Queensland Government

Queensland Treasury Response to Commonwealth Grants Commission

2015 Methodology Review

Response to:

Commission Position Paper CGC 2014-04

Significant changes since the Draft Report

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1. INTRODUCTION AND SUMMARY

As the 2015 Review enters its final stage, Queensland welcomes the opportunity to respond to the Commission's latest position paper on significant changes since the Draft Report.

Queensland apologises for this submission being lodged several days late, but notes that this reflects in part the late receipt of significant material from the Commission and the very short timeframe provided to consider and respond to this material.

While the Commission is proposing some reasonable changes to methodology, such as greater recognition of mining related expenditure, overall Queensland continues to hold grave reservations about some significant methodological changes being contemplated by the Commission in the last weeks of the review.

Queensland is concerned the Commission has left a great deal of work until the very last stages, presenting new and underdeveloped methodology in its latest position paper. The Commission's approach and work has lacked its usual rigour, transparency and meaningful consultation, with inadequate provision of evidence, data and details of methodology associated with key proposed changes.

Shortly before state submissions on the Commission's latest position paper were due, the Commission provided net operating expense data relevant to the transport assessments to States, with the possibility of urban transport asset value data being available to share at a later date. Availability of this data at this late stage in the review effectively removes the ability of states to examine the veracity of the data and the proposed methodology, to identify shortcomings or to propose alternative methods. States have also been given very limited opportunity to consider and provide meaningful comment on release of a 26 page report outlining the Commission's position on health substitutability matters.

Queensland has grave concerns about the credibility, robustness, and stability of outcomes of the 2015 Review, which impact profoundly on the extent to which the principle of Horizontal Fiscal Equalisation (HFE) is achieved. The issues emerging from the Commission's Draft Report and its latest Position Paper highlight that it is not possible to comprehensively undertake a review of the methodology for determining state revenue sharing relativities in little more than 18 months.

Queensland supports the Commission's equalisation task, and has worked constructively to improve the quality and robustness of methodology underpinning HFE, however the pressures surrounding this Review have exposed a number of concerning trends.

In particular, Queensland is concerned about the following trends:

- An absence of quality evidence and adoption of underdeveloped methodologies;
- A decline in the usual standards of rigour in the Commission's analysis;
- An erosion of the principle of policy neutrality;
- Inadequate consultation ;
- Special treatment compromising the application of HFE principles;

- Changing drivers of HFE; and
- Volatility in outcomes.

These trends are addressed in more detail below.

1.1 Areas of significant concern

1.1.1 Absence of quality evidence and adoption of underdeveloped methodologies

Perhaps more than any other review in the past, the 2015 Review has revealed a trend of an absence of quality evidence and data to support Commission decisions.

Queensland has presented strong arguments during this Review for improved methodology across key assessments such as Transport, Mining, and Interstate Wages, all supported by analysis, data and evidence. Yet it is disappointing that much of this work seems to have been ignored or dismissed by the Commission, without any rational explanation.

At this late stage, methodology should be mature and robust, supported by strong evidence and data, not untested or unproved. Changes should only result in small gains or losses for jurisdictions. There should be no doubt or uncertainty in the Commission's considerations when deliberating the use of new methods or changes this late in the process. If there is weakness in the methods, then they should not be used or their influences should be reduced until a better method can be developed. The Urban Transport Infrastructure assessment is a case in point where numerous deficiencies with the methodology and Commission's assumptions necessitate that this assessment be excluded from the 2015 Review, and examined more fully in a future Review.

Akin to the Commission's reasonable decision to delay further consideration of major changes that were proposed for the Interstate Wages assessment, this cautious approach should be applied in other areas where major changes are being contemplated but there is uncertainty over their reliability and robustness. Issues of contemporaneity and the Urban Transport Infrastructure assessment are prime examples of important matters that should be held over for proper consideration in a future Review.

Queensland also is concerned about the late reference to the Commission of issues relating to the treatment of GST relativities where a particular revenue source is a large and volatile proportion of a state's revenue. In the short time available for the Commission to assess this issue, there is limited opportunity for the Commission to develop a robust methodology. There is a significant risk that a piecemeal and partial approach is adopted which compromises the principle of horizontal fiscal equalisation (HFE).

Queensland supports a more broad-based review of issues relating to contemporaneity and volatility of the Commission's assessments, but this is simply not possible in the time remaining for this review. As requested by Commission staff on 5 January 2015, Queensland will provide more detailed comment on the specific matters of contemporaneity and adjustments for volatile revenue bases by 15 January 2015.

1.1.2 A decline in the usual standards of rigour in the Commission's analysis

Work across several assessments are not up to the usual high standards and rigour of the Commission. Premature decisions on changes to methodology seem to be foregone conclusions in the Commission's documentation yet are clearly underdeveloped, lack robustness, or rely on unsubstantiated assumptions without the necessary supporting evidence. This is a worrying indication that the Commission has run out of time, and is trying to achieve far more than is reasonably possible in the timeframe for this Review.

While we acknowledge the challenging timeframe in this Review, it would be a very poor outcome if the truncated timeframes led to locking in rushed new methodology that is underdeveloped and contains significant deficiencies, particularly when proposed changes would benefit from a more considered and robust approach.

There is a significant risk that the adoption of underdeveloped and deficient methodology could have unnecessarily large and unpredictable swings in the distribution of GST grants to the states and territories. The nature of the Commission's methodology reviews is such that redistributive effects will always occur. However, it is unsatisfactory for the magnitude of such redistributive effects to be exacerbated by underdeveloped or deficient methodology which has not been properly tested and does not have a strong evidence basis. In a subdued revenue environment, there is little discretionary capacity among the states to absorb large redistributive effects, especially if they do not have a rigorous analytical foundation.

1.1.3 Erosion of policy neutrality

A fundamental and long-standing tenet of the Commission's assessments has been the application of the principle of policy neutrality. There is a worrying pattern surfacing in this Review that the principle of policy neutrality is being eroded. This not only means a state's own policy decisions can have increasingly significant impacts on their GST outcomes, but it erodes credibility of the Commission's equalisation process.

The Commission's proposed definition of average policy allows a choice of average policy to suit particular methodology. This is a significant departure from the single consistent approach that has stood the test of time.

The Commission's proposed 'mineral-by-mineral' structure for the Mining Revenue assessment is a stark example of how the principle of policy neutrality is being compromised. Mining development is also policy influenced, and not fully recognising this in the Commission's methodology creates a disincentive for states to facilitate industry development, as much of the benefits of a State's policy actions can be redistributed away to other jurisdictions as a windfall or 'free-rider' gain.

The Commission's proposal to extend the 50% concessional treatment of payments for National Network Roads to nationally significant rail projects is beset by concerns about policy neutrality. The concept of nationally significant projects is largely driven by policy and politics, and as such this assessment is not an effective assessment of needs.

1.1.4 Inadequate consultation

Queensland appreciates the complexity and unique timing challenges of the 2015 Review. However, the Commission is conducting this Review in a very rushed manner. It is deeply disturbing that within only a matter of eight weeks prior to the final report, the Commission is still proposing new and significant methodology changes. States have effectively been allocated three weeks to respond to significant changes that will impact the next five years distribution of GST revenue.

The 2015 Review has seen a diminished amount of meaningful consultation by the Commission, and adequate opportunity has not been afforded for states to properly analyse and consider proposals in a way that can add value and improve the Commission's equalisation methodology. Efforts by the Commission to the contrary have been rushed and of limited use, instead of a more considered approach to realise sustained improvements to methodology.

In the Health category for example, the Commission's most recent intention to standardise bulk billed services in the Health assessment by SES and age, and consideration of the impacts of substitutability, are occurring with very limited and late consultation and little transparency in the data and calculation methods being used. Queensland does not necessarily object to additional standardisation. However, states need to see the data and how the Commission is using it to arrive at their assessment if they are to have any confidence that the data is sound and the proposed methodology or adjustments are appropriate and robust, and are not contaminated by policy factors.

The 2010 Review Mining Revenue assessment is also a stark reminder of the risk of unsatisfactory outcomes when significant last minute methodology changes are applied, without adequate scrutiny and 'reality-testing', and this is accentuated when consultation with the states is limited.

1.1.5 Special treatment compromising the application of HFE principles

Over time, all jurisdictions have needed to absorb and deal with the impacts of cyclical and one-off experiences and the redistributive impacts via the HFE process. Queensland is concerned that the Commission has received an exceptionally late direction on contemporaneity issues and adjustments to respond to sudden or large scale shocks to revenue bases. It is disconcerting that the Commission must investigate such a fundamental matter of HFE at such a late stage in the Review.

The task now set for the Commission to examine the impact of volatile revenue sources on GST shares, and deriving alternative relativities, is a substantial HFE task. This appears to be based on the concern over the position the Western Australian government faces as iron ore prices fall rapidly.

While Western Australia's concerns are understandable, Queensland believes a more broad-based review of issues relating to contemporaneity and volatility would be more sensible, rather than any narrowly focused special consideration for specific mineral royalties.

However, a broad-based review cannot be achieved in the 2015 Review. Rushed consideration of these matters at a very late stage will not provide adequate opportunity for rigorous scrutiny of the Commission's approach, and could erode confidence in the Commission's HFE task and ability to fulfil its key role - a fair distribution of the GST. Changes to the Commission's methodology, and to HFE, ought to be broadly based and support clear objectives that are fair and reasonable.

The Commission must be cautious to not solely consider the volatile revenue of Western Australia in isolation. This would necessarily be to the detriment of all other states. Such an approach may address Western Australia's concerns about its current fiscal circumstances, but it may result in a piecemeal and partial approach to the revenue difficulties of the States, and may compromise the application of the principle of HFE.

1.1.6 Changing drivers of HFE

Queensland believes the underpinning agreement between jurisdictions of the need for HFE and the scale of equalisation are showing signs of breaking down. The need for reform of the Federation, roles and responsibilities, a more appropriate level of VFI, and a contemporary system of HFE, is no more evident or important than now.

The 2015 Review has emphasised more than ever that the current system of assessing state revenue sharing relativities is less than ideal in achieving satisfactory HFE, and is vulnerable to changes in Commonwealth-State relations. The Commission's attempt to complete this review in a truncated timeframe has only served to expose deficiencies and weaknesses in the current equalisation system.

The time has come for a fresh and mature discussion on the need for, goals and extent of HFE to fit with a modern and dynamic system of federation. Such a discussion would be best done in the context of the Commonwealth Government's current White Paper processes on reform of the Federation and taxation reforms. There is a strong appetite for real improvements to the system of federation which may diminish the need or desire for such a large HFE task. Queensland welcomes such a discussion prior to the next Review.

1.1.7 Volatility in outcomes

Queensland is concerned that the issues raised above are likely to give rise to unjustifiable and unwarranted volatility in the redistributive effects for jurisdictions. Given the compressed timeframe for this review, Queensland believes that the Commission has attempted to undertake an unreasonably large workload. It is contemplating major methodological changes that are ill-founded, lacking in solid evidence and based on implausible and unrealistic assumptions.

In these circumstances, Queensland considers that the Commission should proceed cautiously and circumspectly in introducing major changes in methodology. The default position should be that the existing methodology should be retained. Changes should be made only where there are compelling grounds based on strong and undisputed evidence, rigorous scrutiny (including by the states and territories) and 'reality testing' of proposed changes to ensure they enhance rather than detract from the achievement of HFE.

