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MR MORRIS: Good morning everyone. I note that Tim Marney - can you hear me all right?

MR ....: Yes.

MR MORRIS: I note that Tim Marney has not yet arrived, but I understand, Alex, that he's not far away somewhere?

MR SCHERINI: He's definitely in this city.

MR MORRIS: He's definitely in the city? Well, Canberra traffic being what it is, he's no doubt held up somewhere, but I think we should start. Welcome everyone. We understand that all of you face considerable demands for your time and attention, and we do particularly appreciate the opportunity that you've given us this morning to meet with you to talk about the progress of the Commission's 2010 review. Can I particularly welcome Michael Schur from New South Wales. This is Michael's first time in this sort of forum. It's a bit of a tough act to, I think, make your debut performance at this particular time of the review, but you are nonetheless very welcome, Michael.

MR SCHUR: Thank you.

MR MORRIS: And can I also welcome Nigel Ray who, as you can see from the expression on his face, is absolutely delighted to be here this morning, and I think, Nigel, this is your first time with your current responsibilities with the Australian Treasury. Can I also, Nigel, through you, thank the Treasury for making this room available for our meeting this morning.

I don't propose to make a detailed opening statement. The draft report which we've circulated sets out the Commission's position on the range of assessment issues for 2010, so we see this morning as far more a time for you to respond to what we have proposed; to indicate where you feel the Commission should undertake further work; or why the position that we have reached in relation to one assessment or another should be revisited.

So we think this meeting is very, very important for you and for us. This I would expect to be the last time that we will have an opportunity to talk face to face before the 2010 review is concluded. We would expect the discussions this morning to be at a high level. Our respective staffs have recently held discussions on the draft report, focusing essentially on technical issues. We understand these discussions have been useful and several areas for further work have been identified and are being followed up. As always, Commission staff are ready and will continue to be ready to address further technical issues that may arise.

What we are proposing in the draft report involves some significant changes, and we don't resile from that. For example, we consider that State capital needs should be reflected in the GST distribution as that capital is constructed or acquired and as their population grows. We consider that the simplification of assessments and the application of our assessment guidelines now improves the balance between methodology, including data quality, and achieving fiscal equalisation. And we consider that the move from five to three-year averaging is the right thing to do. Making the relativities more contemporaneous means that they better reflect actual State fiscal circumstances in the application year, and we think this is consistent with strengthening the robustness and wider acceptance of equalisation.

We know from your submissions and from the recent round of staff level discussions that views differ in each of these areas and, as a result of the visit of Commission staff to states over the past weeks, we are already aware of some state concerns. For example, with the assessment guidelines, their use and consistency. Some states are concerned that we have been inconsistent in the use of the assessment guidelines. We welcome states identifying areas where that may be the case, and we aim to ensure consistency of treatment in the final report.

In relation to discounts, at several places in the draft report we have discounted the impact of certain data or derived differences between the states. Consistent with the assessment guidelines, we have done this because of concerns over the quality of available data. We understand that in some cases states are concerned that a discount is not a conservative approach in the face of data uncertainty. If states believe we have discounted inappropriately in some cases and can point to data or evidence which supports their view, we will reconsider the discounts we have applied.

On the role of judgment, some states have been critical of the Commission using judgment rather than only making assessments where there is high quality data. As a general approach, we would prefer not to have to make judgments, particularly where the issue is data quality. However, when we are given a strong conceptual case and evidence such as in the form of submissions from service providers or indeed what we ourselves have seen on state visits, and when we are confident the issue is material, we believe the exercise of judgment, when data quality is poor, is entirely appropriate. We would not be closer to fiscal equalisation by ignoring the evidence provided. We believe that whenever we have exercised judgment, we have acted conservatively and in keeping with the aim of achieving fiscal equalisation. We welcome your observations if you consider we have not exercised our judgment conservatively, or indeed if you feel we've been too conservative, always keeping in mind that our obligation is to deliver fiscal equalisation.

On the basis of your advice and in the light of our own requirements, a draft agenda has been circulated. In line with our normal practice, I propose to give states the opportunity to speak to each agenda item. We will take your comments today as the first instalment of state responses to the draft report, with final comment coming in the form of state submissions due in September.

When we circulated the draft agenda, we did so on the basis of what appeared to be a logical order of discussion. Now, I understand that Nigel is with us until 11, and it would be my expectation that the discussion of item 5 at least, The Treatment of Commonwealth Payments, is one that you would probably want to have with Nigel present and, if that is the general sense, then we can adjust the agenda to make sure that we have that discussion while Nigel is here. You may also think there would be benefit in having the discussion on Transitional Arrangements, if any, while Nigel is here. Are there any other factors which suggest we should change the order of the agenda? Okay, thank you.

A couple of administrative matters: the Commission's standard sumptuous morning tea and lunch will be available. We'll break for morning tea at a time that make sense, and given the run of the discussion. You may start fidgeting about 10.30-ish, and we'll see how the discussion goes. I believe we should aim to finish by 2, to allow you time for your pre-HOTS states meeting and so we'll fit the lunch depending on where we are on the agenda as either a social occasion at the end of this meeting, or a working lunch if we're still going up to that time.

We have asked the staff to prepare some numbers. We have seen in recent media reports that some states have indicated that the grant share distribution impacts of the Commission's relativities will visit the end of civilisation as we know it on the citizens of their states, so in order to at least give us one set of numbers to work off - in this case, two sets - rather than eight-plus sets, we thought it would be useful to provide you with some indicative numbers, and I'll ask for those to be circulated now. You will note that there are some caveats about these numbers. In particular, there are some important placeholders where, in our report, we've indicated that we have not finalised our assessment methods - the value distribution adjustment and the water assessment - and, of course, the numbers there don't reflect what will be the last year of the assessment period, so they are indicative only. There are two sets of numbers: a one-year effect, and a three-year effect, the three-year effect being consistent with our proposal that we reduce the averaging period from five to three years. I know these numbers will be of very little interest to you, and so I'm sure we won't need to spend any time discussing them, but we did feel it would be sensible to give you the numbers that we believe, as best we can produce them at this time, given that our work is not yet complete, or that the timeframe is not complete. We thought it would be helpful to provide them.

Now, before I invite states to make any opening comments, can I ask my colleagues if they have anything they'd like to add? No? Well, that's a first. Thank you very much. In line with our normal practice, I'll call on New South Wales to go first. I have cleared this with Michael. I did offer him some relief, but he's ready to charge ahead. Once we get into the agenda itself, I don't propose to maintain a strict state order intervention. I think it would be appropriate to enable you to intervene when you feel the time is right on subsequent agenda items - nor is it mandatory for you to make opening statements if you don't wish to do so. So, New South Wales: Michael?

MR SCHUR: Yes, thank you, Alan, and thank you for your welcome. Can everyone hear me? Is this working all right?

MR MORRIS: Yes. I understand, by the way, that this is an automatically activated system, so you don't have to press buttons, but it does mean that we will capture and record and be able to scrutinise any grumblings that you might make to the person seated either on your left or your right. We know where you live, so just - I thought I should alert you to that.

MR SCHUR: Thank you. And, Alan, I'll be really brief, because I'm sure we're going to get into the details under the specific agenda items as the day proceeds. I do want to say, though, you won't be surprised to hear that our major concern is the extension of the definition of HFE to include new infrastructure and the equalisation of net financial worth, and the way in which these assessments are currently determined. As the Commission itself has said, this implies a major change in the interpretation of State fiscal capacity. New South Wales believes that this inclusion extends the interpretation of fiscal capacity too far and goes beyond the Commission's Terms of Reference. And, through the day, I would like to know how much scope there is for changing the Commission's view on the extension of the definition, and the structure of the capital assessment.

And while I appreciate what you have said about the Commission not focusing on the distributive impacts of its work, the financial picture emerging and confirmed by these numbers here is that the capital assessment in the draft report entails a very large redistribution away from New South Wales, Victoria, South Australia, Tasmania and the ACT towards Queensland, Western Australia and Northern Territory. A large redistribution away from New South Wales will lead to significant budget management issues, and these will be compounded by the fact that we are unlikely to receive any further update until the report is finalised in February. Thank you.

MR MORRIS: Thank you very much, Michael. I won't respond in turn. I'll wait till the end. So, Victoria: Grant?

MR HEHIR: I won't say very much either. I think most of the issues that we'll want to raise are on the agenda. I think this was always going to be a difficult task. The Commission's efforts to undertake simplification of the methodology I think are welcome. A lot of the impact on reducing data requirements and all of that, I think, are quite positive. We remain concerned around the capital issue, similar to New South Wales, and I think there's a number of areas where the debate around the use and quality of data will be things that we'll talk about during the morning.

I suppose the one thing that doesn't significantly appear on the agenda, which we're a bit disappointed about, is the fact that the Commission hasn't picked up the issues that we've raised around the impact to put a hold on the disability of jurisdictions, and I think that's a growing issue, and to sort of leave it off the table for another five-year period is of concern when it's been such an issue of growing importance in our company in recent times but, other than that, I think I'll leave it for the individual items.

MR MORRIS: Thanks very much, Grant. Queensland: Gerard?

MR BRADLEY: Thanks. Queensland is broadly supportive of the Commission's work in the review. Obviously, there are pluses and minuses in various assessments, but we think the Commission's taken their Terms of Reference quite seriously and has made quite good progress towards simplifying the methods used in the 2004 review and, on balance, we would see the Commission as having done a commendable job. Obviously, the capital assessment is critical to Queensland and our capacity to provide services to a rapidly growing population. We don't see it as an extension of HCOP but, really, a more appropriate assessment of that capital need for a growing State's population, and we consider the Commission has incorporated that appropriately into its revised assessments.

I think we also look at the assessment as a package, from our perspective. Certainly, the move from five to three years isn't to our benefit, and it would see significant flows of our resource revenue to New South Wales, Victoria, other states. We see it as a package, however, and if capital assessment is to be made on a more timely basis, then we would see that being consistent in approach, albeit that it's not to our advantage. I think it's also important that states bear in mind that there have been significant shifts in relativities in recent years which needs to be seen in context of these changes also. So, on balance, we support the direction the assessment's heading in. We have obviously continuing contributions to make around technical issues where we think we can improve and inform a perhaps better judgment and better consideration to issues like discounts, but would be pleased to continue to participate actively in the process to assist the Commission in that regard.

MR MORRIS: Thanks very much, Gerard. I think that brings us to your colleague from the west. Tim?

