AUSTRALIAN CAPITAL TERRITORY

2020 Review

ACT Response to Commonwealth Grants Commission Staff Discussion Paper

The Principle of HFE and its Implementation

CGC 2017-02-S

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Chief Minister, Treasury and
Economic Development Directorate

Contents

1 BACKGROUND

This submission addresses the issues raised in the Commonwealth Grants Commission (Commission) Staff Discussion Paper CGC 2017-02-S titled *‘The Principle of Horizontal Fiscal Equalisation (HFE) and its implementation”* issued in May 2017.

In responding, the Australian Capital Territory (ACT) also reviewed and called upon the three supporting Staff Research Papers, namely:

- 2017-03-S Achieving HFE – other approaches to distributing the GST;
- 2017-04-S State mining policies; and
- 2017 05-S Options for improving contemporaneity.

As stated in the Staff Discussion Paper (CGC 2017-02-S, paragraph 35), jurisdictions’ preliminary views were sought by the Commission Secretary on the work program for the Commission’s 2020 Methodology Review on 1 December 2016. As part of that process all parties were asked:

> *‘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’?*

The ACT, along with four other jurisdictions, namely Victoria (VIC), Tasmania, South Australia (SA) and the Northern Territory (NT), are recorded as expressing support for the existing objective, definition and supporting principles (what States do, policy neutrality, practicality and contemporaneity).

Notwithstanding, the Commission, through the Staff Discussion Paper, has determined that these matters be addressed upfront in accordance with the work program.

Premised on the ACT’s extensive experience with methodology reviews since self-government, this process constitutes a normal first step by any Commission, past or present, to a pending methodology review before the detailed assessment phase commences in 2018.

As the Commission would also be aware, the ACT has, in parallel, forwarded a submission to the Productivity Commission (PC) tasked with reviewing the economic effects of HFE. That submission is on the PC website.

It would be no surprise to the Commission that many of the issues covered in the ACT submission equally applies to matters raised by the Commission in the Staff Discussion Paper. Indeed, the ACT considers the Staff Discussion Paper covers most of the issues canvassed in the PC issues paper, which parties were asked to address in their respective submissions.

The ACT agrees with the Commission's view in the Staff Discussion Paper that its consideration of the HFE objective and the issues associated with its implementation in the context of the 2020 Review will complement and assist the PC's work in responding to its terms of reference (ToR). In that context, the ACT urges the Commission to publish its views on the HFE objective and its implementation, based on the current *Intergovernmental Agreement on Federal Financial Relations* (IGA-FFR) and ToR, by the end of September 2017 as suggested.

Finally, the ACT also acknowledges the expressed intention of the Commission to provide further opportunity for views on its approach to the 2020 review - the objective(s), supporting principles and their implementation - to be expressed after the PC has reported and the Commonwealth Government has dealt with its findings.

2 INTRODUCTION

The ACT considers that fiscal equalisation remains central to intergovernmental financial arrangements in Australia.

The ACT has not changed its views in responding to the matters raised in the staff papers and considers that the current approach to HFE continues to achieve the goals of the equalisation system.

However, given the zero-sum nature of the Goods and Services Tax (GST) distribution under HFE, it is not surprising that the system generates friction between the States and Territories (States) and that some have opposing views. The views raised by critics of the current HFE framework are fully understood by the ACT. Namely, they are less about the principles of equalisation arrangements and more about whether the current approach continues to be justified in achieving those principles.

The ACT considers the Staff Discussion Paper and supporting research papers achieve the objective of drawing out the discussion at hand and importantly, highlighting how the HFE framework has responded to changing economic circumstances and what considerations need to be addressed to allow the Commission to respond to the ToR.

As stipulated in the Staff Discussion Paper, the ACT will review any change recommended to the definition and supporting principles by critics of the system.

The ACT maintains that it is incumbent on the critics to make clear how HFE can be achieved while also facilitating other objectives, or at least minimising any perceived adverse impacts of HFE on the operations of government and the economy in ways other than those dealt with by the supporting principles.

3 ACT OVERVIEW

At the outset, the ACT maintains that critics' arguments for change to the current HFE framework have, in the main, been effectively addressed on a number of past occasions, with the Staff Discussion Paper again clearly documenting how HFE has responded.

From an ACT viewpoint, the main objective of HFE is to achieve equity of community access to services. The available evidence supports the view that the impact of HFE on economic efficiency, one of the main areas of criticism, is at worst quite small and well within an acceptable level of 'trade off' with the equity objective. Indeed, the ACT continues to support the view that HFE may enhance economic efficiency as it can operate to offset fiscally induced migration of capital and labour between States. It is also, arguably, an important element in supporting a single currency economy.

In addition, the ACT suggests that in past reviews the Commission has established conclusively that the HFE system has virtually no impact on the efficiency of service delivery and States overwhelmingly get to keep the benefits of reforms which enable services to be delivered at lower cost. Similarly, States keep the benefits of measures to improve the effectiveness of revenue raised from their existing tax bases. These conclusions were also recognised by the 2012 GST Distribution Review.

The ACT considers, however, that there is a clear risk that the pursuit of economic reform and development policies by States which generate significant expansion in their tax bases will impact adversely on their GST shares if other States are not undertaking such reforms. The ACT has led the nation in reform of property related taxes, with substantial positive effects for its economy. However, it is essential that further reform not be jeopardised by unintended impacts of the GST distribution system. Accordingly, the ACT is calling for the Commission to reconsider its approach to such impacts of reform in the calculation of States' GST entitlements. It is the ACT's strong view that such changes can be accommodated within the framework of the current equalisation system.

In that context and as requested in the Staff Discussion Paper, this submission has identified three particular areas for the Commission to address in the current assessment framework centred around:

- Changes to take account of the effects of State tax reform measures on underlying tax bases, via so-called "elasticity adjustments". The current system of HFE allows for such adjustments to be made, which would offset any disincentives for State tax reform.

- Adjustments to allow for State expenditure on economic development which increases the size of State tax bases. Such adjustments must take account of the fact that all States actively pursue economic development and that the effectiveness of this expenditure in enhancing tax bases may differ across jurisdictions. The effects of such investment by States also need to be distinguished from differences in natural endowments, which can be a fundamental driver of States' ability to generate own-source revenue.

- Changes to take into account data which is closer to the application year of the GST distribution and which, the ACT contends, allows a more contemporaneous distribution of the GST without impacting data-reliability too adversely.

While not specifically canvassed in the responses to the questions in the Staff Discussion Paper, this submission also calls on the Commission to continue to recognise that the ACT is an independent territory of the federation which receives Commonwealth funding commensurate with its State counterparts, while also receiving funding in recognition of its unique circumstances as a city/state in a national capital setting and as a major regional centre. These special circumstances warrant continuing specific consideration in the 2020 Review. They go to the fundamental core of the ACT's self government model and must be transparent to all Australians.

Finally, whatever direction the Commission might take in its final report, the one lesson the ACT took from the 2012 GST Distribution Review was recognition of the need for strong supporting protocols and governance arrangements to accompany any revised framework. All States continue to have concerns about the governance of the current HFE system. Unfortunately, many of the recommendations of the 2012 GST Distribution Review in this space have not seen the light of day but remain relevant more so today than ever. Specifically, governance arrangements for any system must reflect the need for the States and the Commonwealth to act as joint stewards of the system, rather than competitors or critics.

Similarly, effective communication and transparency of process are essential for public confidence in any HFE system and federal financial relations more broadly. Ultimately, whatever system arises from the review, it must be able to be clearly understood as to how the system works, with full transparency of the process and confidence in the system paramount.

4 THE PRINCIPLE OF HFE AND ITS IMPLEMENTATION

4.1 Objective and Definition of HFE

Do the IGA and the ToR require the Commission to distribute the GST in such a way as to achieve HFE as the sole objective?

Yes.

As per the 2020 Review ToR, the Commission has been instructed to undertake a comprehensive review of all the methods that underlie its assessments to calculate the per capita relativities used to distribute GST revenue among the States. The ToR further note in paragraph 5 that "In undertaking the review, the Commission should take into account the IGA-FFR (as amended), which provides that GST revenue will be distributed among the States in accordance with the principle of HFE." The ACT notes that the ToR provide no further explicit objectives or principles for distribution of the GST other than HFE. Given that, the ToR are clear in their instruction that GST should be distributed only according to HFE, provided that the IGA-FFR also instructs the same.

To this end, Section D63 of the IGA-FFR states "The Commonwealth will distribute GST payments among the States in accordance with the principle of horizontal fiscal equalisation". As the Commission is the Commonwealth agency charged with managing the distribution of the GST and given the absence of any additional specified objectives of the GST distribution in the IGA-FFR, it then follows that the IGA-FFR requires the Commission to distribute the GST solely in accordance with the principle of HFE.

Therefore, both the IGA-FFR and the ToR clearly and unambiguously require the Commission to distribute the GST in such a way as to achieve HFE as the sole objective.

Moreover, the ACT agrees with the current framework of the IGA-FFR and that the sole objective of the GST distribution should be HFE and should not be qualified or diminished by the inclusion of other secondary objectives; nor should the importance of HFE be diminished as an objective in the absence of a multilateral agreement to alter the IGA-FFR.

Is the aim of HFE to achieve equal fiscal capacities?

Yes.

James Buchanan, in his seminal work on federalism, characterised the need for equalisation as arising from the progressive national integration of economies within a decentralised political structure (1950, p. 584-585). This was reinforced by the extension of governmental activity through the provision of social services, to which all citizens were regarded as having an equal entitlement.

At the same time, he accepted the desirability of retaining the federal, rather than a unitary, form of government in the United States. These considerations also underpin the equalisation system we have in Australia today.

Therefore, if equalisation in Australia is to continue as a fundamental element of the federal structure, it must constitute equalisation among the States, such as will further equity of treatment between all citizens of Australia, whichever State they live in. This means equity in the scope, standard and availability of the services which States are expected to provide and equity in the taxes and charges which are imposed on citizens to pay for these services. Such an objective is entirely in accordance with the economic principle of horizontal equity, which requires that individuals in the same circumstances be entitled to the same net benefits (services less taxes) and that this treatment should not differ as a result of geography.

Given this, the overall aim of HFE is to provide the States an equal capacity to provide services to their citizens in terms of quality, quantity and cost to the citizenry. As an inevitable consequence of this objective, it is required that HFE achieves equal fiscal capacities among the States.

- <u>*If it is, then, how would different approaches to the achievement of HFE, such as including other desirable policy goals, be implemented consistent with this? How would the definition need to be modified to support them?*</u>

While secondary considerations such as economic efficiency and incentives should be noted by the Commission, the ACT contends the definition of HFE should not be altered to cater to secondary objectives, at the expense of State fiscal equalisation. The sole objective of the GST distribution should be HFE. That does not mean that potential adverse impacts of equalisation on other desirable outcomes, such as economic efficiency, should not be considered. If equivalent equity outcomes can be obtained with either reduced economic loss or increased economic gain, then the design of the HFE system should be altered accordingly.

Therefore, any alternative approach to achieving HFE must be compliant with the supporting principles (discussed later) that currently guide the Commission's assessments towards HFE. In essence, approaches to achieving HFE 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.

These existing principles as currently constituted imply methods need to be developed that reflect State policy and practice in service delivery and revenue raising and must prove resilient so that they continue to be relevant and appropriate as State policies change and as respective economic and social circumstances change. These are the existing fundamental pillars of the framework underlying the HFE definition which the ACT continues to support.