As indicated in our earlier submissions, Queensland considers that the Commission's methodology has evolved over a long period of time, and should be subject to incremental change, rather than some of the fundamental changes being contemplated by the Commission. Where the Commission has residual concerns about current methodology, greater use should be made of discounting, rather than introducing new, untested and undeveloped methodologies. More extensive discounting (up to say 75%) could be used to take account of data and methodology deficiencies.

1.2 Queensland's position on priority changes

In the main, Queensland believes the Commission is not giving a balanced and necessary consideration of the detailed analysis and evidence which Queensland has provided throughout this Review process in support of several of our priority areas, for example the mining revenue and transport assessments. Comments, views and evidence presented in Queensland's submissions to-date have yet to be adequately addressed by the Commission and therefore still remain relevant. Queensland's views on the specific significant changes since the Draft Report follow.

1.2.1 Urban Transport Infrastructure

The Urban Transport Infrastructure assessment is underdeveloped and should be examined fully in a future review. We urge the Commission to avoid making the mistake of rushing into a final assessment methodology and getting it wrong.

Queensland understands the impetus to develop a new Transport Infrastructure assessment, but the Commission's efforts to develop a model for new investment needs in urban centres have consistently been thwarted by poor quality and non-comparable data, and little supporting evidence. Work by the Queensland Government Statistician has clearly demonstrated these deficiencies, and it appears these are precisely why the Commission has moved away from the model in the Draft Report for quantity of stock disabilities.

The Commission have rightly abandoned the model proposed in the Draft Report. However, the new proposal (using the square of city populations) does not solve any of the problems with the Draft Report proposal as it lacks a clear conceptual basis and relies solely on assumptions that are not supported by evidence. Using the square of city populations in the assessment requires very specific assumptions – that per capita asset requirements are driven by city population size, and that this relationship is linear and passes through the origin. These assumptions are not supported by evidence.

State-provided data that are not sufficiently reliable to produce a robust methodology cannot now be used to support assumptions in an alternative model. Even if asset value and expense data is made available at this late stage, the opportunity for states to properly consider and analyse it, and the Commission's proposed method, has now effectively been eliminated.

Significant further work is required in this area before a fully developed assessment method can be established. There is insufficient time remaining in the 2015 Review to achieve this. The final report should implement a temporary placeholder for quantity of stock disabilities, such as states' shares of urban populations, and conclude that work in this area should be ongoing. Using states' shares of urban populations would not require the Commission to make unsubstantiated assumptions.

If the Commission decide to implement the square of population approach, a discount of at least 50% must be applied to reflect the uncertainty in its outcome. There is no reason to consider this approach any more reliable than that proposed in the Draft Report, and the Commission's consultant did not provide any justification for reducing the discount.

As proposed in Section 1.1.7 above, Queensland considers that the Commission's use of discounts must extend beyond matters of reliability to include poor data, simplicity, transparency, and what states do in practice, including excessive policy influence. This is preferable to the introduction of underdeveloped and untested changes in methodology.

The Queensland Government Statistician has developed more detailed analysis identifying further concerns with the urban transport assessments which suggests that further research is needed before they meet the Commission's Terms of Reference (ToR) criteria of 'robust quality' and 'fitness for purpose'. In the absence of this, the Commission should not implement the proposed Urban Transport Infrastructure assessment. A temporary placeholder based on the service population for Urban Transport Infrastructure should be used until a more robust methodology can be developed. At a minimum, a heavy discount (possibly as high as 75%) should be imposed for both the urban transport services and infrastructure assessments.

1.2.2 Nationally significant infrastructure projects

This proposal is completely new in this Review, and to-date there has been no meaningful consultation from the Commission. Unlike nationally significant roads, the recognition and appropriate treatment of nationally significant rail is not a straightforward issue. The Commission should not attempt to unravel the methodological complexities in this area at this late stage in this Review.

The national significance of rail investment projects should be determined by the Commonwealth in consultation with states. Instructions on which payments are to receive concessional treatments would then be provided to the Commission through the ToR. Putting the decision about which payments are to be treated national network payments in the hands of the relevant Commonwealth agency is less objective than instruction through ToR, and could be open to inconsistency.

If the Commission decides to proceed with its proposal to assess 50% of Commonwealth payments for rail investment, it should be cautious in defining rail projects as "nationally significant", and ensure the definition is not expanded beyond that suggested in the Position Paper.

1.2.3 Mining Revenue

The Commission have received an exceptionally late request from the Commonwealth Government to consider possible approaches for the treatment of volatile revenue sources.

This request was underpinned by Western Australia's concerns about the volatility of mining royalty revenue.

Queensland broadly supports concerns about own source revenue volatility, however the final stage of the 2015 Review is not the time for the Commission to have to be considering fundamental changes to HFE such as contemporaneity or principles for making adjustments for large-scale revenue shocks. Queensland believes a more broad-based review of issues relating to contemporaneity and volatility would be more sensible, rather than any narrowly focused special consideration for specific mineral royalties. These are significant matters of HFE and a full examination and discussion of the issue should follow in the next Review.

Queensland supports greater contemporaneity, but this should not be at the cost of simple, reliable and robust assessments with stable outcomes. For this Review, the Commission's current three year averaging with lags strikes a reasonable balance given the practical constraints and unfavourable trade-offs associated with achieving full contemporaneity.

The Commission has been asked to examine this issue in the context of challenges facing Western Australia, however, a number of states have been affected by falls in commodity prices, resulting in major reductions in revenue from mining royalties. The reduction in revenue experienced by Western Australia in 2014-15 is not dissimilar to that experienced by Queensland following high coal royalties in 2008-09. It is essential that any proposed changes to the Mining Revenue assessment to account for volatility are universally applied to all jurisdictions.

Specifically, it would be unreasonable for Western Australia's circumstances to be addressed by the Commission at the expense of Queensland. The Queensland Government has undertaken a significant task of fiscal repair, at a time when coal prices have fallen significantly, and royalty revenue write-downs have occurred. Given the fiscal repair efforts Queensland has undertaken to date, it would be unfortunate if Queensland now was to be unfairly penalised by actions designed to cushion the impact of revenue write-downs in other jurisdictions.

The need to have symmetry over the equalisation cycle is also important to Queensland, rather than applying one treatment on the up-cycle and potentially another treatment on the down-cycle. A more robust and considered approach to this issue, and contemporaneity, would be welcome in the next Review.

The 2015 Review Final Report should reflect the impact of the iron ore fines at the current royalty rate, rather than applying special treatment and phasing-in the impact. Phasing-in would be at odds with the Commission's primary objective of HFE, and there is also no directive in the Commission's ToR to do so – the ToR quarantining the impact of iron ore fines in previous Updates has been removed.

Given the possibility of significant last-minute changes relating to contemporaneity and the treatment of volatile revenue bases, it is imperative that states are provided with the proposed changes and can respond to them before they are finalised.

1.2.4 Mining related expenditure

Queensland welcomes the Commission's proposed new assessment to recognise some elements of additional mining related expenditure. This is a step forward in the Commission's methodology that can be built on in future reviews, where a more holistic approach could be attempted, where the impact on fiscal capacities of both mining revenue and associated expenditure is recognised in the Commission's methodology. As a whole, this would recognise the full costs of industry development and support, along with the extent to which these are provided by government.

It has clearly been demonstrated that government involvement is integral to mining industry development, though returns from this investment are uncertain and often slow in coming. In particular, it needs to be recognised that significant expenditure (for example investment in rail and port facilities) needs to be undertaken some years ahead of the time that royalty revenues are received by the government.

Currently, there is an asymmetry in the Commission's assessments where the impact on fiscal capacities of mining revenue is recognised but the associated expenditure is not. A more holistic approach may be more relevant in future as delivery of services changes, for example increased contestability and a focus toward proactive, early intervention.

There are further areas of expenditure that could still be recognised in the 2015 Review, most notably for roads related to mining economic activity. Queensland looks forward to working with the Commission during the next Review to progress work on recognising more mining related expenditure in its assessment.

1.2.5 Health

At this late stage in the Review, the Health assessment is still underdeveloped with insufficient collaboration with States. Queensland has unsuccessfully requested data underpinning the Commission's calculations to standardise bulk billing services. In the absence of this data, it is difficult to make meaningful comment, and Queensland believes this situation is not satisfactory.

Generally, Queensland supports reducing substitutability levels, and this is verified by Queensland Health's experience. However, the Commission's paper regarding health substitutability was only provided shortly before state submissions were due on the Commission's latest discussion paper. This last minute effort to change methodology with limited consultation and a lack of transparency does nothing but add further doubt to Queensland's faith in the Commission's system of equalisation for this Review.

1.2.6 Welfare

Queensland supports assessing other general welfare using the bottom quintile of the 2006 Socio-Economic Index for Individuals (SEIFI), with an adjustment (based on the proportion of Health Care Card holders) to reflect changes in states' circumstances since the 2006 Census. If the ABS does not produce an updated version of SEIFI in the next few years, a future Update will need to revisit whether the 2006 data (with adjustments) is the best option.

1.2.7 Regional Cost Gradient

Queensland supports extrapolation of the ACARA regional cost gradient to other categories, rather than a general regional cost gradient that combines ACARA data with out-of-date police expenses data.

The Commission has not indicated when and if they intend to update the police data. Queensland supports further work on the police data in future, with a preference for the 2016 Update, so that the data remains contemporary to be used as a base for any cost gradient.

1.3 Concluding comment

In the little time remaining to finalise the 2015 Review, the Commission should concentrate its attention on incremental refinements or revisions to methodology, rather than major controversial changes which have significant redistributive effects, lack sufficient rigour and a strong evidence base, and call into question the credibility of the Review. It would be unfortunate if the 2015 Review resulted in major volatility in financial outcomes for states based on underdeveloped methodologies, a lack of strong evidence, a decline in the Commission's usual analytical rigour and inadequate consultation. This could seriously compromise the achievement of fiscal equalisation.

2. URBAN TRANSPORT INFRASTRUCTURE ASSESSMENT

Queensland's position

- The development of a new Transport Infrastructure assessment was identified in the Terms of Reference as an objective for the 2015 Review, but efforts to develop a model for new investment requirements in urban centres have been undermined by data that is not comparable and of poor quality, a lack of supporting evidence, and the shortened timeframes for this review.
- The Commission have rightly abandoned the model proposed in the Draft Report for quantity of stock disabilities. However, the new proposal (using the square of city populations) does not solve any of the problems with the Draft Report proposal as it lacks a clear conceptual basis and relies on assumptions that are not supported by evidence. State-provided data that are not sufficiently reliable to produce a robust methodology cannot now be used to support assumptions in the alternative model.
- A great deal of further work is required in this area before a fully developed assessment can be implemented. This cannot be completed in the time remaining for the 2015 Review. The final report should implement a temporary placeholder and conclude that work in this area should be ongoing.
- The attached report from the Queensland Government Statistician's Office (QGSO) details issues that affect both the Transport Services and Transport Infrastructure assessments. These lend further weight to not implementing the new Transport Infrastructure assessment at this stage of the Review, and of applying a large discount (50%) to the Transport Services assessment.
- An appropriate temporary placeholder for quantity of stock disabilities would be states' shares of the service population for urban transport infrastructure, which would not require the Commission to make unsubstantiated assumptions. Ideally, this would be based on a fit-for-purpose geography that reflects the transport task. If there is insufficient time to apply a fit-for-purpose geography, urban populations could be used as the placeholder.
- If the Commission decide to implement the square of population approach, a discount of at least 50% (and possibly as high as 75%) must be applied to reflect the uncertainty in its outcome. There is no reason to consider this approach any more reliable than that proposed in the Draft Report, and the Commission's consultant did not provide any justification for reducing the discount.

