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## TRANSCRIPT OF PROCEEDINGS

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O/N 69029

### **COMMONWEALTH GRANTS COMMISSION / HEADS OF TREASURIES 2010 REVIEW CONFERENCE**

**MR A. MORRIS, Chairman**

**MELBOURNE**

**10.07 AM, THURSDAY, 29 NOVEMBER 2007**

<b>ATTENDEE</b>	<b>TITLE</b>	<b>AGENCY</b>
Alan Morris	Chairman	Commonwealth Grants Commission
Ross Williams	Commissioner	Commonwealth Grants Commission
Glenn Appleyard	Commissioner	Commonwealth Grants Commission
Jennifer Westacott	Commissioner	Commonwealth Grants Commission
Greg Smith	Commissioner	Commonwealth Grants Commission
John Spasojevic	Secretary	Commonwealth Grants Commission
Catherine Hull	Assistant Secretary	Commonwealth Grants Commission
Dermot Doherty	Assistant Secretary	Commonwealth Grants Commission
Marc Boisseau	Director Law and Order	Commonwealth Grants Commission
Megan Smithies	Under Treasurer	ACT Treasury
Roger Broughton	Executive Director Investment and Economics Division	ACT Treasury
John Purcell	Senior Manager Commonwealth-State Finances Unit	ACT Treasury
Andrew Philip	Manager Commonwealth-State Finances Unit	ACT Treasury
Michael Willcock	General Manager Commonwealth-State Relations Division	Australian Treasury
Nhon Tran	Unit Manager State Finances and Reporting	Australian Treasury
Derek Bazen	Policy Analyst	Australian Treasury
Kevin Cosgriff	Deputy Secretary	New South Wales Treasury
Bruce Freeland	Director Intergovernmental Finances	New South Wales Treasury
Tony Stubbin	Assistant Under Treasurer Economics	Northern Territory Treasury
Bruce Michael	Senior Director Public Finance	Northern Territory Treasury
Gerard Bradley	Under Treasurer	Queensland Treasury
Gary Ward	Assistant Under Treasurer	Queensland Treasury
Jim Wright	Under Treasurer	South Australian Treasury
John Henderson	Director Commonwealth-State Relations	South Australian Treasury

Don Challen	Secretary	Tasmanian Treasury
Rob Nicholl	Deputy Secretary Economic & Financial Policy	Tasmanian Treasury
Adrian Christian	Director, Intergovernment & Financial Policy	Tasmanian Treasury
Alex Tay	Assistant Director Intergovernment and Financial Policy	Tasmanian Treasury
Grant Hehir	Secretary	Victorian Treasury
Joe Monforte	Director Tax Insurance and Intergovernmental Relations	Victorian Treasury
Karen Hew	Assistant Director Intergovernmental Relations	Victorian Treasury
Alain Baillie	Senior Economist Intergovernmental Relations	Victorian Treasury
Simran Mehta	Senior Economist Intergovernmental Relations	Victorian Treasury
Triada Papadimitriou	Economist Intergovernmental Relations	Victorian Treasury
Tim Marney	Under Treasurer	Western Australian Treasury
David Smith	Executive Director Economic	Western Australian Treasury
Mark Altus	Director Revenue and Intergovernmental Relations	Western Australian Treasury
Alex Scherini	Assistant Director Intergovernmental Relations	Western Australian Treasury

**COMMONWEALTH GRANTS COMMISSION/  
HEADS OF TREASURIES 2010 REVIEW CONFERENCE  
10.00AM 29 NOVEMBER 2007, AIRPORT HILTON BALLROOM SOUTH, MELBOURNE  
AGENDA**

5

**Welcome  
Adoption of Agenda**

**Opening State Comments**

10

**A: Progress with Assessments**

Do States have concerns with how assessments are being developed, against the background of the needs to achieve HFE in a simpler way?

15

Do we need to modify the work program going forward?

**B: Capital**

20 How do States view the two assessment options being proposed (direct assessment or holding cost) against the methodology principles of: what States do, policy neutrality, practicality, and contemporaneity?

Which offers the prospect of achieving HFE with least reliance on judgment?

25

**C: Economic development**

30 If the Commission adopts the direct assessment of capital needs, so that differential population growth has a more immediate impact on the GST distribution, are most economic development concerns addressed?

What indicator could be used to measure the economic development disability?

35 If there is no simple measure, how could economic development be incorporated into expense and/or revenue assessments?

**D: Contemporaneity**

40 Do States share the Commission's concern about contemporaneity?

What are State's views on adopting a shorter averaging period, say, 3 years?

45 If we move to a shorter period, when should that decision occur and be implemented?

Should SPPs be included in the application year, as with Health Care Grants, or in the reference years?

MR MORRIS: Good morning, everyone, and welcome. Thank you very much for coming. There are several empty chairs. I understand that this morning's flight from Adelaide has been delayed, and Jim and his colleagues will be here sometime after 11. I have no advice about the ACT, or the Commonwealth. Yes, WA is here, over  
5 there. Jim's there. So I was going to welcome Megan Smithies to her first meeting, but I'm not going to do that now. I would welcome, though, I think, Greg Smith from the Commission. I think, Greg, this is your first exposure to – at this side of the table. I do recall you sitting over there once, and helpfully declining to provide any contribution whatsoever to the day. So let's hope that's not now an established  
10 precedent. We have, I think, Bruce, an apology from John Pierce. Is that right?

MR FREELAND: That's correct, Alan. Unfortunately, he got caught up with something last night. As of about 2 o'clock yesterday afternoon he was coming. As of about 6 o'clock last night he got called away.

15

MR MORRIS: Okay.

MR FREELAND: So apologies from John.

20 MR MORRIS: Okay. And, Tony, we also have an apology from Jennifer.

MR STUBBIN: Yes. She's dealing a new Cabinet and new Ministers about to be announced. She wasn't able to come.

25 MR MORRIS: Nonetheless, I think we're sufficiently quorate to proceed. The heavy hitters are here, so I think we can get underway. The important stuff. Morning tea, I think, will be served around 11.30. The facilities are on either side of the lifts, down that way, and not that I anticipate this will actually be relevant, but we do need to finish before 2 o'clock in order for you to segue into your own meeting.  
30 We see this meeting as very important in hearing your views - and I emphasise the "your," particularly Heads of Treasury views, rather than officer level views – about a couple of key issues that we need to resolve as we progress the 2010 review.

35 That said, this isn't a meeting at which I would expect that we would make firm decisions. For us, it's an important opportunity to hear what you have to say about the issues that are on the agenda so that we can then, as we continue our work, we can be guided by and informed by those views. It's a higher level opportunity to address strategic issues, and at this point of the review that seems entirely appropriate and, indeed, it is quite some time – in fact, I think it's probably about a  
40 year since we last met like this. We have identified the key issues for the agenda. There is an opportunity for other matters to be raised if you wish, but I can just note that no one has forewarned us in any way about any other matters that they wanted to raise.

45 We certainly will reflect on what you have to say about the matters on the agenda, and as we will, of course, on the written submissions that are yet to come. There have been, and there will continue to be opportunities for detailed interaction at staff level. The iterative process has been both stressful and valuable, and probably in

about equal measure, and we see that as continuing. That is the way in which we have designed this review process. And of course, next year we have our workplace visits, which I think start in March and go through till July, and we would anticipate that our views on many of the more detailed issues that you have raised and will  
5 continue to raise with us will be tested in the field, as it were. I think I now can welcome Megan Smithies to her first meeting.

MS SMITHIES: Thank you very much. It's good to be here.

10 MR MORRIS: Better late than never. You're not the last to arrive, if that's any consolation.

MS SMITHIES: Okay. Will I be the last?

15 MR MORRIS: The agenda that we proposed – the cavalry has arrived, with not quite the impeccable timing of B-grade Westerns. I don't think I have to welcome you, Michael. You've been to one of these meetings before?

MR WILLCOCK: I have indeed, yes.

20

MR MORRIS: Yes, I thought that was the case. The agenda that we have identified for the day, a review of assessments – not a detailed review of assessments; I'm not actually going to go through every assessment item and tell you what we think. Capital, the assessment of capital; the treatment of economic development;  
25 contemporaneity; and then if there are any other matters that you would like to raise. I don't see it as necessary to provide or to seek opening state comments of a general nature, but of course if there is something that any state would like to say before we start on the agenda, then certainly now would be the time to say that.

30 If not, let's turn to the first agenda item, which is a review of the work we've been doing on assessments to date. We think it's sensible to take this opportunity to indicate how we think the review is progressing, and where we're heading, and importantly, to hear from you if there are any particular areas of concern, or particular matters that you think need more, or perhaps less, attention. And now that  
35 we're about halfway through the review process, it's probably a sensible time for some broader reflection as well. We've established working assessment guidelines to inform the way in which we'll go about our assessments and make our decisions. Can I just say, though, because sometimes people talk about the rules, we have quite deliberately and carefully described our assessment guidelines as guidelines.

40

They're not rules. Their purpose is to support the robust implementation of fiscal equalisation post-2010. A more simple process is an important part of that challenge, and that's what we're required by the terms of reference to deliver. The guidelines will enhance this by supporting greater consistency and requiring better evidence-based assessments. But they don't eliminate completely the need for Commission  
45 judgment, nor do we see them as rules which would preclude us from progressing our work in a sensible way. We regard them as extremely important, but not as a

constraint to doing something which on balance we consider to be sensible and appropriate.

5 We've set out our interpretation of the objective of fiscal equalisation, and the principles that shape how we will build our assessments. And as far as we're concerned, we have closed off that discussion. We have initiated an iterative process of consulting with states on individual assessments. Commission staff have circulated staff discussion papers on all assessment issues, each of which was considered carefully by the Commission before being circulated. We hope to  
10 conclude that initial round early in the new year. We've quite deliberately adopted this working level approach to foster as much interaction as possible with states. But I can – I want to make it clear so there's no misunderstanding that as a commission we are fully aware of the matters that have been put on the table through this series of papers. The approach we take is that the matters contained in the papers are  
15 appropriate matters to raise, but we as a commission are not necessarily committed to the specific assessment issues they contain. We think they are worth putting on the table, we want to hear what you think, and we will make our judgments about them as the review progresses.

20 Commission staff and the states have met to discuss individual assessments and explain the options being proposed or being considered. States are progressively responding to those discussion papers, and we on the Commission are being kept fully informed of state positions as they are put forward. States have been informed on how Commission thinking is evolving on individual assessments as we reflect on  
25 state views, and as meat is put on the bones of our proposed assessments. The working level discussions at staff level have provided opportunities for Commission staff to come back to you and let you know how the Commission is thinking about the issues that you've raised. We think it's important that as far as possible you understand how we are travelling on different issues as our thinking evolves.

30 We're not making final decisions at this stage. We won't be making final decisions until after we've seen state responses to the draft report in 2009. We will consider reasoned and well-supported arguments throughout the process, but we've tried to be clear and firm that general unsupported claims will carry little weight. Where states  
35 have specific issues they want to be considered, we expect them to build the case, providing the conceptual justification, identifying the data that will enable the case to be tested, and demonstrating how the assessment can be progressed reliably. We're now preparing for our round of state visits next year, which we see as an important part of the review process.