The ACT does not see addressing shorter-term differences, such as cyclical differences, between States as part of the fundamental objective of HFE. Rather, these go to the level of secondary objectives which should be considered only if achieving them does not cause a deleterious impact on HFE. Mitigation of cyclical differences is desirable, in accordance with the principle that the equalisation process should, as far as possible, reflect the current circumstances of States, but it should not be at the cost of accurately compensating for structural differences.

Another possible secondary objective is that States should not be rewarded for inefficient tax arrangements or service delivery, nor penalised for efficiency in their tax regimes and service delivery. An effective HFE system should minimise such adverse impacts. However, it should not be an objective of the system to promote reform; other policy mechanisms should be used to achieve reform objectives. Where reforms undertaken by States significantly affect their underlying revenue raising capacity or expenditure needs, the HFE system must not operate to penalise such reforms. These are commonly referred to as "second order" effects and should be explicitly accounted for in the equalisation system, which does not occur at present.

- *<u>If not, what should HFE be achieving and what changes to the definition would be required?</u>*

Not applicable.

<u>Are changes to the definition necessary, or are State concerns more about the way HFE and its current definition is implemented?</u>

The ACT affirms that no changes to the definition are warranted.

The criticism by some States and other parties of HFE as currently implemented has focused on what is allegedly wrong with the system without making clear what this means for the fundamental objective of HFE. The reality is that implementation of the changes proposed by critics would in practice require a radical redefinition of the objective – it could no longer be to equalise the fiscal capacities of States. In that context, adoption of such radical redefinitions, such as an equal per capita (EPC) distribution of the GST, implies on its own the abolition of HFE. The ACT's views on some of those options – EPC distribution, partial equalisation and actual per capita (APC) distribution – are as follows.

Equal per Capita Distribution

As the Commission has pointed out, the combination of an EPC distribution of GST with additional assistance to fiscally weaker States would impose a very large additional burden on the Commonwealth Budget and hence on all taxpayers across the nation. The ACT estimates that this model would have required an additional $23 billion, based on 2015-16 assessment year data, to achieve full equalisation (**Attachment A**). Calculations by the Commission also show that this amount would have been $42.2 billion in the 2016-17 application year (Commonwealth Grants Commission, "Trends in Horizontal Fiscal Equalisation", April 2016-01, box 2, p. 8).

An alternative option would be to sequester a portion of the GST for an equalisation fund and distribute the balance EPC. This does not necessarily mean partial equalisation, as discussed below. It can be used to achieve full equalisation, with any surplus funds distributed to States on an equal per capita basis.

There is an issue about the long-term sustainability of government budgets in Australia. Loan Council nominations indicate that currently the Commonwealth is running a much larger deficit than the States when considered in relation to the division of expenditure responsibilities between the levels of government (the Commonwealth has 77.5% of the total deficit compared with 55% of the expenditure responsibilities). However, in the longer term States may face greater sustainability problems particularly because of the growth rate of health expenditure and the inefficiency of many State taxes.

The ACT contends that many of the alleged deficiencies of the current system are the product of misunderstandings, both about the objective of the equalisation system and about how it actually operates. Primary among these misunderstandings is the belief that the GST is a tax raised by States, or in some way "owned" by the State in which it is raised and hence that if a State's relativity is less than one it is giving away some of "its" GST to other States. The fact is that the GST is a Commonwealth tax and is used to achieve equalisation in lieu of alternative methods such as grants from consolidated revenue. Such grants were used to achieve equalisation before the introduction of the GST in 2000.

As the Commission has commented in its paper on *Achieving HFE: Other Approaches to Distributing the GST*, the expression of States' GST shares as a ratio of their population shares (relativities) is purely presentational and an historical legacy:

- A State's relativity shows the proportion of the average GST per person it should receive. It is not a measure of how much of the GST raised in the State should be returned to it.

This continued myth played out in the national media suggests serious thought should be given to an alternative way of presenting the Commission's recommendations. For example, reporting State GST payments purely in dollar terms would reduce the excessive attention given to relative shares – if States wish to calculate relativities it is easy enough for them to do that.

Partial Equalisation

The ACT notes that the partial equalisation option canvassed by the Commission (CGC 2017-03-S, Table 1) means that fiscally weaker States receive less GST than under full equalisation, essentially because this option doesn't redistribute "excess" GST from fiscally stronger States (i.e. the EPC component of the distribution "over-equalises" the stronger States).

NSW has claimed that an EPC distribution can be considered partially equalising because more GST per capita is likely to be raised in the fiscally stronger States, which assumes acceptance of the fundamental proposition that the GST is "owned" by the State in which it is paid. However, direct data on how much GST is actually paid in each State is not available. Proxy measures, such as household final consumption expenditure (HFCE) must be used to estimate the potential GST raised in each jurisdiction. See **Attachment B** for analysis using the Australian Bureau of Statistics data for Household Final Consumption Expenditure by State at June 2016.

The ACT's analysis clearly illustrates if any proxy measure such as HFCE for determining GST paid in a State was applied, an EPC distribution could **not** be considered as partially equalising. This arises as fiscally stronger States like VIC and Western Australia (WA) have a higher share of the national population in comparison to their share of national expenditure and hence will draw GST share from the fiscally weaker States, the NT and the ACT, due to the latter's lower shares of national population in comparison to their share of national expenditure.

This point is further emphasised by the statement in the Commission paper (CGC 2017-03-S, paragraph 13) that "an EPC distribution which, by definition, does not change the fiscal capacities of State governments cannot result in the equalisation of their fiscal capacities".

Actual per Capita Distribution

A further option canvassed by the Commission is that of an APC distribution. An APC assessment assumes that States' actual revenue raised or expense incurred accurately reflects its capacity. However, such an APC distribution would clearly be influenced by policy decisions of individual States. Putting aside the possibility of false reporting (over-reporting of expenditure and under-reporting of revenue) to gain an advantage, a State making an explicit policy decision to increase expenditure per capita relative to other States would recoup all but its population share in GST and a State making an explicit policy decision to reduce revenue per capita relative to other States would similarly recoup all but its population share in GST. However, if all States tended to make the same type of policy moves, they could largely cancel each other out.

The Commission has suggested (CGC 2017-03-S, paragraph 26) that the closeness of the equalisation and APC distributions suggests disabilities rather than policy differences are the biggest contributor to differences in what States do. However, it is quite possible that this would change if the system moved to an APC method.

The underlying incentives would change – at least to some degree rewarding particular policy choices compared with the current system, which tries to ensure that States do not benefit from specific policy choices. This is a weakness of taking a purely static, ‘snapshot’ kind of approach to the analysis.

Impact of HFE on Disabilities

Attachment A of the Commission paper (CGC 2017-03-S, paragraph 23) suggests that most State disabilities are not dissipating. The ACT challenges this observation.

Analysis by the Commission shows that since the Commission began utilising relativities, the amount of fiscal redistribution per capita decreased markedly from 1993 to 2010; from $298 per capita to $198 per capita (**Attachment C**). Although the amount of redistribution has increased since 2010 to $320 per capita in 2016, it is the ACT’s view that this is solely a result of the mining boom and would not have occurred in the absence of such a large increase in the value of mineral royalties. There is evidence in the two most recent Updates by the Commission that the effects of the boom are starting to wash out of the system, with a progressive decline in the spread of relativities between States in these two updates.

Moreover, analysis of the relativity of the most dependent State in the Commonwealth, the NT, shows that its relativity has decreased considerably (from 5.42252 to 4.66024) between 1993 and 2017 and that the difference between the NT’s relativity and the second most reliant State in each given year has also decreased by 26.47 per cent (from 3.88355 to 2.85547) over the same time period (**Attachment D**). The conclusion from this evidence is that the HFE system has not been associated with, let alone caused an increase in the overall disparities of fiscal capacity between States.

4.2 Supporting Principles

Should the Commission continue to adopt supporting principles (or guiding considerations) to assist it in developing methods to give effect to the principle of HFE?

Yes. The ACT’s position is that the existing principles are more than adequate for the 2020 Review and should remain in place, without more time spent redefining possible alternative approaches and principles to achieve HFE.

In absence of the Commonwealth and State Governments reaching any degree of consensus on alternative interpretations of the existing definition of HFE, the ACT supports the continued use of the same supporting principles used in the 2015 Review to again guide parties through the 2020 Review. From its perspective, the ACT cannot identify any new principles that could be developed to further the exercise within the bounds of the existing HFE definition.

These four existing supporting principles; policy neutrality, what States do, practicality and contemporaneity are essential to the principle of HFE. They, in essence, guide the decision making process of the Commission in a manner that ensures fair and relevant outcomes from its relativity assessments:

- By way of assessing State needs on the basis of the facts rather than perceptions or judgements (what States do);

- Maintaining the integrity of the model and ensuring that States cannot have undue influence over the GST distribution (policy neutrality);

- Ensuring the materiality, reliability, quality and fitness for purpose of data used in assessments (practicality) and

- Ensuring the applicability of the Commission's relativities to the current circumstances of the States (contemporaneity).

The ACT considers the principles of policy neutrality and what States do 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 and 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*).

Should HFE continue to be the priority, or are there circumstances under which certain supporting principles should take precedence over HFE?

The ACT contends that the supporting principles exist for the express purpose of achieving HFE in a manner that is fair and relevant. The ACT does however acknowledge that there are inherent tradeoffs between the supporting principles and the fundamental principle of HFE in certain circumstances. The framework has proven, in the main, to be flexible when outliers occur.

One example is the Commission's assessment of mining royalty revenues. In the 2015 Review, the Commission moved its assessment of mining revenue from a two-group methodology to a mineral-by-mineral methodology for the highest royalty earning minerals. This introduced significant policy neutrality concerns, as States that dominated production in one of the specific minerals could exert a high degree of influence over the national average, such as WA and iron ore.

However, the mineral-by-mineral approach does more accurately capture each State's revenue capacity in regards to these minerals. In this instance then, the principle of policy neutrality was regarded as a lower priority than HFE as a whole.

Conversely, an example of a supporting principle taking precedence over HFE is with gambling revenue. From the 2015 Review, gambling revenue is assessed on an EPC basis as part of the Other Revenue category. This is despite the large discrepancies in the proliferation of gaming machines throughout the different States and the similarly large discrepancies in gambling revenue generated by each State. The Commission has nevertheless assessed gambling revenue on an EPC basis due to difficulty in designing an appropriate assessment. In this case then the supporting principle of practicality has taken precedence over HFE. The ACT notes that the Commission is aware of this issue and appears to be interested in reconsidering its assessment approach towards gambling revenue.

Should the supporting principles have a pre-determined hierarchy, or should the Commission seek to balance the supporting principles case by case in order to best achieve HFE?

Regarding the issue of weights being applied to the underlying principles, the ACT has consistently argued that by their very nature, there is an implicit weighting built into the listing of the four principles (as shown above in order of importance), though not in a quantitative sense.

The Commission, however, proposes to utilise a two-tiered approach to the principles, with *what States do* and *practicality* generally being considered "first order" principles and the remaining supporting principles being considered "second order", when considering the scope of HFE, disabilities and assessment method (*what States do* is considered "second order" for assessment methods) (CGC 2017-02-S, Table 1, p. 12).