2.1 Outline of changes since the Draft Report

The Draft Report proposed to assess quantity of stock disabilities for Urban Transport Infrastructure using the outcome of a linear regression of urban centre population size and the per capita value of infrastructure stock.

Since the Draft Report, the Commission have decided not to use its regression of urban centre population size and the per capita value of stock, due to concerns about the quality and policy neutrality of the state-provided data on urban transport infrastructure by city. Instead, the Commission intends to make a set of assumptions about the relationship (that it is upward sloping, linear, and passes through the origin). Under these assumptions, the new model uses the square of city populations to determine states' quantity of stock requirements.

2.2 Overview

The development of a new assessment of Transport Infrastructure was identified in the Terms of Reference as an objective of the 2015 Review. An assessment that specifically measures states' asset requirements for Urban Transport would represent an important improvement to HFE and Queensland supports the development of such a methodology. Unfortunately, the Commission's efforts in this area have been undermined by poor quality data, a lack of supporting evidence, and the limited timeframes for this review.

The Commission have rightly abandoned the Draft Report proposal to derive a relationship between city population size and per capita asset requirements using state-provided data. However, at this late stage of the Review, it is difficult to see how an assessment can be developed before the release of the final report that is any more reliable than the previous proposal. The assessment proposed in the Positon Paper does not have a clear conceptual basis and relies on assumptions that are not supported by evidence.

The Commission should not implement an underdeveloped assessment as a finished product when this is clearly not the case. A great deal of further work is required to gain a conceptual understanding of the factors influencing states' expenditure requirements, and to develop a methodology that reflects these factors. Without this, the proposed assessment is just as likely to move the Commission's methodology further away from HFE as it is to improve it.

Such an undesirable outcome is not the intention of the Terms of Reference direction. Where data limitations and the short timeframe for this review have meant that an assessment could not be fully developed prior to the release of the final report, an acceptable response to the Terms of Reference is for the final report to conclude that work in this area needs to be ongoing.

Queensland is keen to continue working with the Commission on this assessment as a priority following the release of the final report. The Commission should implement a temporary placeholder for the quantity of stock disabilities until this work is complete. At the very least, a substantial discount of at least 50% (and possibly as high as 75%) should be applied if the Commission decide to implement its population squared approach.

2.2.1 Data limitations

At the time of finalising this submission, the transport infrastructure data underpinning the Commission's analysis had still not been made available to states due to confidentiality concerns. Queensland understands that the data is likely to be made available to states in the near future (pending Commission staff analysis of some data revisions).

Even if the data is provided to states in the near future, it is difficult to see how a meaningful analysis can be completed in the time remaining for the 2015 Review. Transparency and the capacity for meaningful consultation has been entirely undermined in the development of a new assessment for Urban Transport Infrastructure as states will be unable to access key data until after these final formal submissions are completed.

The only reasonable option for the Commission in these circumstances is to delay making a decision on this assessment until it can be fully and transparently reviewed.

2.3 The Commission's new proposal

The new proposal to calculate quantity of stock disabilities by squaring city populations does not solve any of the problems with the Commission's previous proposal. The population squared approach requires the Commission to assume that the relationship between assets per capita and city size is upward sloping, linear and passes through the origin. These assumptions can only be justified with a strong conceptual case and a rigorous analysis of the relationship between assets per capita and city size.

The following discussion demonstrates that:

- A conceptual case has not been established for the relationship between city size and requirements for new infrastructure used in the population squared model;
- The assumptions in the population squared model are not supported by evidence; neither the state-provided data nor the consultant's findings can be used to justify the assumptions.

Without satisfying the conditions of a conceptual case and strong evidence to support the proposal, the new model should not be used to derive quantity of stock disabilities. A placeholder should be implemented until these issues can be fully investigated, or a discount of at least 50% applied to the population squared model.

2.3.1 Conceptual case for quantity of stock disabilities

The Position Paper states that the conceptual case that larger cities require more assets per capita to deliver urban transport services has been established. Queensland disagrees with this assertion as previous discussion papers and the Draft Report have not properly addressed the conceptual case.

The assumption that larger cities require more assets per capita to deliver urban transport services was first put forward in the Proposed Assessments paper. Rather than attempt to explain why larger cities would need to have higher asset values per capita, this discussion simply stated that the Commission's preference was to use a similar approach to that currently used for urban operating subsidies[1].

The Draft Report relies on the 2010 Review consultant's report to verify the conceptual case, stating that the consultant found that stock levels are likely to be higher in larger cities because the transport task rises as city population increases[2].

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[1] Staff Discussion Paper CGC 2013-07S *Proposed Assessments*, Chapter 20 paragraph 17.
[2] Attachment 21 – Infrastructure Assessments, paragraph 56.

As discussed in Queensland's response to the Draft Report, the 2010 Review consultant's findings cannot be used to support an assessment of new transport infrastructure that is based on the population size of cities. This is because:

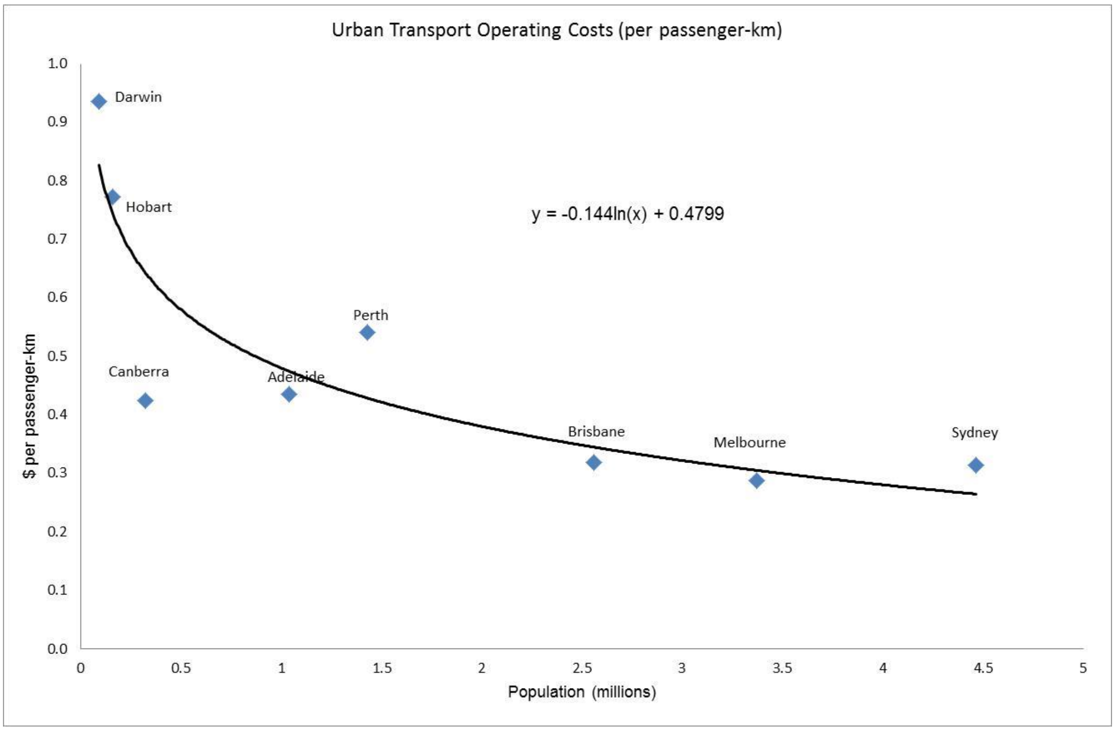
- Most of the capital discussion in the 2010 Review consultancy refers to the replacement of existing assets, not to new investment (Section 3.5.1 – Existing Assets). It is only for existing assets that the consultant suggests there may be some relationship between per capita assets and city size, but in the Commission's framework, the consideration of replacement costs for existing assets is a matter for the Depreciation assessment, not for the Investment assessment. Even then, the Existing Assets discussion suggests that economies of scale could work both ways, and that the dominant factor is not population size, but the existence of rail:
    - *[Diseconomies of scale] can result from, for example, the need for more buses due to slower average travel time in larger cities, or the use of trains systems in larger cities to accommodate high levels of demand. Such effects may, however, also be offset by greater productivity of the assets in larger cities, for example with higher average vehicle occupancy*;
    - *It is concluded from the data that the dominant factor driving differences in the intensity of public transport capital between cities is whether they choose to implement a fixed track facility, most especially train systems*[3].
- The consultant considers that the drivers of costs for system expansion may be quite different, and are unlikely to relate to current stock levels. When specifically discussing the costs of new investment (Section 3.5.2 – System expansion), the consultant does not support using current asset stock levels:
    - *If actual future investment in capacity expansion was a similar proportion of current assets in all cities, current assets could be used as a proxy for any desired adjustment to take account of future investment. However, the available evidence suggests that this is unlikely to be the case*[4].

There is also clear evidence of economies of scale in urban public transport, as demonstrated in the attached paper prepared by QGSO. An analysis of total operating cost rather than operating subsidies (the approach recommended by the 2010 Review consultant) demonstrates that costs decline per passenger kilometre as city population increases (Chart 1). It is worrying that while economies of scale can be clearly demonstrated for operating costs, the Commission does not appear to have investigated this important element of the conceptual case for urban public transport assets.

[3] *2010 Review of State Government Subsidies Urban Public Transport Services: Consultant Advice*, April 2009, pages 20-21

[4] *2010 Review of State Government Subsidies Urban Public Transport Services: Consultant Advice*, April 2009, page 22

Chart 1 – Urban Transport Operating Costs (per passenger km)[5]



It is also problematic that the Commission does not appear to have investigated other factors that may influence the quantity of stock required. For Transport Services, the Commission conducted a literature review that found a variety of other factors have significant impacts on net transport expenses per capita. While the Commission ultimately disregarded the results of its literature review, such an exercise does not appear to have been attempted for infrastructure. This means that the Commission cannot know which are the key factors influencing the need for new investment in Urban Transport Infrastructure.

Queensland does not believe it is reasonable for the Commission to state that the conceptual case that larger cities require more urban transport assets per capita has been established when this issue has not been properly addressed in this review.

2.3.2 Evidence to support assumptions

With an unclear conceptual case and an incomplete understanding of the causes of underlying differences between the states for Urban Transport Infrastructure, there must be strong evidence that assumptions made in the assessment are valid. This has not been presented.