MR MARNEY: And thank you - a very similar position on (inaudible 01:20:37) impact. Three basic points: I guess Michael's comments that changes of the magnitude proposed in the capital assessments would cause budget difficulties. I think we've all got those anyway across the jurisdictions, so I'm not sure that they should be an overriding concern. We'd certainly be keen for the Commission to maintain its focus on the core principles, as it has done. In that regard, you can't provide services without the assets to provide them, and the recognition appropriately of capital is extremely important, as Gerard has pointed out, in the context of a growing population - a rapidly growing population.

In terms of contemporaneity, three to five years: we can see the merits of a shorter averaging period, and would be supportive of that so long as the Transition Arrangements are appropriate and that it's a case of no one being worse off out of that move, then that would be supported. That's pretty much it from WA's perspective.

MR MORRIS: Thank you very much, Tim. Jim has graced us. Jim, of course, is on leave at the moment and looks every inch a person on leave, so we're very grateful, Jim, that you've broken your family time, so make it worth our while, will you?

MR WRIGHT: I'm not sure I can do that. In fact, what's enhancing the family is that I'm allowing them to stay two more nights in Canberra with the grandchildren, so there's - - -

MR MORRIS: And that's an enhancement?

MR WRIGHT: It is in my - - -

MR MORRIS: Right. Okay.

MR WRIGHT: I'm a fairly new grandfather.

MORRIS: Okay.

MR WRIGHT: Yes. South Australia is appreciative of the effort the Commission and staff have put into the process. Capital assessment has obviously been a particularly difficult area, and continues to be an area that causes us concern. Simplicity and transparency seems to be very hard to find in that area and, as I say, we appreciate the efforts that have been made, but we're looking forward to further discussion of the issues this morning. The other things are of lower order of concern, and I won't address them at this point. Thanks.

MR MORRIS: Thanks, Jim. Tasmania: Don?

MR CHALLEN: Thanks, Alan. I won't say much either, apart from thanking the Commission for this opportunity today. I think it's an important meeting and we appreciate the effort that's gone into it. As someone that's been through a few of these reviews, my observation is that this review has been more successful than the last, in the sense that the Commission has responded, I think, professionally and very well to its Terms of Reference, challenging as they were, and the processes amongst the States have been a little tidier than they were on the last occasion. We don't, I don't think, look like soldiers of the Boar War on this occasion, down to our last bullets.

I do think there is a little more to be done, and it won't surprise you to hear that Tasmania remains concerns about the capital assessment, and we'll have some more to say on that. The agenda gives me the scope to say the things I want through the course of the morning, so I won't detain you now, apart from saying that I would like the opportunity, under Other Business, to talk about the timing of the next review, if I may.

MR MORRIS: Thanks very much, Don. The ACT: Megan?

MS SMITHIES: Thanks, Chair. The ACT is also very appreciative of the work that the Commission has put in in this assessment. A lot of good work has been done in relation to simplification. Our major concern is also the capital assessment, and we'll go into that as we move through the agenda. Our concern rests both at the principle level in terms of the extension of HFE, and also in the application, and I think, in taking a look at the assessment in relation to what it set out to achieve, we're not convinced that it presents a better approach. I think that's all we need to say. Thank you.

MR MORRIS: Thanks, Megan. And Jennifer, the Northern Territory?

MS PRINCE: Thanks, Alan. I won't go over all of the things that others have raised, but I'd like to make a point that perhaps others have not raised, and that's in relation to simplification. Quite clearly, when the Commission embarked on this task, it was after a lot of work done by Treasuries, and the pursuit of simplification was made clear in the Terms of Reference. But as we go through the draft report, I think it's increasingly clear that simplification can co-exist with equalisation when jurisdictions are relatively homogenous. The difficulty for the Northern Territory is that there are many, many areas where we are very different from the states on average, and I think that's borne out in the results in the draft report, where the outcome in per capita terms is 10 times worse than the most affected jurisdiction. So we have quite a lot of concerns in a number of areas. I think our largest concern is with the location assessment.

Our concern is not really in relation to the methodology that's been developed, but it is in the data that is used to support the methodology. There's a number of examples where national data sets have been used, and we understand why the Commission would want to take that course, but because of a range of reasons, national data sets are far less reliable for the Northern Territory than they are for other jurisdictions. The census, which is the best data source from our point of view, is vastly more unreliable for the Northern Territory than others. I'm not sure whether all of you would know, but there is a 20 per cent undercount in the census for indigenous people in the Northern Territory, and that has a huge influence on our figures. Now, those sorts of outcomes are similar for other remote parts of Australia, but because of the population characteristics that we have, it's a far greater effect on the relativities for us. As we go through the discussions today, we will point out a number of those areas and ways in which we think better data can be used to give a more credible result.

Others have spoken about the capital assessment. We obviously support the inclusion of that. We also support, as we always have done, the use of the three-year base period rather than a five year, and we thank the Commission and the Commission's staff for the very good consultations throughout the process.

MR MORRIS: Thanks very much, Jennifer. Nigel, is there anything the Commonwealth would like to say?

MR RAY: No.

MR MORRIS: Thank you. Thank you very much for that. That was thanks for not wanting to say anything, by the way. You've all mentioned capital. I won't respond, because that's the next item on the agenda. Jennifer, you've mentioned location. That's on the agenda. A couple of you have mentioned, without necessarily wanting to chance your armour getting the word right, contemporaneity. That's on the agenda. The discussion of those can fall as they will. Really, I think the only issue that was raised that's not on the agenda is Grant's point about cultural and linguistic diversity. Can I just say, Grant, if Victoria had something that it wished to put to this conference today then the opportunity was there and, indeed, still is - to take it under Other Business - but we have, on the agenda, picked up items from New South Wales and Western Australia where they had specific points they wanted to make. We have, in the draft report, I think, gone to some lengths to consider, reflect on and draw our tentative conclusions about cultural and linguistic diversity, and I think we have set out quite clearly why we have done what we've done or, in this case, why we've not done what we've not done, but if there is something that you feel would benefit in this forum from a discussion of cultural and linguistic diversity, then the opportunity is there under Other Business for you to do so.

I don't think there was anything else that I need to respond to that's not going to be otherwise covered. I think, and I'm conscious of 11 o'clock, we can probably take the Capital discussion, and then move to those items where you would particularly want Nigel to be present. So if that's generally agreed, let's move to Capital, which is item 3, The Capital Assessments, item 3 on the agenda.

There's probably not much need for me to acknowledge that the appropriate of assessment of capital has been a contentious issue over the course of the review. The Commission is quite clearly of the view that it is not appropriate that different state needs for capital or the ability to acquire net financial assets should not impact on the GST distribution. The current situation where no differential has been assessed in recent updates has to be addressed in the 2010 review methodology, and most of you will recall at past Heads of Treasury meetings - I myself recall November 2007 - states acknowledged the problems with the current debt charges approach, and indicated support for a more direct approach to dealing with capital.

For the 2010 review, the Commission has started with a simple premise. The GST is general revenue to be used by the states as they see fit. It can be, and has been, used for capital expenditures as well as recurrent. We note that over the run of years, states used GST to acquire assets and states all appear keen to return to that position, with most state budgets highlighting investment in new capital as a priority. So we think the approach we have proposed is consistent with what states do, and this is, in essence, the response I would make, Michael, to your point that we have gone beyond our Terms of Reference. One of the fundamental principles that we have always followed is that we try to reflect what States do, and we observe that states use the GST revenue for capital as well as for recurrent expenses.

Much of the debate has centred on when state needs for investments should be recognised. Again, consistent with what states actually do, we consider that HFE is better achieved if different state needs for investment are reflected in the GST distribution when states undertake that investment and as their populations grow. We understand that some States prefer that different investment needs are reflected over the life of the investment, but that is not our position. Our approach distributes GST to states to recognise their needs for investment as they arise, and give the states the capacity to hold the same net financial worth per capita. We are aware that some states do not support our approach to the capital assessment because it extends fiscal equalisation to equalisation of per capita net financial worth, but we consider that this is as valid from a fiscal equalisation perspective; we consider it as valid to equalise net financial worth as it is to equalise net incomes. We have not seen any conceptual case put forward why, from an HFE perspective, the approach we have proposed is not appropriate, and this is what we anticipate we should focus on today.

The way this assessment is constructed has benefited from the robust exchange of views between states and Treasury officials. This is continuing, and may well lead to further technical improvements over the coming months - and we embrace and welcome that ongoing work, and your officers will no doubt know some of the things that are still (inaudible 01:36:43) So we have put, I think very clearly, our view on the table. We have argued in the draft report why we hold that view. We have endeavoured to reflect objectively what it is that you have said to us, and to explain why we have come to the position that we've taken. This discussion today will benefit us really only if it is a discussion about the appropriateness of the Commission's intent in this assessment, rather than a discussion of the technical merits of one particular approach versus another. It is the Commission's intent that we think needs to be vigorously contested, and that's what we would expect to hear from you, and that's where we hope your focus will be today. So I now dispense with the state pecking order, and invite you to respond to the position the Commission has put in its Capital Assessment. And, of course, in the Commission's tradition, silence means acquiescence.

MR WRIGHT: Well, Alan, while people are thinking about it, can I - - -

MR MORRIS: Jim?

MR WRIGHT: I mean, no one would dispute that we do use GST funds for capital assets, for capital investment and, I mean, I'm surprised that that kind of gets as much emphasis as you give it. I mean, the issue of the source of funds is something I've never quite understood why it gets the weight the Commission gives it, but I'm not going to go into that in any detail. The main point that I wanted to raise, I suppose, is what I wrote down as your second point, which is that the Commission wants to take account of needs as investments are made, as opposed to over their life. Now, at the conceptual level, you've got a question here. I mean, there are some purposes that can be served in different ways.

You can substitute capital for other resources and deliver services either in a capital intensive manner, or in another resource intensive manner, if you like. Now, the holding cost model, of course, would bring the capital cost to account over the life of the service delivery, whereas your model does that less obviously anyway. There's a timing difference, if I've understood you. So that was one conceptual point that I would like to hear some more about.

MR MORRIS: Okay. Is that the only point?

MR WRIGHT: No, no. There are other points that Rob Schwarz would like to make, I'm sure, but I was going to just focus on that one to start off with.

MR MORRIS: But I'm not intending to have a series of bilateral conversations here. I really - - -

MR WRIGHT: Well, if you like, I can ask Rob to make some other - - -

MR MORRIS: No, I'd actually prefer that you didn't.

MR WRIGHT: Right.

MR MORRIS: Unless it is to, again, as I say, go to the Commission's intent. I don't think it will be beneficial today to have a technical discussion about the merits of model A versus model B. If you have things to say about the intent which the Commission has set out in its Capital Assessment then, of course, that's what we're here for. Michael, was that you?