40 We don't expect issues of principle to be addressed during those state visits. For our part, their important purpose is to demonstrate and highlight particular assessment issues and allow states to put forward specific disability issues, and for the Commission to test them. When that stage is concluded, we aim to issue another  
45 round of consultative documents on individual assessments, probably around September of next year. At this point, these will be Commission discussion papers, as distinct from staff discussion papers that you've seen so far. States will be able to respond, and we'll consider those responses as we prepare our draft report.

This has been designed to be a very inclusive process. One in which we've tried to strike a balance between consultation and not overburdening the states. In my bilateral discussions with you earlier this year, some states were concerned they were having difficulty with the iterative nature of the process. We understand that there are gaps between submission dates, gaps between staff or working party meeting dates, gaps in which the Commission continues to move forward in its own thinking.

I appreciate that concern, but all I would say to you is that the review can't stop. So far as the Commission is concerned, we have to keep moving forward. Our experience is, at least for some issues, some states are struggling to meet deadlines for submissions and there is a perfectly reasonable desire for states to know how our thinking is evolving as we move along. We've provided opportunities for staff level bilateral meetings to try to assist with these concerns, and if we need to do more of this, then we will certainly do so.

Your respective staff will have briefed you on the status of individual assessments and I don't propose to cover that detail today, but I would like to take the opportunity to say a couple of things on just one or two assessment issues as a result of our consideration of the latest round of state submissions. As you know, we are required to develop assessments which achieve fiscal equalisation using simpler methods, such as using broader indicators. We've attempted this in relation to certain revenue categories, where we have long standing concerns about the comparability of state supplied data.

Commission staff developed possible broad indicators of relative tax bases and consulted with states on how they might operate. We've pushed the envelope as far as we and the staff of the Commission feel is possible. It now seems clear that, for some assessments, the alternate approaches do not offer any clear advantage and our inclination is for both the conveyances, the stamp duty on conveyances and payroll tax categories to develop methods closer to the 2004 approach. If a state wants to develop an alternate broader indicator approach, the door is always open, but we feel we've taken those two as far as we can with no useful outcome in sight.

On the expense side, we had also proposed a possible way of undertaking a single health and a single transport assessment. We're not satisfied that the date to support these proposals is available and we now propose to focus on the alternative, more disaggregated approach on which states have already made very useful suggestions. I don't see today as being an appropriate forum to discuss detailed assessment issues, but there may well be some generic issues that states wish to raise.

In the annotated agenda that we circulated for today's meeting, we listed two questions that might guide any responses from you. These were, do states have concerns about how the assessment have been developed against the background of the need to achieve fiscal equalisation in a simpler way, and secondly, do we need to modify the work program going forward. On this occasion, I really don't think there's any value in following protocol and requiring New South Wales to speak first followed by Victoria, etcetera, etcetera, so the floor is open, and I'll take your

thoughts and comments and responses in any order that they come. The floor is now open.

MR COSGRIFF: Perhaps I can kick off on that, New South Wales.

5

MR MORRIS: New South Wales.

MR COSGRIFF: Look, in general, believes that the Commission is attempting to balance simpler assessments, and while the assessment guidelines are a good tool to ensure the assessment structures achieve HFE in a simpler way, we are – have some concerns that the guidelines are not being consistently applied, nor necessarily is the application a clean slate process. For example, with regard to their administrative scale assessments, New South Wales does not agree that there is yet a sufficient conceptual case established, nor that the proposed data and methods are reliable enough to justify inclusion in the 2010 review.

We appreciate the Commission's efforts in consulting with the states and not attempting to overburden them. Significant work has been done by the state treasuries throughout 2007 to develop and approach the assessments for the 2010 review. While I appreciate the timetable, the submissions place a significant workload on, certainly, the New South Wales treasury, particularly during the budget process, the second iteration of submissions, I think, should consider the workload and it's – particularly, it's timing in relation to key dates for, in particular, the preparation of the budget process.

25

In general, I would say we support the latest work program. We see no need for modification at this stage, but the key message, I think, would be that, to the extent there is any revision to the work program, that needs to ..... the state resources its implications on the other activities that will be pursued, particularly by that area of the New South Wales treasury and its contribution to the budget. New South Wales supports the iterative approach the Commission has undertaken.

30

The working level discussions are – have been very useful, both for us and hopefully for the Commission in developing its view on the assessments. We, however, suggest an administrative modification, if we can, which is that we would like to see a little more interaction with the staff between the assessments and the conferences, for instances, so – because we appreciate that views will evolve as time goes on and it would be useful to hit the conferences and other forums with an understanding of exactly how the Commission's views respond. I think you'll find that will put us in a better position in terms of our submissions because we will be able to turn those around more quickly and more effectively.

40

MR MORRIS: Thank you very much. I'll take the round of discussions and then if we come back to any points where we can, perhaps, usefully, make a contribution. Tim?

45

MR MARNEY: Yes, thank you. I guess, as part of an observation of the process overall, the sort of thinking that's happening and the work that's been under way is

looking positive from our perspective in terms of looking at innovative approaches to try and achieve simplicity. I'd be keen for the Commission's views on whether or not that principle of simplicity remains realistic, and if there are significant blockers to that, what are they, where are they and how we can address them, because we do  
5 see that, I guess, the fundamental guiding principle to this whole process, to achieve greater simplicity.

In terms of resourcing, I think it's, from our perspective, resourcing and, if you like, keeping up with the Commission's work program is not so much of an issue because  
10 we've positioned ourselves in anticipation of the work program and have had the work program for some time to be able to do so. Our only concern is that there will be a significant gap between when we – basically the work to date and when we receive the next set of methodology discussion papers in September '08 and we welcome the opportunity to have early release of some of those if possible or some  
15 structured discussion around the – ahead of September '08 so that we can remain as engaged in this process as possible and have ongoing awareness of the Commission's thinking in terms of methodology.

Having said that, we have no concerns with respect to the communications that we  
20 are having with officers of the Commission and that remains very positive and I guess, the access to officers and preparedness to share views, thoughts, is very much appreciated. So, really going forward, the only concern – request we have is that some of those discussion papers be released as early as possible after the conclusion of the workplace discussions, I think, in July next year with South Australia, but  
25 other than that, we're quite pleased with how things are progressing but keen for your views on whether or not we are progressing well towards an objective of simplicity.

MR MORRIS: Thanks, Tim. Gerard?  
30

MR BRADLEY: Thanks, Alan. I'm pleased you're not going to ask for a discussion on particular items. So that plays to my strength. I guess, we acknowledge that work has been underway in the Commission and we appreciate the opportunities we've had to work constructively with the Commission and staff. I  
35 think we're making reasonable progress across a number of areas, and indeed, I think we are making some progress on areas that can be simplified.

I guess, if I could make a – one or two key messages. I think it's important that, in looking at the detail in working it up, that we also, I guess, the Commission keeps its  
40 eye on some of the big drivers that are occurring across the states as well. I guess, two come to mind here, and they're important in terms of some of the particular topics you mentioned for today. The first one that really is a major issue for us is the huge impact of population growth and the shift of population that's occurring and impacting, particularly in Queensland, so while we make up, you know, 20 per cent  
45 by population, we're catching 35 per cent of the population growth.

That's driving a whole series of both service delivery and capital needs across the state, so in the past 10 years, I think, we've grown by about 750,000 and in the next

10, there'll be another million people – extra people in Queensland. So that's why it's no coincidence we have a now Queensland Prime Minister, I suppose, and – I had to throw that in somewhere along the way.

5 MR MORRIS: One less, then. He's going to Canberra.

MR BRADLEY: Transitional – yes. That's a big issue, driving our capital needs and our service delivery needs, and it's a constant focus in terms of a development of our budget, but it's a major national issue in terms of actually addressing the issues  
10 as we think about participation, population and productivity, all those things. There is this very large shift to accommodate some of the drivers behind that as well, the resources being a very important drivers to, I guess, be considered across the range of Commission assessments.

15 There could be a number of other big drivers across this, so in a sense, simplification, we also note, we shouldn't lose sight of, and I guess, the other one that occurs to us is the – what we consider to be the emergence or continuing maturity of the national employment market, national wages market, and that has many important implications going forward for how the Commission approaches issues like its wages  
20 input cost assessment, which we're looking to seeing more detailed work on, and I think, we need to really fundamentally challenge the thinking and the basis upon which that's been put together.

Obviously, the productivity Commission work a few years back did really raise some  
25 questions around that. From Queensland's point of view, we're looking to work constructively with the Commission and to try and actually build and develop better methodology we've tried to do that in key areas like in the road area and I certainly acknowledge the fact the Commission was open to those – that new way of thinking and to actually try and develop a better methodology which reflects more  
30 contemporarily the issues that are driving service delivery in the state – in all states.

So I guess, going forward, we're trying very hard to try and see if we can help the Commission develop better and a more robust methodology and better quality data, which underpins that. In terms of other issues that have arisen, I think we have some  
35 concerns around the some particular issues around the land tax assessment. I think we welcome your comments around being pragmatic on terms of your revenue assessments that you've already mentioned. If you cannot need – develop better and higher quality methodology, then – but to go back to perhaps some of the more proven and established and accepted methodology is appropriate on occasions.

40 In the case of land tax, that's a complex area and it's one where we'd like to have a further exchange of views on what might be a better approach to actually underpin that assessment as well. They're probably as much as I need to say in broad terms at the moment. I'd be happy to elaborate as we go through the morning, thank you.

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

MR HEHIR: We reiterate a lot of the comments that have been made about progress of the review. We're very comfortable with how things are going on. We support the whole approach of the review and support the – I suppose the resolve of the Commission in sticking to the terms of reference and driving the simplification and robustness of data type of agenda. The – I also sort of support some of your opening comments about the need to do that within a framework which is focussed on achieving the objectives of this equalisation process.

10 I suppose if we have any concern at a high level, they'd be around ensuring that when we're looking at the assessment process, we should always – we would support an approach which didn't assume that the support continues simply because they've been – they're in the past and that there's a responsibility on jurisdictions to continue to justify that the – that this ability that existed in the past continues to do so going forward.

15 One sort of proviso I'd put around our support for the use of more robust data, and I think it's something that you used in your opening comments is that you have to be careful that focusing on the quality of the data doesn't lead us away from the core objectives of what the process is designed to achieve and what I mean by that is that simply because we've got good data in one area shouldn't lead us to a process where the assessment methodology distorts the – an appropriate outcome because there isn't broader data elsewhere.

25 I think there's a couple of areas where we've identified some concerns that the availability of data is leading to a broad assessment of a particular area without it – where we think that a – that taking into account a lack of data in other areas could be beneficial and I suppose, from our point of view, the example there would be the difference in indigeneity where you've got decades of data collection and research and we've been ..... long time and the growing issues that we're dealing with around cold populations where the data isn't as significant, but some of the issues and concerns that we confront are of a similar magnitude and problems. So we would encourage that that sort of balance between focusing on where there's good data and focussing on the needs is done appropriately.