The Position Paper explains that the reasons for discarding the Draft Report regression model were concerns about the quality and policy neutrality of the state-provided data on asset values by city, and the nature of the regression model used to capture the relationship between city size and asset stocks. Paradoxically, the Position Paper concludes that this

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[5] QGSO review of CGC Urban Transport assessment (Figure 1)

same data can be used to justify very specific assumptions about the relationship between city size and asset stocks, which are required for the population squared model to be valid.

The key assumptions made in the assessment are:

1. Cities with larger populations require higher per capita new investment in transport infrastructure;
2. The relationship is linear and upward sloping; and
3. The relationship passes through the origin.

Assumption 1 – larger populations require higher per capita new investment

There is little evidence that larger cities require greater per capita new investment. The Commission consider that the state-provided data on asset stock value by city are good enough to establish a broad relationship between asset values per capita and city size, but this assertion has not been supported by a rigorous statistical analysis. While the data underlying the assessment has still not been made available to states, it is clear that there are too few data points to support the assertion that there is a relationship between asset values per capita and city size.

While very large cities, such as Sydney and Brisbane, appear to have higher asset levels than cities of much smaller populations (such as those close to 20,000), there is no evidence that the differences between large cities are not driven by policy choice. The difference in asset requirements between large cities is the key element in the assessment, as this is where a large majority of the urban population resides. The relative expenses of smaller urban centres are far less important. The impact of individual states' policies on large city investment is impossible to determine, as each state has no more than one city the size of Sydney or Brisbane.

Without further analysis, the extent to which data points in the previous regression analysis are driven by other factors, such as the relative technical efficiency of different cities also cannot be determined. It cannot be assumed that the regression represents some kind of average technical efficiency for the larger cities, particularly with so few data points.

The application of this assumption in the assessment relies on a further assumption – that existing stock levels are indicative of future investment needs. Even if a relationship between existing stocks and population size could be demonstrated, the model would still rely on the observation of existing stocks, not an analysis of drivers of future investment. As discussed above, the assumption that existing stock levels are indicative of future investment needs was explicitly not supported by the 2010 Review consultant.

Assumption 2 – the relationship is linear and upward sloping

Even if there was sufficient evidence to conclude that new investment requirements were related to the population size of cities, the functional form of the relationship would still need to be determined. It is not valid to simply assume that the relationship is linear and upward sloping (as appears to have been done in the new proposed assessment) without a full assessment of model fit and functional form. The relative simplicity of a linear assumption is not a valid justification in itself.

The assumption that the relationship is upward sloping appears to arise from a broad comparison of the per capita assets of small urban centres (close to 20,000) to those of very large cities. This is not a useful comparison. Many states do not own (or own few) of the public transport assets in small urban centres, so smaller per capita stocks in these centres are to be expected. The level of stock held in small urban centres provides no information about the relative stock requirement in large cities. It cannot be assumed that because, for example, Brisbane may have a larger per capita asset requirement than Maryborough, Sydney must require more assets per capita than Melbourne. There are too many intrinsic differences in methods and level of service delivery between smaller and larger centres for any comparison to be useful – for example: the transport modes employed, the ownership of assets (public or private) and the need to provide for 'peak hour' travel to a central business district.

As discussed in the previous section, the assessed per capita asset levels for large cities have the largest effect on the quantity of stock factors, as this is where the majority of the population resides. At the same time, it is at these higher population levels where differences in the needs of cities become far less certain due to the lack of data.

The consultant engaged by the Commission to review its regression model did not believe that a conclusion on the model's functional form could be reached using the data available:

Given the small number of cities, the regression results will always be sensitive to some observations. There is no quick statistical fix to this problem other than increasing the sample size. Judgement based upon additional information could be required in choosing the functional form and interpreting the result[6]*.*

The attached report from QGSO also analyses the sensitivity of the Transport Services regression to model changes (Sensitivity analysis 3). An alternate choice of model, that is at least equally statistically significant, could easily have a material impact on state's shares of assessed expenditure. This demonstrates the importance of model changes to the approach to the transport assessments adopted by the Commission.

The Commission must take on the advice of its own consultant and either provide additional evidence to support its assumptions, or implement an assessment that does not require assumptions until supporting evidence can be identified.

<u>Assumption 3 – the regression passes through the origin</u>

The Commission propose to assume that the relationship between per capita assets and city size passes through the origin because the previous regression model passed close to the origin. The observation that the previous model passed close to the origin is no more valid

[6] *Report on econometric work conducted by the CGC*, Xiaodong Gong, IGPA, University of Canberra

than any other observation about the previous model for similar reasons (too few data points, a full assessment of model fit and functional form do not appear to have been made).

Forcing a regression through the origin (or assuming the regression passes through the origin) should only be undertaken after careful consideration of the observed range of data. It should only be used if data is available for x-values close to zero. If there are no data near the origin, which in this case there are not, attempting to predict values near the origin is not advisable. In this case, the origin (no population = no assets) merely represents a discontinuity in the data and does not imply that the relationship can be assumed to pass through the origin.

2.4 Results of work undertaken by the Queensland Government Statistician's Office (QGSO)

The results of QGSO's analysis of the approach to the transport assessments are attached. These findings have implications for both the Transport Services and Transport Infrastructure assessments. The main concerns identified by QGSO are:

1. A fundamental problem with the current approach is that the Roads and Transport assessments are developed independently, when they are intrinsically connected.
2. The assessment uses the population of urban areas rather than the number of users (including potential users) of public transport within an urban area, or the transport task.
3. The proposed regression model is based on the relationship between urban size and subsidy, rather than the more policy neutral variable of operating cost.
4. The regression models use weighted observations so that larger weights are given to urban centres with larger populations.

The QGSO report identifies that in these areas of concern, the Commission have made judgements that are not consistent with the advice of consultants, or that are not robust to alternate, equally plausible assumptions.

The results reported by QGSO further support the position that the Commission should not use its current proposal for Urban Transport Infrastructure in this review and that a large discount (of at least 50%) should be applied to the Transport Services assessment.

2.4.1 Sensitivity analysis conducted by QGSO

QGSO have also conducted an analysis of the sensitivity of the transport approach to a number of different changes[7]:

- Using different geographical regions;
- Small variations to the expenditure of urban centres (that could plausibly occur from year to year); and

[7] The analysis is based on transport services data, as these were the only data available at the time the report was completed.

- Changing the model used in the regression.

All three analyses demonstrated that states' assessed expenditure can vary markedly when reasonable and plausible changes are made to the assumptions and model inputs. This means that, as well as the model having no clear conceptual case and little supporting evidence, its outcomes are not robust. The additional uncertainty in outcomes demonstrated by the QGSO analysis is further evidence for the Commission to only use its models for urban transport services and transport infrastructure with a significant discount.

2.4.2 Need for ongoing work

The work conducted by QGSO offers some further potential lines of investigation for ongoing Commission work on the Transport assessments following the release of the 2015 Review.

It may be fruitful for the Commission to investigate possibilities for developing Roads and Transport assessments that reflect the interconnectedness of these services and that public transport subsidies are an inducement for commuters to switch from private road vehicles towards public transport.

The Commission should also further investigate the use of operating costs rather than subsidies and measuring the potential users of public transport services rather than simply using urban populations.

This work could be conducted alongside a more thorough analysis of conceptual issues – that is, the factors that influence states' requirements to invest in transport infrastructure, and the impact of economies of scale.

2.5 Discount

The Position Paper proposes the 50% discount applied in the Draft Report can be reduced because the conceptual case is strong and concerns about the sensitivity and non-policy neutrality of asset data have been reduced.

There is no justification for reducing the 50% discount applied in the Draft Report. Concerns about the data and model have not been reduced because the new model is just as reliant on the data to justify its assumptions as the old model was to calculate its regression output. As described above, the conceptual case cannot be described as strong when it has not been clearly defined, was not supported by the 2010 Review consultant and the influence of other factors have not been investigated.

The Draft Report implemented the 50% discount as a placeholder when the report of the consultant engaged to review the regression model had not yet been received. The consultant's comments are highly relevant given that the new proposal is reliant on assumptions that can only be verified using the previous regression model. There is nothing in the consultant's comments to justify reducing the discount. Instead, the consultant outlined serious issues with the model and suggested that additional information is required. In these circumstances, the Commission should consider increasing the discount (possibly to as high as 75%) rather than reducing it.

2.6 Way forward

The development of an assessment of Urban Transport Infrastructure has been limited by poor quality data, a lack of supporting evidence and the short timeframes of the 2015 Review. At this late stage of the review, the previously proposed model has been discarded and replaced by one that relies on assumptions that are not supported by evidence or a strong conceptual case. While the new model may appear simple, its underlying assumptions raise complex issues that cannot be settled at this stage of the review.

The Urban Transport Infrastructure assessment should continue to be developed after the 2015 Review is complete. The final report should implement a temporary placeholder and conclude that work in this area should be ongoing. The work conducted by QGSO suggests some potential lines of investigation for continuing to develop an assessment.

The current proposal is not suitable as a temporary placeholder because it is heavily reliant on assumptions that cannot be substantiated. Queensland considers that a more reasonable placeholder would be to use states' shares of the service population for urban transport infrastructure. This would not require the Commission to make assumptions about the relative costs in different cities that are not supported by evidence. Ideally, such a placeholder would be based on a fit-for-purpose geography that reflects the transport task, along the lines of the approach applied in QGSO's report. If the Commission believes there is insufficient time remaining in the review to apply a revised geography, the placeholder could be based on total urban populations until a more reliable methodology is developed.

3. NATIONALLY SIGNIFICANT INFRASTRUCTURE PROJECTS

Queensland's position

- The recognition and appropriate treatment of nationally significant rail is not a straightforward issue. The Commission should not attempt to make changes in this area at a late stage of the Review.
- The national significance of rail investment projects, and subsequent 50% treatment, should be determined by the Commonwealth in consultation with states. Instructions on which payments are to receive concessional treatments would then be provided to the Commission through the Terms of Reference.
- If the Commission decides to proceed with its proposal to assess 50% of Commonwealth payments for rail investment, it should be cautious in defining rail projects as "nationally significant", and ensure that the definition is not expanded beyond what is suggested in the Position Paper.

3.1 Outline of changes since the Draft Report

The Commission is proposing to change the treatment of some Commonwealth payments for rail infrastructure. Payments for projects that are deemed to be "nationally significant" will be assessed so that 50% of the payment has no impact on the relativities. Payments for nationally significant projects will be identified based on advice from the Department of Infrastructure and Regional Development on which payments affect the national rail network.

3.2 Queensland's views

Queensland is concerned the Commission is seeking to implement a new proposal for the treatment of Commonwealth payments for rail infrastructure at this late stage of the review. The recognition and appropriate treatment of nationally significant rail payments is not a straightforward issue.

National Network Roads are assessed so that 50% of the payment does not impact on relativities because the Commission's assessment of roads investment uses state-based disabilities which cannot account for the need to invest in a national road network. For roads, the identification and appropriate treatment of nationally significant payments is straightforward. In recognition of the need to maintain a national road network, the Commonwealth provides funding for that purpose and provides minimal funding for other roads, recognising that other roads construction is a state activity. The national network is clearly defined and other complicating factors (such as the impact of private service provision) are very limited.