As referenced earlier, the ACT continues to support considering *what States do* and *policy neutrality* to be of paramount importance for all elements of HFE. At the same time, the ACT affirms that in each case where there is a trade-off between any of the supporting principles; it should be done based on its own merits, with regard to best achieving the fundamental principle of HFE.

Should any of the 2015 Review supporting principles be removed, or any new supporting principles introduced? For any new principles, what is it that the new principle would achieve, not otherwise achieved?

No.

The ACT 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.

4.3 What States Do

4.3.1 Internal or External Standards

Is the use of internal standards a sound approach to the achievement of HFE with no further consideration necessary?

Yes.

The use of internal standards ('what States do') is supported by the ACT as it obviates the need for value judgements that are required when determining external standards, such as those based on an efficiency concept or an 'ideal' level of service.

Similarly, while it would be possible to develop less inclusive internal standards, such as limiting the standard to the average of only some States, it is unclear as to what criteria would be used to decide which States are part of the standard and which are not. Indeed, the concept of rotating standards between States has been adopted and then rejected by past Commissions ranging from a six-State rotating standard to a two-State rotating standard. The ACT does not support its reinstatement.

The consequence of using external standards is that it may lead to greater criticism of HFE given greater levels of judgement that are not factually supported by data.

However, the ACT does note that there are compromises in using internal standards in certain circumstances. For example, a tax base that is unequally distributed across States creates a situation in which assessments of the base closely resembles an actual per capita assessment, meaning that a State's capacity is assessed as equal to the revenue it actually raises. This situation raises significant issues of policy non-neutrality and possible perverse incentives, which warrants consideration of alternative approaches such as those discussed below

One alternative is the use of external standards in assessment categories where needs-based funding from the Commonwealth plays a key role, such as Health and Education. To some extent the Commission already does that in these assessments, by adopting elements of the Commonwealth funding models in the way it assesses need (whether by explicit direction in ToR, or through its own internal considerations). This approach could be taken further, as suggested below, with associated benefits in reducing the complexity and potential for inconsistency in the current assessment methods used for these major categories of expenditure.

This approach would imply replacement of standards based on the average of what States do with an external, nationally established benchmark (in Health, the National Efficient Price and associated Diagnosis Related Group (DRG) weightings; in Education, the Schooling Resource Standard). Under a single national model, these benchmarks would in effect represent what States do, with a constraint that services are delivered efficiently.

However, usage of such external benchmarks would introduce inconsistency in how different State expenditures and revenues are assessed and would also require the development of national models for areas where none currently exists.

Alternatively, are there any circumstances in which it would be appropriate for the Commission to apply an external standard?

If a State raises a large or dominant share of the total national revenue for a particular revenue source then its actions will substantially influence the national average tax rate. This can mean an assessment not dissimilar from actual per capita. Therefore:

- An increase in its own rate will incur a substantial loss of GST to offset its own source revenue gain. At worst, the net gain will be only a population share of the additional revenue generated.

- A decrease in its own rate will reap a substantial gain in GST to offset its own source revenue loss. At best, the net loss will be only a population share of the total reduction in own source revenue.

The most often cited example of this is mining royalties. The Commission claims that there is no evidence the mineral by mineral approach has influenced State behaviour (CGC 2017-04-S, paragraph 24). However, absence of policy action/change could be evidence of influence. The above considerations indicate that it may have constrained potential increases in State royalty rates in large producer States.

The conclusion is that, under the current assessment approach, a State which is a dominant producer of a mineral has some policy incentive not to raise its royalty rates and indeed some incentive to reduce them, if it would be otherwise considering some kind of change to rates. However, the GST effect alone does not seem to be sufficient to warrant policy change in the absence of other drivers of change. Consequently, the ACT's view is that there is insufficient reason to warrant consideration of an external standard for mining revenue.

4.3.2 Average Policy

Should the Commission retain the 2015 Review approach — the 'weighted average' approach — to determine average policy or is there a better alternative?

Yes.

The ACT supports the ongoing use of the 2015 Review's weighted average approach. It is our view that the weighted average approach enhances the policy neutrality of the assessments by assessing capacity regardless of whether a given State applies taxes on a base or spends on a given service. As noted by the Commission, it also reduces confusion about what constitutes a (double) majority of jurisdictions compared to the 2010 double majority approach (CGC 2017-02-S, paragraph 69).

The ACT notes however, that the average policy approach may be problematic if some States deliberately rule out the development of a particular tax base (e.g. by a fracking moratorium; or banning electronic gaming machines in hotels and clubs) and may induce policy changes that impact State GST distributions in the event of a State unilaterally applying a tax.

How might the practical problems arising from the weighted average approach be handled to ensure HFE is achieved?

The Commission has raised the implications of State government policies imposing bans or moratoriums on exploration and mining of certain minerals and energy resources.

Assessing States to have no capacity to raise revenue in relation to any banned activity, as applied in the 2015 Review, is not in accordance with policy neutrality. It allows a policy decision to directly affect a State's assessed revenue base. This is contrary to the approach applied by the Commission in relation to other revenue sources and should be re-evaluated.

Although Queensland (QLD) is claimed to have over 90 per cent of known coal seam gas (CSG) reserves in Australia (source: Australian Institute of Mining and Metallurgy), the Queensland Budget estimates petroleum-related royalty revenue (including CSG) of only $982 million over the five-year period from 2016-17, rising gradually over this period to $296m in 2020-21.

A Commission assessment of CSG revenue on the 90 per cent assumption at the 2020-21 level would entail an offsetting GST loss to QLD of approximately $230m, which would imply only an approximate 1.3 per cent reduction in its relativity above equal per capita i.e. from 1.18769 to 1.17221 on its 2017-18 estimates (**Attachment E**).

The ACT notes there appears to be minimal use of fracking in relation to other sources of gas and oil (i.e. shale) in Australia. A tentative conclusion is that only State bans on conventional gas exploration and production are likely to be relevant as having a potential significant impact on Commission assessments.

Assessment of "missing" capacity appears in theory in the ACT view to be the best method of dealing with the problem, as it would be in accord with the Commission's general approach to taxes and charges which are not applied by all States. However, its application in practice is clearly problematic, if for example prospectivity (proven resources) cannot be effectively determined without exploration. Assessing no capacity for a State that bans production of a mineral or energy resource is fundamentally contrary to the principles of equalisation. If capacity for production of a particular mineral cannot be assessed across all States, then it would be better to assess all States as having no capacity to produce that mineral i.e.: the equivalent of an EPC assessment.

Further, the bank tax recently announced in the 2017-18 SA Budget raises concerns that unilateral decisions to tax a given base when no other State is doing so may produce a GST distribution impact which influences policy decisions of other States.

ACT analysis does however indicate that this particular tax will not have a material impact on the GST distribution and that most unilateral tax policy decisions also would not likely be material. This suggests that materiality thresholds have a role to play in mitigating unintended policy influences in such situations. Further discussion on materiality thresholds can be found later in this paper.

4.3.3 Scope of Equalisation

Should the fiscal outcome of States the Commission equalises continue to be the same average per capita net financial worth?

Yes.

The ACT considers that 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.

- *If not, what fiscal outcome should the Commission equalise?*

Not applicable.

Given current State circumstances, does the existing scope of equalisation (general government, plus urban transport and public housing PNFCs but excluding local government except for the interactions between it and the State sector) remain appropriate?

The ACT agrees that the existing scope of equalisation remains appropriate and that the Commission should not include local governments in their assessments beyond their interactions with State governments. We consider that limiting the assessments any further would detract from the equalisation process and from the equity of citizens, in particular with regard to limiting the assessment of revenues such as mining royalties (Boadway 2004, Brennan and Pincus 2010, Murphy 2015, etc).

Any further expansion of the assessments, such as to government owned corporations, would not be appropriate given that such corporations are required to operate on a commercial basis and their operations should be fully independent of the general government sector.

- *If not, what activities should the Commission equalise?*

Not applicable.

4.3.4 Disability Measurement

Should assessments reflect what States do on average?

Yes.

To reiterate earlier comments, the use of internal standards ('what States do') is supported by the ACT as it obviates the need for value judgements that are required when determining external standards, such as those based on an efficiency concept or an 'ideal' level of service.

Similarly, while it would be possible to develop less inclusive internal standards, such as limiting the standard to the average of only some States, it is unclear as to what criteria would be used to decide which States are part of the standard and which are not.

The consequence of using external standards is that it may lead to greater criticism of HFE given greater levels of judgement that are not factually supported by data.

Should changes be made to the general approaches used by the Commission in the past?

No.

The ACT's position is that the general approach adopted by the Commission for assessing disabilities is suitable for its purpose and that any changes to the process should be refinements rather than radical rethinks.

4.4 Policy Neutrality

Do States consider that a rotating State average would improve policy neutrality? If so, how could such an approach be implemented in practice?

No.

Considering the complexity associated with using rotating State averages, the ACT considers that such an approach is unlikely to be worthwhile and for most assessments it is unlikely to produce a significant difference in outcomes. The ACT notes that in most areas of assessment, policy neutrality is not a major concern, given the approaches taken by the Commission. It is principally of concern only in areas where revenues or expenses are heavily skewed towards one or two States (e.g. mining revenues). However, considering the challenges already referred to by the Commission, e.g. complexity of calculations and technical complications, the ACT contends that the benefits of reverting to the rotating standard are not worth the costs.

Does HFE act as a disincentive to tax reform? If so, how does it do so — in reality as opposed to theory — and could such effects be mitigated in practice?

Incentives from first order effects were addressed as part of the GST Distribution Review (Greiner, Brumby and Carter, 2012.), with the final report finding that while there are theoretical incentives and disincentives, there is no definitive evidence of HFE exerting any material influence on State economic and tax reform decisions through first order effects in practice.

The GST Distribution Review's finding is also corroborated by academic literature, including econometric analysis performed by Dahlby and Warren (2003) which found only weak evidence of a relationship between State tax rates and the GST distribution:

"We interpret the regression results as providing some relatively weak evidence in support of the hypothesis that the equalisation grant formula has affected the tax policy decisions of Australian state governments. However, the estimated model is very simplistic and does not include other variables that might affect the fiscal choices of the state governments."

- *Fiscal Incentive Effects of the Australian Equalisation System, Dahlby and Warren, 2003, The Economic Record, Vol. 79, No. 247, p 444.*

The GST Distribution Review's Second Interim Report provided a State-by-State numeric analysis of the first-order impact of a unilateral tax increase on a series of different tax bases (**Attachment F**). This analysis clearly established that, apart from mineral royalties, the first order effect of tax rate changes on States' GST entitlements is minimal.

In light of the information presented above, the ACT continues to support the GST Distribution Review's finding that there is no definitive evidence that HFE creates material first order incentives or disincentives to the economic and tax policy decisions of State governments.

At the same time, the ACT contends that current implementation of HFE may pose indirect incentives or disincentives for State economic and tax reform through second order effects. Such second order effects and a proposed method to reduce their impact are discussed here.

Tax Elasticity Effects

One of the key second order effects that may induce incentives and disincentives for State tax reform is tax elasticity. Under the current HFE framework, the Commission assesses each State's revenue capacity assuming an average tax policy is being applied to each of its assessed tax bases. If any given State's tax policy differs from this average, the relative size of the relevant tax base may be affected and therefore impact the State's GST distribution.