35 I suppose, the only other thing I'd mention is that we need to be careful in looking at proposals to extend the scope of the fiscal equalisation process into areas like capital doesn't lead to duplicative counting or a distortion of outcomes. As you know, we're not certain about the whole issue of population growth and capital. It's something that needs to be debated through. I don't think it makes a great deal of difference to Victoria because we tend to be at the average population growth, so I'm not certain that the – that some of the papers that have been circulated, that I really comprehend what the argument is, and I think that's a debate that we're going to have a bit more of this morning, but going back generally, I think we're supportive of how the process is going and think that it's all been working along quite well.

45 MR MORRIS: Thank you very much. Don, is there anything that Tasmania wants to say about this issue?

MR CHALLEN: Yes, thank you, Chairman. I guess, I had a little level of concern about the way the assessments have been progressing. It's hard to know, in the environment in which the Commission is working, how seriously I should take those concerns. Obviously, we're under some pressure from the workload of responding to you as others are, and somebody earlier raised the question of the timing of responses to your papers during next calendar year.

It would be helpful if we weren't being bombarded with a lot of stuff that requires responses during the April May period, when we're putting our budgets together, but that aside, we understand that you have a big work program and an immovable timetable to work to, and we will find the resources that are necessary to respond to you. I also like the iterative approach that you are taking to the exercise, though I would encourage you to close the loops on the elements of that iteration a little bit more quickly, if it's possible to do so.

There are cases where our people feel that they haven't understood enough about where the Commission has got to on assessments of materiality and aggregation for instance. So we'd like to see just a little more of what the Commission has used to come to conclusions on those sorts of issues. You have relieved a fair bit of anxiety that I had and saved me the trouble of working through quite a few pages of notes here in relation to the revenue assessments this morning. I have been very concerned that, in particular, in relation to the revenue assessments, the simplification objective seems to have been taking precedence over the achievement of HFE.

I'm sure I don't need to remind the Commission of this, but your terms of reference, while they do call for you to pursue the goal of simplification where it's possible to do so, there's a very important rider in front of the words that ask you to do so only where it is consistent with achieving the principle of HFE. So let us not get caught up with the feeling that – it's a very spooky thing. This 2010 review is about simplification, isn't it, it's about HFE, and the Commission is being asked to simplify, where it can, consistent with achieving HFE.

Now, you know, my anxiety was rising because it seemed to me that in pursuit of the simplification objective in the number of revenue assessments, looking for proxy measures to use and so on, a lot of the richness that was inherent in methods of it being used in previous reviews, which was at the end of the day about achieving HFE, was being abandoned in the pursuit of simplification and it's very reassuring to hear the chairman say this morning that you've come to a conclusion in relation to conveyances and payroll tax that the old way is the better way.

You know, if that sets the standard for the way in which you are going to pursue these matters, then my concerns will pretty much evaporate. I'm comfortable with that. I would, however, just ask that where it's possible to do so and I understand it may not be practical in every case, if you can close the gap between a staff paper, reactions being received from the states and the position coming to the kind of conclusion that you've adumbrated to us this morning, it would be helpful, because it leaves us a bit anxious.

I have some things to say about some of the other specific assessments later, on the agenda, but I would like to raise a question that is of huge importance to Tasmania. I note that you are, of course, pursuing the notion of a single location disability assessment, and that sounds like a fine idea to me, the feedback that my people have  
5 been giving to me is that you are struggling and that there is some indications from the Commission's staff that if you can't achieve a robust single location assessment, you may be driven back to further consideration of the issue of wages input costs.

As you know from my contributions to these sorts of conferences in the past,  
10 Tasmania has never been comfortable that the assessment of wages input costs meets the standards that the Commission normally expects either from a conceptual perspective or from the perspective of the robustness of the method that is used to implement it, and the experience that we've had in the past few years with our industrial negotiations has very much confirmed, in my mind, that the conceptual  
15 basis for your wages input and costs assessment is basically nonexistent.

We are in a national market. We find Western Australia actively recruiting teachers from Tasmania. We've just had our nurses on strike for a number of weeks following the Victorian strike, the outcome of which is that we could not get our  
20 nurses back to work without paying them what they're being paid in Victoria, basically.

When you look around the major occupational groups in the public sector in Tasmania, there is now virtually nobody that is not being paid wage levels by  
25 reference to the wages paid in the other states. There's just a long list of them, doctors, nurses, police, fireys, ambos and we're about to go into a negotiation with the admin and clerical group, the general white collar workforce in which their position is you have to pay us the average of what our occupational group is being paid in the other states.  
30

We also remain extremely unhappy with the notion of using private sector data to try and assess disabilities that exist in relation to the wages costs for public sector employees. We don't think the conceptual basis for that is sound, and frankly, we don't believe the data. So a long way of saying, please work hard to see if you can  
35 make that single locational assessment work. It seems to us to be a very worthwhile endeavour, but if you can't we'd ask the Commission to look very hard indeed at the wages input costs assessment because we do not think that is the way to do, and I think, chairman, that's all I needed to say, yes. Thank you very much.

40 MR MORRIS: Thanks very much, Don. Megan, does the ACT - - -

MS SMITHIES: Yes, I'd just like to, I guess, reiterate a lot of the positive comments that have come out across the table. The only thing that I'd actually like to put on the table is a concern around a tendency to – this issue around simplicity and  
45 perhaps erring too much on the side of simplicity and materiality at the expense of what could possibly be transparency, and I guess, the case in point for us is some of the issues around cross bordering and the way the process means for cross border, etcetera, and that's pretty much all I'd like to put on the table.

MR MORRIS: Okay, thanks very much, Megan. Tony?

MR STUBBIN: Thanks, Alan, one of the challenges of going last is that all the good things have been said.

5

MR MORRIS: I gave you a chance to go first, you didn't take it.

MR STUBBIN: I was much more polite than that. Just to pick up on just one of Don's points. I won't cover all of Don's points. We might be here for a long time. The issue of simplicity, obviously, is the big change in this current review and it's all something we've acknowledge is highly desirable. We've been in the group that's felt that simplicity was being taken a bit too far and that the achievement of equalisation had been demoted a little bit. The Commission's examination of broad indicators has had mixed results, we believe and I have to say, I was extremely happy to hear you indicate at the start that, in some of those broad revenue assessments, that you are retreating a little from that position and acknowledging that some of the methods used in the 2004 assessment were closer to the mark and that you'll be exploring those further. So that was the only thing I wanted to say.

MR MORRIS: Thanks, Tony. I don't know that you want me to respond to all of that. Let me say a couple of things. On the question of – well, if you – perhaps where I should start is the thing that came up most, and that is the balance between or perhaps the tension that might exist between simplification and the delivery of equalisation. The Commission is in no doubt whatsoever about what its mandate is. Its mandate is to deliver equalisation, and it's probably appropriate but totally unnecessary to remind you that it was the Commission in that context that raised concerns about the extent to which complexity had evolved through to the 2004 review.

It was the Commission which listed a number of concerns, data concerns, methodology concerns, a number of concerns which were then picked up in the review that heads of treasury were asked to do in 2005 under almost identical language to the concerns that the Commission raised. So our view about simplification was not – was not that there is some sort of contestability between simplification and equalisation, our view in 2004, and I say our because the – my colleagues can walk away from it, of course.

The view of the then Commission was that there were elements of the simplification – of the equalisation process and methodology which were not as robust as they should be, given the importance of the task of equalisation, and that, indeed you would get more robust and hopefully more acceptable of equalisation if you were to move to a basis which was less complex, more transparent and which afforded all of the stakeholders greater confidence.

So that's the way we have progressed. Now it is in the nature of things that states have differing views about the way this process should roll out. The conventional wisdom is that the states who are beneficiaries of the equalisation process will want the greater number of categories, the greater number of assessments, the greater

number of adjustments and so on. States that feel that they are contributors to the process conventionally would feel that their interests would be better served by a more streamlined and a less complex process with fewer adjustments.

5 It isn't evident that the conventional wisdom is right, but – so we'll just pass on from there. It's not evident. It's not evident that it's wrong either at this stage. It has been necessary, in order to progress the agenda which we are given under the terms of reference, and I emphasise that we are in no doubt as to what the terms of reference require us to do. Simplification is, in this sense, to contribute to that objective of  
10 equalisation, and if it doesn't contribute to it, then it's the equalisation objective that is pre-eminent.

In order to progress that, it has been obviously necessary to put some very different ideas on the table. Some very different ideas indeed, and we have observed over the  
15 last 12 to 18 months or so, and will observe over the next 12 to 18 months or so, the struggle between maintaining some of those ideas and winding back to go back to methodologies and approaches and concepts that states have become used to over the years.

20 Now, I've been saying for some time in the Commission that, you know, the battle over simplification has hardly been joined yet, and elements of that battle could be heard around the room today in gentle ways, but nonetheless, they could be heard. We have had to put some ideas in play. Some of those ideas, as I said in my introduction, some of those ideas, we are satisfied, won't fly. They will not achieve  
25 the things that gave rise to the Commission's concern in 2004 and so we don't intend to pursue them, and in that respect, on – there's a difference between categorically and formally closing the loops and functionally closing the loops.

30 So I'm not going to sit here today and say, "We will refuse under any and all circumstance to consider any further issue in relation to, say, a new approach to payroll tax." I'm not going to say that, but functionally, we've come to a conclusion. So for us, that loop is closed, but it's not categorically and formally closed forever. The location assessment is another one that is still in play. It is still in play. My recollection is that location papers will come to you early in the new year, and the  
35 relationship between location – the approach of location and wages input costs is obviously a central element of those papers.

We have not closed our thinking. We've hardly opened it. I recall the tortuous processes in developing the various location assessments in previous reviews, and I  
40 think it could fairly be said that some of them were less methodologically robust and less data robust than would have been desirable. So we are looking and we continue to look for better ways to identify where the locational differences exist, what they are, what drives them, how they can be measured and whether and how an assessment can be – a methodology to implement such an assessment can be  
45 reasonably developed. So that's still very much in play, that one.

The consistent application of the guidelines was raised a couple of times. I think, the Commission's view is that the development of guidelines has been a necessary and

an important step in providing a framework which would enable the stakeholders to have a greater level of confidence that there was consistency in the way that the Commission was going about its work, but those guidelines, yes, they have to be applied consistently, but they also have to be applied with common sense and with  
5 some capacity for common sense judgment to inform the decisions that the Commission makes.

For example, if we look at the guideline on materiality, which says that you would only make a further disaggregation above a certain threshold, that doesn't mean that  
10 we are absolutely in any and all circumstances going to make that further disaggregation. I mean, if having worked the numbers, it makes absolutely no difference to do it, why complicate the assessment by doing something that makes no difference, particularly if it introduces a layer of complexity and opacity to the whole process? So we're going to implement – we're going to use those guidelines  
15 diligently, but they're not rules.

By the same token, we won't set the guidelines aside to do something if there's no good reason to do that. The issue of work level, look, we appreciate that this process is burdensome on you and we appreciate that there are some times of the year when  
20 its an absolute impossibility for you. We understand that. Two points, one is we'll do everything we can to make it as easy for you as possible, and where we can bring forward that next round of papers earlier, and distribute them to you so that you get something more of a flow, then we will do that.