Conversely, rail issues are far more complicated. The Commonwealth provides funding for a range of different projects on a case-by-case basis. Some of these may have national significance, but others (such as projects whose main purpose is passenger transport in large cities) are of local benefit and are provided as infrastructure assistance rather than as part of a broader national purpose. Unlike national network roads, identifying nationally significant rail is problematic, and the impacts of various rail networks on states' fiscal capacities are difficult to recognise consistently because of differences in ownership and operations.

The Commission's reasons for making the proposed change late in the Review are not fully explained in the Position Paper. The paper states that the Commission intends to treat all Commonwealth payments for projects which affect the national road or rail networks in the same way.

Conceptually, Queensland supports the Commission not fully redistributing Commonwealth payments that provide for national (rather than state-based) need. However, it does not follow automatically that symmetry in the treatment of roads and rail payments is necessary or desirable:

- Since roads and rail investment needs are assessed in different parts of the Investment category using different methodologies, it could easily be the case that different treatments of related Commonwealth payments are required;
- Methodologically, the identification and treatment of payments for nationally significant rail is far more complex than for roads (this is discussed in Section 3.3); and
- Given this methodological complexity, it is preferable for nationally significant rail to be defined through the Terms of Reference. Ideally, the Commonwealth would have clear criteria for rail projects that attract Commonwealth support, and the purpose of that support (national interest or assistance for state activities). Without clarity from the Commonwealth on the purpose of rail payments, the Commission cannot reliably develop criteria for determining national significance and this must be provided through the Terms of Reference. In any case, it is unnecessary for the Commission to develop a methodology for recognising nationally significant rail at this late stage of the Review when an effective mechanism already exists.

A decision on the treatment of nationally significant rail payments should be based on whether a 50% treatment best reflects HFE for rail and whether the treatment can be applied reliably. It should not be based on a perceived inconsistency with the treatment of national network roads.

3.3 Methodological issues with the assessment of nationally significant rail

If the Commission is going to make changes to the methodology at this point in the Review, they need to be confident that the new methodology can be applied reliably and that the changes more closely reflect HFE. Queensland does not believe the Commission can be confident of either of these requirements for the proposal to recognise nationally significant rail projects.

Nationally significant rail infrastructure cannot be identified reliably because there is no single definition of nationally significant rail that would ensure similar Commonwealth investment would receive similar treatment.

Unlike roads infrastructure, which is generally provided by states with some level of Commonwealth subsidy, the provision of rail infrastructure is very complicated. Without a fuller consideration of rail operations and the impact of different service delivery methods and asset ownership on states' fiscal capacities, the Commission cannot be confident that this proposed change improves HFE.

3.3.1 Definition of nationally significant rail projects

There are at least two potential definitions for nationally significant rail. One is the track owned or leased by the Commonwealth Government's Australian Rail Track Corporation (ARTC). Another is the National Land Transport Network, developed from the Auslink national network. These definitions have some overlap, and both contain rail networks or sections of track that are not part of the other[8]. This makes it difficult for the Commission to determine which definition (if either) actually represents "nationally significant" rail. It is not sufficient to simply rely on advice from the Department of Infrastructure and Regional Development without clearly defining the basis for that advice.

From the Position Paper, it appears that the Commission are intending to use the National Land Transport Network as the definition of "nationally significant" rail. This definition is clearly not the single point of truth when identifying "nationally significant" rail:

- Any ARTC network or track must also be regarded as "nationally significant" on the basis that the ARTC is a Commonwealth entity.
- If the ARTC were to incorporate tracks currently owned and managed by Queensland Rail into their national rail network, (most of which are not part of the National Land Transport Network), as has been suggested[9] does this imply that these tracks have now become "nationally significant", or perhaps were always "nationally significant"?
- Future projects of clear benefit to multiple states, or involving the ARTC will not necessarily form part of the National Land Transport Network. For example, the proposed Inland Rail project (linking Melbourne and Brisbane) is described by the ARTC as the "backbone for the national interstate freight network"[10] but is not currently part of the National Land Transport Network. Even if networks such as Inland Rail are eventually added to the National Land Transport Network, this is unlikely to be known at the time of construction or when the Commonwealth makes its contribution to investment funding.

3.3.2 How should the methodology treat networks that are not state-owned?

If the Commission were to recognise the extent to which nationally significant rail projects impact states' fiscal capacities, they would need to ensure that all nationally significant rail networks are treated consistently.

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[8] Examples of this can be seen in Attachment 1 to Section 3. In Queensland, the North Coast line to Townsville is part of the National Land Transport Network rail corridors, but is not part of the ARTC (Maps A and B). In Victoria, the ARTC line from Maroona to Portland is not identified as part of the National Land Transport Network (Maps C and D).

[9] Media release, Queensland Minister for Transport and Main Roads, J*oint statement: ARTC to investigate incorporating Queensland into the national rail network* (25 February 2014)

[10] ARTC Media Release, *ARTC and Port of Brisbane Sign Cooperation Deed* (1 June 2014)

If the Commission considers that a state-owned segment of the national land transport network has a dual state/national purpose, it follows that this is also the case for segments that are owned or leased by the ARTC. Rail networks owned by the ARTC can be expected to impact on states' fiscal capacities, providing a substitute for networks that would otherwise be owned by the states.

As well as providing payments to states for state-owned rail networks, the Commonwealth supports the ARTC through equity injections and direct payments for capital improvements to the ARTC-owned segments of the network. In the current proposal, these payments do not affect the relativities. This creates an inconsistency for the Commission, where Commonwealth subsidies are treated differently for state-owned and ARTC-owned segments of the network, even though these can be expected to provide similar "spill over" benefits to states.

These inconsistencies are compounded by the role of privately owned networks. In many cases, these serve a similar purpose to rail networks owned by the ARTC, or on the national land transport network. For example, large sections of the coal freight rail network in Queensland are privately owned (see Attachment 1[11]). Arguably, there is no need for the Commonwealth or states to maintain rail freight networks, even when these have significant national benefits, if they are provided by the private sector. However, they are likely to impact on Commonwealth and state requirements to provide rail freight infrastructure.

Differences in ownership and incorporation by the ARTC are particularly important because of the large variation in the ownership and operation of rail in different states. For example, Attachment 1 to Section 3 compares National Land Transport Network corridors with rail network overviews, including ARTC lines, for Queensland and Victoria. Large sections of Victoria's National Land Transport Network are part of the ARTC network[12] – this means that Commonwealth support for these tracks will not impact the relativities. In contrast, only a very small component of Queensland's network is part of the ARTC[13], so any Commonwealth support for state-owned track would be assessed by the Commission.

3.4 Conclusion

The Commission should not attempt to address these complex issues in the time remaining for the 2015 Review. The key issue is that state and national requirements for rail investment and the extent to which these are met by Commonwealth payments to states, Commonwealth-owned entities and the private sector are complicated. This is in contrast to roads investment, where the consistent treatment of Commonwealth subsidies is straightforward.

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[11] Map A - Rail Networks of Queensland Systems overview (Queensland Rail). The Aurizon network services mining areas in central Queensland.
[12] Maps C and D – Victorian Regional Rail Network (Essential Services Commission) and National Land Transport Network rail corridors, Victoria. ARTC lines include the National Land Transport Network corridors from Melbourne to Serviceton and from Melbourne to Albury.
[13] Map A – ARTC line from northern New South Wales to Brisbane only.

If the Commission decides to proceed with its proposal, it should be cautious in classifying rail segments as "nationally significant" as the definition of national significance is problematic. The Commission should ensure that its definition is not expanded beyond what is deemed nationally significant in the Position Paper. Any additional rail payments should not be deemed nationally significant unless specified in the Terms of Reference.

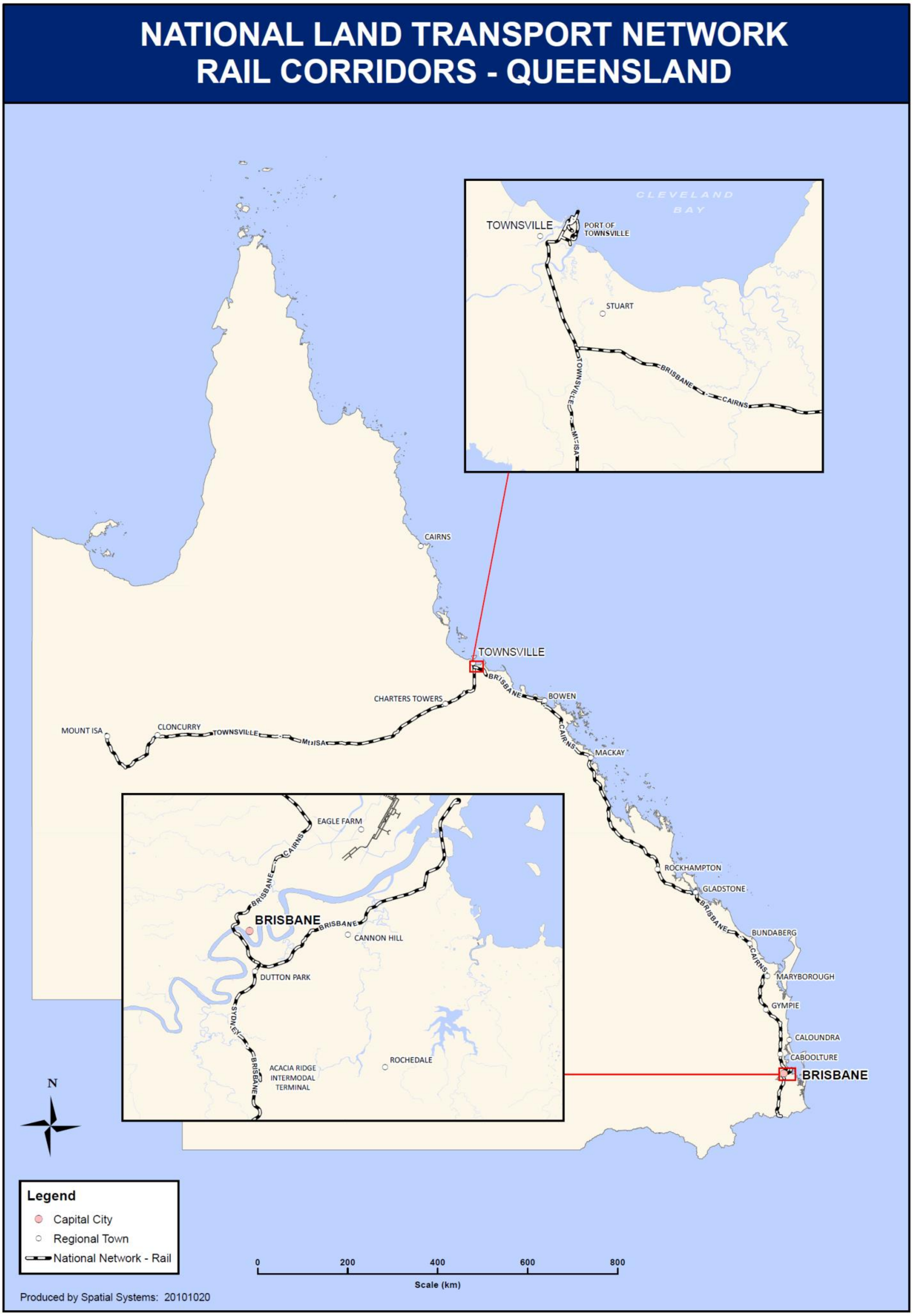
Recognising that rail is complex and there is insufficient time to unravel the issues with its treatment in the eight weeks before the release of the final report, the most reasonable option is not to proceed with the proposal in the Position Paper. It is unnecessary to implement an underdeveloped proposal because the Terms of Reference already provides a mechanism for nationally significant rail payments and their preferred treatment to be identified. The Commonwealth, in consultation with states, are best placed to determine the national significance of rail payments, where no clear rule can be easily developed by the Commission.