MR SCHUR: Yes. Alan, I'll add something on this specific issue which is, I think, similar to the point that Jim is making, and it goes to the Commission's interpretation of what states do, and I think, from our perspective, we would argue that capital is used in delivering services and not acquired for its own sake. So we think of it as an extension of how we deliver services. Likewise, financial assets are not acquired for their own sake, but only as a by-product or outcome of the decisions that states make in raising revenue and providing services, and so that conceptual difference, we believe, is more consistent with a holding-cost approach to capital.

MR MORRIS: Thanks, Michael. Gerard?

MR BRADLEY: Chair, if I could say, we certainly endorse the intent, in the sense that it is critically important, from our perspective, to reflect what we do in practice, which is that we provide the infrastructure to meet the demand, the service demand, and growth that's occurring as and when it occurs, not over a long, gradual period; over a long period of time. We have to respond to rapid population growth and make significant investments to improve or lift the capacity of our service delivery very significantly. We've had a very large increase in population over a sustained period of time. We've been investing at higher levels per capita to address that need. I'd agree with the point that we build our assets to deliver services. That's the whole point, obviously, but you can't just look at the cost of the service. You need to look at the capital investment to deliver that service at the same time as well so, clearly, if we have 100 classrooms and our populations grows by 20 per cent, we need to increase it to 120 classrooms. It's quite apparent in our case. We have whole new communities which we have to build all the new infrastructure for emerging in our western corridor in Springfield. You've got to provide the police stations, the schools, roads, railways, the whole level of infrastructure needed to deliver services to those new and emerging and growing communities.

In our case, we've got more than, I think, half a million people more than we had five years ago. It's the equivalent of a move in population of around, say, Tasmania, basically, so we've had to build and replicate all the schools and hospitals, police stations, etcetera, of Tasmania. So it's a very significant impact, and a very pressing demand on our GST and other resources. We think the intent to reflect that in the way in which the methodology considers capital, as it always has, doing it simply on an equal per-share capita on a debt-charges basis, clearly doesn't in any way reflect the reality of what actually happens in practice. So we certainly endorse the intent, but we're happy to discuss the technical aspects later - but certainly the intent of where we're seeking to go here is what we agreed a year ago or so, I think, and we certainly endorse that approach.

MR MORRIS: Thanks, Gerard. Grant?

MR HEHIR: Just keeping at the high level, my recollection of November '07 was that Victoria put a position, which we retain today, which is that there's no need for this assessment and there's no need for this assessment because the cost of capital is included in the service cost which would assess the possible service provision already. Conceptually, the mixing up of cash and operating issues just leads to potential complexity and confusion about funding. There is absolutely no doubt that different jurisdictions and different suburbs have different capital costs at any particular time because of change in population. Whether that's caused by growth or migration within that jurisdiction is interesting but, at the end of the day, the aggregate cost of provision of services is picked up through the operating statement, and that seems like a reasonable way of dealing with equalisation. That's the proposition we put in November '07. I know we were the only ones - I think we were the only ones - who said that at that time, but we maintain that position.

Most of the factors that you've got here driving this are around population growth. Victoria is growing at the national average, so the impact on Victoria, by definition, is not huge. Our problem is a conceptual one rather than an impact on the State from that perspective. I think that the way that the disability factors has been applied to this, the solution you're putting is appropriate, given our - if we're going to go down this path, I think we've got to take an approach which is a bit more conservative about the impact on these things, so I think the way it's been done from that perspective is a reasonable one, if we're going down that path. We disagree with the starting premise of it all, as we have all the way through.

MR MORRIS: Thanks. Thanks, Grant. Yes. I can't swear that it was November '07 in Mount Lofty House, but I do recall that you have previously put to the Commission precisely that view, and I acknowledge that quite freely. Rob?

MR SCHWARZ: Chairman, there are significant problems with the Grants Commission's assessment, and that can be summarised as scale and complexity. If we take complexity first: the large needs to high-growth states which you produce actually stem from net worth population with dilution needs, even if it's an obscured and convoluted formulation. There is, in fact, a simple and transparent way of achieving your intent, and that is to produce those needs in a net operating balance model upfront and if there is, why not do it? Simple and transparent is consistent with the Terms of Reference and, also, it is good for the Commission's credibility. And turning to scale, there does exist a population growth dilution effect in respect of interest income per capita that can be earned on net worth, because net interest that's earned on net worth does support the provision of services. However, the draft report net worth dilution needs go way beyond what is actually necessary to ensure the capacity for the equal provision of services even in an upfront approach.

MR MORRIS: Thanks, Rob. I won't respond to all of that at the moment, other than to say that South Australia, in particular, in the email traffic that I have seen - and mercifully, I'm sure I've only seen a fraction of it - South Australia has consistently said that the approach we are proposing is complex, confusing - I think you've used even more pejorative language than that from time to time. Our view is that just because someone says that it's complex doesn't necessarily mean that it is. Indeed, our view is that the approach we have proposed is far more transparent and simpler than most of the other proposals which are floating around - and I don't want to get into the technicalities of it but, to this point, I can't accept that what we have done is more complex than other proposals, so I just want to make that point.

MR SCHWARZ: In response, Chairman, the holding-costs model is quite simple and much more transparent than what - - -

MR MORRIS: Well, you say that, Rob, but I have read some of the traffic on this subject, and I find myself completely unable to understand it, completely unable to understand it, so I think let's leave that for the moment, because we are at risk of getting into a technical discussion which is not the most appropriate place for us to be this morning. Tim?

MR MARNEY: I think, in terms of alternative methods and the technicalities, we've done some work and provided work to the Commission that demonstrates the outcome from the different approaches is broadly similar and therefore transparency and simplicity could really guide the approach that's adopted and the proposed approach seems, to us, to be the simplest and most transparent. At the end of the day, I think, we come back to the key principle in terms of why are we proposing this capital assessment, and it comes back to HFB and the principle that the states should have the capacity to hold the average stock of service asset per capita. So, putting those together, we think the proposed methodology is appropriate. It's similar in outcome to other proposals, but it's the simplest and most transparent.

MR MORRIS: Thanks, Tim. Michael?

MR SCHUR: Alan, if I can respond to a comment that Gerard made about what seems to be this notion of a linear relationship between population growth and investment in physical assets and he used the examples of, "As your population growth increases, you need new schools, new hospitals, new classrooms, etcetera, etcetera." I think the problem conceptually with this is that it makes no allowance for changing intensity of use, efficiency of use, or different technologies. In the context of the road, for example, increased road congestion that flows out of an increased population could be dealt with by expanding the road, but it could also be dealt with by changing technology that impacts on traffic flows. One could put a price signal on the use of that resource which changes behaviour. One could have a price signal for different times of the day that changes traffic flows etcetera, etcetera, so this notion that there is one fixed capital labour ratio - and only one that provides the average level of services per capita - is just, we think, flawed.

MR MORRIS: I take that point, Michael. It occurs to me that that's a reflection of how you might decide to do a particular assessment rather than what you think that assessment should be about.

MR SMITH: Can I - - -

MR MORRIS: Greg?

MR SMITH: This problem comes up in every sphere, you know. Different states could do things different ways; different people can approach policy issues in different ways, and a lot of people in our community think the Grants Commission should be making a lot of these judgments. And our methodology, I think, for many years has been getting clearer and clearer and clearer, that we don't make those judgments. Instead, what we do with things like efficiency and all of the other dimensions that you've mentioned, is we just take an average state as the standard, so over and over again, we don't make judgments. Over and over again, the standard is the average of what states do. Our approach to what is the reach of fiscal equalisation is what the states do. Our approach to the way they approach the task of fulfilling their service obligations or expectations is what do they do? And to handle the vast diversity of possibilities - we just go to the average. It's a very boring solution, but it is the nearest you can get to value-free and assessment-free in the sense of we're not making the judgments. We don't stand up as people with suggestions about how roads could be priced. "Are they priced? Do you want average price cost?" will be the answer, not, "Should they be? Could they be? Might they be? What would happen if they were?" We just don't. And that's almost a universal approach. Most of what you say about capital you can say about labour. You could do those different ways. You could educate. You could have different qualification profiles of people. There are many different ways to configure everything we do. So our solution, as a Commission, seems to be a central philosophical position. A central philosophical that has led us to include capital is to ask, "What do States, on average, do?" It's almost our universal approach, and I think when you say that we're beyond Terms of Reference - that's what I ask. You know, "Well, the Terms of Reference ask us to apply HFE, fiscal equalisation." Our philosophy for years has been to do that on the basis of what the average state does and then to give everyone that capacity.

Now, it's led us to this position. I haven't heard any argument at all, really, that goes to contesting the way we have gone. Leaving all the technical data issues aside - and I understand a number of those from South Australia (inaudible 01:57:39) - these are things that we have tried to look at and will continue to look at at that level, but in terms of that conceptual approach, that is how we handle all of those other issues.

MR HEHIR: I think the fundamental technical - - -

MR MORRIS: Grant?

MR HEHIR: I think the fundamental issue from our perspective is that services are provided when capital is consumed, not when it's constructed, and that's the differential input. Now, what you're trying to equalise for is variations in cash expenditure at a particular point in time, but that's not about service provision. That's about how you cash flow a particular activity, and that's the difference, that's the fundamental conceptual difference I think we've put on the table which - and you're not accepting that for reasons - - -

MS SMITHIES: Can I - - -

MR MORRIS: Just a minute: I think Jim has been - - -

MR WRIGHT: Yes. I listened carefully to what Greg said, and I couldn't get the - out of what you said, I couldn't understand why you claim that the Grants Commission's current proposal avoids the need for judgments, while the holding-cost proposal implicitly in your remarks does involve a judgment. It seems to me that the reverse would be the case; that the holding-cost proposal, because it amortises things across - it treats them neutrally. It brings them to account when they're needed. You would meet your criteria more than the one you put forward.

MR SMITH: I was responding to issues around efficiency and technology and all those things.

MR WRIGHT: Right.

MR SMITH: And trying to deal with that. I think the point's been made that the holding-cost model and the upfront models are both conceptually capable of doing the job.

MR WRIGHT: Right.

MR SMITH: We have then gone to questions of, "Well, what do you actually use your revenue set for? What is the actual fiscal position of the states when they receive revenues? Do they use some of it for capital for balance sheet purposes, or do they use none of it for those purposes?" We've discovered that they do use it for balance sheet purposes, not just for recurrent purposes, and so that's been a relevant consideration and we've put the questions of simplicity of assessment and so on - and all of that's in our paper. We've gone to that.

MR WRIGHT: Yes.