Tax elasticity means that States that impose above average effective tax rates would see their tax bases reduce over time. Conversely, States that impose below average effective tax rates would see their tax bases increase over time.

Consequently, States that shift their taxes away from tax bases with high levels of elasticity and towards tax bases with low levels of elasticity would see their revenue raising capacity increase over time, lowering their share of the GST and therefore, disincentivising such tax reforms.

The ACT considers that there is a strong conceptual basis for incorporating tax elasticity effects into the HFE system. Hence, the ACT welcomes the fact that the Commission is currently engaged in a consultancy with the Australian National University's Tax and Transfer Policy Institute on the impact of tax elasticity on State revenue bases as part of the 2020 Review. It notes that prior to 2004, the Commission incorporated tax elasticity adjustments into its calculations for business franchise fees and mining royalties, but discontinued this practice from 2004 due to data availability concerns.

The ACT proposes that tax elasticity effects should be integrated into the HFE system as an adjustment to each State's assessed tax bases that are either undergoing significant reform or that have effective tax rates that are significantly different from the national average. The ACT proposed such an adjustment in its submission to the Commission for the 2015 Review; however the Commission rejected the idea on the grounds that the adjustment would not cause a material impact on the GST distribution. However, the ACT disagrees with the methodology used by the Commission to calculate the elasticity effect and proposes an alternative approach that it considers to more accurately capture the impact of tax elasticity on States' assessed revenues.

The Commission's approach in the 2015 Review for calculating possible elasticity effects was based on the absolute difference between State tax rates and the national tax rate. This method, which the ACT considers to be flawed, produces very small differences between the State and national average rates and substantially underestimates the impact of tax elasticity on each State's revenue capacity.

The ACT's alternative approach is to use a proportional difference between the State and national average rates. The ACT holds that this approach is more logically sound and measures the relative differences between the State and national average rates in a better fashion.

Analysis of an example of the results of this change show that the per capita difference between the ACT's conveyance duty assessed revenue and the elasticity adjusted assessment in 2011-12 increases from $4.75 to $41.46, which would make the elasticity adjustment clearly above the Commission's $30 materiality threshold[1]. For further analysis of the two approaches, as well as an explanation of the mathematical logic of using a proportional difference rather than an absolute difference, please refer to **Attachment G.**

[1] The materiality threshold requires that a differential assessment of a category of revenue or expenditure produces a difference of at least $30 per capita compared with an equal per capita distribution for at least one state.

4.5 Practicality

A further aspect of practicality is the transparent use of data. In the 2015 Review the Commission made use of data that were in some cases confidential. Should assessments be made using confidential data?

Yes.

The ACT contends that any data that makes the HFE process fair, equitable and transparent should be used for the purpose. At the same time, it is possible that some of such data could be confidential.

- 'Confidential' in this context refers to data that cannot be shared with other jurisdictions or other Commonwealth agencies.

The ACT affirms that it is perfectly understandable that some data cannot be shared with third parties and the public at large. It notes that the latter is not confidential from the perspective of use by other jurisdictions and Commonwealth agencies for any analysis at their end.

Such confidential data sets could be used for assessment but the Commission should take steps to minimise States' need to request treatment of data as confidential:

- A cross-check of confidentiality of data that the ACT has shared with the Commission over the course of past updates and reviews (2012-13 onwards) shows that only the data shared for natural disaster relief expenses was confidential since the information was commercial-in-confidence.

Hence, the ACT considers that it makes minimal use of confidentiality and is already doing its bit in making the assessment process as transparent as possible. Further, with developments in greater access to government data and transparency in general, data confidentiality is likely to become less of an issue over time.

4.5.1 Discounting

Are the three levels of discounting appropriate? If not how could discounts be changed?

Yes. The ACT considers that the three levels of discounting currently used by the Commission are appropriate. Hence, no changes are proposed.

4.5.2 Materiality Thresholds

Should the materiality thresholds remain at the 2015 Review levels or should they be increased? If increased, to what levels?

The ACT does not support any increases from the thresholds used in the 2015 Review, including that due to any sort of indexation:

- Materiality thresholds are arbitrary, detract from equalisation and in practice, do not make equalisation simpler.

As a general concept, the ACT acknowledges that higher thresholds for materiality may not necessarily affect the achievement of equalisation in a very broad sense. It depends very much on whether the effects of applying materiality thresholds are randomly and evenly distributed. That is, a jurisdiction may be disadvantaged by the application of a threshold in one assessment and advantaged by the application in another assessment.

This materiality concept is at odds with the incremental and methodical consideration applied by the Commission Staff in developing and refining complex assessments across the board. To follow this approach and then apply thresholds is simply undermining the HFE principle which the Commission goes to great lengths elsewhere to uphold.

An example of the adverse impact of any further increase in the materiality threshold used in disability assessment, with its implication that a $30 difference from EPC would not lead to any redistribution, is as follows. At the ACT's estimated population of 406,403 as on 31 December 2017[2], the current materiality threshold of $30 pc (in terms of difference from EPC), equates to a redistribution of $12.2 million. If the ACT would have, but for the application of the threshold, made such a gain from an assessment, application of the threshold would have lost it an amount sufficient to fund a new health-centre for Aboriginal and Torres Strait Islanders in Central Canberra (ACT Budget 2017-18, Budget Paper 2, page 23). The current materiality threshold, even though it appears to be relatively small, can thus have a significant impact in practice on States' fiscal capacities.

4.5.3 Quality Assurance

Is this an acceptable way to ensure 'robust quality assurance processes'?

Yes. The ACT has reviewed the 2015 Quality Assurance Plan and is confident that the Commission's quality assurance processes are robust.

[2] As per ABS 3101.0 estimates

Are there any new risks that the Commission should take into account from a State perspective?

No.

How might the 2015 Strategic Plan be changed to deal with those risks?

Not applicable.

Should any other changes be made?

The ACT has no view on this at this point.

4.6 Contemporaneity

Should the Commission maintain the aim of achieving a GST distribution relevant to the application year, or should the aim be varied to achieve equalisation over time using historical assessments?

Yes.

In the Commission's own words (from the 2010 Review), *"The Commission's objective is to provide all States with the same capacity to provide services to their populations in the application year"* (CGC, "Contemporaneity", Issues Paper 2006_04, paragraph 5). The ACT agrees that the GST distribution should be relevant to the application year, rather than equalisation being achieved over time using historical assessments.

Does the current three year lagged average approach present undue difficulties to managing your State's cyclical cash flows?

Mixed view.

An analysis of GST payments to the ACT over the period (2013-14 onwards) illustrates the ACT's GST share, while reasonably stable, has seen increases or decreases of ±7.5 per cent or less, year-on-year. While the current three year lagged approach does not present undue difficulties to the ACT, the variability year to year has not necessarily reflected changes in the ACT's circumstances; rather external forces have come to bear. A move to greater contemporaneity will be likely to create greater volatility for small States and those with few mineral resources.

- *<u>If so, which of the approaches discussed would result in an improvement to cyclical cash flow management and why, noting the concerns about using reliable and consistent data, the unreliability of forward estimates and the risk of policy contamination through the different budgeting practices of the States (with the consequent likelihood of increasing complexity through a completions type process)?</u>*

<u>State Budget Management</u>

First and foremost, the ACT does not see addressing shorter-term differences, such as cyclical differences between States, as part of the fundamental objective of HFE. Rather, the former goes to the level of secondary or supporting principles which should be considered. Mitigation of cyclical differences is desirable, in accordance with the principle that the equalisation process should, as far as possible, reflect the current circumstances of States, but it should not be at the cost of accurately compensating for structural differences.

That said, some of the suggested options may actually increase State budgeting problems. For example, the option of updating the February relativities later in the year (CGC 2017-05-S, paragraphs 16 & 34) would exacerbate the current budgeting problems for States, creating the possibility of additional Budget reviews or mini Budgets being brought down within a couple of months after their original Budgets.

The impact of a later reporting option (CGC 2017-05-S, paragraph 32) should be tested against data for some additional years to see if it makes any significant difference.

In summary, the ACT considers that there are substantial deficiencies in the options for contemporaneity suggested by the Commission and has proposed another option for consideration. Please refer to the next question for further details.

- *<u>If none of the proposed approaches appeals, what approach would your State propose and why?</u>*

The ACT realises that a key challenge in the context of cyclical cash flow management, from the perspective of GST grants, is the trade-off between contemporaneity and availability of reliable data. The ACT contends the Commission's current approach, which is based on data for a period starting four years before the financial year in which it is to be applied, places too heavy an emphasis on reliability as against contemporaneity.

On the other hand, if contemporaneity is given priority, apart from the challenge of data-reliability, another consideration is that GST grants will reflect the current economic scenario more closely and hence, can be more volatile. Key revenue drivers like mining revenues and stamp duty conveyance are known to be significantly volatile.

The ACT's proposal takes into account the contemporaneity and data reliability issues and tries to strike a middle path. This proposal is outlined in the paper titled *Contemporaneity – A Fresh Approach* (**<u>Attachment H</u>**).

The ACT stresses that this should be seen as a refinement of the current system and one not intended to reflect a radical new approach for calculating relativities in the HFE process. Some key perspectives from the ACT's proposal, when compared with the Commission's suggestions, are reiterated below.

<u>Projections and Forecasts</u>

The ACT does not favour the use of projections or forecasts beyond what we have suggested in our proposal for improving contemporaneity. Forward estimates in government budgets are subject to significant uncertainty and should preferably not be used. Moreover, using state budgets forecasts to determine equalisation would also provide an incentive for States to take account of the effect of their forecasts on their GST revenue and hence, may affect the forecasts made by States. To the extent that estimates or forecasts are required, it would be better for the Commission to draw on independent sources (e.g.: the Reserve Bank of Australia; the Australian Bureau of Agricultural and Resource Economics). Attempts to predict short-term cyclical or random variations are unlikely to be worthwhile, particularly in light of recent reviews of Commonwealth Treasury and RBA forecasting which confirm the difficulty of doing so.

The concept of corrections or adjustments for errors under a forecasting model is highly problematic. If the required adjustments were large, the corrections required for errors would defeat the contemporaneity objective. If they were not, they would probably not be necessary, i.e. the inclusion of completions or adjustments in any model is probably self-defeating.

In this respect, the forecasting and 'advance and completion' approaches are essentially the same and would recreate the current problem of lagging in another form. The main difference is that the "gaps" would be more random under these alternative approaches, whereas they reflect trends in relative capacity under the current system.

<u>Volatile Revenues</u>

Application of a different treatment to volatile revenues is likely to have the effect of increasing the overall volatility of revenues (including GST) for most States. The ACT agrees with the Commission's statement that an approach such as a one-year assessment for a particular revenue stream would "increase volatility in GST shares and consequently overall revenue for all States except those assessed to have a strong capacity in the relevant revenue stream" (CGC 2017-05-S, paragraph 58).

The ACT's analysis shows that certain state treasuries - QLD with regard to stamp duty conveyance revenues and WA with regard to mining revenues - perform reasonably accurately in terms of predicting such revenues. Hence, the ACT's suggestion is that the Commission can examine the models the QLD and WA treasuries use for predicting such highly volatile revenues and see how the lessons can be used in implementing the ACT's contemporaneity proposal.

Under any contemporaneous approach, should backcasting in its current limited form continue? If so, can/should backcasting be expanded to cover a wider range of Commonwealth payments or other volatile revenues?