Rail Networks of Queensland
Systems overview

Queensland Rail ABN 68 598 268 528

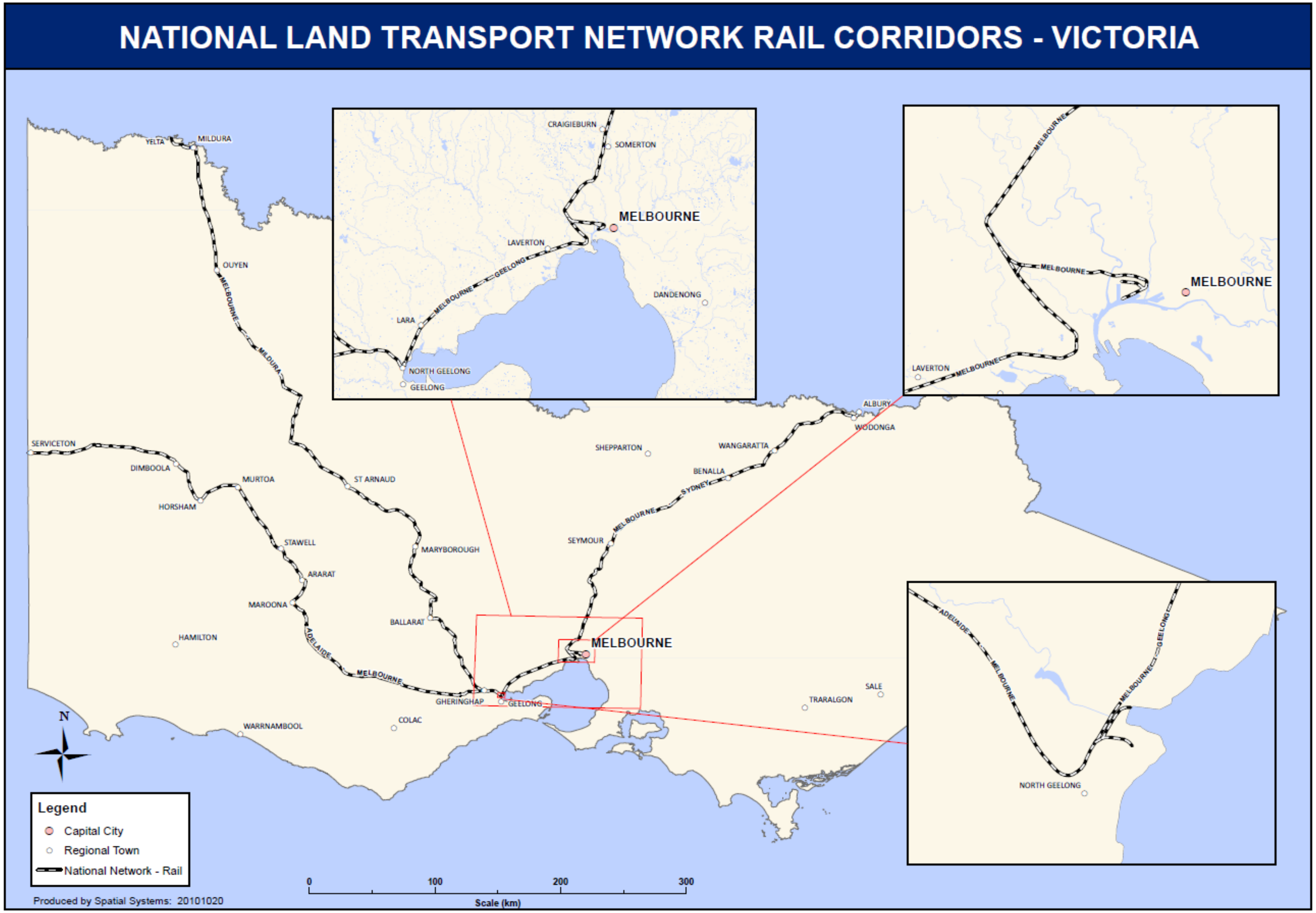
QueenslandRail

SECTION 3 ATTACHMENT 1 – MAP B



SECTION 3 ATTACHMENT 1 – MAP C

SECTION 3 ATTACHMENT 1 – MAP D



4. MINING REVENUE ASSESSMENT

Queensland's position

- Queensland is concerned with the very late development of considering matters of contemporaneity and adjustments in an attempt to deal with falling iron ore prices.
- A more broad-based review of issues relating to contemporaneity and volatility would be more sensible, rather than any narrowly focused special consideration for specific mineral royalties. This cannot be done for the 2015 Review.
- Rushed consideration of these matters at a very late stage will not provide adequate opportunity for rigorous scrutiny of the Commission's approach, and could erode confidence in the Commission's HFE task.
- Queensland supports contemporaneity in principle, but it needs to be balanced with stability - contemporaneity should not be at the cost of simple, reliable and robust assessments with stable outcomes. Full contemporaneity is likely to have large unpredictable impacts.
- The Commission's current three year averaging with lags strikes a reasonable balance between contemporaneity, stability, accuracy and predictability.
- Queensland broadly supports Western Australia's concerns about own source revenue volatility, but it is too late in this Review to entertain such far reaching issues of HFE.
- The need to have symmetry over the equalisation cycle is also important, rather than potentially applying one treatment on the up-cycle and another treatment on the down-cycle. The slowing of the resources sector will have large impacts on the revenue of both mining and non-mining states through GST shares.
- The Commission must be cautious to not solely consider the volatile revenue of Western Australia in isolation. This would necessarily be to the detriment of all other states. Such an approach may address Western Australia's concerns about its current fiscal circumstances, but it may result in a piecemeal and partial approach to the revenue difficulties of the States, and may compromise the application of the principle of HFE.
- It would be unreasonable for Western Australia's circumstances to be addressed by the Commission at the expense of Queensland. The Queensland Government has undertaken a significant task of fiscal repair, at a time when coal prices have fallen significantly, and royalty revenue write-downs have occurred. Given the fiscal efforts Queensland has undertaken to date, it would be unfortunate if Queensland now was to be unfairly penalised by actions designed to cushion the impact of revenue write-downs in other jurisdictions.
- The impact of higher effective royalty rates on iron ore fines should not be phased in. Phasing-in is at odds with HFE. With the removal of the specific Terms of Reference (ToR) direction relating to iron ore fines, the Commission must implement the approach that best reflects HFE, and fully recognise the impact of higher effective royalty rates.

4.1 Contemporaneity

4.1.1 An important HFE discussion, but one to be had in the next Review

Queensland has, for a number of years, recognised the need for improvements to be made to the Mining Assessment. At the same time Queensland has emphasised that any changes to these rules must be fairly applied to all States and Territories.

To address the impact of falls in iron ore prices, the Commission has been tasked to provide an alternative set of relativities. Addressing the impact of iron ore prices will presumably necessitate adjusting the degree of contemporaneity, either overall or solely in the mining assessment.

Queensland is concerned that the issue of contemporaneity and adjustments for volatility are being considered at a very late stage of this Review, and there will not be adequate opportunity for rigorous scrutiny of the Commission's proposed approach to this issue. Queensland is reminded of the outcomes of the last minute changes to the mining assessment in the 2010 Review that led to a remarkable erosion of confidence in the Commission's equalisation task.

Queensland supports a more broad-based review of issues relating to contemporaneity and volatility of the Commission's assessments, but this is simply not possible in the time remaining for this review.

Western Australia has raised concerns over the degree of revenue volatility created by lagged assessments. For example, substantial falls in the iron ore price (and royalty revenue) will not affect relativities for a number of years, increasing the difficulty of managing volatile revenues in state budgets.

Following the release of the Position Paper, the Federal Treasurer wrote to the Commission requesting advice on an approach that would '*mitigate negative effects of revenue volatility on the GST distribution system and ensure that states' shares of the GST in a given year are appropriate for their fiscal circumstances in that year*.'

Queensland shares these concerns in principle and agrees that it is difficult in practice for governments to 'bank' the temporary benefits of lagged equalisation as a reserve for future equalisation losses. However, Queensland is not convinced that a more contemporaneous approach would be practical, particularly in the time remaining for the 2015 Review. Such an approach would need to rely on projections of important data, with revisions made in following years after actual data becomes available. It is also unclear whether it would be an improvement on the current approach - it may not be worthwhile to implement a fully contemporaneous assessment where significant revisions are required each year to offset inaccurate projections.

Queensland agrees with the Commission that state or independent forecasts of revenues in the application year are insufficiently reliable for the Commission to use as the basis of GST distribution. Forecast errors can be large and would require consequent GST adjustments to compensate. This issue alone is sufficient to not base GST distribution on forecasted conditions.

Under a fully contemporaneous approach, it would also be necessary to develop a methodology for creating forecasts for relativity purposes. States' own forecasts are likely to rely on different assumptions and methodologies which would make them unsuitable for use in the Commission's methodology. Developing a methodology for producing reasonable and consistent forecasts of the data required for the Commission's assessments would be a major new area of work.

It is also possible that forecasting the data required for fully contemporaneous equalisation is not practical with the current level of complexity in the Commission's assessments. If full contemporaneity is to be attempted, the Commission may need to develop assessment methods that are simpler and broader, which may be better suited to the forecasting of key parameters.

It would not be practical to attempt this in the time remaining for the 2015 Review. If a fully contemporaneous method is to be implemented, this should form part of a future review.

The issue of whether fully contemporaneous assessments are desirable also raises the larger question of what HFE is intended to achieve. While a fully contemporaneous assessment would assist in reducing revenue volatility, it would also be less accurate (being based on projections) and less predictable.

In past reviews, the Commission have alternated between three and five year averaging of relativities in attempts to strike a balance between these issues. The Commission notes that with the exception of backcasting major changes in Commonwealth-State financial arrangements where the change is reliably known, it considers a 3 year lagged assessment the most reliable practical approach to providing a reasonable estimate of State circumstances in the application year.

For the 2015 Review, Queensland agrees – the Commission should maintain this approach in this methodology review. The current system of lags and three year averaging strikes a reasonable balance between contemporaneity, stability, accuracy and predictability. Using forecasts of royalty revenue are insufficient and unreliable as the basis of the GST distribution. The circumstances in which major changes in Commonwealth-State financial arrangements are backcast are entirely different to current circumstances surrounding iron ore fines.

Queensland supports contemporaneity in principle, but contemporaneity should not be at the cost of simple, reliable and robust assessments with stable outcomes. A broader discussion on the relative importance of contemporaneity in the implementation of HFE would need to be undertaken prior to the Commission pursuing a more contemporaneous methodology, potentially in a future review.