We won't dump them. We don't hold them all and dump them all on you at once, unless that happens to be the way in which we develop them, and we won't do that ourselves. So we – to the extent that it is possible we will get the papers out earlier to you, but the other thing is, we did agree at the start of this review that the states needed to do their share of the work as well, and the Commission hasn't change its  
30 view about that. If there are issues that you want to raise, raise them, by all means. Show us the conceptual validity, show us the data. Explain to us a method and we'll take that up.

Similarly, where we have put – where the Commission has put things on the table, if  
35 you have difficulties, objections, concerns, we expect a careful evaluation of the proposals that we put, careful responses indicating why they are or are not useful thing to consider. So it is – it's not only an iterative process, it's an iterative process between two parties, each of which has particular responsibilities to do certain things to make the whole process effective.

40 They, I think, are the main points that I would like to say by way of response. Somebody said more interaction at staff level; you can have as much as you like. You can have as much as you like. I had thought some of you had said to me in earlier discussions there was too much, you couldn't keep up. But you can have as  
45 much as you like. I actually think the more the better, because you take things in smaller chunks, and you can really work things through. But so far as the Commission staff are concerned, they are available to meet with you as and when

that would be helpful. It is traditionally in the nature of things that these things are multi-lateral rather than bilateral because you're all deeply suspicious of each other.

5 But if you can overcome those suspicions, if there are individual states that have particular issues that they would want to work through, the Commission staff would be happy to deal with you bilaterally, as long as there was a process for ensuring that people were kept in the loop about what was going on. Now, I think they are the major things that I wanted to say. My colleagues might want to pick up things I've missed, or correct things that I've said, or – they're looking – well, Greg's looking  
10 glum, but don't be put off by that. Greg always looks glum. No? All right. Looks like we're okay. Tim?

MR MARNEY: Just going back to my earlier comments. Are there any major blockers to the achievement of simplicity within the overall context of HFE that we  
15 need to be thinking about?

MR MORRIS: Well, if we did not have state treasuries it would be a lot easier, I can tell you that.

20 MR MARNEY: Yes, yes.

MR MORRIS: No, I don't think – so far as we're concerned there aren't. Not in the sense that there are these – someone or some issue is – has placed huge impediments in the road. There are different views about whether simplification of this issue or  
25 that issue, if done in this way or that way, will achieve better or worse equalisation. But that's bread and butter for this process. I don't believe there are. We have guidance through the terms of reference and through the Heads of Treasury review in 2005 about data. We have – through our assessment guidelines we placed conceptual and methodological issues on the table for robustness and comparability  
30 and so on. I don't think there are any major, major problems.

I would appreciate not having to read any more than 35 pages of equations. That's not a blocker, because I didn't understand the first page so I didn't worry about the other 34. But no, I don't think there are. From a staff point of view?  
35

MR SPASOJEVIC: I think the only – the only real question is data. In some cases data has precluded going down the simpler way, and Don's point about location – you know, if you had a perfect locational index, perhaps you could do location in a very simple way. But without that index it's very difficult. But you don't – but not  
40 for this review. I mean, in a sense it's too late. I mean, it might identify some things for – should there ever be another one, for future reviews.

MR MORRIS: And my colleague from the Accounting Standards Board reminds me that the ABS is committed to working to improve GFS data. So that will also  
45 help with that process. I see I can now welcome Jim and John.

MR WRIGHT: Thanks.

MR MORRIS: Yes.

MR SPASOJEVIC: Sorry, Alan. There were a few comments about submissions and budget timetables. To my understanding of the agreed work plan, we see the  
5 next round of state submissions in the second part of next year, after state visits – so there's no submissions from states in the first half of next year – and the round after that, in 2009, is scheduled for January. So this is the plan that was agreed with the states, so you – we see a round in January. So we have another reiteration in the  
10 second half of next year, and the state submission before the draft report. So that was geared, I think, to avoid your budget timetables. So I hope that's actually consistent where your concerns are.

MR MORRIS: Other than that, I should just note with appreciation the positive things that you have said about the way in which we've tried to engage and consult  
15 and work with the states. I acknowledge the states that have made particular contributions to our own thinking. At this stage, we have a lot – at this stage of the review we acknowledge we've got a lot to be done, but in general, as a group of stakeholders, I think we are travelling reasonably well together, and I thank you for your support, and look forward – despite the difficulties that you have, look forward  
20 to that support continuing through to 2010.

Well, I think we can now turn to the issue of capital, which I do with some trepidation, I must say. In the round of bilateral discussions that I had with each of  
25 you earlier this year, it was agreed, I think, by everyone that we should look very carefully at the capital assessments. You all shared the Commission's view that, for example, the debt charges assessment – the current debt charges assessment is cumbersome and opaque. And I want to say at the outset that I think it's important – you know, that we don't set things in stone and say because we've always done  
30 something we have to keep doing that; you know, we shouldn't be looking at whether there are different ways of approaching issues that will actually give us more robust outcomes.

Because as you know, the Commission's consideration of capital-related issues has evolved over time. It was only, I think, in the 1999 review that depreciation entered  
35 the list. So things do change. I remember well the quite understandable protests about the introduction of depreciation in 1999, principally because it was done very, very late in the process and you got – you were caught unawares in many respects. It's quietened down. So it is possible to do new things and come to get comfortable with them, and feel that they're – you know, they're okay, they are useful. The 2004  
40 approach also gives us some particular problems at the present time.

It provided the capacity for the states to have equal capital stocks adjusted for expense disabilities, and reflecting the fact that states were in debt and borrowing, the capacity to service equal-per-capita debt relating to their accumulated deficits.  
45 All well and good. The problem that's emerged is that with the change in state financial conditions, debt charges have become interests earnings and assessed EPC, so that other than for depreciation capital disabilities are not currently recognised in the GST distribution. And I think in the discussions with you in March, April,

whenever it was, there was a general recognition that something needed to change because the debt charges assessment had come to look quite odd. Quite odd.

5 And not particularly robust as a way of moving forward beyond 2010 in whatever  
circumstances prevail at the time. So our thinking on capital has been guided by a  
few observations. The first is that the GST pool is untied and is available to fund  
recurrent services, fund the acquisition of physical assets, and the acquisition of  
financial assets, as indeed your own state revenues do. You use – states use their  
10 own revenue to – and the GST revenue – to deliver services, to fund physical assets,  
to fund financial assets. That’s what you do. There is nothing in the GST  
arrangements that says GST distribution is only available to states to fund recurrent  
services. It just doesn’t say that. And that’s not what you do.

15 So the first question that emerges is whether the distinction between GST to fund  
recurrent services and states in fact funding physical and financial assets, whether  
that’s a distinction that really needs to remain. What is it about the GST distribution  
and recurrent service spending that requires this narrower view of the use of GST  
and the distribution of GST? And we also want to be practical. We want to reflect  
20 what states do. We want to be practical. If we take the view that states fund capital,  
and if we take the view that that’s a relevant consideration for the distribution of the  
GST, then the question for us is, well, what is a practical, conceptually valid and  
robust way of going about making an appropriate assessment?

25 I was going to go through a quite lengthy introduction here, but following the  
Challen model earlier, where he skipped three pages of his notes, I’m going to not do  
that, because I actually want to have a conversation with you rather than a series of  
set pieces. We think that it is appropriate – when we stop and think about it  
unencumbered by history, we think it’s appropriate to move – to look at the  
assessment of capital in a more direct way. The word “more” is important. In a  
30 more direct way. We understand, and I think, indeed, you told me this when we met  
earlier in the year. We understand that states are generally fairly comfortable with  
the depreciation assessment and agree that we should allocate depreciation across  
functions, and we think that’s now a reasonably settled proposition for depreciation.  
That is to deal with the costs of states in relation to replacement capital.

35 Now, that leaves the issue of non-replacement or new capital, and there, we’ve put  
on the table two broad approaches, both of which are a more direct assessment of  
capital, although, one is, certainly, much more direct than the other. The first – the  
very direct assessment of capital is to look at states requirements to spend on new  
40 capital, non-replacement capital in a particular year and to include that assessment in  
the total assessment of relativities and GST distribution.

45 There are differing views about how complex or simple that is. It’s endlessly  
intriguing, that eight parties can have such distinctly different views about whether  
something is simple or complex. The advantage of that approach – one advantage is  
that it is supported by data. By GFS data, I think. It is supported by comparable  
GFS data, and conceptually, it meets the needs of states in the year in which they  
have to undertake the expenditure.

The other approach is to think about capital not in terms of a direct assessment of when you spend it, but an assessment of when it – of when you need to pay for it, or over time, a holding cost approach. The – this produces a very different pattern of distribution. It requires judgments about the imputed costs. The holding costs that you are to apply, but it is a more direct assessment of capital needs than the current approach. We need to move forward on this issue and why I'm not going to go through the notes for today is I'm going to tell you what I think we need from today.

We need to get a sense of whether the states agree that a more direct assessment of capital is appropriate and that it should be progressed either through what's called in the staff papers the direct approach or the holding cost approach. We need to decide that, and in the process, I think we need to put the depth chargers – the old depth chargers assessment to bed. We need to put it to one side. I notice – I did note that there is a slightly nostalgic Tasmanian view that maybe it's not so bad after all, but other than that, nobody seems to be greatly enamoured of trying to resuscitate the depth chargers assessment.

So that's the first thing that I think that – well, they're the first two things we need to do, that we are going to move to a more direct assessment of capital and that it will be through a variant of the direct or the holding cost approach, and then we need to be clear about the things that will determine which approach that we use. And the things that I think are important are, What's the data? What data is there to make the kind of robust and reliable assessment of state needs? What is the level – what is the practicality of the approach?

We need to agree that we're not going to proceed with an approach which we simply can't do robustly and reliably, and third, we need some sense of where states are on the differing pattern of GST distribution that each of the two approaches implies. I'll take Western Australia at face value and say that if you do it properly, over time they are both equal. I'm sorry, Alex, but I couldn't follow the maths, but I'll take that at face value, but it does seem to me that the words over time have a particular significance in this regard.

You may get the same outcome – you may not. You may not. You may get the same outcome over time, but you certainly won't get the same outcome in any given year. So we need to know where – whether that is prominent in your thinking and we need to have a discussion I think, about whether there is anything heretical about moving equalisation, nudging it away from the notion that it has to refer and reflect only the operating statement to a concept of net lending.

They are the things that I think we need to talk about, and that's the guidance that I would like from you. I'm not going to talk about consensus or decisions or – but I need to know what you think about those things. I don't need to hear the detail. I don't think any of us do. I think we need this higher level strategic discussion about principle so that we can then, as a commission then sit down and continue to build an assessment approach, which we will develop iteratively with you, but so we can get rid of the things that we don't need to fuss and argue about any more.

The secretary who always has the chairman's interest at heart has indicated that now would be a perfect moment, take the stunned silence to have a cup of coffee and then you might like to come back in, say, 10 minute? Ten minutes. I believe that – I'm  
5 assuming the coffee is outside on the table. So the floor will be open after we come back after coffee.