The ACT supports continuing backcasting with regard to Commonwealth payments for specific purposes, as has been the norm. In fact, the ACT holds that backcasting should be considered to cover all Commonwealth payments, since it will improve contemporaneity, in line with the ACT's argument in the contemporaneity proposal. A fundamental assumption here is that the Commonwealth's estimates of the distribution of its payments for the coming year are pretty accurate – which the ACT deems to be a quite reasonable assumption.

The ACT also considers that backcasting should be applied to new population data (e.g. at the Census) where that data indicates that population estimates for prior assessment years which are still in play were incorrect.

On the other hand, the ACT does not support backcasting any State own revenue or expenditures, particularly the volatile revenue (or expenditure) categories. It would involve relying on State Budget forward estimates or other independent data to avoid gaming concerns. In any case, the ACT's contemporaneity proposal does not involve any estimating beyond the current year.

4.7 Commonwealth Payments

Are changes needed to the way other Commonwealth payments will be treated?

Yes.

The ACT has long argued that the principle of equalisation could and should be extended to the sector of Commonwealth Government transfers outside the current IGA-FFR framework of the State general government sector. Consideration should also be given to the Commonwealth reviewing its Commonwealth Own Purpose Expenses (COPE) structures (via the Department of Finance) to identify a quantum of funding that might be untied and allocated to the States.

A review of the current approach to such payments should be considered as part of the 2020 Review.

The ACT contends that the current equalisation treatment of infrastructure funding is one of the most significant areas of weakness in the system as, unlike the other assessment categories, it is characterised by fundamental inequities.

The fundamental causes of these inequities reflects a perceived politicisation of Commonwealth decisions on allocation of payments to States for infrastructure and the apparent quarantining from equalisation of a major proportion of those payments.

Current year and budgeted Commonwealth infrastructure spending over the next four years shows enormous variability of per capita funding across States, with the NT and QLD receiving amounts around 4 to 5 times the payments received by the ACT and VIC (**Attachment I**). In the context of relativities or category factors assessed by the Commission, this represents a range of 0.378 to 1.999. While the infrastructure category assessment in the Commission's 2016 Update had a reasonably similar range of 0.693 to 2.347, their assessment of relative needs by State differed hugely from the Commonwealth Budget allocations. It would be very difficult to argue that the Commonwealth Budget distribution of funding is in any way reflective of need.

The conclusion to be drawn from these inequities is that the equalisation process should be used to the fullest extent possible to correct them. This requires both a commitment by the Commonwealth Government to avoid quarantining infrastructure payments from equalisation in other than exceptional circumstances and a commitment by the Commission to review the indiscriminate application of a 50 per cent discount to Commonwealth funding for national network roads and rail. An analysis undertaken by ACT Treasury in October 2014 showed an average exclusion of 50 per cent of total Commonwealth infrastructure payments from equalisation over the period 2013-14 to 2017-18 (**Attachment J**).

The ACT understands that terms of reference are commonly used by the Commonwealth Treasurer to prevent equalisation of grants for specific projects which the Commonwealth Government considers are achieving some desirable objective which they do not wish to see unwound by the Commission process. A good example of this is the decision to quarantine the Asset Recycling Initiative from equalisation, which all governments agreed to from the outset.

The exclusion of 50 per cent of national network funding from equalisation is based on an estimate of assumed benefits to other States and the Commonwealth, but the 50 per cent is an arbitrary figure applied by the Commission to all such projects, with no attempt made to quantify the actual distribution of benefits across jurisdictions.

4.8 Assessment Guidelines

Are changes needed to the assessment guidelines?

A review of the assessment guidelines, along with the principle of practicality, shows that the Commission attaches great importance to data reliability e.g. it is sufficient for the Commission to adopt an EPC assessment if "it has not been possible to measure a material disability reliably" (CGC 2017-02-S, paragraph 209). Hence, the ACT contends that it would be desirable to incorporate a formal definition of data reliability in the Guidelines and that an attempt should be made to quantify this factor. Apart from this suggested addition, the ACT is comfortable with rest of the assessment guidelines.

5 REFERENCE LIST

Commonwealth Grants Commission, "The Principles of HFE and its Implementation", 2017-02-S Staff Discussion Paper

Commonwealth Grants Commission, "State Mining Policies", 2017-04-S Staff Research Paper

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6 ATTACHMENTS

A. Funding requirement to support an EPC distribution of GST with additional assistance to fiscally weaker States

B. Estimation of GST paid in States using household final consumption expenditure

C. Pool redistribution per person since 1993 Review (2016-17 dollars).

D. CGC Relativities and comparison with NT

E. QLD coal seam gas relativity impact

F. Effect on GST payments of a unilateral tax increase relative to change in tax amount, 2010-11

G. Calculations of impact of a tax elasticity adjustment for stamp duty.

H. Contemporaneity – A Fresh Approach.

I. Commonwealth Budgeted Infrastructure Funding 2016-17 to 2020-21.

J. Equalisation of Commonwealth Infrastructure Funding 2013-14 to 2019-20.

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6.1 Attachment A

Funding requirement to support an EPC distribution of GST with additional assistance to fiscally weaker States

State	Assessed Need ($pc)	Difference vs. WA ($pc)	Population 2015-16 (m)	Equ'n Grant Required ($m)	EPC Component ($m)	Total Grant ($m)
NSW	2,002	569	7.672	4,365	10,994	15,359
VIC	2,232	799	5.998	4,792	8,595	13,388
QLD	2,727	1,294	4.808	6,222	6,890	13,111
WA	1,433	0	2.603	0	3,730	3,730
SA	3,446	2,013	1.703	3,428	2,440	5,869
TAS	4,382	2,949	0.517	1,525	741	2,265
ACT	2,868	1,435	0.393	564	563	1,127
NT	10,251	8,818	0.244	2,152	350	2,501
Total			**23.938**	**23,048**	**34,303**	**57,351**

Sources: 2017 Update Report, Table S3-1-8, Assessed budgets summary, 2015-16 ($ per capita)
2017 Update Report, Table S1-1, Estimated resident populations and projections by State, at 31 December (persons)

Summary

- This table shows the amount of funds that would be required to equalise all States and bring them to the level of the fiscally strongest State; WA. The latter is the strongest State fiscally as, per the Commission's calculations, it has the lowest assessed need across all States ($1,433 per capita (pc)).

- At first, the difference in assessed need with respect to WA is calculated.

    - For each State, the product of the difference in per-capita assessed need with WA and the State's population gives the equalisation grant that the State needs, to bring it to WA's level.

- The sum of the equalisation grants required across all States leads to the overall equalisation grant requirement of $23 billion, as highlighted above.

- Finally, in order to ensure that all States' fiscal needs are met, the rest of the funds are assumed to be distributed EPC, which is calculated by taking the product of WA's assessed need ($1433 pc) with each State's population.

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6.2 Attachment B

Estimation of GST paid in States using household final consumption expenditure

State	Expenditure[1] ($m)	% of National Expenditure	% of National Population[2]
ACT	16,446	1.75%	1.64%
NSW	316,821	33.67%	32.05%
NT	10,466	1.11%	1.02%
QLD	182,808	19.43%	20.08%
SA	61,553	6.54%	7.12%
TAS	17,749	1.89%	2.16%
VIC	232,990	24.76%	25.03%
WA	102,158	10.86%	10.89%
Total	**940,991**	**100%**	**100%**

Notes

1. Household final consumption expenditure data sourced from ABS 5220.0, Australian National Accounts: State Accounts, 2015-16
2. Population numbers as on 31 Dec 2015, sourced from Commonwealth budget.

Summary

- This table shows the relationship between GST raised in a State and EPC distribution of GST, assuming that the former can be measured using State Household Final Consumption Expenditure (HFCE) as a proxy.

- National expenditure is the sum of all States' HFCE.

- Taking the example of the NT and Victoria, it is observed that the NT raises 1.11% of total GST (as measured using HFCE data) while Victoria raises 24.76% of all GST. At the same time, the NT's and Victoria's populations are 1.02% and 25.03% of Australia's respectively. Thus, if GST was to be distributed EPC, it would mean that the NT would get less GST than it raised, while Victoria would get more GST than it raised.

- This completely negates the argument of partial equalisation since a fiscally stronger State like Victoria would get more GST than it raised while a fiscally weaker State like the NT would get less GST than it raised, equivalent to GST being moved from the NT to Victoria.

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6.3 Attachment C

Pool redistribution per person since 1993 Review (2016-17 dollars)

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Redis	Redis /Pool
	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc	$pc	%
R1993	-507	-489	343	403	692	1 337	-150	11 007	298	11.9
U1994	-375	-510	168	318	646	1 580	-673	11 513	266	10.7
U1995	-355	-459	216	270	200	1 778	-687	12 168	246	9.9
U1996	-398	-443	187	103	593	1 788	-740	11 922	257	10.3
U1997	-392	-460	190	46	612	1 835	-759	12 304	260	10.4
U1998	-397	-467	148	23	747	1 832	-463	12 184	258	10.3
R1999	-288	-475	78	-203	594	2 039	3	12 319	236	9.4
U2000	-260	-404	88	-61	498	1 596	211	9 507	194	7.8
U2001	-232	-379	31	-75	483	1 544	431	9 019	180	7.2
U2002	-280	-395	53	-63	535	1 730	496	9 783	198	8.0
U2003	-330	-391	72	-89	598	1 898	521	10 348	216	8.7
R2004	-411	-407	176	97	577	1 786	536	9 998	238	9.5
U2005	-410	-377	142	82	567	1 756	570	9 995	230	9.2
U2006	-398	-316	78	16	516	1 731	567	10 126	209	8.4
U2007	-343	-298	24	-163	573	1 707	612	10 201	203	8.1
U2008	-281	-216	-95	-355	578	1 655	638	10 623	200	8.0
U2009	-168	-201	-208	-535	620	1 552	678	10 621	201	8.1
R2010	-116	-146	-213	-788	716	1 556	386	10 186	198	7.9
U2011	-103	-235	-175	-703	679	1 501	294	10 889	201	8.1
U2012	-111	-191	-32	-1 117	718	1 459	500	11 334	210	8.4
U2013	-78	-232	149	-1 379	663	1 547	561	10 809	233	9.4
U2014	-55	-286	205	-1 554	728	1 597	598	11 673	259	10.4
R2015	-123	-260	328	-1 744	907	2 060	259	11 455	299	12.0
U2016	-231	-218	436	-1 736	1 052	1 953	399	10 734	320	12.8

Note: These redistributions were derived by applying each inquiry's relativities to the 2016-17 pool and the relevant State populations scaled to the 2016-17 total.

Source: Commission calculation.