4.1.2 Adjustments for revenue base shocks

No mineral royalties should be given special treatment in the Commission's assessment, yet the issues of contemporaneity and adjustment in the mining assessment are seemingly being driven by Western Australia's forecast falls in iron ore royalties, and impacts from their increased royalty rate on iron ore fines.

The need to have symmetry over the equalisation cycle is very important. Queensland would not want a situation where the Commission, either directed to, or reacting to the impacts of one-off shocks, applies one methodology or treatment on the up-cycle, while another methodology or treatment potentially applies on the down-cycle. Over the history of HFE, all jurisdictions have needed to absorb and manage volatility in their GST shares brought on by varying economic shocks.

A number of states have been affected by falls in commodity prices, resulting in major reductions in revenue from mining royalties. In particular, the downturn in coal prices has had a major impact on Queensland's budget. Between 2012-13 and 2015-16, revenue write-downs from all royalties have so far amounted to $4.9 billion. New South Wales, South Australia and the Northern Territory have also made revenue write-downs. It is essential that any proposed changes to the Mining Revenue assessment are universally applied to all jurisdictions.

For the purposes of the 2015 Review, the current approach of a three-year lagged average would appear to adequately address concerns relating to revenue volatility, including reductions in iron ore royalties currently anticipated by Western Australia. While Western Australia experienced particularly strong royalty revenue in 2013-14, the state has estimated that 2014-15 royalty revenue will fall to a level similar to 2012-13, and afterwards continue to grow[14]. A three-year lagged average assessment of the unusually high 2013-14 royalty revenue makes it unlikely that WA's assessed royalty capacity will differ significantly between assessment years and the application year.

Conversely, if a fully contemporaneous assessment had applied in 2014-15 and relied on forward estimates of iron ore prices, the assessment would have been extremely inaccurate, less predictable and no less volatile.

The fall in royalties currently estimated by Western Australia does not appear to warrant significant changes to HFE at this late stage of the 2015 Review.

The slowing of the resources sector is likely to have large impacts on the revenue of both the mining and non-mining states through GST shares. A fully contemporaneous assessment would have large, unpredictable impacts on all states' GST shares.

4.2 Phasing in of iron ore fines

Similar to the Draft Report, the Position Paper emphasises that the Commission's primary objective is achieving HFE. However, the Position Paper does not suggest reversing the Draft Report proposal to phase-in the impact of higher royalty rates on iron ore fines, even though this is clearly at odds with HFE.

Subsequent to Western Australia removing the royalty rate concessions on iron ore fines in 2010, the Commonwealth issued a specific ToR direction to ensure that iron ore fines remained in the low royalty rate group for the 2011, 2012, 2013 and 2014 Updates until a new mining assessment could be developed in the 2015 Methodology Review. This direction has now been removed from the Terms of Reference.

The removal of the Terms of Reference direction for the treatment of iron ore fines is a clear indication that the Commission are expected to implement the methodology that best reflects HFE. The Commission have not been asked to take action to phase-in or smooth the impact of the new mining assessment on Western Australia because the original ToR

[14] Western Australia 2014-15 Government Mid-Year Financial Projections Statement

direction was only ever intended to be an interim measure until a new mining assessment could be developed. It is not consistent with the current ToR for the Commission to continue to apply a special treatment for iron ore fines. The 2015 Review should fully recognise the impact of higher effective royalty rates.

4.3 Assessment structure

A mining assessment based on a single aggregated minerals structure would strike a more appropriate balance of HFE and its principles. This approach would greatly enhance the policy neutrality of the assessment and reduce the potential for grant design effects while still assessing each state's relative capacity to raise revenue through mining royalties. It would also remove the potential for minerals to move between groups or redistribute a proportion of revenue when a commodities' royalty rate is changed.

If an aggregated mining revenue assessment is rejected, it may be preferable to retain the current two-rate structure (with iron ore fines appropriately in the higher rate group) but address its shortcomings in dealing with cases where there are significant changes to royalty rates. At least the methodological shortcomings of a two rate mining assessment are well understood and the grouping has some relationship to 'what states do'.

If the two rate structure were to be retained, a remedial arrangement would be required to ensure the assessment structure addresses potential mobility of minerals between mineral groups rather than a reliance on Terms of Reference directives. It is conceivable that provisions in the methodology could be established to adequately address changing royalty rates between reviews and guarantee an outcome consistent with the overarching principles of equalisation.

4.4 Conclusion

While noting that the Commission has been set this task, at this late stage Queensland is concerned about any rushed consideration of contemporaneity matters and adjustments for sudden or large-scale shocks to revenue bases. There will not be adequate opportunity for rigorous scrutiny of the Commission's proposed approach to this issue. A more broad-based review of issues relating to contemporaneity and volatility would be more sensible, rather than any narrowly focused special consideration for specific mineral royalties, yet this cannot be done for the 2015 Review. The need to have symmetry and consistency over the equalisation cycle is also important to Queensland, rather than potentially applying different treatments or adjustment during the equalisation cycle. Equally, it is essential that any proposed changes to the Mining Assessment in relation to contemporaneity or volatility adjustments, are universally applied to all jurisdictions.

5. MINING RELATED EXPENDITURE

Queensland's position

- Queensland welcomes the new assessment to recognise some elements of additional mining related expenditure. This is a step forward in the Commission's methodology that can be built on in future reviews, where a more holistic approach could be attempted which assesses the impact on fiscal capacities of both mining revenue and associated expenditures.
- There are further areas of expenditure that could still be recognised in the 2015 Review, most notably for roads related to mining economic activity.
- Queensland looks forward to working with the Commission during the next Review to progress work on recognising all mining related expenditure in its assessment.

5.1 Outline of changes since the Draft Report

The Commission intends to assess additional elements of mining related expenditure not recognised in the Draft Report:

- Planning and regulation of investment projects (assessed using state shares of private non-dwelling construction expenditure); and
- Capital grants to local governments relating to community development and amenities and culture and recreation (assessed using population growth).

5.2 Queensland's views

Ideally, the Commission would assess mining revenue on a net basis. This would reduce the mining revenue of states, and their assessed capacity to raise revenue, by the expenses and other costs they had to incur to grow their revenue capacities. Currently, there is an asymmetry in the Commission's assessments, where the impact on fiscal capacities of mining revenue is recognised but the associated expenditure is not.

In the course of the Review, Queensland has provided the Commission with clear evidence and data to support full recognition of mining related expenses in its assessments. This has clearly demonstrated how government involvement is integral to mining industry development, though returns from this investment are uncertain and often slow in coming.

Queensland welcomes the proposal in the Position Paper to recognise some additional elements of mining related expenditure. Along with the Draft Report proposal, the 2015 Review methodology would now recognise mining related expenditure in the areas of mining regulation expenditure, planning and regulation of investment projects and capital grants to local governments.

While this approach is only a partial recognition of mining related expenditure, it is a step forward in the Commission's methodology. There are also other important elements of mining related expenditure where recognition in the Commission's methodology is achievable in the time remaining for the 2015 Review (business development expenditure, environmental protection and roads relating to economic activity).

Future reviews can build on the 2015 Review work to ensure that the expenditure associated with supporting mining industry growth is fully recognised. This may indicate a more holistic approach, where the full costs of industry development and support are recognised, along with the extent to which these are provided by government. This kind of approach may be more relevant in the future as the delivery of services changes to be made more contestable.

5.3 New proposals for assessing mining related expenditure

Queensland supports the Commission's proposal to introduce assessments of expenditure related to the planning and regulation of investment projects and capital grants to local governments (relating to community development and amenities and culture and recreation).

5.3.1 Planning and regulation of investment projects

Prior to the release of the Draft Report, the Commission collected data from states on expenses associated with the planning and regulation of investment projects. This data covered all projects, including (but not limited to) mining-related expenditure. The Positon Paper proposes to assess this expenditure using a broad indicator of the level of construction activity (states' shares of private non-dwelling construction expenditure).

While Queensland's preference is for the Commission to explicitly recognise the additional needs of mining states through indicators directly related to mining (such as the level of new mining investment), the more general indicator of construction appears to be a reasonable alternative. This reflects the higher levels of construction in mining states and is well-aligned with the data collection (which did not specifically focus on mining related expenditure). In a future review, the Commission should further investigate assessing mining related planning and regulation of investment projects more directly.

5.3.2 Capital grants to local government

The Commission's proposal to assess capital grants to local governments recognises the impact of rapid population growth on states' needs to provide grants relating to community development and amenities and culture and recreation. Queensland supports this proposal, as the rapid population growth experienced in mining communities places demand on local government infrastructure, and on grants provided by states governments.

5.4 Other elements of mining related expenditure not recognised

While Queensland welcomes the Commission's proposal to recognise additional elements of mining related expenditure, there are further elements the Commission has not proposed to recognise at this stage, which can be incorporated in the time remaining for the 2015 Review.

5.4.1 *Business development expenditure*

Queensland has provided information detailing the business development support it provides to the mining industry, and data on the costs. This includes a range of business development expenditures that would not be required for other industries (such as resources policy, the Gasfields Commission, mine water management and the Coal Infrastructure Coordination Taskforce). This is clear evidence that mining states incur additional expenditure for business development.

While it would be simplest to group additional elements with broad indicators the Commission is already using, Queensland does not believe the proposed indicators are very closely related to business development expenditure. A more reliable indicator would be private sector investment in the mining industry.

5.4.2 *Environmental protection*

The nature of mining operations and its potential environmental impacts means that mining states have higher environmental protection expenditure than non-mining states. This conceptual case was supported by state data returns, which showed higher levels of environmental protection expenditure for mining states (Table 22 of the Services to Communities attachment in the Draft Report). Queensland has also provided data on the costs of environmental assessment functions specifically related to mining projects.

This element should also be assessed using an indicator directly related to mining, such as private sector mining investment.

5.4.3 *Roads relating to economic activity*

The Commission has collected data on the location and lengths of roads relating to economic activity that are not currently included in the synthetic roads network. This includes the industry to which these roads mainly relate and details of the purpose of each road and the areas it connects. This information demonstrates that states build and maintain roads where the main purpose is the support of economic activities, and that these roads are not recognised in the current synthetic roads network.

The Draft Report advised that this issue was yet to be addressed, and that there would be further consultation with states before the final report. Queensland looks forward to engaging with the Commission further on this issue in the time remaining for the Review.

6. HEALTH ASSESSMENT

Queensland's position

- At this late stage of the Review, the Health assessment is still being developed, with late collaboration with States. Queensland has unsuccessfully requested the data and calculations used to standardise bulk billing services. Without this information, it is difficult to make meaningful comment.
- Queensland supports the direction of work on the ranges of substitutability, but there is room for improvement, for example community health substitutability should be closer to 50%.
- The timeframe for developing the Health assessment has not been ideal, placing pressure on states which gives little time for in-depth analysis.

6.1 Outline of changes since the Draft Report

Further to the Draft Report, the Commission proposes the following changes to the Health assessment:

- The Commission is not considering changes to the structure of the Health assessment. Health will be assessed using a direct approach based upon administrative data on state provided services, with economic factors used to reflect the effect of private provision on state provided services.
- To calculate the economic environment factor, the Commission intends to standardise bulk billed services by Indigeneity, remoteness, SES and age (the draft report standardised just for indigeneity and remoteness).