MR SMITH: But I wasn't addressing any conceptual view about how one would look at these assessments. They become practical matters, although I think it is relevant. I think it is relevant to look at what states do and the way Australia's States have, in fact, financed themselves, to ask the question, "Which method has the most conceptual validity?" I think both are possible, and when people make the point that you could, at least in theory - I don't know that you'll get there in practice because of all the various data issues and timing issues, but the conceptual difference between amortising something, if you like, and delivering it upfront is - there's no - you know, like, they're potentially the same thing. I mean, there's no doubt about that.

MR WRIGHT: Yes.   Well, you've just - - -

MR SMITH: That's why I think South Australia's been very good, because it's recognised dilution and it's identified the issue, and the old debt assessment, to some extent, always recognised some aspect of the differential capital needs. It is not the first time the Commission has recognised capital needs. To say that that's conceptually new space would be wrong.

MR MORRIS: Megan, you wanted - - -

MS SMITHIES: Yes. Sorry, I was going to say, when this came up in November 2007, the ACT also supported the view put by Victoria. For us it's difficult, in that to conceptually move away from a model that has an assessment based on consumption and moves to equalise upfront capital costs. You know, we put it in terms of - or you put it in terms that it provides states with the capacity to fund investment in new infrastructure when the need arises; that's when the infrastructure is built or purchased. I guess, from my State's - we practise just in time provision of infrastructure, quite often well beyond time provision of infrastructure. I suspect that the statistics around differential growth rates, population growth rates, if you look back, are probably more influenced by well beyond time provision of infrastructure rather than infrastructure in advance. It seems to me that this assessment provides capacity well in advance, or in advance, of when infrastructure's brought in line, and I question whether that's policy neutral or whether the Commission is confident that you've distinguished between policy and non-policy influences in the differences of State population growth rates in this assessment.

MR MORRIS: Thank you. I don't think the Commission has ever pretended that its assessments are non-policy. The best we can aspire to is to reflect average policy and so we use the word policy neutrality rather than non-policy. And what our assessment aims to do, as Greg indicated previously, is to look at what states do and give them the capacity to do what, on average, they do. And it seems to me that if, on average, the states make investments ahead of at the point that they're needed or after they're needed, provided that we are correctly assessing the average of what it is they do then what they actually do is not actually relevant to the assessment that we produce. If you all did the same thing in the same way, it would be much easier to see this. You don't all do the same thing in the same way, and that's why we endeavour to replicate what, on average, you do. Michael?

MR SCHUR: Yes, but just to respond to that, and the point that Greg makes - because it implies that, on average, states try to maintain the capital stock as a share of population and, you know, I think we have to question if that is fundamentally what states do.

MR SMITH: Our methodology will just reflect what states do, so these capital values that we'll use will be the ones that are, on average, there. If in the next, let's say, 10, 20 years you all move into American style fiscal policy with large deficits - - -

MR MORRIS: Isn't that an oxymoron?

MR SMITH: Well - - -

MR MORRIS: What do you mean, "If", Greg?

MR SMITH: Then this methodology would follow that, right? If you were all in net debt, right, there would be a mirror reversal of the assessments.

MR MORRIS: Yes.

MR SMITH: That would follow from this methodology. So the methodology will follow what you do, is really what I'm saying. It doesn't assume that you will continue doing what you've been doing; it will follow what you do. In formulating a view about the way in which we construct it, we are observing that you've all got net balance sheets. That's what you've done. You've all taken your revenues and acquired balance sheets, net policy balance sheets. You've all done that. Well, on average you've done it, right? We've followed your average behaviour. If your average behaviour radically changes, well, obviously, the assessment will follow that change. It's within our methodology - just as if you all left Health tomorrow, our methodology would leave Health (inaudible 02:06:33). It would go down with you on that aspect.

MR MARNEY: We'll just savour that picture.

MR SMITH: And I'm not really wanting to get into Health, but I just illustrate; it's the same thing. I mean, if you change the way, on average, capital is being address well, then, so will the assessment change, just, as you know, some parts of state functions have changed and state taxes can change. I mean, when a State tax is abolished, out it goes, the methodology.

MR MORRIS: Don, I think you were wanting to speak?

MR CHALLEN: Yes. I'm desperate to speak, so that my silence isn't interpreted as acquiescence. I'm struggling to find a way of contributing to this debate that doesn't just repeat things others have said. But just to pick up Greg's last point, while you can observe at a point in time that we all seem to be doing the same thing, you know, acquiring assets and being in surplus, being in deficit or whatever it is - building up or running down financial assets - at the end of the day, those things are accidents of timing and, conceptually, it's perfectly possible to have some states in deficit while others are in surplus. And it could easily be the case that differential population growth produces those kinds of outcomes. You could easily have a rapidly growing state needing to fund the acquisition of new capital and putting itself into deficit while a slowly growing State with low needs to acquire new capital is running surplus.

MR MORRIS: Yes.

MR CHALLEN: And the thing that troubles me about this is that at the end of the day, the decision to acquire capital, or the decision to build up or run down financial assets, is fundamentally a funding decision. You don't acquire a new school because you want to own a new school. You acquire a new school because your population requires you to deliver the services that you need a school to deliver in. And the Commission's intent, as you describe it, seems to me to be a big move away from the old HFE definition that focused on equalising the states' capacities to deliver services. Now, I recognise there's a bit of sophistry in this, because you've changed the definition to legitimise what you're now doing, but it seems to me that it's a big step away from where you've been in past reviews, and I am uncomfortable that the Commission's current intent will remain robust through time.

MR MORRIS: Well, our previous practice didn't prove to be robust through time, and you recall the Heads of Treasury gave us what I think at the time was unanimous advice in relation to the way we treated aspects of this assessment, so robustness is not something that can be guaranteed, I think, under any approach.

MR CHALLEN: Accepting that, but different isn't necessarily better.

MR MORRIS: No. Nor is the same necessarily as good. Your point about the definition: I think the Commission has been uneasy about the current definition for some time because it does imply something that's probably not quite what's happened. If the capacity to provide equals fiscal capacity to provide equal services, you can't really take that too literally. But nor does that definition and that principle and that way of articulating it - nor does it pick up the absolutely indisputable fact that the undertaking of investment and the acquisition of assets is integral to the delivery of services, the point that Grant has made, but in a different way, with a different object in mind - so that if we take the point that we have made quite consistently from the Commission that we observe what it is that states do in the delivery of services, they make recurrent and capital expenditures, then if we are to reflect, even for purposes of the definition - if we are to reflect what it is that we are setting out to do, we have come to the view that we have to acknowledge that, and we have to articulate it, and we actually have to do it.

MR CHALLEN: Well, the question, if I could just continue for - - -

MR MORRIS: Yes, Don.

MR CHALLEN: The question that troubles me, though, is that while it's hard to disagree with the points you just made, because they're just observations of fact - that we need the services of capital to deliver the recurrent services we deliver. The fact that we choose to own capital assets is actually a funding decision. I mean, we could, at the end of the day, rent all our schools and hospitals from somebody else, so you could convert the acquisition of capital into a recurrent payment, and I think that the current methodology proposed by the Commission is not neutral to the way in which the acquisition of capital is funded.

MR MORRIS: The intention is that we would reflect the average of what it is that states do.

MR ....: Indeed, yes.

MR SMITH: If you do that, that will flow.

MR MORRIS: Yes.

MR CHALLEN: If we just extend this for a moment to the accumulation or depletion of financial assets, I think what you saw happening over the decade or so that ended with the global financial crisis was a lot of accumulation of financial assets because it was fashionable to do that, and when state budgets were in relatively good shape, governments found policy reasons to need to accumulate financial assets, and the most popular one that they came up with was, "We have these large unfunded superannuation liabilities we must do something about, therefore, we've got to make funding decisions to fully fund them by day X. That means we need to have these large holdings of financial assets." Now, you've noticed, as we've moved into a tougher period and lower revenues, a lot less being said about the need to fund unfunded superannuation liabilities and, indeed, all, I think - or virtually all - the states are now projecting the largest deficits for extended periods. They're all frantically running down their financial assets. And, you know, I think that illustrates the point that we don't accumulate financial assets for the sake of it. It's fashionable to do it at particular points in time. It's sort of policy driven, almost an excuse, because we're trying to find reasons not to use the financial assets for recurrent services. We want to have them there to do something on another day. And I'm labouring this point, I realise, but what it illustrates is that we don't deliberately target a particular level of financial assets. It's a consequence of other decisions that are being made.

MR MORRIS: I understand that. I mean, you're talking about policy which we are trying to replicate only in the average.

MR CHALLEN: That's a very good tool in your tool kit, I'd have to say.

MR MORRIS: Yes. Rob?

MR SCHWARZ: The discussion about investments with cap ex - it's misleading if you don't also keep an eye on what's happening in the other half of your model in relation to net financial worth. So, for example, if we have looked at a situation where investment goes up and we go into deficit for that to happen, it's true that the needs on your physical assets calculation will go up, but because we've gone into deficit to fund that, the net financial worth goes down, right? So the needs on net financial worth go down. You've got to look at the package of your assessment. So, in the end result, it is the two things combined (inaudible 02:15:55) its net worth which is generating the needs, as I've asserted. So it is quite a trap to discuss who's got the greater needs for more or less physical investment when, in fact, your model more or less automatically offsets whatever happens on the physical assets side, and it is the combination of the level of physical assets and the level of net financial worth which is producing your needs results.

MR ....: Thank you, Rob.

MR MORRIS: Well, I mean, I think the answer to that, in a sort of a way, is yes. I mean, we understand that the approach that we have proposed does have two components, and that both components are necessary in order to deliver the outcomes and the intention that we've articulated.

MR SCHWARZ: I just keep coming back to that if you do recognise that it is net worth population dilution needs that are the main source of the needs for high-growth states. Why not just recognise it, and do it simply and transparent?

MR MORRIS: Yes, well, we have.

MR ....: We would agree.

MR MORRIS: We agree. Gerard, did you want to - - -

MR BRADLEY: In our view, you do pick up what states do. I mean, we're currently selling airports to pay for hospitals. We think the methodology allows for those different combinations, whether we're borrowing or not borrowing, or using our financial assets to fund assets. We think it's neutral in terms of how we fund, but what're more important to us is that it reflects the need for new infrastructure for growth at the appropriate time, when it's required, and that's really important in terms of actually addressing the needs and the equalisation requirements of your methodology, so, from our point of view, when the investment's needed to cater for growth, which is very important. Clearly, the replacement of assets through depreciation is addressed as well so, from our point of view, having a methodology which reflects when the need is there for the infrastructure as the population demands really puts the pressure on states to lift the quantity of services that's critical from a methodology and certainly the intent of equalisation.

MR MORRIS: Yes. Grant?

MR HEHIR: Yes. If you were about to wind up - - -

MR MORRIS: Well, I was, yes.

