Victorian Response to Significant Changes Since the Draft Report - Commission Position Paper

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Treasury and Finance

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1. Introduction

The Commonwealth Grants Commission (the Commission) has circulated the ‘Significant Changes Since the Draft Report’ position paper (Position Paper) outlining expected changes to methodology since the draft report was released.

Victoria thanks the Commission for the opportunity to provide comments on its proposed approach to the issues identified.

The issues identified in the Position Paper are the:

- disaster recovery expenses;
- mining revenue;
- welfare assessment;
- electricity and water subsidies assessment;
- negative assessed investment and capital cost disabilities in the investment assessment;
- various adjustments applying to the stamp duty on conveyances assessment; and
- various changes applying to the land tax assessment

The Victorian responses to these issues are presented in the following sections.

Victoria also provides comments on the wages regression provided to states in the same notification email advising of the release of the Position Paper.

1.1 The Commission’s decision on “non-substantive changes”

Victoria notes that the Position Paper has described a number of proposed amendments as “minor method changes” and, in most of these cases, not provided a table showing the effect on the GST distribution of the decision to amend the assessment methodology.

To satisfy states that the method change would result in only minor redistribution, it would be useful if the Commission provided an explanation of the term “non-substantive” and whether this correlates to materiality of the changes. If there is no material impact, then it would seem that the changes would not meet the simplicity component of the practicality supporting principle. Victoria considers that adding complexity to the assessment methodology that has no material impact is unnecessary.

2. Disaster recovery expenses

Victoria notes the Commission said in the draft report that it intended to assess states’ net expenses for natural disaster relief on an actual per capita basis excluding local government expenses. This was partly due to local government activities being excluded from the Commission’s assessment of state activities. However, following state submissions on the draft report, the Commission has decided that local government expenses should remain in the assessment, advising that states fund most of these expenses and they represent an unavoidable cost for the states.

Victoria does not support the Commission's decision to include local government expenses in the disaster recovery assessment. Victoria believes that the Commission's arguments for excluding local government costs in the draft report and the 2019 Update report were sound and comprehensive. The Position Paper does not provide a convincing case to reverse this position.

States have provided the Commission with data to allow local government expenses for natural disaster relief to be removed from the assessment. As previously identified by the Commission, most local governments fund their out of pocket costs from own source revenue, such as rates. Therefore, local government net costs have no effect on state fiscal capacities. It would be inconsistent for the Commission to include state payment to local government for natural disaster relief in the assessment when the Commission removes these type of payments in other assessments, such as local roads.

3. Mining Revenue

Victoria notes that the Commission has now decided that grants in lieu of royalties should be assessed in the Mining revenue category instead of in the Commonwealth payments category. This change is does not change states' GST entitlement.

Victoria has no objection as the proposed change is only presentational.

4. Welfare assessment

Victoria notes that the Commission intends to make minor changes to the draft report assessment of welfare expenses.

4.1 Other welfare expenses

The Commission proposes to assess Other welfare expenses on an equal per capita (EPC) basis instead of using a low social-economic score due to lack of substantive information.

Victoria supports the proposed change on the basis that the available evidence does not support the conceptual case for a differential assessment.

4.2 Cross-border allowance

Cross-border allowances recognise the net use by New South Wales residents to ACT services. The Commission proposes including the cross-border allowance from the Welfare assessment to the Health category.

In principle, Victoria supports a cross-border allowance if services provided by one state are used by citizens of another state. However, it is not clear why a cross-border allowance for welfare services should be included in the health assessment. It would be helpful if the Commission provided an explanation for this.

4.3 Child protection and family services

The Commission intends to recognise service delivery scale and regional costs in the child protection and family services assessment.

The draft report proposed that general regional costs be applied to this assessment. It would be helpful for the Commission to clarify whether they propose to change the basis of determining regional costs for this assessment.

Victoria, in principle, supports the recognition of service delivery scale where there is evidence that such expenses exist and can be reliably estimated. The Commission has not indicated how service delivery scale expenses for this assessment will be estimated. As such, Victoria does not have sufficient information to express an opinion at this stage.

5. Electricity and water subsidies assessment

Victoria notes that the Commission intends to make several non-substantive changes to the draft report method of assessing electricity and water subsides.

5.1 Definition of small communities

The Commission proposes to broaden the definition of small communities for the water subsidies component to include communities of less than 3 000 people (instead of 1 000 people).

Victoria notes that in the draft report the rationale for the definition of small communities was on the basis that utilities provided to these communities could not capture scale economies. If this remains the case for communities of less than 3 000 people then Victoria supports this change.

5.2 Regional cost weight discount

The Commission proposes to remove the discount for the regional cost weight for the small community water subsidies component.

Victoria notes that the draft report proposed a discount to the cost weights as complete data were not available by remoteness for all states. Unless the Commission has received more complete data, Victoria does not support the removal of a discount. However, as the Commission's original proposal was to apply a high discount, Victoria would be supportive of a lesser discount if the discount level was determined using the Commission's stated criteria.