**ADJOURNED** [11.29 am]  
10

**RESUMED** [11.48 am]

15 MR MORRIS: All right, let's resume, and the floor is open. Gerard?

MR BRADLEY: If I could say I strongly support the Commissions' opening or re-examining this issue. We think it's very important, and I have already mentioned, from Queensland's point of view, the big infrastructure burden that we have relating  
20 to strong population growth in our state. And certainly as we frame our budget each year, it's very important that we consider both our serviceability needs in a recurrent sense, but also our capital investment requirements each year, to cater for growing population. We have very large new capital requirements that we need to consider each year.

25 I mentioned before the population growth, that we're spending almost \$1000 per capita on general government capital spending, whereas other states are around a little over \$500 per capita. So it's a very big issue in Queensland's case and to not give very careful consideration to that in the way in which we use our revenue  
30 sources, our GST in the way we formulate our budget, would be very hard to justify. It is very hard to see how the Commission couldn't give every consideration to that in its assessment of relative needs in different states. So we think it's very important that you do look very carefully at this issue in terms of your assessment.

35 We do feel that the direct assessment approach has the, probably, most likelihood of being able to best pick up the capital needs and given that these are, in our case, very pressing and, you know, very contemporary in terms of how we frame our budget. So to ensure that they're picked up in a timely way within your methodology, is extremely important from our perspective. We appreciate that in taking a new  
40 approach, there are obviously challenges around the methodology and the data and so on. There is a good base there with GFS data as you have mentioned. We think this does look as though we can develop an approach which hopefully is simple and transparent.

45 Being contemporary, we certainly would intend to work very actively with the Commission to see if we can assist in developing an appropriate methodology which would allow an appropriate direct assessment of capital to be a robust part of your methodology. And indeed, we would be very concerned if the Commission weren't

to actively pursue that because it, in our view, it wouldn't address the very pressing capital requirements which, certainly our state faces every year.

MR MORRIS: Thanks, Gerard. Yes.

5

MR COSGRIFF: From the New South Wales perspective, I mean, I agree with Gerard that the capital pressures that the state budget's under are escalating and the New South Wales budget proposes 50 billion in capital expenditure over the next four years. But that said, the framework for the approach to capital spend is one of essentially, service delivery. The argument that, you know, is made is that that investment is about an investment in the service delivery potential of the state. And that the reason we're investing in the capital is to change, develop, improve service delivery, both in the year in which the capital is spent and in subsequent years.

15 So, from that framework, while in the paper that we sent to the staff discussing this, we made some comments about the, sort of, methodology, I wasn't proposing to run through those today. But more to say that the strategic approach would lead us to support, I think, sort of thinking about it in equalising in the year of use of the capital, rather than the year of acquisition. Principally, I didn't think the distinction you made between receiving GST for services or for capital, was one that I necessarily would make quite that strongly, because I would say that the reason we would be spending capital is for the service deliveries. Fundamentally the service delivery aspect drives the spending - the GST revenue - in New South Wales, irrespective of whether there is an increase or an unchanged capital spending in any one year.

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25

MR MORRIS: Thank you. Thanks very much. Jim.

MR WRIGHT: Chairman - the, well I think I'm agreeing with Kevin in the - it seems to me that if you want to look at this from basic concepts, the right answer is the capital that you use in the year rather than the capital that you buy in the year. And I think that's the conceptual approach that that's clearly preferable, and the only reason you would move away from it was if there were significant measurement problems, and I don't think there are in this case. The other approach - the measuring the capital you buy in the year - I haven't had the benefit of WA's equations but I find it a bit hard to understand how you have the depreciation going and then you add in the new capital in the year. Then in the following year that new capital's been depreciated, but why you aren't getting some double counting in it.

30  
35  
40 Now, as I say, I haven't crawled through the equations, I haven't seen them, but that's a question I have about it. And it seems a rather messy way of trying to measure something rather than going directly to what we would be measuring which is capital you use. So we support that one. But we also agree that we need a new assessment. There's no question about that.

45

MR MORRIS: Thanks, Jim. I actually have the equations here if you would like to have a look at them.

MR WRIGHT: I'll flick through them at lunch time.

MR MORRIS: Okay. Thanks very much, Jim. Don.

5 MR CHALLEN: Yes, well I say I agree with Kevin too. I mean, I think the  
fundamental question here is what states do. We don't accumulate capital for the  
sake of it. We only accumulate capital for the services that it can provide in  
delivering, you know, the standard services of education, health, and law and order,  
and transport and so on. And, you know, logically I think that drives you to a less  
10 direct method of assessing capital needs. I think the other point that's worth making  
quickly, is that population growth is not the only thing that drives the need to  
undertake new capital spending.

Our communities impose all sorts of demands on us for enriched services, more  
15 efficient services, faster services and so on, that require us to undertake new capital  
spending even with zero population growth. So, you know, the easy argument is that  
Queensland's growing very rapidly, Western Australia's got economic development  
opportunities so, yes, they have got huge capital needs. And of course they have, I  
don't move away from that for a minute. But, you know, Tasmania's got school  
20 children that have to be educated to modern standards and capital is required to  
replace the existing capital stock and to enhance it to provide the services that we're  
expected to provide to our children.

And, you know, you can come up with any number of examples in the health and the  
25 transport sector and so on. And, I just reinforce the comments that Kevin and Jim  
made which, I think, drive you to something like a holding cost approach. And I  
don't – it doesn't seem to me that it's methodologically all that challenging to  
implement. It's not straight forward, necessary, but it's very do-able.

30 MR MORRIS: Thanks, Don. Grant.

MR HEHIR: Well, I reiterate some things, I suppose. I have really struggled with  
this question because conceptually I haven't been able to figure out what the problem  
was. It seems to me that, once you put depreciation in – I'll start again. This  
35 collectivisation is about service delivery in my mind. Once you put depreciation in  
to the cost of delivering a service, you're talking about how you're consuming the  
asset for the delivery of a service. So, that sounds to me like it's built in to the cost  
structure pretty well. So what's the problem?

40 We have spent, I thought, the last decade or so trying to get financial management in  
to a phase where we look at the whole cost of delivery of services, which has meant a  
move away from a cash flow statement or a cash statement view of the world to an  
operating statement view of the world. And a proposition that we start using the cash  
flow statement as the dominant driver of business seems to miss some things. So,  
45 conceptually I'm really struggling with what the issue is. You're right when you say  
that we use all of our revenues for both capital and recurrent purposes, but when we  
think about the delivery of services, we don't say, "Well, the cost of delivering a

service is the operating side and that we have got to add in our capital expenditure in that area,” because that’s not the way we think about the delivery of a service.

5 The delivery of a service – the cost of delivery, the amount that we pay the Education Department or the Health Department for the delivery of services in a year, is the recurrent revenue that we give them. And that recurrent revenue includes depreciation costs, other non-cash costs as well as the cash related cost, but not capital. Like, that’s not the cost of delivering a service. They fund those things out of depreciation and we make equity investments in to them from the balance sheet, if  
10 we need to top-up their cash needs to deal with any capital expenditure and a particular year. But that’s sort of a balance sheet related issue.

15 So, I just – I don’t, sort of, get it. If the idea is that because at a particular point in time, most of us are now spending a larger proportion of our cash on capital than we did five years ago, and therefore we want to drag forward some payments that might occur later when depreciation feeds through in a different balance between jurisdictions, so that some jurisdictions get additional money now because they’re spending a bit more cash now, I think it’s conceptually flawed. To me the right way of thinking about the allocation of GST funding is on a revenue basis not on a cash  
20 flow basis. So I’m really – I struggle with it. Conceptually, you talk about new capital and I don’t know what that means. If new capital means your capital spending in your cash flow statement, minus your depreciation - and I don’t know what the new thing in there because that goes up and down depending on how much cash you’re spending on capital in a year. It’s not really about – it can be as just as much replacing an old school as it can be building a new school, so I’m not certain  
25 that those things mix up. When you look at the capital expenditure of states, it isn’t directly related to population growth. You know, it’s related to a whole pile of political decision making that goes on as well.

30 So through time, you don’t see, sort of, a direct relationship between population growth and the level of capital expenditure. In a lot of jurisdictions, the grown in capital expenditure at the moment is as much being driven by a desire to use the good times that we have got to fix up a whole pile of existing infrastructure, as it is to meet the demands of population growth. I know in Victoria we’re doing both of  
35 those things. So, to say that what’s happening at the moment is driven by population growth, I don’t think is borne out by the data. But I just come back to it conceptually. It seems to me that shifting from essentially an operating statement basis to a cash flow statement basis, doesn’t make sense.

40 There might be an argument for it, but I just don’t – it certainly doesn’t make sense with the way I thought we were trying to move public financial management over many years. But, I’ll leave it there.

45 MR BRADLEY: Perhaps if I can just make a couple of responses just to help that. I guess, from our point of view, it’s a bit more complex in the sense that new capitalism isn’t just a smooth relationship with the population, we do in fact – we’re currently building three new major tertiary hospitals and they will have a period when they’re – we have to build them for their future capacity as well, there’s a

lumpiness to our capital outlays as well, which is apparent, but also the cost of new capital at the moment is very, you know, there are cost pressures around and it is actually impacting us in a very immediate way.

5 So I guess if Western Australia is right and over time it balances out, that may be fine, but in the immediate sense though we're facing the immediate pressures we encounter as we build the infrastructure from day one and having that reflected in a contemporary way within the methodology of the Commission actually reflects what we do, we make those decisions and they impact our budget, we factor them into our  
10 forward estimates immediately, so it's not just a sort of not just a simple thing and we can certainly try and demonstrate that in terms of the data and submissions we make to the Commission.

MR WRIGHT: But, Gerard, that's, I mean, what you're worried about is a  
15 financing question, it's not a use of services, it's not a service provision related question. So the two – I mean, I think my point about it being conceptually what you should be kind of worrying about each year is the actual usage of capital, I mean I think that's what you need to focus on in terms of working out whether a state has a disability or whatever. And the other thing is simply a matter of financing, how  
20 much you have to borrow or not borrow in that year in order to fund whatever you want to invest in.

MR BRADLEY: But they're all important, but in our case we're really struggling to keep up with population growth as well, to actually meet demand at the same time,  
25 so it's a very major challenge.

MR CHALLEN: That will be reflected in an assessment of what services you need from the capital stock. I mean by definition, if you're struggling to keep up with population growth, you are struggling to provide the services from the capital stock  
30 that you need to service that population growth. I mean there's no argument about that. The other point, just to reinforce the point Grant was making, is this is an area in which the level of quality contamination is enormous.

You know, the timing of capital expenditure, what projects get funded, the location  
35 of the capital expenditure is probably explainable to a very high degree with the location of marginal electorates, nationally and within individual states. And so, you know, the level of policy contamination in terms of the services that you get in a particular year from the capital stock is extremely low, the level of policy contamination about what gets spent in an individual year on new capital is very  
40 high.

MR BRADLEY: But, Don, it's not policy contamination to build a tertiary hospital on the Gold Coast where there is half a million people, and there's no question that's  
45 an absolute must have.