MR HEHIR: Good. Then I'd like to raise a different issue on the capital - - -

MR MORRIS: Certainly.

MR HEHIR: - - - side of things, which is around the treatment of national network roads under the proposition. We're very concerned with the proposal that the Commonwealth National Network Road capital funding is being assessed as actual per capita. That is, it's taken out of the whole relativities calculation, and it seems to us that if you start from the basis of determining average capital need, but then say a large lump of the money is completely divorced from that, you're undermining the whole process of the assessment and we'd argue very strongly that the methodology proposed for Commonwealth funding of the National Network Road capital funding is inappropriate, or the way it's being proposed is inappropriate, that it undermines the relativities calculation.

MR MORRIS: Thanks. Thanks, Grant. We'll certainly have a look at that. My recollection, the last time that the Commission looked at this issue, is that there was an even starter difference amongst the States about this road funding. Some states categorically maintained that they had absolutely no say at all in where the money was spent, while others put, essentially, exactly the opposite view. And we have tried - I think we went to the Commonwealth department and the approach that we have proposed was based on the advice from the Commonwealth department about the extent to which the States had discretion in the use of these funds.

MR HEHIR: Can I just make one point about that. I'm not aware of one piece of infrastructure that's been funded by the Commonwealth which isn't in use in a jurisdiction.

MR MORRIS: Well, I would find that hard to disagree with, I think, yes; very hard to disagree with. Okay. But - - -

MR HEHIR: If it was a road built between two Commonwealth Army bases with a fence around it to only facilitate the transport of Defence equipment between those two bases, yes, that sounds reasonable, but that's not what occurs.

MR MORRIS: And, certainly, I'm happy to undertake to revisit that and test the appropriateness of the way that we have proposed it.

MR CHALLEN: So you don't need others to support Victoria on this point?

MR MORRIS: Not in terms of a willingness to have another look at it, no. Thank you very much for that discussion. I'm not sure that it provided crystal clarity around the issue, and I haven't detected a significant change of view from any of the participants on the strength of the various arguments that have been put. So I think we now turn to what happens next. The Commission's proposed approach to this assessment has been set out in some detail in the draft report. I would imagine that this assessment will be a particular focus of the final submissions which you're invited to make by the end of September. There is some technical work going on at officer level. I recollect, for example, that our relative staffs are still talking about the appropriate way to deal with land held by PTEs, for example, so that technical work is still going on. We are not in dispute that there are different ways of assessing capital. What we are in dispute about is - well, from our point of view - which approach delivers what we intend to deliver and, from your point of view, what our intention ought to be, and which assessment approach best does that. I am sure that you will want to put these arguments to us again as forcefully and clearly as you can in your final assessments but, equally, we have not come to the position that we've put forward lightly, and we would be expecting some very clear and forceful arguments that our intent is wrong if we are going to do other than revisit some of the technical aspects of the assessment. So I wouldn't want you - and I'm sure you don't - to leave this meeting with a sense that we have been convinced that what we are setting out to do is inappropriate. That is the task which I think remains to you if we are to change the focus and intent of this assessment. But you have that opportunity in your final submissions. So, thank you very much for that. I suggest that we now move to agenda item 5 which is The Treatment of Commonwealth Payments, given that it's 25 past 10 because this is, I'm sure, something that you will want to talk about with the benefit of Nigel's presence.

The emergence of new types of Commonwealth payments make it important that we establish the clearest possible guidelines for how they will interact with the process of HFE. We have set out such guidelines as we think are appropriate in the draft report. Discussions at staff level suggest to us that the guidelines themselves don't need to be changed for the final report, but we note that some states are concerned that the Commission would be overriding the intent of some payments agreed between the Commonwealth and the states. The Commission's position is, I think in this case, quite simple. The IGA states that project and facilitation payments should impact on the relativities, while reward payments should not. We intend to make recommendations to achieve fiscal equalisation while adhering to the IGA advice in regard to project facilitation and reward payments.

Some states have placed emphasis on the discretion given to the Commission in the IGA in determining the treatment of payments. We don't think this discretion allows us to reflect on any underlying policy intent in relation to particular payments. Our discretion is limited to exercising our judgment consistent with the IGA and any direction in the Terms of Reference about whether a payment contributes to a state's fiscal circumstances in terms of the Commission's approach to HFE, or if it does not. If it does, we consider the Terms of Reference as they stand require us to treat it in line with the guidelines we have developed. If states want specific payments or classes of payments to be treated other than as indicated in the IGA, the Commission needs to be directed to do so through the Terms of Reference and, of course, that is open. This is the approach adopted in the past, and the Commission would welcome such guidance in the Terms of Reference if that's the wish of the stakeholders.

The question of classification is one for the Commonwealth and State Treasuries, and we don't see it as the role of the Commission to reclassify payments to change their GST treatment. I have seen some passing commentary on this issue in the media. If you have views about this, this is as good an opportunity as you are going to get - well, maybe not; maybe tomorrow will be a better one, but I'm Nigel would appreciate a heads up if there are particular views that you want to put, given that I hope we have been clear about what we will do unless otherwise directed. Gary?

MR WARD: Mr Chairman, thank you. I've already raised these issues with the Commonwealth but, just for the record, clauses D41 in the IGA apply in this instance. D41(a) indicates that a project payment should be treated by inclusion, whereas clause (b) indicates that the incentive and facilitation payments should be treated by exclusion. I think the incentive here simply means rewards, so facilitation and reward payments should be treated by exclusion. The issue that I have raised with the Commonwealth is some of the issues - and I haven't gone through every single item in your draft report in detail, but if I can refer you to page 112 and 113, you indicate how you intend treating access to early childhood education, and literacy and numeracy NP payments. Now, both of those are facilitation payments and, in fact, the literacy and numeracy is a facilitation and a reward component and just by way of example, in your draft report, you indicate that you intend treating those two - just for example - by inclusion. That appears to be not in accord with what's set out in the IGA - and I add there very quickly Queensland is comfortable to abide by whatever the Commission decides it wishes to do with these payments. The intent of my comments to the Commonwealth were merely to flag the fact that there do appear to be one or two occasions in your draft report where you appear to flag treatment of payments which may not be in accord with what the IGA had intended. That was it, pretty much.

MR MORRIS: Thanks, Gary. If indeed that's what we have done, that wasn't what we intend to do, and if we can be advised about that, then we will, unless otherwise directed, change the treatment to reflect the provisions of the IGA. So there isn't a debate between us about that. I think that's a case of ignorance. I mean, we are comfortably ignorant about the detail and nature of some of these payments and that's something that I'll mention at the end of the morning. Yes, Grant?

MR HEHIR: I'd just say that we support what you’ve basically outlined as an approach and I think that’s reasonable. I think the intent which you are talking about is consistent with what the system is about, and that is, if funding from the Commonwealth is about the delivery of core services, then it could affect the relativities, and I think that's a fundamental principle and I think that's consistent with the IGA. It's also, I suppose, what I was referring to with respect to the transport matters.

MR MORRIS: Sure. Yes, thank you. Thank you. Yes, Gary?

MR WARD: Sorry, Mr Chairman, just one further point - and I guess this is really a comment for the Commonwealth and I have, as I say, made this comment before, and it really goes to the heart of what the Commonwealth intended to achieve through some of the payments that it put on the table. An example here would be the monies for the Digital Education Revolution. My understanding is the policy intent under that bracket of payments was to bring all States up to pretty much the same standard in terms of access to PCs for senior school students. That bundle of money, according to the draft report, is also treated by inclusion, and I guess the only comment or question I was asking the Commonwealth is, is it comfortable for that money to be equalised if its policy intent was specifically intended to have differential payments to states to bring states up to an even par and, again, I don't think that's an issue for the Commission.

MR MORRIS: No.

MR WARD: I think that's an issue for the Commonwealth.

MR MORRIS: No. Well, Nigel, do you just want to take that on board, or do you want to respond?

MR RAY: I'm a little uncomfortable, because I don't want to comment on the approach that you're taking, but I would have thought that as a group, as Treasuries, we want to apply the agreement that we reached last year between us. That's what I'd say. So it's a question about - and I fully accept that the definition of different payments as facilitation or project payments isn't as precise as it might be, and that's something which deputies are working on, so we're trying to clean it up.

MR MORRIS: Okay. Okay. If there's nothing else? I take it then that, by and large, you are supportive of the approach that we have said we'll take to those payments. Thank you. Well, while Nigel's here, can I also deal with item 7, Transitional Arrangements, and I don't think this will take very long at all. The draft report noted that relativities which lead to large changes in State fiscal conditions might not be appropriate and that transition arrangements might need to be considered. Under the current Terms of Reference and consistent with precedent, this would not be something the Commission would address in preparing its final report. From staff level discussions, we're aware that some States consider that any consideration of transition should be undertaken by and at the Ministerial Council. We note that clause 7 of the Terms of Reference which, if you looked at them, were given to us by Sharman Stone. That's how long ago this started. Clause 7 states that, "The Ministerial Council will give further instruction to the Commission on transitional arrangements if and as necessary." And we would abide by that, and we, as you well know, have not had any further terms of reference, although we are expecting that we will get some, but they won't necessarily contain any guidance in relation to transitional arrangements.

But it would be helpful to hear if Heads of Treasury consider whether there would be any value in the Commission identifying possible options in its final report, and whether it would be appropriate to do so. I invite Heads of Treasury views on the issue, but we will, of course, be guided by any directions, or the absence thereof, in the final Terms of Reference. So if there are any messages that you want to give us or others - Grant?

MR HEHIR: I think we'd have a view that the transitional arrangements are probably something that the Ministerial Council should deal with at the end of the day rather than the Commission and, you know, the need for - well, whether you have transitional arrangements or not won't be known until we get the final report and then - - -

MR MORRIS: Indeed.

MR HEHIR: - - - it could be considered at that stage. I mean, I think we need to - when looking at those things, we'd obviously look broadly at them and consider issues, a broad range of issues; not only what comes out of the report, but factors like the differential impact of the different rates of implementing the taxation changes under the governmental agreement which sort of differentially impact jurisdictions as well that aren't covered within the Terms of Reference by the Commission. So on the basis that there's more than just one moving party in any transitional arrangements, I would have thought that it being dealt with by the Ministerial Council is more effective.

MR MORRIS: Thanks, Grant. Jim?

MR WRIGHT: Yes, but we're in the same patch of the ground; the only thing is that if people do start contemplating particular transitional arrangements, there may be some technical issues where our staff might want to talk to your staff about how it might actually work in practice, but I'm supporting Grant, I think.

MR MORRIS: Yes. Yes, and that's fine.   That would be fine, entirely appropriate, if we get to that point. That's rather different than the Commission pontificating, of course. Jennifer?