5.3 Wage costs

The Commission proposes to apply wage costs to the smaller community water subsidies component and the remote community electricity subsidies component.

Victoria notes that in the draft report it was proposed not to assess a wage cost factor as there was no evidence that subsidies are influenced by wage levels. It would be helpful if the Commission indicated what evidence has led it to reverse its position.

6. Investment assessment

6.1 Negative assessed investment

The Commission intends to no longer apply capital cost factors to negative assessed investments. To do so would have implied that a state can receive higher returns on the sale of assets by applying cost factors.

The draft report proposed that investment be assessed on a gross basis, that is net investment and depreciation together. Negative gross investment would occur if net investment was negative and of greater magnitude than depreciation.

Victoria accepts the argument that capital cost factors should not be applied to the sale of assets. This should apply across the board as net investment, whether positive or negative, is a combination of purchases of non-financial assets and the sale of non-financial assets.

6.2 Capital cost disabilities (factors)

In the draft report, the Commission noted that, due to significant changes in the assessment of recurrent regional costs, the derivation of capital cost factors would need to be further considered.

The Commission intends to apply only the Rawlinsons' measure of differences in regional costs to interstate cost differences for certain categories.

The draft report was uncertain as to how regional costs were to be determined for the investment assessment. Victoria supports the proposal to base these on the Rawlinsons' measure as this represents the best available information.

7. Stamp duty on conveyances

7.1 Off-the-plan adjustment

In the past, the Commission made an adjustment for Victoria's off-the-plan concession. The Commission notes that Victoria has provided additional data so that a specific adjustment is no longer required.

Victoria supports the use of better data that removes the need for an adjustment.

7.2 Unit trusts adjustment

The unit trusts adjustment was introduced in 1990 to capture state legislative differences in the application of conveyance duty to the issue and redemption of units in private unit trusts. This applied to Queensland, Western Australian and South Australia.

The Commission intends to remove the adjustment as legislative changes means an adjustment is no longer warranted.

Victoria believes that removing this adjustment would be consistent with the 'what states do' supporting principle. If this is regarded as a method change then removing this adjustment would not have a material impact based on the information presented in the Position Paper.

7.3 Land rich adjustment

In the draft report, the Commission proposed differentially assessing land rich transactions by listed companies. As five states apply duty at 10 per cent of their general rate, the Commission intends to introduce a 10 per cent adjustment, which would apply to all states.

Applying this adjustment to all states is consistent with the 'what states do' supporting principle. If this is regarded as a method change then applying this adjustment to all states would not have a material impact based on the information presented in the Position Paper.

8. Land tax

8.1 The ACT adjustment

The ACT's lack of aggregation means more of its taxable land holdings are reported in lower value ranges. In the 2015 Review, the Commission applied a 2 per cent adjustment to estimate the effect of aggregation.

Based on their analysis, the Commission intends to increase the ACT adjustment to 10 per cent.

Victoria notes that the increase in the ACT adjustment is supported by evidence.

8.2 The Northern Territory adjustment

An adjustment is required for the Northern Territory to estimate its taxable land holdings. In both the 2010 and 2015 reviews, an adjustment of 0.6 per cent was used. This percentage was the Territory's share of the nation's Valuers'-General land values.

Based on more recent data, the Commission intends to estimate the Northern Territory's taxable land holdings as 0.8 per cent of the other states' taxable land holdings.

Victoria recognises that an alternative measure of estimating the Northern Territory's taxable land values is required. The proposal to base taxable land values as a share of ABS land values seems appropriate.

8.3 Expanding the number of value ranges

For practicality reasons, the Commission uses a fixed set of value ranges for the period of review. In response to state feedback, the Commission has canvassed increasing the top value range into three value ranges.

The Commission notes that it is yet to receive data from all states on this basis so is not in a position to decide whether to use the same number of value ranges as in previous review.

Victoria notes that the Commission is not able to provide any information about this proposal due to all the data not being currently available. The Commission should inform the states of its position once all the data are available.

9. Wages regression used in wage costs assessment

The wages regression used in the wage costs assessment was provided to states in the same email that notified states of the release of the Position Paper. Victoria provides comments on the wages regression below.

As stated in our response to the draft report, Victoria was disappointed that the draft report did not address in detail the issues raised by Victoria in its response to the Commission's staff draft assessment papers. In particular, Victoria was concerned that the inclusion of a large number of variables in the econometric model can lead to inflated standard errors for the regression coefficients.

Model results for the most recent regression provided to states indicate that:

- only South Australia and Tasmania have wages significantly different to the Northern Territory;
- none of the remaining states have wages significantly different to the Northern Territory; and
- none of the states, other than the Northern Territory, have wages that are significantly different to each other.

Victoria's position is that given the amount of GST that is redistributed from the interstate wage assessment, greater econometric rigour is required for the specification of the model and the interpretation of the results.

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