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6.4 Attachment D

CGC Relativities comparison with NT

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Max non-NT relativity	Difference between Max and NT
R1993	0.79844	0.80587	1.14009	1.16392	1.27997	1.53897	0.94204	5.42252	1.53897	3.88355
U1994	0.85117	0.79708	1.06904	1.12942	1.26083	1.63558	0.73149	5.62222	1.63558	3.98664
U1995	0.8595	0.81791	1.08894	1.11058	1.08241	1.71648	0.72621	5.8891	1.71648	4.17262
U1996	0.84258	0.82469	1.07765	1.04376	1.24074	1.72075	0.70526	5.79195	1.72075	4.0712
U1997	0.84514	0.81757	1.07875	1.02096	1.24845	1.73984	0.69749	5.94504	1.73984	4.2052
U1998	0.84159	0.81353	1.06022	1.0101	1.30036	1.73541	0.81509	5.88675	1.73541	4.15134
R1999	0.88394	0.80925	1.03071	0.91827	1.23721	1.81617	1.00072	5.93271	1.81617	4.11654
U2000	0.89543	0.83771	1.03509	0.97505	1.19927	1.63899	1.08404	4.80772	1.63899	3.16873
U2001	0.90659	0.84782	1.01194	0.96943	1.1927	1.61763	1.1718	4.61118	1.61763	2.99355
U2002	0.88659	0.84044	1.01989	0.97336	1.21241	1.69064	1.19686	4.91305	1.69064	3.22241
U2003	0.86632	0.84207	1.02717	0.96269	1.23759	1.75772	1.2069	5.1383	1.75772	3.38058
R2004	0.83474	0.83645	1.06971	1.03819	1.2305	1.71446	1.21415	5.00336	1.71446	3.2889
U2005	0.83571	0.849	1.057	1.03303	1.22712	1.7037	1.22837	5.00537	1.7037	3.30167
U2006	0.84193	0.87451	1.03271	1.00778	1.20839	1.69599	1.22918	5.06502	1.69599	3.36903
U2007	0.8638	0.88206	1.01143	0.93616	1.23141	1.68662	1.24724	5.09597	1.68662	3.40935
U2008	0.88743	0.91347	0.96196	0.85797	1.23192	1.66348	1.25603	5.25758	1.66348	3.5941
U2009	0.93186	0.91875	0.91556	0.78485	1.24724	1.6204	1.27051	5.25073	1.6204	3.63033
R2010	0.95205	0.93995	0.91322	0.68298	1.28497	1.62091	1.15295	5.07383	1.62091	3.45292
U2011	0.95776	0.90476	0.92861	0.71729	1.2707	1.59942	1.11647	5.35708	1.59942	3.75766
U2012	0.95312	0.92106	0.98477	0.55105	1.28472	1.58088	1.19757	5.52818	1.58088	3.9473
U2013	0.96576	0.90398	1.05624	0.44581	1.26167	1.61454	1.22083	5.31414	1.61454	3.6996
U2014	0.975	0.88282	1.07876	0.37627	1.28803	1.63485	1.236	5.66061	1.63485	4.02576
R2015	0.94737	0.89254	1.12753	0.29999	1.35883	1.81906	1.10012	5.57053	1.81906	3.75147
U2016	0.90464	0.90967	1.17109	0.30331	1.41695	1.77693	1.15647	5.28452	1.77693	3.50759
U2017	0.87672	0.93239	1.18769	0.34434	1.43997	1.80477	1.19496	4.66024	1.80477	2.85547

Difference - NT relativity in 1993 and in 2017		**0.76228**
Difference - NT to second place in 1993 and in 2017	Value	**1.02808**
	Percent	**26.47%**

Summary

- This table presents each State's relativity between 1993 and 2017.
- The 'Max non-NT relativity' column specifies what the second highest relativity of all the States (behind the NT) was in each given year.
- The 'Difference between Max and NT' column calculates the difference between the NT's relativity and the second highest relativity in each year.
- Right of the table shows the change in the NT's relativity from 1993 to 2017 and the change in the difference between the NT's relativity and the second highest relativity from 1993 to 2017 in both absolute and percentage terms.

6.5 Attachment E

Impact of coal seam gas (CSG) revenue equalisation on QLD's relativity

Percentage of coal seam gas revenues with QLD	90%
Projected petroleum royalty related revenues (including CSG) for QLD in 2020-21[c] ($m)	296
Total revenue in Australia from CSG ($m) (using assumptions 1 and 2)	328.89
Australia population as on 31 Dec, 2017[a] (million)	24.662
QLD population as on 31 Dec, 2017[a] (million)	4.941
QLD population as a per cent of Australia's	20%
National average revenue from CSG royalties ($pc)	13.336
QLD's per capita assessed revenue from CSG ($pc)	59.907
Difference between national average and QLD's assessed revenue ($pc)	-46.571
Total GST revenue redistributed away from QLD ($m)	**-230.108**
QLD's relativity for 2017-18[b]	1.18769
Total GST Pool for 2017-18[a]	62340.0
QLD's GST entitlement ($m)[a] as per 2017-18 relativity	14870.7
QLD's new GST entitlement if CSG revenue was equalised ($m)	14640.58
QLD's EPC share of GST ($m)	12489.74
New relativity, if CSG revenues were equalised	**1.17221**
Difference between new and old relativity	**1.32%**

Notes

a. Population, GST pool and GST entitlement data sourced from Commonwealth budget 2017-18
b. QLD's relativity sourced from the CGC's 2017 Update report
c. Petroleum royalty revenues sourced from QLD's 2017-18 state budget

Assumptions
1. Revenues from petroleum royalty are negligible in comparison to revenues from coal seam gas in the total revenue of $296 m.
2. 90% of Australia's revenues from coal seam gas are from QLD.

Summary

- This table calculates the impact on QLD's GST share and relativity, if its revenues from Coal Seam Gas, projected to be $296m in 2020-21, were to be equalised.
- Using the actual per capita assessment process followed by the Commission and the assumptions 1 and 2 above, it is calculated that approximately $230m of GST would be distributed away from QLD.
- As an example, a loss of $230m in GST entitlements would imply a very minor reduction in QLD's relativity for 2017-18, from 1.18769 to 1.17221 – a reduction of just 1.3%.

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6.6 Attachment F

Effect on GST payments of a unilateral tax increase relative to change in tax amount, 2010-11

%	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.

Summary

- This table shows the direct effects of a unilateral increase in tax rates 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 example, for each additional dollar of mining revenue that they generate, NSW will gain an additional $0.1858 in GST and WA will lose $0.4184 in GST.

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6.7 Attachment G

Calculations of impact of tax elasticity adjustment for stamp duty.

	National Actual	ACT Actual	ACT Elasticity Adjustment	National Elasticity Adjustment
Population	22,482,217	370,729	370,729	22,482,217
Revenue ($m)	10,517	239	221	10,499
Revenue ($pc)	468	644	595	467
Tax Rate	3.50%	4.17%	4.17%	3.50%
Tax Base ($m)	300,486	5,728	5,290	300,048
Elasticity factor	-0.4			
Assessed Revenue		200	185	
Assessed Difference ($m)			-15	
Assessed Difference ($pc)			-41.46	
Diff from avge rate			**1.19**	

Source: CGC data for 2011-12 (from 2013 Update)

Summary

- This table illustrates the difference between the ACT and National actual Commission assessed revenues and tax bases and the elasticity adjusted ACT and National assessed revenues and tax bases for stamp duty, in the 2011-12 financial year.

- The table calculates the ACT and National tax bases from actual revenues and tax rates and adjusts the ACT tax base with the elasticity adjustment mechanism explained below.

- The impact on the ACT's tax base then follows through to the National tax base and creates a new assessed revenue for the ACT.

- This new assessed revenue is then compared with the ACT's actual assessed revenue for 2011-12 to determine the per capita impact of the elasticity adjustment.

Discussion of the Approach

The CGC's current elasticity calculation, for a particular tax base, can be summarised as follows:

$R_E = R_{Adj} - R_{Act}$

Where:

R_E = Elasticity effect on assessed revenue base

R_{Act} = Actual assessed revenue base (i.e. actual assessed revenue for that base obtained by multiplying this amount with the average tax rate)

R_{Adj} = Elasticity adjusted assessed revenue base

And:

$R_{Adj} = R_{Act}(1+(E((T_N–T_S)/100))$

Where:

E = Elasticity factor
T_N = National average tax rate
T_S = State tax rate

Therefore, R_E is driven by the expression $(E((T_N–T_S)/100)$.

Keeping in mind that the output of the expression has to be a pure number (i.e. without any units associated with it), it implies that E must have a difference in tax rates as its denominator. Since $T_N–T_S$ is going to be a fairly small number (in few-hundredths), even if the numerator of E is unity (i.e. 1), then the resultant value of E would be in tens or hundreds (or even more). Hence, an E value of 1 is extremely low and unrealistic. Also, keeping in mind that E has to be unit-less and it has a difference of tax-rates as its denominator, it is not clear what the numerator should be, for E to be unit-less.

Alternatively, the ACT proposes using a proportional approach, summarised as follows:

$R_E = R_{Adj} - R_{Act}$

And:

$R_{Adj} = R_{Act}(1+(E((T_N/T_S)-1)))$

Using this approach, E will have the difference in proportion of tax rates as the denominator. With a similar proportionate change as the numerator, it is indeed possible for it to have values around +/-1 or less than that (in absolute value).

Purely from the perspective of construct of E, this also makes intuitive sense. For the purposes of the calculation in the table above, an E value of -0.4 was used as it is consistent with academic literature on the tax elasticity of stamp duty (Leigh, 2013, p. 402).

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6.8 Attachment H

Contemporaneity – A Fresh Approach

- At present, there are time lags in the manner in which HFE works.

- Reason: The Commonwealth Grants Commission (CGC), in line with its principle of 'Practicality', wants to use reliable data in its models associated with determination of relativity for each State (the term includes the territories of ACT and NT).

- Implication: For the 2017 update, which is applicable for distributing GST in the financial year 2017-18, the CGC calculated relativities for each of the years 2013-14, 2014-15 and 2015-16 and took an average of these relativities to arrive at the final figure for each State.

    - Note that 2015-16 is two years back from the application year, which can be a long time in today's fast-changing economic scenario.

- Proposals:

    - Replace the farthest year with estimates of the current year (which is the year closest to application-year) so that a temporally closer period can be taken into account to distribute GST.

        - E.g., for the 2017 Update, instead of using data for 2013-14, the proposal is to use estimates for 2016-17. The source for such data could be as the CGC deems fit – independent sources the Commission already reaches out to with regard to States' data, expertise internally available within the CGC, etc.

    - While averaging relativities, use weights to decide the average relativity for each State. A suggested weighting of relativities for the 2018 Update (for which data for 2015-16, 2016-17 and 2017-18 would be used under the current proposal) and beyond is: 20% for 2015-16 (this is the farthest year, hence the least weight, though data-reliability is high), 40% for 2016-17 (two years away from the application-year, though data-reliability is high) and 40% for 2017-18 (closest to the application-year, though data-reliability is relatively lower).

- Rationale:

    - HFE aims to provide States with the same capacity of providing services to its people, after taking into account relevant *material* differences.

    - 'Practicality' principle guides the CGC into considering only those years for which 'sound and reliable data' is available[3].

    - However, considering today's fast-changing economic scenario, the manner in which the current system works, it appears that in a trade-off between accuracy and contemporaneity, the former is winning hands-down.

        - Just because highly reliable data for the current year is not available, ignoring the economic realities of the current year is proving to be disadvantageous to States. In fact, in a Staff discussion paper associated with the 2010 Review, the CGC itself declared that one of the principles of equalisation should be 'proximate (consistent with the quality of the available data and analysis and the materiality guidelines) rather than precise'[4].

        - Example: In spite of knowing that WA's revenues are going to take a hit in the application-year because of a fall in iron-ore prices, which in turn would impact its ability to provide average services to the people in WA in the application-year, taking data from 4 years back (which happened to be a relative boom-time) and using that data to calculate GST shares does not uphold the principle of HFE.