MS PRINCE: Chair, if I remember back to 2004, the Commission's report did make some observations on the issue of complexity and the benefits of simplicity, and I think the Treasurers over a period of time found those observations useful. I would have thought, while transitional arrangements are a matter for ministers, if there are any observations that the Commission would think would be useful in those considerations, then it should consider making them. There were some - I think you mentioned it earlier - issues about three and five years, the extent to which - or perhaps Tim did, rather - transition arrangements would be relevant in the context. There might be some sort of threshold that ministers might take into account in the changes as a result of the new methodology; whether they should be relevant. So those sorts of observations, I think, would be useful to discussions at the Ministerial Council as opposed to the Commission making definitive statements about it.

MR MORRIS: Thanks, Jennifer. That probably needs to be taken in the context of the point Grant makes, though, but lots of moving parts, and you don't really know where this is going to end up until 26 February, or whatever it is, and there will be different views about what constitutes a sort of threshold at which you'd want to start thinking about transitional arrangements. The points you make about complexity and so on, I take that as a reference to the infamous chapter 7 of the 2004 report, which reflected more on issues of principle than implementation. Implementation is not a part of this process that the Commission would expect to be in. The Commission's work would normally finish with the delivery of what it thinks are an appropriate set of relativities and then it's over to others. We have an opportunity for a separate discussion about the three and five years. I take on board what you say, but I think you will appreciate that this is an area that the Commission would not cavalierly charge into. It's something that we would not normally see ourselves being associated with. Well, it depends how widely you take the definition of technical matters that Jim raised. If there are some observations and reflections, be they capital T technical or small T technical, that the Commission could make in some way, then we would be quite happy to do so if asked. Michael?

MR SCHUR: Yes, Alan, I agree with the points that - the proposal that Grant has made in relation to transition arrangements to accommodate potentially significant changes in the GST distribution income. They also have to consider some kind of ongoing arrangement. We'll get to this when we deal with the averaging issue to accommodate and for volatility in GST distributions resulting from that short averaging period and possibly greater volatility from the proposed capital assessment - just to note that.

MR MORRIS: Okay. Thanks, Michael. Well, the position is, I think, quite clear. In the absence of direction through the Terms of Reference, this is not something that we will carry forward in our 2010 report, but to the extent that there may be some useful comment or observation that the Commission can make if called on to do so subsequent to that time, then the Commission - or perhaps it will be the Commission's staff rather than the Commission - will be happy to oblige. Thank you. Thank you very much. Don, would you find it useful to take up your point about the timing of the next review while Nigel was present?

MR CHALLEN: I'm very happy to, yes.

MR MORRIS: Okay. Let's do that, and then we'll break for morning tea, I think.

MR CHALLEN: Okay. Mr Chairman, as you know, in the draft report the Commission has flagged the possibility of the next review being scheduled for 2013. As I understand it, that thinking is driven by the timing of the release of the census date and the effect that the census date is going to have on the relativities. I'm not persuaded it's a good idea to go into another review so soon after completing this one - it's been a very long running and thorough one - and I'm concerned that you won't really be in a position to do what you want to do in 2013 anyway. It seems to me that if the release of the next lot of census data is going to cause that kind of shock that you're concerned about, you need to see the census data before you know what to do about it, and reporting in 2013 is not going to give you enough time to see the census data, examine what you need to do at the level of your methodology, and then respond to it sensibly to report in February 2013. Our preference would be for the next review to report in 2015, and we think that provides a sensible period of time after the release of the census data to reflect whatever methodological change is necessary.

Alternatively, if you really strongly feel you must realign the timing of the reviews to pick up the release of census data, our preference would be to go out to 2018, not bring it forward to 2013.

MR MORRIS: Thanks, Don. Can I just be clear about what was behind that very light touch suggestion that that's the way it was meant to be taken. For us, it's not so much a question of what to do about the census data. We use the census date. We use it. So it's the utilisation of appropriate data in the appropriate way. And it was to get these things back in sync a bit, so that the census impact would correspond to a review point. In proposing 2013, we thought that would give us enough time, but our intention was not that there be a full throttle review necessarily in 2013, nor that it would be a review that it was constrained through Terms of Reference to some narrower set of issues but, rather, to take a period, let's say nine months after the 2010 review, to agree with the States on what are the half a dozen or whatever it is main assessment areas that really do justify some further work, and doubtless capital might be on them; location might be on them; where should we focus on the data; where was the methodology considered to be in most need of revisiting, and so to have a review which, by agreement, would leave a number of areas basically untouched so not to put the whole cast on the stage again, but to do it in a collaborative way. That was the intention. It's not something that I think any of us at the Commission feel strongly about. We thought there was value in a practical sense in trying to get a better alignment between the census and the review point. If that is not the wish of the States, it's not something that we would press.

MR CHALLEN: I don't find it appealing, and I don't understand why, having got to the end of a long running and very thorough process, you would immediately want to single out some areas of the methodology for re-examination. I mean, it's pretty obvious what they're going to be. They're going to be the ones about which we're still having debate at this stage of the process, and I don't think it helps anybody for us to think in terms of those areas of the methodology being still open and subject to potentially substantial change in, say, 2013. I think it's actually in everybody's interest that we put the whole thing to bed and regard the methodology as stable for a decent period of time. So I accept that the suggestion was made with a light touch, but the reason I wanted to raise it is that I don't want to see it get legs.

MR MORRIS: Well, the alternative then, of course, is to leave everything open for just two more years or whatever it is, rather than just have a few things open but if there is no interest in progressing that way, this is not something that the Commission would press at all, and I take it that there is very little interest. However, I would expect that there would be considerable interest in morning tea, so shall we adjourn for 10 minutes or so? Thank you.

MEETING ADJOURNED [10.52 am]

MEETING RESUMED [11.18 am]

MR MORRIS: Thank you very much. If we can return to the agenda. We move to item 4, Location Costs. During the course of this review, we've been left in no doubt that the cost of delivering services varies between states and within a state. Capturing that impact has been a major focus of our work, but has been hampered by lack of good quality data. Where possible, we've used national data sets. Where more limited data is available, we have used that conservatively. In some instances, we've constructed estimates based on very limited data, but which we believe nonetheless improves the fiscal equalisation outcome. As indicated in the draft report, we are concerned that we may not have adequately captured some part of these costs, notably costs in remote parts of the country. Commission staff have discussed this with all the states and are working to see if the available data can be used to improve our methodology. We are aware that some states have concerns that the Commission is relying too much on judgment in this area. We would, of course, prefer to rely on information which shows what states spend to deliver services to residents across their regions. Given the relevance of this information for different purposes, it is surprising that most states can't provide such information, even at the most basic level. Until this kind of data is improved, the Commission will have to use judgment to incorporate locational costs, which the evidence provided through the course of the review has clearly demonstrated.

We know that some states have argued that we've not been consistent, that we've not recognised some location costs such as the costs of urbanisation. The Commission accepts that some costs in large cities are high, and our public transit assessment, for example, recognises that. However, even in those states, line agencies generally noted that their costs were higher in remote areas. Just as some states are working with the Commission staff to examine the available data, it remains open for others to build a factual case albeit with limited to data, to show that costs per capita are higher in larger urban areas, and I make that point in particular because you are aware that the focus of our work on location has been towards remote areas, so I just want to make sure that it's clear that we remain open to further consideration of locational issues, be they urban or remote.

This assessment is one of the areas that led us to make it clear in the opening chapter of our draft report that we haven't finalised where we are in all respects. This has been a troublesome assessment because of the lack of data which, in the normal course, would pass easily through our assessment guidelines but as I've said, our workplace visits and, indeed, the evidence that's been provided through some state submissions, leaves us in no doubt that there are cost differentials faced by states as a consequence of locational considerations. And having made the point that the further work is going on, I invite states to comment on this issue, including where we together might look in order to improve this assessment. I don't think we should expect Grant to go first every time, so - - -

MR ....: Why not?

MR HEHIR: I don't want to - - -

MR MARNEY: With that, I'll go first.

MR MORRIS: Tim. Thank you.

MR MARNEY: We're broadly accepting the direction, understand the frustrations and share them, in terms of lacking a data set. I think there is more that we can do to explore and improve data and to do that in the areas which pragmatically make the most sense. I mean, housing costs in remote areas are probably the key area where it's going to make a difference and that (a) we should be able to get the data and it is actually material and likely to have an impact on assessment. We support the use of estimation and extrapolation as appropriate but I guess it's a judgment all in terms of how far do you go, but we actually start to dilute the data set and the quality across the board to such an extent that it's counter-productive and pollutes the rest of the assessment. I guess we're very keen to work with Commission staff to explore possible data sets and look differently at how we tackle that, the measurement issue, because it is a very important area for us to capture better.

MR MORRIS: Thank you, Tim. Jim?

MR WRIGHT: Yes. South Australia, basically, is happy with the general approach as well. Yes, the data is a big issue. In a conversation with Commission staff, it was a bit frightening that we found so much uncertainty to do with housing data in our case. Now, that's being worked on but, I mean, whether the new number is as good as it can be is another question still, so I mean it is very kind of concerning that we haven't got better data. I said that's the reality. There is some an awful lot of work being done in the Commonwealth State area in general to try and improve data sets in terms of, you know, accountability of states for money that the Commonwealth are giving and that kind of thing, and we should make sure that we pick everything up that emerges out of that to feed into this process.

The only other comment we were going to make was, you've got a discount factor in there. Now, we accept the discount factors are judgmental, if you like. You know, there isn't a right and a wrong one. I mean, if we had our (inaudible 03:24:12) we'd think a slightly bigger one, but we'll just leave it at that.

MR MORRIS: Thanks very much, Jim. Yes, Glenn?

MR APPLEYARD: Could I just pick up on Jim's comment there, and I think New South Wales, as part of the state visits, also alluded to some of this information that may be coming forward through the COAC process. I just wanted to ask him what form is that expected to be published? Is that being progressed through ABS or what form will it take if it comes in November?

MR WRIGHT: Sorry, I missed the beginning of it, Glenn. I was - - -

MR APPLEYARD: This information that I understand might be coming forward through the COAC process.

MR WRIGHT: Yes?

MR APPLEYARD: What form will it take when it's published?

MR WRIGHT: I think it's going to emerge over time. I mean, this is stuff that's going to be ongoing so I'm talking about longer term, really, Glenn. I mean, it may not emerge in time or be fed into this review but, I mean, you know, the next year's update you may have the data.

MR APPLEYARD: Sorry, I understood there was some data expected in November of this year?

MR WRIGHT: That may be right. Someone may know more than I do - - -

MR MORRIS: Yes. I think Bruce might be able to throw some light on that one.