MR HEHIR: But there is a policy contamination if you do it – if you build it and you borrow money to do it, okay, and then it goes in depreciation. But if you get the private sector to build it you pay an access charge, that's just a different policy

document, so that it's a different funding mechanism. But on one stage you're saying it gets built into the accounting of a process of funding and straight away, but in the other it gets built in through a service charge later, what's the difference? You know, I suppose the policy outcome would have to be that you would have to include  
5 all public/private partnership things into the calculation as if they were a capital expenditure of the state in that year, because if you didn't do that you would get policy contamination.

MR CHALLEN: Correct. And to tell a story against myself, we have a major  
10 tertiary hospital in Hobart and, you know, if you look at the service of the – the recurrent services we're getting from that facility, that tells you something about what services we need from the capital stock of that hospital to service our health needs in the south of the state. Our government has made an announcement that we're going to replace this with a brand new gee wiz tertiary hospital on a brand new  
15 site. Now why, why did they choose to do that now, why didn't they choose to do it some other – it's a policy decision. But if you only recognise, for instance, the depreciation, the recurrent service associated with the capital stock, the Commission will not have to worry about that, they won't have to think about do we have to somehow or other adjust for the Tasmanian Government's decision to build a gee  
20 wiz new hospital.

MR MORRIS: I can tell better stories against you than that.

MR CHALLEN: Yeah, but I get to choose which stories I tell against myself.  
25

MR MORRIS: Tim.

MR MARNEY: I think we need to come back to kind of first principles and go  
30 back to the conceptual issues of what are we trying to do in terms of equalisation, what do we use the pool of funds for, and it's to provide services, partly we have to build infrastructure to provide those services over time, it's picked up in part through depreciation. But I think the financing aspects are missed in the current methodology and we take point that there is issues of PPPs in that and that they should be treated equally, I would accept that as a necessary condition. Population  
35 growth brings an underlying need, whether or not there's contamination of infrastructure decisions, it's undeniable that population growth brings a capital requirement, and in periods of acceleration or deceleration that requirement is very different.

40 Indeed if there's contamination of infrastructure, then the cost of service delivery is by virtue of that contaminated over time also, so if there's a wiz bang new hospital in the south of Tasmania, yeah, that decision might be politically contaminated, but so will be the recurrent expenditures that flow from that over the next 30 years.

45 MR CHALLEN: Not if you measure your depreciation problem. It doesn't matter whether it's a brand new hospital today or a 50 year old hospital, if you measure your depreciation correctly the number is the same.

MR MARNEY: As if you didn't build that new hospital?

MR CHALLEN: Depreciation based on the replacement cost of the facility will be the same, whether it's 50 years old or brand new.

5

MR MARNEY: Yeah.

MR CHALLEN: We can deal with your debt services problem by – if you have two components in your holding cost measure, one which is depreciation and the other one is some measure of the opportunity cost of capital, you're done.

10

MR MARNEY: Well I guess that's what the principle that we're after is that there is a financing dimension and an opportunity cost dimension that we're not capturing in the current methodology. In the direct assessment model, the drivers of capital spend, whether it be population growth or economic growth, I think are captured, and also it is consistent with the direct assessment model is consistent with what we actually do, it's consistent with practicality and simplicity, and it's also a more contemporaneous approach than the holding cost model which probably has a longer run flow through, which I think Alex's 35 pages of equations demonstrate.

15  
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MR WRIGHT: See, I mean, I would reject the argument that a more contemporaneous – I mean, I think what the direct cost model is doing is letting things be measured before they are actually being used, whereas the other one is being measured at the time it's being used. So I think the holding cost model is the contemporaneous one.

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MR BRADLEY: There's very little gap between them when they're built and when they're used in that case I must say.

MR WRIGHT: Well then it is not a problem.

30

MR MARNEY: And that's where there's, I guess, a couple of thresholds to this issue is, one is do we want to capture those broader costs, yes or no, and then secondly if we do, do we go direct to a holding cost? I think, certainly from our perspective, we want to capture the costs more appropriately and then once we go to that second order of questions driven by practicality, simplicity, data availability, we are strongly supportive of the direct assessment method.

35

MR MORRIS: Thanks. Thanks, Tim.

40

MR CHALLEN: Chairman, just whilst there is a lull. The other issue about policy contemporaneous, of course the decision to own infrastructure is a policy decision, and there are lots of ways of getting the services from a piece of capital other than owning it, you know, you can do a PPP for instance. So I think, you know, the direct approach is going to suck the Commission into a nightmare of decision making about why particular timing decisions were made, why particular financing decisions were made, why particular ownership decisions were made, and unpicking the policy from the non-policy elements of that is going to be very challenging indeed.

45

MR HEHIR: Yeah, it gets into sort of equity structures of your GBEs and the amount of asset base you put into those. So, you know, in the case of our water authorities, you know, what your gearing ratios are, because that's how you're utilising cash in particular years, either through dividend policy or equity injections  
5 and doing all of that type of stuff, which is just another form of asset investment.

MR BRADLEY: I imagine the Commission's focus is on general government though, not some of the GBE activities perhaps.

10 MR HEHIR: But it's asset investment, you're buying it to deliver a service.

MR BRADLEY: Yeah.

MR MORRIS: Megan, did you want to say anything at this point?  
15

MS SMITHIES: No, again I just would echo the comments that were made, particularly Grant. I have to say I'm so glad you said that, because I've been struggling to understand essentially why it was such an issue as well and, you know, again I get a bit more colour from Tim. I struggle to see how necessarily your  
20 model B actually does anything more than just smooth cash flow. It's capital, you consume it to provide services, it's there, I can't add anything to this conversation.

MR MORRIS: Thank you. Tony, did you want to say anything?

25 MR STUBBIN: Alan, we've expressed a preference for the direct method over the holding cost method. Similarly, many of the comments made by Tim in terms of simplicity and contemporaneity we've also acknowledged and they were less need for judgment. But there's a parochial issue that I would like to raise, that irrespective of which of those two approaches is taken that the Commission in the 2004 review  
30 acknowledge that the challenges in addressing the Territory's special needs in regard to the capital requirements, and that something else will be required within either of those two frameworks to capture those needs, and it is possible within either of them.

MR MORRIS: Thanks, Tony. We haven't forgotten the parochial issues, so we'll  
35 now just put that to one side. The discussion this morning I think demonstrates that this is not straight forward for the Commission, not straight forward at all. We have used, you know which range from, well this isn't even an issue, why are we are we talking about it, right through to this is something which is sort of overwhelming our budget so we must do something about it. One point that I would make though, and  
40 it goes to the policy contamination issue. There are very few assessments we make anywhere where we don't have to think about policy contamination and how we deal with those and in general what we do is by determining standard policy and working off averages.

45 We are not suggesting, in this case, that there'd be anything like an APC, an actual per capita approach, we would be examining the needs of the states in relation – and based on the average expenditure and making adjustments as appropriate around that average. So the starting position would be equal per capita and then you'd look at

what circumstances might require you to move away from that, which is similar to the way we approach all of our assessments. So it may well remain that some tricky decisions, tricky judgments would be required by the Commission, but I don't think they're any trickier in capital than they are anywhere else. So I'm not sure that that's  
5 a defining issue for us in thinking about this.

MR CHALLEN: Or the claimant to be, of course, chairman. It's just that while none of these flaws may be fatal, the accumulation of them has a certain weight.

10 MR MORRIS: And it's not as though we haven't grappled with capital type issues in the past, admittedly they are in degrees of success, but we have been assessing roads for quite some time. I wouldn't claim that we have been assessing it to everyone's satisfaction, and roads are pretty tricky. What's new and what's depreciation with roads is a very moot point, but roads are probably a very large item  
15 in the capital stock of a state. The question – and I mention roads because I am not sure of the significance of the question about whether capital is a means, or a means to an end, it seems to me that that's not really – I haven't grasped the significance of whether you only – states only invest in capital in order to provide services, I'm not quite sure what the importance of that last bit is.

20 You do all sorts of things to only provide services, you transport rural school children in buses to provide education services. It doesn't seem to me that there's something conceptually absolutely neat about saying well, we employ teachers to provide services but building new schools is different. I haven't quite grasped that.  
25 I don't know that a great deal of purpose will be served by carrying that discussion down to any level of detail. I think we're probably close to the point where we can demonstrate to each other what we all already know that we don't actually quite fully understand how this would play out and how you would do it.

30 People have talked about population as a driver but not necessarily the, or the only driver. I agree with that, but I think even there you're starting to drop down now to try and tinker with some of the machinery of the assessment rather than think about the way forward. My objectives at the outset of this were to agree that we should move forward with an approach built around either a direct assessment or a holding  
35 cost approach to capital, there's a lot of support for that, a lot of support for that. I think the balance of view is that that is the way to go forward in developing this assessment.

40 We haven't heard much about the methodological advantages or disadvantages of either of those approaches. Don has indicated that the holding cost approach might be difficult, but it shouldn't be too difficult. Given the work that the Commission has done, that's not overwhelmingly reassuring, we haven't exactly found it easy to get to grips with this. But if we could leave it on the basis that appropriate and reliable data a methodology which is sound and robust are two very important  
45 considerations when coming to finally make a choice between these two approaches, then I think that would be a useful resting point for now.

There's been no discussion of the approach of depreciation so I take it that my comments of that seems to be pretty well clear in people's minds is okay. Now there's obviously a lot of work to be done on this. If there are further – in the light of today's discussion if there are further quick submissions, or even just thoughts that  
5 you would like to put on the table for us by the end of the year that would be extremely helpful. I'm not going to propose that we set up something like a working party of states or something on this issue. I think this can be picked up in the iterative processes that are in place already.

10 We're not going to resuscitate the debt charges assessment, we will move forward by considering carefully against issues like data, reliability, robustness, methodological practicality, we will go forward looking at either – looking at both the direct and the holding cost approach and we will come back to you, more than once I'm sure, we will come back to you to lay out the thinking and provide opportunities for you. I  
15 suggest you don't make a big deal of this and feel you have – we don't need another 34 pages of equations, but if you have got ideas to help us in a constructive and practical way to settle on the assessment approach and to strengthen that particular approach, I think that is the best way forward.

20 I haven't offered my colleagues a – yes, Jennifer.

MS WESTACOTT: At the risk of not wanting to prolong the debate. Can I just understand the Victorian position. I got a sense, Grant, that you were arguing, you didn't support the direct or the holding cost approach, is that correct?  
25

MR HEHIR: I'm more comfortable with the holding approach.

MS WESTACOTT: Right, okay.

30 MR HEHIR: It's consistent with actually how we do things in Victoria, because we have a capital assets charge which is equivalent to that component. The reason we do that is because we're trying to get a full cost of service concept in and build that opportunity cost in, so that when we are making investment decisions between one service and another we're clear about the true measure of costs. I think it's  
35 worthwhile checking whether adding holding costs actually will add any additional information than what depreciation already does, because you might find that depreciation is a good proxy for the remaining holding costs. In that case whether you want to do it or not is an issue on the simplicity grounds, but conceptually it's the right, I would argue, it's the right way to go.