The Commission engaged two consultants to examine and report on substitutability. These reports were provided to States shortly after the Commission position paper. Subsequently, the CGC released a Health substitutability report to States. With submissions to be provided by the end of the month, states have fourteen and five working days respectively in which to consider each lengthy report.

In our response to the Draft Report, Queensland indicated our support for the development of a new health assessment in the future where there is sufficient time to introduce a fully formed methodology, greater opportunity for state consultation and uncertainty around the IHPA data is resolved.

At this late stage of the review process, the Health assessment is still under construction and continuously subjected to significant changes, updates and consideration of conceptual cases, data and assessment method.

There has been little time for states to fully digest and analyse the implications of the consultants' reports and the subsequent Health substitutability report to make meaningful comment for the Commission's consideration prior to the release of the final report.

6.2 Standardisation of Bulk Billed services

At the time of the Draft report, the Commission advised they were not able to standardise by SES and age as they had not been able to source the data required. Queensland understands the Commission are now able to standardise bulk billed services by Indigeneity and remoteness, and SES and age, using Medicare data.

Queensland has requested the Commission provide states with the Medicare data and the Commission's calculation methods for States' perusal and further analysis. Queensland would like the opportunity to review and be assured that, while still only in its infancy, the Health assessment is at least sound and a basis for continual development towards a robust methodology.

6.3 Substitutability - consultants' reports

The Commission individually engaged consultants Elizabeth Savage and James Downie to review and advise on the methodology proposed by the Commission with particular focus on substitutability, that is, what percentage of State provided health services can be provided by non-State providers.

Advice on the consultants' reports was sought from Queensland Health. Queensland is able to make the following comments in the short time frame provided:

Admitted patients

Savage's view is that additional work should be undertaken to test for State differences in private and public hospital rates within major cities.

Downie comments that substitutability for admitted patients is likely to be less than 28%, where 28% is derived by multiplying 47.2% (percentage of the population who have private hospital cover) by 60% (proportions of admissions that were non-emergency).

As substitutability is premised on those who use State provided health services as oppose to the general population, it is the proportion of publicly admitted patients who have private hospital cover that is relevant, not the proportion of the total population that has private hospital cover. This is only around 10%[15]. Using 10% instead of 47% reduces substitutability to around 6%. Further, some patients who have private hospital cover but are currently seen in the public system would not avail themselves of private services because of policy excesses and gaps, lack of private hospitals in their region, lack of private hospitals that provide the treatment they need in their region and so forth.

Queensland views where substitutability exists in admitted patients, the percentage of substitutability would be low.

Emergency department

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[15] King, D. (April 2013) *Private patients in public hospitals*, available from https://www.ahsa.com.au/web/freestyler/files/Private%20Patients%20in%20Public%20Hospitals%20May%202013.pdf (accessed 4/12/2014)

Savage provides a substitutability range of 10% to 20% with 20% being a suitable approximation level.

Downie says substitutability is 15%.

Queensland's view is that both consultants' conclusions appear reasonable and agrees with a substitutability level within the range of 15% to 20%.

Outpatients

Savage notes that the percentage of bulk billed specialists visits is low where:

- For specialists, the level of substitutability is considerably low due to the considerable price constraint of services not bulk billed.
- For pathology and imaging, where most services are bulk billed, there would be a high level of substitutability as there is no price constraint.

Savage considers that using bulk billing specialists, pathology and imaging, as the proxy of private provision seems appropriate. She concludes that determining the level of expenses associated with specialists and pathology and imaging within a public hospital will be able to assist in the determination of the approximate level of substitutability.

Downie estimates substitutability at 55% based on bulk-billing rates for all non-admitted patient services including pathology and diagnostic imaging.

Queensland considers it would be appropriate to exclude pathology and diagnostic imaging before estimating substitutability.

- In general these are bundled as part of the underlying service. For instance, if a medical specialist does not bulk bill but refers patients to a bulk-billed pathology service, the fact that the pathology service is bulk-billed is unlikely of itself to induce the patient to see a private specialist.
- Moreover, the National Health Reform Agreement limits substitutability for pathology and diagnostic imaging. In the case of public outpatient services, public hospitals are not able to bulk bill the associated pathology and diagnostic imaging.

Based on bulk-billing rates for all non-admitted patient services, including pathology and diagnostic imaging, Downie's estimate of 55% substitutability appears too high.

It would be more appropriate to exclude pathology and diagnostic imaging before estimating substitutability, and focus on the percentage of bundled services that are substitutable.

Community Health

Savage considers substitutability is likely closer to 50% than 75%.

Downie thinks a 75% substitutability factor appears reasonable.

Queensland considers Downie's estimate of 75% is likely too high and an estimate closer to 50% is reasonable. There is very little data on which to base an estimate for community health (nor is not even a generally agreed definition of community health). However:

- Many community services are targeted at client groups who are unlikely to access private services. For instance, oral health services have eligibility criteria which exclude most people who are likely to access private dentists.
- The State provides a broad range of primary health services as 'provider of last resort' in rural and remote communities where there are no private doctors. These services are not substitutable.

Overall, Queensland considers there is sufficient evidence to reduce the substitutability placeholder estimates of each component. If the Commission cannot determine what the substitutability percentage should be reduced to, a discount of 50% should be applied to the placeholders.

6.4 Health Substitutability report

Commission staff have analysed the consultants' reports and with other considerations, including a change in assessment method, have concluded the following substitutability ranges will be recommended to the Commission:

- **Admitted patients** – within the range of 10-20%.
- **Emergency department** – within the range of 10-20%.
- **Outpatients** – within the range of 40-45%.
- **Community Health** – within the range of 60-75%.

With the limited time in which to consider the implications of the report, Queensland supports the direction of work on the substitutability ranges.

6.5 Way forward

While Queensland appreciates that staff have shared with states how the available information (up to the consultants reports) have been assessed and what advice staff intend to provide the Commission, it is evident the Health assessment has run on a timeline that is not ideal, placing much pressure on states which gives little time for in-depth analysis.

Whilst Queensland supports the direction of work on the ranges of substitutability, we consider there is room for improvement as substitutability for outpatients and community health are still slightly high, i.e. substitutability for community health should be closer to 50%.

Further consultant with states after the Commission has considered the Health assessment is preferable. A fully formed and robust methodology is preferred over a rushed methodology that requires revision where it may not hold up to a reality test.

7. WELFARE ASSESSMENT

Queensland's position

- Queensland supports assessing other general welfare using the bottom quintile of the 2006 Socio-Economic Index for Individuals (SEIFI), with an adjustment (based on the proportion of Health Care Card holders) to reflect changes in states' circumstances since the 2006 Census.

7.1 Outline of changes since the Draft Report

The choice of a broad indicator for the other general welfare component of the Welfare category was last addressed in Staff Discussion paper 2014-03-S *Update and Supplementary Issues for the 2015 Review*. That paper proposed using the proportion of one parent families with dependents, as the ABS Socio-Economic Index for Individuals (SEIFI) has not been updated for the 2011 Census.

Position Paper 2014-04 instead proposes to assess other general welfare by adjusting the 2006 SEIFI (bottom quintile) for more recent changes in state circumstances, using the proportion of Health Care Card holders in each state.

7.2 Queensland's views

Queensland agrees that SEIFI is an appropriate measure for the other general welfare component of the Welfare category. Ideally, 2011 SEIFI would be used because it is a broad, policy neutral measure of disadvantage that would reflect the most up-to-date Census data. However, the ABS has not yet developed a 2011 Census version of SEIFI. From the Commission staff responses to questions raised by the ACT (circulated on 5 December 2014), it is understood that the ABS intends to develop a 2011 index, though it is not clear when this will happen.

The age of the 2006 SEIFI means that it cannot be used as an indicator without adjustment. It is clear from other indicators of socio-economic disadvantage, such as the proportion of Health Care Card holders, that state circumstances have changed since the 2006 Census.

Until the ABS produce a household level socio-economic index for the 2011 Census, Queensland supports the Commission adjusting the 2006 SEIFI measure using changes in the proportion of Health Care Card holders in each state. As SEIFI is a broad measure, this is likely to produce a more reliable outcome for the assessment of general welfare than the preferred option from the Supplementary Issues paper (the proportion of one-parent families with dependents). The proportion of Health Care Card holders is a policy neutral indicator of the socio-economic status of individuals and will reflect states' changing circumstances.

If the ABS does not produce an updated version of SEIFI in the next few years, a future update will need to consider whether using 2006 SEIFI with adjustments is the best option for this assessment in the longer term, or whether an alternative approach needs to be developed.

8. REGIONAL COST GRADIENT

Queensland's position

- Queensland supports extrapolation of the ACARA regional cost gradient to other categories, rather than a general regional cost gradient that combines ACARA data with out-of-date police expenses data.
- The Commission has not indicated when and if they intend to update the police data. Queensland supports further work on the police data in the near future, with preference for the 2016 Update, so that the data remains contemporary to be used as a base for any cost gradient.

8.1 Outline of changes since the Draft Report

Further to the Draft Report, the Commission proposes the following changes to the Regional costs assessment:

- A general regional cost gradient - the average of the schools education and police gradients - is to be extrapolated to categories (other than Schools education and Justice).
- The regional cost factors for all categories (other than Schools education and Justice) have been derived using the general cost gradient and a client base or expense base applicable to the category.
- A 12.5% discount has been applied to the regional cost factor for all categories in which the general gradient cost gradient has been used.

8.2 Regional costs gradient

Queensland continues to support the extrapolation of the schools regional cost gradient, based on ACARA data, to the relevant categories.

The Commission intends to use a general regional cost gradient because it draws on two different service delivery models, creates a smoother gradient and assists in reducing the sensitivity of the gradient to changes in ACARA over time. Queensland refers to advice provided in the Draft Report that the ACARA data is based on higher quality data, and therefore is a more reliable measure of regional costs, whereas the police data is based on state provided data from 2008-09 with no update. This reasoning is sounder for extrapolating the ACARA gradient as opposed to the general regional cost gradient. A general regional cost gradient can be reconsidered when the police data is updated.

8.2.1 Police data

In the Draft Report the CGC questioned the merit in obtaining updated police data given the burden it placed on states. The 2008-09 data was collected for the purpose of the 2010 Review and in hindsight, given the quite different gradient the new ACARA data produced, it would have been purposeful and accurate to update the police data for the 2015 Review.

The police data should not be used in this review because:

- There could have been changes over the last five years that would have resulted in changes to the cost gradient.
  - In the Draft Report, the Commission state without significant improvement to the quality of the police data, it is not clear that changes would be meaningfully captured.
  - It is unknown if there is significant improvement to the quality of the police data until such time that new data is collected.
- Given the burden associated with updating the police data, it is reasonable the data is not updated every year. However, data that is not updated at least with each methodology review is unlikely to be reliable.
- Updated police data may be of sufficient quality so as to support the removal, or review, of the 25% discount which is applied for uncertainty.

8.3 Way forward

Further to the Draft Report, the Commission has not indicated when and if they intend to update the police data. Queensland can only see that the issues with the 2008-09 police data will be magnified as the data becomes less contemporary.

Queensland supports further work on the police data in the near future. The quality and reliability of the police data, and its suitability for use in the general gradient is becoming more questionable as the data gets older. Updating the data should be considered for the 2016 Update.