MR FREELAND: Thanks, Alan. Yes, I understand that the Education Departments are improving the quality of their data in line with the Ministerial Council for Education. That data is expected in November and, hopefully, that will provide a more consistent broader-based series than the partial series that have been available for use to date. It should be more consistent across the states; hopefully a bigger sample, and hopefully more reliable than the data that have been available to date. The Education Ministerial Council has asked for that.

MR APPLEYARD: Does it have a focus on locational issues then?

MR FREELAND: As I understand it, it should pick up issues around that and the regional costs, or at least that should be able to be derived from it in a consistent fashion, whereas we've had problems on that score with the data that's been available to date.

MR MORRIS: And if it's available, it would be available to us?

MR FREELAND: I would certainly expect so.

MR MORRIS: Thanks. Thanks, Bruce. Jennifer?

MS PRINCE: As I said earlier, location is obviously a major concern for us. Perhaps I'd just start by talking about the regional costs and service delivery scale. The Commission's looked at two categories, Education and Police, and then has used some averaging of those to apply to other categories. While the method is the same in both, in that the Commission's estimating costs by SARIA region and then a number of staff by those regions, the result is the combination of the two. With Education, for the number of staff, it's using state-based data, but for Education for the number of staff by SARIA region it's using census-derived data. From the work that we've done, it's fairly clear that if the number of staff used in each part of the equation are not the same, then there will be a bias in the assessment, and if we compare our actual Education staff, and we have done a comprehensive survey, compared with the numbers that are derived using the census method, there is a 72 per cent understatement of the number of staff using the census method than then comparing that with our actual staff in the very remote areas, and the reason for that is that the census is done in remote areas very differently than it is done in urban areas. There is, as I said earlier, a 20 per cent undercount. Now, while that undercount is picked up through the PES and estimated resident populations are far more reliable than account data, the data that the Commission is using in this category for staff in remote areas is unadjusted account data, and there is a very large discrepancy.

We are working on a method that would enable the census data to be adjusted to take account of that discrepancy, and we would urge you to look at it when we provide that to you, but it is a major cause of one of the reasons in this aspect of location.

MR MORRIS: Thanks. Thanks very much, Jennifer. I mean, I think you all know that there is still some furious paddling beneath the surface of the lake going on in relation to the location assessment to address the kinds of issues that Jennifer has identified, and this broader problem that the data that we might have expected would reasonably be available to do the sorts of things that we want to do just hasn't been available and Tim, who's probably here somewhere now, I think, is in almost daily contact with many of your offices to see how far we can go with this. So, in that context, Jennifer, yes, we remain very open to consider that if it proves to be satisfactory for the purposes of the assessment. Grant, I think you indicated?

MR HEHIR: Yes. I understand that there's data issues and there's data issues across a lot of what we deal with, and I accept the proposition that the Commission needs to undertake a judgment in certain circumstances. The only caution I'd put on is that the process should be about trying to get the best data possible and if the evidence doesn't support the prior perception of what the outcome should be, it shouldn't automatically result in judgment being applied to get the outcome that was first thought of. I would expect that over time, the locational disability would decrease; through time, through technological change, a whole pile of other factors, and if that's happening, we need to be careful not to dismiss that change through time because the data might actually just be reflecting what's occurring rather than something else. Now, I'm quite comfortable, and we're quite comfortable with continuing to look at data in those areas. I'm quite comfortable with the fact that judgment has to be made at various points, as long as it's very transparent where judgment calls are being made, the evidence on which they're being made, and we have an opportunity to comment on that, which we're relatively comfortable with, is what's going on at the moment, that's fine.

One underlying concern is that we lose on the simplification process when things that at the margin for a jurisdiction like ours make it different for us, but if we simplify that data out of existence, then we lose on the judgment side of things. There might be a consistent bias in one direction on both the simplification and the judgment side, and I'd urge you to keep that in mind as well.

MR MORRIS: Thanks. Thanks very much, Grant. I think the point's well taken and, indeed, sits firmly behind why we have been somewhat equivocal in the draft report about this, more equivocal than we undertook we would be some years ago when we said we would give a draft report at this time, but this is one of the areas where, because of the lack of appropriate data, and the concerns that you've just expressed about the way you use judgment, we have just held back a little bit. So thank you for that. Gerard?

MR BRADLEY: We're in support of the work you're doing here and, obviously, it's complex and difficult and we'll certainly work to continue to improve the data. I think, though, I guess what's driving your reservations also is that, I guess anecdotally, you know that it doesn't always seem to make sense in terms of the actual cost factors here. You know, if you think of Mount Isa being only 10 or 15 per cent more expensive to deliver police services than Brisbane CBD, it just doesn't sort of make sense in your head as when you actually see it in reality and understand the challenges and the costs they face. Similarly, yes, we can try and use technology, but that costs money as well. Better technology is often quite expensive to put in place. So I think, at the end of the day, that will require some level of assessment and judgment by the Commission, and I think we'll try and form that as best we can with the quality of the data.

MR MORRIS: Thanks, Gerard. It's pretty clear, I think. We're not going to end up with a judgment-free assessment in location, but the use of our judgment needs to be very careful, and done minimalistically rather than with gusto.

MR HEHIR: With respect to anecdotes, it might be worthwhile to go to King Street, Melbourne on a Saturday night and look at the cost of the metropolitan police as well, so - - there's anecdotes, and anecdotes.

MR MORRIS: Yes.

MR ....: You're right.

MR MORRIS: Yes. Michael, were you - - -

MR SCHUR: I mean, I think the sentiments have been covered, Alan, you know, to the extent that the data's lacking. I think what's critical, everyone said, is that where judgment has to be applied, that it's transparent, and we understand the basis for it. That should extend to the application of varying discount rates which - the point that Jim mentions - though we understand there are judgments based on the application of those discount rates as well.

MR MORRIS: Thanks, Michael. Yes, Jim?

MR WRIGHT: The only additional point I'd make that a couple of people have said, that, you know, technology, etcetera, might be reducing the cost burden in remote locations. I mean, I think the other thing we've got to keep in mind is the fact that community expectations about what kind of service is going to be delivered out there are going up fairly rapidly as well so that, you know, that's a (inaudible 03:35:51) course, I think.

MR MORRIS: My recollection is we gave this issue a fair workout in the 2004 review, and I think we understand that there is an increasing opportunity to deliver services with the use of technology. That might reduce some costs; it might increase others. It may reflect itself in lower costs or, in fact, it may reflect itself in higher levels of service delivered to people who weren't previously able to access. There's all of those things. We understand all of those. That discussion is probably getting a bit ahead of some of the basic data like housing costs in remote areas and so on. That would be the building blocks of a more data-driven assessment in this area. If there are no further comments, then we've indicated the direction that we are going in the draft report; the direction we're going, the areas of work where we are trying to improve the approach, and the opportunity is there if people feel that there are other locational directions that we haven't addressed as vigorously as we should then the opportunity is there through your final submissions to remind us that we need to do so. So, thank you. Thank you very much for that.

Item 6 on the agenda is the question five or three-year average, which one or two of you have touched on already. We have taken, as a fairly important principle - indeed, as a very important principle - that the GST distribution should reflect as closely as possible, and as practicable, the conditions in the year the revenue is provided. We consider three-year averaging achieves that better than five-year averaging. We understand that some States are concerned about the revenue volatility associated with a shorter assessment period, because the State circumstances differ. For some states, a three-year averaging might increase overall volatility but, for others, it would be reduced. Overall, we don't consider that a shorter averaging period needs to raise overall revenue volatility, but I would note in saying that that we're not directed as a Commission to take revenue volatility into account in our making recommendations. We're asked to make recommendations that deliver fiscal equalisation.

We understand, of course, that some states are concerned about the impact of the change to three-year averaging because they see big negative revenue implications. We're not persuaded that the possibility of revenue impacts, positive or negative, constitutes a case for the Commission not to make the recommendation to move to three-year averaging, which we consider better reflects the divergences across the states in their fiscal circumstances and strengthens the implementation of HFE and the delivery of the intentions of HFE. Five and three-year averaging has been around as long, and indeed longer, than I've been on the Commission. We used to have, as I recall, this mantra that it really doesn't matter because over the run of time, everything gets equalised and so it all sorts itself out. That may never have been right. It seems less right now than it did then. State fiscal circumstances are diverging one from the other rather more rapidly than we've seen in the past and there appears to be no real reason to consider that that won't continue, and so we think there are very strong and important reasons to make the assessments as contemporaneous as possible.

Over the course of the review, we've floated a number of ways that we might do this, and we've settled on this as being simple and practicable, and most consistent with the views of those of you who support a shorter assessment period. So in the draft report we have indicated that this is what we propose to recommend and we would, of course, be keen to hear your views about this. Don?

MR CHALLEN: We are happy for you to do so, Chairman. In fact, you will recall that we've been indicating this move for some years. We're happy to do it.

MR MORRIS: The Commission moves in its own mysterious way, Don. It's wonders to perform. Yes, Gerard?

MR BRADLEY: Chair, I think from our point of view this has quite significant impacts, given we're coming out of a time of high volatility of our revenue base in particular, with the global crisis and so on, so the way we look at it is probably - if we can see that the other significant factor and the flaw we see in the methodology in terms of the capital assessment and have some more immediacy to that, I guess we'd see those factors as extremely interlinked and important, which would cause us not to take as much issue as we might otherwise take to them, given where we are and the volatility in our revenue base - but it is a significant impact on how the whole assessment comes together for the future. So I just would put that on the record, basically.

MR MORRIS: Thanks, Gerard. Tim?

MR MARNEY: We've been happy with the move to three years, so long as we manage the transition from five to three in an appropriate way and no one is worse off by virtue of that transition. I think that's where the issues lie from our perspectives, not necessarily in the move for the shorter averaging period. In fact, the shorter period, I think, would be of greater benefit in the setting of fiscal policies at state level by closer linkage in those trends. At the moment it's hard to bring home the significance of the implications for grants when they're five years out, and no one wants to know. It just loses relevance all together, right, so there needs to be that greater contemporaneity to inform the decision makers.

MR MORRIS: Right. Thanks, Tim. You make the, "So long as no one is worse off" sound like it's a small issue and - - -

MR MARNEY: I said it very quickly.

MR MORRIS: You said it very softly, I must say. I suspect that, in fact, it's a hugely taxing question in the context of so many moving parts and circumstances there, but I'll take it in the spirit in which I heard it, perhaps, rather than in the spirit in which you intended that I might take it.

MR MARNEY: I assume everyone is chasing a greater optimal outcome.

MR MORRIS: Yes.

