/drivers.
- Whether there are any quarantined/specially treated elements (as per Terms of Reference).
- Any offsetting of user charge revenue.

Data

- Number of data sources.
- Use of non-GFS data (State provided, other sources).
- Number of adjustments/scaling required.
- Use/degree of discounting.