        - Note that by the time the relativities are calculated in January, more than 50% of the current financial year has already passed. So, any estimates would be based on reasonable data-points and would not be a complete shot in the dark.

    - One can argue that even a forecast for the application-year itself can be considered for calculation purposes. However, such a forecast could be prone to heavy changes and data-reliability could be a big issue there. Hence, the current proposal seems to be a nice middle-path in terms staying true to the HFE principles and using reliable data to calculate the relativities.

[3] Quoted from 2017-02-S Staff Discussion Paper, 'The Principle of HFE and its implementation', section 'Supporting principles and the HFE Principle – the 2015 Review Approach', page 9, paragraph 33.
[4] Quoted from information paper CGC 2007_12, Principles Interpretation and Scope of HFE, page 11, paragraph 70

Proposed Method of Calculation (using 2017 Update as an example)

1. Use data for 2014-15 and 2015-16 to calculate relativities for those two years (business as usual)
2. For 2016-17, use data-estimates from sources that the CGC deems fit in order to calculate relativity.
3. Final relativity for a State = 20% of $\text{relativity}_{2014\text{-}15}$ + 40% of $\text{relativity}_{2015\text{-}16}$ + 40% of $\text{relativity}_{2016\text{-}17}$.

Reality Check

1. For all States, obtained the following data from their budget review documents between 2011-12 and 2015-16 (this is a **proxy** for the current year estimate that would go into the CGC's calculations; the CGC should source this data from independent sources or develop the expertise themselves).
   a. Mining revenues
   b. Payroll tax revenues
   c. Land tax revenues
   d. Stamp duty conveyance revenues
   e. Commonwealth payments
   f. Private sector WPI (if available)

2. For all States, obtained data for the above heads from their Final Budget Outcomes (FBOs)/annual financial statements published by State Treasuries.

3. Checked for the degree of variation each year between the budget review estimate and the FBO.

4. Recommendations.

Results of Reality Check

The calculations associated with reality check are available in Appendix 1. Two thresholds were considered for the purpose of the analysis, a 5% threshold and a 10% threshold. 'Threshold' in this context refers to the percentage difference between forecasted revenue/expense and the final outcome, using the former as the base.

- 63% of the forecasts could predict the final outcomes within a ±5% threshold while about 81% of the forecasts could predict the final outcomes within a ±10% threshold.
- Number of values underestimated were almost equal to the number of values over-estimated (97 vs. 93, or a split of 51%-49%).

- Key areas of failure in estimation were mining revenues and stamp duty conveyance revenues, irrespective of threshold.

Conclusions

1. The reality check shows that quality of mid-year review estimate needs to be better! Nevertheless, the CGC would anyway have to reach out to independent sources' to get States' data-estimates or develop the expertise themselves. Considering the volatility of mining and stamp duty conveyance revenues, the CGC would need to find a suitable mechanism to predict such revenues with more accuracy (variations due to natural disasters understandable).

2. Queensland Treasury appears adept at forecasting stamp duty conveyance revenues since their estimates crossed the 5% threshold only once out of 5 years. The CGC can take some cues from Queensland on how they predict their stamp-duty conveyance revenues so accurately and prepare accordingly.

3. Western Australia Treasury is strong at predicting mining revenues; with the maximum difference between their estimate and actual being only 9%. The CGC can take some cues from WA Treasury on this topic and prepare accordingly.

4. Considering that actual relativity calculations associated with the 2020 Methodology Review are still quite some time away, inputs from QLD and WA can be taken into account in the interim to improve estimates of mining revenue and stamp duty conveyance revenue. Once done, this proposal can be put into action.

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Appendix 1- Results of Reality Check

		2011-12 ($ amounts in $mn)				2012-13 ($ amounts in $mn)				2013-14 ($ amounts in $mn)				2014-15 ($ amounts in $mn)				2015-16 ($ amounts in $mn)			
State/Territory	Revenue/Expense Head	Budget Rvw	FBO	Variation	Variation %	Budget Rvw	FBO	Variation	Variation %	Budget Rvw	FBO	Variation	Variation %	Budget Rvw	FBO	Variation	Variation %	Budget Rvw	FBO	Variation	Variation %
ACT	Mining revenues	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
	Payroll tax revenues	311.348	316	4.652	1%	329.7	320.0	-9.68	-3%	334.8	330.0	-4.847	-1%	358.9	358.0	-0.908	0%	422.3	422.0	-0.25	0%
	Land tax revenues	114.996	115	0.004	0%	66.5	71.0	4.512	7%	75.8	79.0	3.222	4%	89.1	98.0	8.935	10%	94.1	101.0	6.931	7%
	Stamp duty conveyance revenues	274.81	320	45.19	16%	266.4	310.0	43.561	16%	232.2	291.0	58.822	25%	226.4	273.0	46.572	21%	276.2	331.0	54.82	20%
	Commonwealth payments	1535.207	1605	69.793	5%	1603.3	1713.0	109.721	7%	1781.6	1840.0	58.393	3%	1920.4	1992.0	71.594	4%	1886.0	1886.0	-0.002	0%
	Private sector WPI (if available)	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
NSW	Mining revenues	1768	1464	-304	-17%	1378.0	1318.0	-60	-4%	1440.0	1338.0	-102	-7%	1350.0	1254.0	-96	-7%	1302.0	1189.0	-113	-9%
	Payroll tax revenues	6623	6721	98	1%	7059.0	6946.0	-113	-2%	7164.0	7083.0	-81	-1%	7454.0	7461.0	7	0%	7854.0	7924.0	70	1%
	Land tax revenues	2482	2350	-132	-5%	2438.0	2333.0	-105	-4%	2525.0	2335.0	-190	-8%	2497.0	2467.0	-30	-1%	2764.0	2747.0	-17	-1%
	Stamp duty conveyance revenues	5221	5338	117	2%	6189.0	5269.0	-920	-15%	6884.0	6765.0	-119	-2%	7290.0	8093.0	803	11%	8704.0	9581.0	877	10%
	Commonwealth payments	26887	26043	-844	-3%	24578.0	24466.0	-112	0%	25885.0	27306.0	1421	5%	27483.0	28067.0	584	2%	28769.0	29172.0	403	1%
	Private sector WPI (if available)	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
NT	Mining revenues	162.3	145.764	-16.536	-10%	117.7	112.0	-5.671	-5%	113.3	154.4	41.058	36%	164.1	162.3	-1.812	-1%	167.7	196.3	28.619	17%
	Payroll tax revenues	164	171.447	7.447	5%	191.0	205.5	14.46	8%	215.0	250.2	35.162	16%	259.0	268.7	9.706	4%	283.0	289.6	6.59	2%
	Land tax revenues	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
	Stamp duty conveyance revenues	78	93.192	15.192	19%	131.0	128.4	-2.589	-2%	130.0	144.6	14.583	11%	150.0	265.1	115.143	77%	138.0	136.0	-1.984	-1%
	Commonwealth payments	3790.959	3985.489	194.53	5%	3846.3	3779.2	-67.184	-2%	3850.3	3891.3	40.97	1%	4275.0	4394.1	119.025	3%	4594.4	4682.6	88.247	2%
	Private sector WPI (if available)	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
QLD	Mining revenues	3257	2795	-462	-14%	2426.0	2139.0	-287	-12%	2686.0	2378.0	-308	-11%	2506.0	2058.0	-448	-18%	2350.0	2122.0	-228	-10%
	Payroll tax revenues	3492	3462	-30	-1%	3715.0	3751.0	36	1%	3976.0	3914.0	-62	-2%	3955.0	3782.0	-173	-4%	3795.0	3712.0	-83	-2%
	Land tax revenues	1047	1013	-34	-3%	1012.0	990.0	-22	-2%	980.0	986.0	6	1%	995.0	977.0	-18	-2%	996.0	1010.0	14	1%
	Stamp duty conveyance revenues	1960	2023	63	3%	1968.0	1887.0	-81	-4%	2320.0	2403.0	83	4%	2883.0	3082.0	199	7%	3117.0	3005.0	-112	-4%
	Commonwealth payments	21898	22749	851	4%	18506.0	18295.0	-211	-1%	20330.0	21755.0	1425	7%	23037.0	23594.0	557	2%	24869.0	23740.0	-1129	-5%
	Private sector WPI (if available)	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
SA	Mining revenues	195.75	203.69	7.94	4%	204.6	171.9	-32.7	-16%	281.8	312.3	30.5	11%	293.1	238.5	-54.6	-19%	248.7	201.4	-47.3	-19%
	Payroll tax revenues	1039	1010	-29	-3%	1105	1077	-28	-3%	1139	1079	-60	-5%	1147	1096	-51	-4%	1139	1111	-28	-2%
	Land tax revenues	601	588	-13	-2%	576	562	-14	-2%	572	565	-7	-1%	564	559	-5	-1%	581	570	-11	-2%
	Stamp duty conveyance revenues	817	764	-53	-6%	807	894	87	11%	936	874	-62	-7%	1002	1026	24	2%	1023	1007	-16	-2%
	Commonwealth payments	7622	7636	14	0%	6865	6655	-210	-3%	6806	6731	-75	-1%	7190	7210	20	0%	8095	7995	-100	-1%
	Private sector WPI (if available)	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
TAS	Mining revenues	50	54	4	8%	41	29	-12	-29%	34.6	36	1.4	4%	29	27	-2	-7%	28	15	-13	-46%
	Payroll tax revenues	302.4	304	1.6	1%	305.7	275	-30.7	-10%	298.6	300	1.4	0%	310.1	312	1.9	1%	321.5	325	3.5	1%
	Land tax revenues	90	88	-2	-2%	89.8	89	-0.8	-1%	86.6	86	-0.6	-1%	90.7	83	-7.7	-8%	90.4	97	6.6	7%
	Stamp duty conveyance revenues	137.5	136	-1.5	-1%	131.5	139	7.5	6%	153.6	154	0.4	0%	174.1	193	18.9	11%	194.4	216	21.6	11%
	Commonwealth payments	2895.3	3016	120.7	4%	2861.7	2937	75.3	3%	2881.5	2976	94.5	3%	3071.7	3133	61.3	2%	3477.4	3510	32.6	1%
	Private sector WPI (if available)	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
WA	Mining revenues	4579	4343	-236	-5%	4366	4425	59	1%	6089	6025	-64	-1%	4368	4603	235	5%	3788	4126	338	9%
	Payroll tax revenues	3032	3096	64	2%	3584	3476	-108	-3%	3730	3566	-164	-4%	3737	3602	-135	-4%	3697	3502	-195	-5%
	Land tax revenues	549	552	3	1%	569	568	-1	0%	662	661	-1	0%	750	744	-6	-1%	949	948	-1	0%
	Stamp duty conveyance revenues	1291	1362	71	5%	1624	1870	246	15%	2047	1969	-78	-4%	1882	1699	-183	-10%	1546	1756	210	14%
	Commonwealth payments	8599	8633	34	0%	7693	7781	88	1%	7583	7498	-85	-1%	7533	7810	277	4%	6748	7038	290	4%
	Private sector WPI (if available)	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
VIC	Mining revenues	45.7	65.6	19.9	44%	46.3	45.1	-1.2	-3%	47.5	52.4	4.9	10%	51.4	44.3	-7.1	-14%	51.2	49	-2.2	-4%
	Payroll tax revenues	4659.8	4695.8	36	1%	4868.5	4750.9	-117.6	-2%	4910	4949.1	39.1	1%	5148.4	5135	-13.4	0%	5394.2	5365	-29.2	-1%
	Land tax revenues	1360.1	1401.4	41.3	3%	1587.3	1589.2	1.9	0%	1566.4	1658.7	92.3	6%	1750.9	1753	2.1	0%	1740.6	1771	30.4	2%
	Stamp duty conveyance revenues	3650.6	3307	-343.6	-9%	3162	3276.1	114.1	4%	3908.6	4167.5	258.9	7%	4472	4938	466	10%	5418	5839	421	8%
	Commonwealth payments	19728.3	19818.4	90.1	0%	19113.4	19155.9	42.5	0%	20539	22440.6	1901.6	9%	21448.3	21010.3	-438	-2%	22343.6	22309	-34.6	0%
	Private sector WPI (if available)	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA

6.9 Attachment I

Commonwealth Budgeted Infrastructure Funding 2016-17 to 2020-21

$million	**NSW**	**VIC**	**QLD**	**WA**	**SA**	**TAS**	**ACT**	**NT**	**Total**		
Total Payments (exc FAGs)										**Non-allocated Component**	
2016-17	3,616.401	599.463	1,840.163	615.973	619.245	145.486	28.661	96.378	7,561.771		
2017-18	3,058.684	792.897	2,049.140	696.838	921.169	173.650	45.110	223.873	7,961.361		
2018-19	2,240.607	568.542	1,874.978	784.526	473.867	115.175	21.528	140.860	6,220.083		
2019-20	1,264.576	606.252	1,866.708	670.505	349.381	53.477	10.839	80.984	5,102.722	200.000	National Rail Program
2020-21	859.972	280.687	1,652.625	812.834	95.159	61.645	18.443	20.766	4,202.131	400.000	National Rail Program
Local Govt Payments (C'W Own Purpose Expense)											
2016-17	237.413	166.776	177.800	117.836	72.427	26.226	14.465	23.452	836.395		
2017-18	197.566	143.938	144.900	102.400	62.960	22.800	9.666	20.400	704.630		
2018-19	87.324	75.969	88.384	63.339	32.559	11.221	1.461	9.259	369.516		
2019-20	111.489	81.382	81.360	58.487	35.939	13.020	6.375	11.627	399.679		
2020-21	111.489	81.382	81.36	58.487	35.939	13.02	6.375	11.627	399.679		
State Govt Payments											
2016-17	3,378.988	432.687	1,662.363	498.137	546.818	119.260	14.196	72.926	6,725.376		
2017-18	2,861.118	648.959	1,904.240	594.438	858.209	150.850	35.444	203.473	7,256.731		
2018-19	2,153.283	492.573	1,786.594	721.187	441.308	103.954	20.067	131.601	5,850.567		
2019-20	1,153.087	524.870	1,785.348	612.018	313.442	40.457	4.464	69.357	4,703.043		
2020-21											
State Govt Payments per capita											
2016-17	434.14	70.60	341.10	189.44	319.27	229.35	35.56	297.71	276.86		
2017-18	362.04	103.83	385.33	222.83	496.79	288.93	87.63	826.17	294.24		
2018-19	268.24	77.25	356.47	266.42	253.19	198.27	48.96	531.27	233.58		
2019-20	141.34	80.65	351.17	222.74	178.17	76.83	10.75	278.26	184.81		
2020-21											
Average per capita	**301.44**	**83.08**	**358.52**	**225.36**	**311.85**	**198.35**	**45.72**	**483.35**	**247.37**		
FAGs - Local Roads Comp											
2016-17	309.619	220.010	199.948	163.171	58.648	56.552	34.220	24.999	1,067.167		
2017-18	105.532	74.990	68.151	55.617	19.990	19.275	11.663	8.520	363.738		
2018-19	219.001	155.620	141.428	115.415	41.483	40.001	24.204	17.682	754.834		
2019-20	229.732	163.245	148.358	121.071	43.516	41.961	25.390	18.548	791.821		
2020-21	231.133	164.242	149.263	121.809	43.781	42.217	25.545	18.661	796.651		

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total	
FAGs - Local Roads Component per capita										**Non-allocated Component**
2016-17	39.78	35.90	41.03	62.05	34.24	108.76	85.71	102.05	43.93	
2017-18	13.35	12.00	13.79	20.85	11.57	36.92	28.83	34.59	14.75	
2018-19	27.28	24.41	28.22	42.64	23.80	76.29	59.06	71.38	30.14	
2019-20	28.16	25.08	29.18	44.06	24.74	79.68	61.12	74.41	31.11	
2020-21	27.87	24.72	28.94	43.67	24.65	79.81	60.67	74.38	30.80	
Average per capita	**27.29**	**24.42**	**28.23**	**42.65**	**23.80**	**76.29**	**59.08**	**71.37**	**30.15**	
State Govt + FAGs Roads per capita										
Average per capita	**328.73**	**107.50**	**386.75**	**268.01**	**335.65**	**274.64**	**104.80**	**554.72**	**277.52**	
"Relativity"	1.185	0.387	1.394	0.966	1.209	0.990	0.378	1.999	1.000	
CGC Infrastructure Category factor	0.932	0.957	1.007	1.326	0.890	0.693	0.786	2.347	1.000	

State Populations	**NSW**	**VIC**	**QLD**	**WA**	**SA**	**TAS**	**ACT**	**NT**	**Total**
2016-17	7,783,143	6,128,689	4,873,561	2,629,495	1,712,732	519,981	399,268	244,959	24,291,828
2017-18	7,902,664	6,250,329	4,941,791	2,667,621	1,727,517	522,100	404,485	246,285	24,662,792
2018-19	8,027,329	6,376,500	5,011,848	2,706,954	1,742,982	524,300	409,855	247,708	25,047,476
2019-20	8,158,090	6,507,990	5,084,020	2,747,678	1,759,255	526,595	415,403	249,251	25,448,282
2020-21	8,294,112	6,644,058	5,157,784	2,789,486	1,776,157	528,941	421,082	250,881	25,862,501

Summary

- This table shows the amount of Commonwealth funding allocated to each State in the 2017-18 Commonwealth Budget for infrastructure projects in both absolute terms and per capita terms, comprising of Total Commonwealth infrastructure payments less Commonwealth Own Purpose Expenses on infrastructure and the roads expenditure component of the financial assistance grants to local government.

- The average per capita relativity shows the ratio of Commonwealth infrastructure that has been allocated to each State relative to an Equal Per Capita distribution of Commonwealth infrastructure funding. Clearly, relativities for the ACT and Victoria are way below their counterparts.

6.10 Attachment J

Equalisation of Commonwealth Infrastructure Funding 2013-14 to 2019-20

National Partnership Payments ($million)	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	Equalisation - Current
Infrastructure Investment Programme								
Black Spot projects	64.5	60.0	60.0	60.0	60.0			State roads 100% EQ (a)
Bridges renewal programme		60.0	60.0	60.0	60.0			State roads 100% EQ (a)
Heavy vehicle safety and productivity	40.0	48.0	40.0	40.0	40.0			100% EQ
Improving the national network	0.8							
Investment								
Rail	332.7	353.7	124.2	23.5	24.6			100% EQ
Road	4,279.6	3,005.9	3,973.4	5,311.6	2,780.0			50% EQ - NNR (b)
Off-network projects								
Rail	89.6	115.9	219.0	160.1	3.0			100% EQ
Road	404.8	556.4	354.3	395.4	222.6			100% EQ
Supplementary	7.5							
Roads to Recovery	373.2	349.8	349.8	349.8	349.8			State roads 100% EQ (a)
Infrastructure Growth Package								
Asset Recycling Fund								
Asset Recycling Initiative		335.0	1,278.0	1,285.0	1,007.0			0% EQ - ToR
New investments		201.7	1,010.1	969.2	519.3			50% EQ - ToR
Western Sydney Infrastructure Plan		103.0	210.2	351.6	530.9			50% EQ - ToR
Other Projects								
Building Australia Fund								
Rail	1,128.0	331.0	232.1					100% EQ
Road	72.0	48.1						50% EQ - NNR (b)
Community Infrastructure Grants - Glenbrook precinct upgrade	0.8							100% EQ
Interstate road transport	77.0	77.0	77.0	77.0	77.0			100% EQ
Latrobe Valley economic diversification	2.4	5.4	3.1					State roads 100% EQ (a)
Liveable communities	9.5							State roads 100% EQ (a)
Local Government and Regional Development - infrastructure employment projects	1.6							0% EQ - Local
Managed motorways	20.8	9.4						100% EQ
Murray-Darling Basin regional economic diversification programme	10.0	32.5	30.5	24.7				100% EQ
Townsville Convention and Entertainment Centre	5.0							0% EQ - Local
Total	**6,919.8**	**5,692.8**	**8,021.7**	**9,107.9**	**5,674.2**			

	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
<u>Category Totals - All Other States</u>							
100% EQ Total (CGC Approach)	**2,559.0**	**1,990.1**	**1,534.2**	**1,180.3**	**828.4**		
100% EQ Total (ACT Proposal)	**6,775.3**	**4,946.5**	**5,494.5**	**6,489.7**	**3,607.3**		
50% EQ Total (CGC Approach)	**4,288.3**	**3,308.4**	**5,172.6**	**6,627.0**	**3,828.5**		
50% EQ Total (ACT Proposal)	**0.0**	**303.9**	**1,212.3**	**1,317.6**	**1,049.7**		
0% EQ Total	**6.6**	**325.0**	**1,278.0**	**1,285.0**	**1,007.0**		
<u>Redistributed to ACT ($m)</u>							
CGC Approach							
2013-14 payments			25.9	25.9	25.9		
2014-15 payments				20.0	20.0	20.0	
2015-16 payments					22.7	22.7	22.7
2016-17 payments						24.7	24.7
2017-18 payments							15.1
Total - CGC Approach	**0.0**	**0.0**	**25.9**	**45.9**	**68.6**	**67.4**	**62.5**
ACT Proposal							
2013-14 payments			37.3	37.3	37.3		
2014-15 payments				28.0	28.0	28.0	
2015-16 payments					33.6	33.6	33.6
2016-17 payments						39.3	39.3
2017-18 payments							22.7
Total - ACT Proposal	**0.0**	**0.0**	**37.3**	**65.3**	**98.9**	**100.9**	**95.6**

Notes:

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

(b) ACT proposal is 100% EQ for NNR.

Summary

- This table calculates the amount of budgeted Commonwealth infrastructure funding over the 2013-14 to 2017-18 period as per the 2013-14 Commonwealth Budget that was redistributed (i.e. the CGC Approach) and could have been redistributed (i.e. the ACT proposal) towards the ACT, through the equalisation process.
- It specifies the different infrastructure projects that are budgeted and whether they are equalised fully, equalised by 50% or not equalised.
- The sheet then summarises the total Commonwealth infrastructure expenditure, less expenditure on ACT projects, by their level of equalisation.
- The difference between the CGC approach and the ACT proposal categories is the treatment of road investment; the CGC approach is to equalise road investment by 50% while the ACT proposal is to equalise fully.
- The amount of equalisation redistribution of this expenditure to the ACT is then estimated on the basis of whether the CGC approach or the ACT proposal is utilised.