MR MARNEY: But recognise that pragmatics need to prevail, and I think Gerard summarised it pretty well in terms of, you know, there's going to be wins and losses out of this whole process.

MR WRIGHT: So you want contemporaneity, but you don't want it yet?

MR MARNEY: No, just want it at the right time.

MR WRIGHT: I think he's going to struggle to get a greater optimum - - -

MR MORRIS: Yes. Grant?

MR WRIGHT: - - - outcome in a zero something game.

MR HEHIR: I think I agree with Tim. When we started this process, we argued very strongly for contemporaneity - - -

MR MORRIS: Yes, up-to-date-ness.

MR HEHIR: Up to date-ness. I think we're three years behind doing it now, and I wonder whether we should not do any more because the moment's passed, meaning that it's no longer of interest to us - but I won't change our position, which is to support the proposition of going for more a contemporaneous approach.

MR MORRIS: Nobly said, Grant. Nobly said.

MS PRINCE: I think that's how we got the five years in the first place.

MR MORRIS: Yes, Michael?

MR SCHUR: I think, Alan, like everyone else, we support up to date-ness and it makes sense. We flag the issue of volatility. I think it's an issue we have to think through.

MR MORRIS: Okay. Well, we've made our position clear. We've made our intention clear in terms of the final report. If this issue is not further debated through state final submissions, then you can assume that we'll recommend a three-year period. Thank you very much. Western Australia indicated that it would like Welfare and Housing Assessment placed on the agenda, so I think it's appropriate, Tim, that you might open the bowling.

MR MARNEY: I might actually throw it to Alex, if that's permissible?

MR MORRIS: Well, provided I can cut him off when he starts to get beyond the level at which I can keep track of it all.

MR SCHERINI: Yes.

MR MARNEY: Good luck.

MR ....: He'll have to stop now.

MR MORRIS: Yes, Alex. Thank you.

MR SCHERINI: Okay. We were keen to put this one on the agenda because - - -

MR MORRIS: Speak up, if you wouldn't mind, Alex.

MR SCHERINI: Sorry. We were keen to put this one on the agenda because we did think it highlighted a couple of broad issues that would be of interest, and the first of those issues is how the Commission chooses between competing indicators of state need that might show different outcomes, and the example that we have given is in the case of disability services, comparing the measure of disability you get using Commonwealth beneficiaries as opposed to the measure you get using the Productivity Commission's measure of potential populations, which is basically a weighted age formula and with a further weighting for indigenous people. There's two different indicators. You know, we've provided arguments as to which one is more appropriate, but I suppose our main concern is, you know, when the Commission is confronted with different indicators, that it considers them and makes some sort of transparent judgments about which one to use.

Our second issue is, I suppose, in relation to the use of discounting. I notice that it's come up a couple of times. The Commission would know we're not really into discounting, but we note that the Commission has used it in circumstances where the relationship between the indicator and the disability is uncertain. And if there is uncertainty in the case of Welfare and Housing about the relationship between the indicator and the disability, then there is a question of whether discounting might be appropriate if discounting is used in similar circumstances elsewhere. So it's not saying that we support discounting but, rather, that discounting be used consistently where there is a degree of uncertainty. We've got some technical points here. I don't want to get into that. I think the general points are just consistency in the use of discounting and in being articulate and transparent when confronted with competing indicators.

MR MORRIS: Thanks, Alex. I'm happy to give you an assurance on both of those points. I am aware that you have raised the issue of alternate data sets which deliver different outcomes. I know that the staff are preparing analyses for us about that, and we would expect - and this is almost in the category of the technical work that's still to be done. We would expect to settle that over the remaining month of the review. In relation to discounting, we aim to be consistent. We are confident we understand why we discount, because we are, in some cases, faced with the choice - the only other choice is to effectively have a zero or a 100 per cent discount. In other words, to not make an assessment at all, or to let the data speak in circumstances where we are far from convinced that the data on its own is telling the story accurately, but where we feel there is a story to tell and so to discount it by 100 per cent would not deliver an outcome which was directionally sensible. So we try to be consistent. The size of the discount is inevitably a matter of judgment, and that then means that the appropriateness of it is very much in the eye of the beholder. I mean, there's just no way around that. But we stand ready to be challenged on inconsistency and inappropriateness in our use of judgment and discounting and, as I said in my opening remarks, we're perfectly happy to revisit the sorts of discounts that we've indicated in the draft report if there's good argument and good reason, but thank you for that. Is there anyone else who wanted to comment on that point? If not, the second item, the specific item put on, is the Community and Other Health Assessment which New South Wales asked to be put on the agenda so, Michael, over to you.

MR SCHUR: Thanks, Alan, and we'll obviously try to do this - with this in detail in our final submission, but we just wanted to make the point today that we are not convinced that the proposed subtraction method accurately reflects the need for State spending on community and other health services. In fact, we think there's an induced demand aspect there. We think we have a lot of data that will support that view.

MR MORRIS: Thanks, Michael, and we are happy, and the staff are happy, to continue to work with you on this. It's certainly my understanding that most states are satisfied conceptually that this is a reasonable way to handle this assessment. As you know, we've had this assessment externally reviewed and the approach validated through that external review, but we are aware that there are some quite specific pictures that emerge in New South Wales and we know that you'll be putting these to us and that we'll be looking very carefully at them, so you have my assurance on that. No one else wants to speak on that issue? No.

That takes us to Other Business. We have dispatched one item of Other Business, that was the timing of the next review. Grant, I did indicate there would be opportunity under this agenda item if you wanted to make some further points about cultural and linguistic diversity?

MR HEHIR: No, I think we'll leave it - - -

MR MORRIS: Not at this time? I'm assuming that you'll address it in your final submission. Is there anything else that people would like to raise while we have this opportunity? If not, thank you very much for your participation today. The process to get to this point has been long and arduous. One or two have you reflected somewhat ungraciously on that, I think, in the course of the morning, but let me assure you that we share that sort of ungracious sentiment. The major issue today, and for the remainder of the review, not necessarily for a particular State, but across the board, is the capital assessment. As I have said, we are continuing at staff level to work through a number of technical issues. We are clear in our own mind about what we are setting out to achieve, and why, and the opportunity is there for you in your final submissions to speak to us about what our intent is.

We will undertake to look again at the issue, the National Network Roads issue that Grant raised, and there's a great deal of work going on in relation to the location assessment, and we've taken note in particular of some areas that the Northern Territory is working on and we'll continue to work with you and with other states who have locational issues. I think, for the most part, there's little specifically to say about the other agenda items for today. Three to five-year averaging: there is clearly a consensus for three years. Transitional arrangements: unless directed by the Terms of Reference, we will silent in the final report on transitional arrangements, but would be open at either staff or Commission level to provide observations or suggested ways to handle things, if - if - asked, but probably not otherwise. And the treatment of Commonwealth payments: I'll say something about that in a moment. And on the timing of the next review, I think the general consensus is that about 2025 would be a good year for the next review.

Now, let me say just a couple of things. The process between now and the end of the review provides for states to make a further and final submission, and this is not like an airport boarding call; when we say final, we do actually mean final, which should be received by the end of September. Now, it is a grand tradition of the review process that state submissions are late, and while I don't want to disrespect tradition, I just make the point that submissions which are late on this occasion will give us less time to consider the points you raise and the later they are, the less time we will have, and there will come a point at which the logistics of finalising the report will just preclude the opportunity to consider them at all. So I would urge you to be conscious of that. We would welcome a sequence of smaller prioritised submissions from a state, rather than an omnibus delivered in one piece, but late.

A couple of specific points: we've indicated that the draft methodology contains placeholders for a possible VDA factor in land tax, and for water subsidies in the Services to Communities Assessment. As soon as the Commission has proposed methodology in these areas, we will provide this to you and seek your comment, and that may well fall outside the end of September timeframe, but we will provide that to you for comment so that you have an opportunity to think about what we're proposing.

States have raised a number of technical questions relating to the draft methodology. These should continue to be raised directly with Commission staff as and when you feel appropriate, and shouldn't wait for state submissions. As you know, in an update year, we circulate a New Issues paper around September, October time. We propose to circulate a New Issues paper in mid September, essentially to ensure that we've captured all Commonwealth payments to the states appropriately. I think that will constitute the essence of the paper, and we'd seek your views on our proposed approach for these payments by mid November. The Commission envisages that there will be regular and ongoing opportunities for State officials to engage with Commission staff over the coming months, and we would encourage you to do this if there are matters that you want to raise.

I think that's all that I need to say by way of conclusion, but can I firstly ask my colleagues if they have anything to add? No?

MR ....: No, thank you.

MR MORRIS: No? And if there's anything, in closing, that any of you would like to record? Roger?

MR BROUGHTON: Could I ask a question rather than make a comment? We've left a number of things on the table that are going to have further scrutiny, I guess, before the report comes out in February, and some of those have a potential to change dramatically, I guess, the outcome of the relativities. Is there any thought that if there is a change, a significant change, from the draft report that the states will be advised of that prior to the final report?

MR MORRIS: I'm not exactly sure what sort of thing you're talking about. If you take, for example, the VDA adjustment in land, that decision will have a material impact on Grant shares, but as I've already said, we will provide, in advance, the position that we've come to, and you'll have an opportunity to comment on that.

MR BROUGHTON: I guess I'm thinking more along capital and a couple of the other issues we raised; the treatment of National Network Roads claimants, for example. They can have a material impact on the outcome. Will we receive early notification of where you've come out on that, or will we only know when the report comes out?

MR MORRIS: Well, I don't envisage that we would communicate in any way particularly about capital. I mean, you know where we're headed on capital. If we are convinced that we should change that position, we will change it, but I don't think that the process demands that we have an ongoing dialogue with you as we move to finalise our position on various things. That's not been the normal practice, and I don't sense that there's any great need for that.

MS PRINCE: I had a question - - -

MR MORRIS: Jennifer?

MS PRINCE: - - - in relation to location, in that there is a lot of work, a lot more work, being done on the data issues, and we would appreciate an ongoing dialogue between the staff to improve - - -

MR MORRIS: That will happen. That will happen, yes. I'm not sure to what extent that covers off Roger's point. I don't think it does, really, but that ongoing dialogue with the staff will happen for as long as it's necessary and practicable. If there are no further matters, thank you. Thank you very much. There is to be a lunch. I presume it's out there where morning tea was. Please feel free to stay. I assume your States-only meeting is here this afternoon, is it?

MR ....:   Yes.

MR MORRIS: So we will join you for a short lunch, and then, as they say in the opening of Parliament, we will leave you to your important deliberations. So, thank you. Thank you very much for participating this morning, and you'll be hearing from us in February.

MEETING CONCLUDED AT 12.10 PM