40 By the way on roads, we do purchase road services from our Roads Department which is depreciation, maintenance and the overhead and that sort of outward cost that we attribute to them as a recurrent deliverable within our system. But, yes, that's - - -

45 MS WESTACOTT: So you're not advocating the debt charge model, you're advocating the depreciation of the model.

MR HEHIR: I'm comfortable with the holding cost approach, I think it's a better one. My proposition would be going down that path whether you want to go and collect that information or whether depreciation is a good proxy for it is something that you might want to think about, that's all. It's just a suggestion rather than a  
5 view.

MS WESTACOTT: Thank you.

MR APPLEYARD: Just one, if I may, at the risk of raising an accounting issue. I  
10 take it all states are using depreciated replacement cost for their major assets in hospitals, education and police law and order I presume.

MR CHALLEN: I'd have to deploy the accountants to answer that, and since they  
15 all do, they must be.

MR APPLEYARD: And that's what's reflected presumably in their GFS report.

MR MORRIS: Greg.

MR SMITH: At the risk of sort of pointing to an elephant in the room, the debate to  
20 me is not a really – quite the one we have just had necessarily. You have got half a trillion dollars worth of capital between you and you have no net debt, and that is why the existing system gives nothing for this. What we're talking about, there's nothing in the system there, we are basically saying well there's no net interest,  
25 income or expense, we just EPC what there is and it's gone, so there's no interest, debt charges, nothing. So the world we're in now is that you have got an accumulated asset base that is being funded by revenue, because you have no net debt.

30 And the issue going forward is some states are growing much faster than others in population and the question that arises in that case is, is it still fair and reasonable in an HFE setting, horizontal fiscal equalisation, fiscal equalisation, is it fair and reasonable that we continue to have no recognition of that factor. That seems to me to be the issue, if the current balance sheet has been revenue funded, will future  
35 balance sheets be revenue funded, should the GST, which is half the revenue, should it's allocation take into account differential capital needs in future. That to me is the issue, so I'm quite unclear as to where states stand on that issue. I think I am clear where Queensland and Western Australia stand on that issue.

40 But I wasn't clear at all whether when you say that what we should do is follow what states do, what states have done, is revenue fund capital.

MR BRADLEY: Just a couple of factual things, I guess. Net debt is a complex  
45 measure, in a sense – certainly in our case. It's negative because you count superannuation assets but don't count the superannuation liability. But certainly, putting that aside, there is real debt that underpins which has funded capital, if you look at the – if you unpick that particular issue. Going forward though, it is true that we will be increasing gearing substantially to reflect very strongly growing capital

needs, and that will be reflected in growth to a point where I doubt if it will be negative debt, to be honest. But just a couple of factual issues there. So we certainly see it – that's why see it as such a big issue, I guess, going forward.

5 MR WRIGHT: See, I'm not sure, Greg, what – if I have understood your point. I mean, I think the current debt charges assessment is, you know, unwise and probably wrong.

MR SMITH: You mean in concept wrong.

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MR WRIGHT: In concept wrong. I mean, my position would be that how a state funds its balance sheet is really irrelevant. It's just – you just recognise the funding, it does have a cost, the holding cost for all those assets, and that's picked up by depreciation or the opportunity cost of funding whatever you're stock level is, and that's what people should recognise as the cost of providing – as a contributing cost to providing services, same is if you buy a bus to drive your kids around to school, that's a contributing cost there, the depreciation on the bus. But the financing I don't think is an issue that - - -

20 MR SMITH: So you have no regard to the fact that revenues have funded two things historically, not one. That revenues have funded growth of balance sheets, and the provision of services.

MR CHALLEN: I don't think - - -

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MR WRIGHT: Well, I think that's kind of true, but I don't know that it's - - -

MR CHALLEN: Well, I don't think it's right. In the main, capital expenditure in the past was funded through debt, and at a point in time activity levels around all our economies picked up dramatically, so we got burst of revenue, and governments made some choices about what they did with the revenue. Some of them expanded services. Some of them reduced tax rates. Others fixed up bits of their balance sheet. And lots of us chose to pay down the debt that had funded the CapEx in the past in preference, say, to funding our unfunded superannuation liability. So there's a whole mixture of balance sheet adjustments going on and recurrent choices being made, and I can't see how you can unpick that.

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MR SMITH: But you have got an average – we always look to the average to find the standards. Right? So the average policy of the states, of what they actually do, have done, at the point we start, at 2010, is that they have been receiving revenues which have built balance sheets, and they have received revenues which have provided services, and half that revenue has come from the Commonwealth.

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MR CHALLEN: But the observation that we have, on average, no net debt, isn't a very interesting observation in this debate about funding capital, because it just reflects the fact that, in the main, we have made a choice to pick on reducing a set of liabilities on our balance sheet, rather than another set of liabilities on our balance sheet. I don't see what it's got to do with the funding of capital.

45

MR SMITH: No. It's not the detail of that. What the important point of it is, is that revenues have had this dual purpose. That's what states do.

MR HEHIR: That's not quite – I just struggle with it, because it's not quite right,  
5 but it is right. If you look at our operating statements, revenues come into our  
operating statement and they are used to fund operating activities, and to the extent  
that there's a surplus or a deficit it flows over into your balance sheet. Okay? Yes,  
capital expenditure occurs, and it flows into your operating statement through  
10 depreciation, and if you spend more capital then your depreciation goes up. So it's  
completely reflected in your operating statement because it's not a free good.

So to some extent the issue here is, what are we talking about when we're talking  
about equalisation of service delivery, and the proposing being made on the one hand  
15 is that we should look at the cash costs in a particular year of service delivery, and on  
the other hand is that we should be looking at the operating costs of a particular year  
on service delivery. Are they equal? Over the long period of time you would think  
that it should, sort of, equalise in some way or another. What's conceptually the  
best? I'd argue that the thing that we have been trying to move to, to get sound  
20 financial management going, is a stronger focus on the full cost of a service, rather  
than just the cash cost. That's why we have moved to – one of the reasons we have  
moved to common accounting, national - international accounting standards and  
done all of that.

You could do it on a cash basis, but I don't think that looks at the long-term  
25 underlying element of the issue we're trying to address. So that's where – I just –  
conceptually, I don't quite get the financing component of it because, like Jim, I  
don't think this is about financing and the source of finance and, like Don, it's not  
about – you know, we have still got net debt. Why have we got net debt? Because  
we paid down a whole pile of superannuation liabilities and we used it on that side.  
30 If we had have put all of our surpluses into net debt we probably would have got rid  
of a lot more debt. Other people have done that. Like, what you do with the excess  
cash particularly doesn't seem to me to be the key issue.

MR MARNEY: But what is a key issue, and I think Jim, you hit on that, and Grant  
35 also, in your pricing to agencies, or your funding of agencies, to pick up depreciation  
and capital user charge, is the opportunity cost of capital.

MR HEHIR: That's right.

MR MARNEY: And that's what we're not capturing in any of this. It's not how  
40 it's funded, but that's the secondary issue of how do you measure that over time and  
in a consistent and simple way. But what we're not capturing is that opportunity  
cost, whether you call it holding costs or whatever, there's a bit of the equation  
missing. So I would argue that to be consistent with where we have driven our  
45 financial reforms throughout the country, we need to pick that up within this  
framework as well.

MR WRIGHT: And I suspect that Grant is right, that the depreciation isn't a bad proxy for what is the holding cost of capital. But to go back to the – I mean, the comparison you have got to make is, if you outsource a service you would be paying an annual amount which would be obviously kind of classified as operating costs .....  
5 Alternatively, you buy the capital that you need to provide that service internally. You ought to be able to do the – it ought to be measured in the same way in both cases.

10 MR MARNEY: Yes. Yes. No, that's fair enough. Yes.

MR WRIGHT: Yes.

MR MORRIS: I think this might be an appropriate time to bring this discussion to a close. I have indicated a few minutes ago the way in which I felt the Commission would endeavour to take this forward, what we would consider is important, and the process that we would use, including making sure there was opportunity for you to both contribute to the thinking, and respond to the thinking as well. I think we're now starting to have a discussion which is immensely interesting to some people, and immensely dull to others, and I am sure that levels of confusion will be increasing exponentially if we keep going. So I think this is an appropriate point to move to the next agenda item, which is economic development.  
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This is on the agenda because we promised that it would be. It's an issue which has been advanced, and this is no secret – advanced most forcefully by Western  
25 Australia. It was discussed in the last review. I indicated when I met you earlier in the year that opportunity would be provided for us to have a further discussion at this level, and now is that point. Again, I propose not to read through my copious opening remarks. I don't think there's much new that I could say that hasn't already been said. There is a measure of disagreement about what constitutes an economic  
30 development disability, if such a thing exists. There is a large measure of agreement that this is an area that is overwhelmingly influenced by state policy.

It's an area where it seems to me now almost – almost everyone has reached a view that it is very hard to decide how you would progress such an assessment were you to think that it was conceptually valid and appropriate. We have put in papers to the states the issues that we have identified as a commission, with your help, and we have asked what I think has now become the most important question in relation to economic development, and that is, if we were going to make an assessment – whether as a separate category, or as something on the revenue side, or something on  
35 the expense side, or as a disability which is through various assessment – how would we go about it, where would we find the data, and what would we do?  
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The responses to date have not really shed much light on how we might sensibly and usefully proceed, and whether there is a practical assessment approach, or even one that's conceptually valid. We have ruled out the option of ring fencing of specific projects. We simply don't think it's the Commission's role to choose which projects should be included, and then making sure that only relevant expenses or revenues for those activities should be counted. We simply cannot see that this is a role that the  
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Commission could or should play. We have received a further round of submissions from all of the states on economic development, except, I think, from the Northern Territory. I am not sure we got one from the Northern Territory. In fact, I'm sure we didn't.

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Today's discussion is important in a process sense, and I would like to be very clear here. Unless we are able to progress our thinking in a conceptually valid and practical way, either today or in the state submissions which we would get by the end of the year, then we intend to draw a line under the issue, and it wouldn't be covered in the further work that we'll be doing, and we wouldn't be particularly receptive to the issue being a focus of state workplace discussions. This is an area where, as a commission, reflecting on everything that you have said to us on this subject, and with the benefit of the work that the staff has done, we really have just about come to the end of the line, we cannot – we can have endless debates about the conceptual issues, but for us those debates are only worth having if there is some practical way of doing something about it at the end of the debate, and we have not been able to satisfy ourselves that that's where we are. So this in a sense, you know, can I be really quite brutal about this, I mean, this is the last hoorah to keep this on the table as a distinctive separate assessment issue.

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Now, I haven't got the benefit of another coffee break to let you gather your thoughts. You saw the questions on the annotated agenda. It may be that the assessment of capital will help in some regard, but that's subject to the discussion we've just had and the pretty serious thinking that we've still got to have. And you've seen the other two questions, that's where we as a commission are, so it's now, I think, Tim, you have really got to take the floor at this point because you stand in isolation.

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MR MARNEY: My state colleagues, I'm sure, are right behind me, just some distance.

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MR MORRIS: Yes, yes, yes. But it's what's in their hands that's a worry.

MR MARNEY: Look, I think you've summarised it very well. We are able to address the issues of how you would do this, but the concept is very important to us. In short, if we can address this through better addressing capital needs, as per the previous item, then that will go some way to allaying our concerns. So we're happy to focus our efforts on that rather than continuing to, if you like, annoy you with this issue and the rest. Having said that, if we aren't able to achieve an adequate assessment of capital needs, then this issue will still be a live one for us and a very important one for us. So that in short will be our position.

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MR MORRIS: I can assure you that we haven't been as annoyed by this issue as we have by some others, so you don't have to feel too bad.

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MR MARNEY: I don't feel bad about it annoying people at all, I mean, as we know that's our job.

MR MORRIS: And I appreciated the opportunity in the last review to have a few days at the Burrup Peninsula. It was very, very pleasant indeed. I think Mark lectured us at that time, that was the only downside to that.

5 MR MARNEY: Right. Well we'll get Alex to do the lecture next time with a whiteboard.

MR MORRIS: Yes. I'll get back to you on that. Okay, thanks, Tim. Does anyone else wish to speak? Gerard?

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MR BRADLEY: Just only to say I think that's the constructive way through it. I would emphasise that we face many similar issues in terms of economic development challenges and infrastructure provision which – where we do need to fund common use for infrastructure, in some cases to allow development to proceed, and reflecting that in the capital assessment is something that I think would be of quite importance. So I just leave that on the record as something we'll be seeking to contribute to the process.

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MR MORRIS: That's perfectly understandable, thank you. I don't see any other fingers wagging, and I don't really think in the light of that that there's a need for me to summarise where we got to, so thank you very much. Contemporaneity, this is on the agenda for today because we think it needs to be, and my recollection is that when I spoke to you in the bilateral discussions earlier in the year I indicated it would be, and with each of you we had a discussion about why this continues to be an issue of interest to the Commission. We talked about contemporaneity at our conference last year, and your advice then was not to make any changes before the 2010 review, which was on the issues on the table, the specific question that we asked last year was, "Is there a case for advancing consideration of contemporaneity ahead of the 2010 review."

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Your overwhelming view at that time was no, but it was agreed, and it was understood, that contemporaneity remained a live issue for the review itself. Since that time, and as I think we all expected, the update has shown that the relative fiscal capacities of the states mean that the relativities which we recommend on the basis of our present methodology are diverging from those that are required to achieve fiscal equalisation in the application year. And that's unlikely to be reversed any time soon, I should think. Now some may say, "So what," you know, of equalisation over the longer term, but the differences in relative state performance in recent years is suggesting that the length of time over which these things will all be evened out is proving very, very difficult to anticipate, and indeed on current trends equalisation will not be achieved over the longer term.

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I would also observe with some chagrin, as I have said to you, that some of the things that you are saying to us, and some of the guides that you are giving us, is not entirely consistent with the headline political guidance that your ministers are giving us about GST shares and the way they're moving. And that sort of contradiction, you know, does give rise to concerns about the robustness, the reliability and the acceptance of equalisation. So we as a commission think that irrespective of what

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you say, and your guidance to us, we have to think about these issues from our own perspective as well, as well as yours. There are really – there's one and a half things on the agenda today on this issue.

5 The half a thing, because I think I know the answer, the half a thing is if we move to a more contemporaneous assessment, when should we decide to do that and when should it occur. Now we ran this last year and we got a response from you. It's worth giving you the opportunity to say something about that again now because there is something a little appealing from the Commission's perspective about  
10 making a decision which doesn't directly feed into a change in the distribution in and of itself immediately. In other words, this rather quaint notion that you take a decision in principle without, you know, being overwhelmed by the practical implications of it.

15 If anyone would like to make a comment about that, please do. If there's no comment about that, then this will not be discussed again until we come to talk in the context of the review itself, because we've only got – we're not going to do it in the 2009 update. So the questions are, in the light of what's happening, and I've made no secret of our concerns about contemporaneity, how are states viewing this issue  
20 now. It is on the agenda for the 2010 review. If we're going to do something about it, is there a sense of the way in which we should deal with it, like for instance shortening the assessment period. We've had the three year, five year debate before, but have circumstances changed to the point where perhaps you might now respond to that question differently.

25 Should we do something about SPPs so that they're included in the application year, as the health care grants are, that's another way in which you could address – take the SPPs and include them as they fall. We're going to be thinking about contemporaneity, and we will expose that thinking to you in the 2009 draft report, so  
30 one probably final opportunity for you to give us the benefit of your advice and guidance. Jim.

MR WRIGHT: Thanks, Alan. Well, I mean, as we all know, the debate is one  
35 about stability versus accuracy, if you like, and I guess it comes down to a judgment about how much of the year to year variation is due to flaws in regard to the methodology and how much reflects changes in circumstances. And if you think a lot of it, of the year to year variation is kind of random error, then the longer averaging period makes sense, and if you think, you know, you're actually getting something right by getting the number, then a shorter period appeals. We don't have  
40 any empirical basis of actually deciding that, I don't think anyone does, but I guess we would lean a little bit - and this will be partly reflective of self interest - we lean a little bit towards the shorter assessment period in that issue.

45 But if you are going to change then the other issue is how you manage the transition, and that will have to do a lot of thought about that I think. The other point I wanted to make is – and this is something I've just thought of, so maybe it won't stand up – but your point about the SPPs coming in, being included like the health grants, I'm just wondering if that helps with the contemporaneity of course, but also it may help

central agencies with line agencies. In a sense it will be very, very obvious, even more obvious than it is now, that going out and arguing for an SPP is just going to take the money out of one pocket and put it in the other pocket, so it won't have good behavioural consequences at our state, you know, management level. But anyway they're my thoughts.

MR MORRIS: Always a delight to be helpful, Jim, always a delight to be helpful. Gerard?

MR BRADLEY: I guess our thinking is a bit like that in a way, in the sense that if the methodology remained much as it is now I guess the benefits of the five year averaging and the stability of that may have – may sway us to favour that. On the other hand though if the methodology fundamentally changes in important ways in the 2010 process, I guess to give a practical issue I struggle to explain to my politicians how our position is deteriorating at a time when they're under intense pressure to expand services and infrastructure for a growing population.

So if the new methodology has a more contemporary way of dealing with capital may be that helps us in thinking about a shorter averaging period. So I guess it's sort of a bet each way in that sense. So in a sense it's inter related with how the methodology itself might evolve.

MR MORRIS: Thanks Gerard. Tim.

MR MARNEY: In terms of three versus five, we were starting with a clean sheet of paper, we really wouldn't be fussed. They would probably prefer three, if not something shorter, to get greater impact on the decision-making of today in light of what is inevitable in terms of relativities. The key concern for us though is we are not starting with a clean sheet of paper, the transitional issues are real and substantial for us in a period where relativities are changing rapidly, so the fact that we will not have full equalization in some years in a transition phase means hundreds of millions to us and is something that would have to be worked through fairly thoroughly. MPV wise it shouldn't matter, but it's that transition that's the issue.

MR MORRIS: Thanks Tim. Don.

MR CHALLEN: We have been arguing forever that we should move to a three year averaging period rather than five and we still think that, although we also think it will work against us at the moment, but that's okay. The proposals that are around for doing other things like contemplating the use of budget or forward estimate numbers, I find just totally unacceptable. I think they would invite criticism of the process.

MR MORRIS: They're not on the table for us.

MR CHALLEN: Okay, that's good to hear. And I don't favour changing the treatment of SPPs.

MR MORRIS: Grant.

MR HEHIR: We support moving to three years still timing. I think there are transition issues that have to be dealt with, does that mean it's more difficult to do it sooner rather than later, I don't know the answer to that because I haven't thought about transition stuff a great deal. So I'm relaxed on that. Three years seems to be a better way of doing things from our perspective. SPPs pretty relaxed for the change or not. You know to the extent that you can make the change if it makes it more contemporary that's a good thing.

MR MORRIS: Thanks, Grant. Yes, Kevin.

MR COSGRIFF: From our perspective I suspect you know in theory we would argue for three years, short, more Contemporaneity. But as a practical matter when thinking about this, the other matter that does concern us is revenue stability and some preliminary work that Bruce's people have done and shown in moving that three years from five years would increase the volatility of the total revenue stream in New South Wales, which would make me a bit nervous on that sense. I think the arguments are slightly more balanced and so when you take into account both the revenue volatility and the transition, you know I'm not quite so sure it's an open and shut case in terms of a move from five to three.

MR MORRIS: Are there any other comments?

MR STUBBIN: Alan, I'm not going to contribute any clear and coherent way forward on this. It is a tricky one, we as a small jurisdiction value stability, but we do see the benefits of Contemporaneity. The risks of changing from one to another have been discussed and outlined, if there was to be a change there would have to be some approach to smoothing that to an attempt to overcome some of those problems. I'm not sure about the correct timing to make a change either, there can be good and bad times to change and that can vary from jurisdiction to jurisdiction. So if a change was to be made how and when you change would have to be very carefully considered to minimise disruptions. But I don't have a clear preference for other than to be cautious.

MR MORRIS: Thanks, Tony. Are there any – no. Michael, does the Commonwealth have a view about this?

MR WILLCOCK: Thank you, Alan. Yes, I think – well the Commonwealth Treasury's preference would be to move from five years to three years. I think our view essentially is that the five year process does indeed mean that the lags, especially with some of the data being the five year's process being up to seven year's old by the time it's actually reflected in the relevant year, is too long and we would see it moving to a three year period as being desirable. I suppose also we had understood that some attraction to the five year period related to the argument that this somehow or other increased certainty for the states in terms of ensuring that any changes in GST shares was smoothed over a longer period of time.

And I think we had assumed really that that might be true if you're only thinking about the GST revenue share per se, but if you're thinking about total revenue

available to the states, that in a sense movements or changes in a given state's GST revenue share in a particular year, might almost sort of offset or complement changes in a state's own source revenue. And to the extent that a state's own source revenue is reflecting economic conditions prevailing at the time that indeed moving from the  
5 five to the three year period might help to actually smooth the overall revenue available to the state.

Which is why I was interested in the comment that just came from New South Wales which is very much saying that you have done some preliminary work that suggests  
10 in fact that moving from five to three years would actually cause you problems in a total revenue sense, not just sort of greater volatility for the GST.

MR COSGRIFF: No, just in terms of the volatility. There's a lot in this, I don't want to oversell the work, because I was just reacting to that sort of comment was,  
15 you know, the ..... seem to point you in the other direction in terms of ..... or state revenue volatility.

MR WILLCOCK: So, anyway, I think there's just the mere idea also that a more up to date application period would be of itself more useful in terms of enhancing the  
20 credibility of the process, is also a consideration. As to timing or transition, I suppose in a sense there is – people can argue that it would be good if the Commission were to – wanted to go down this track to make a decision in-principle at a given time and for the implementation of that decision to be delayed for a little period of time. On the other hand if in-principle it is desirable to move from five  
25 years to three years, what is the inference for reason for not implementing that decision.

It's pretty difficult, and I suppose the only argument that I could come up with is that you might decide that it's best to implement it as part of the post 2010 new  
30 dispensation.

MR MORRIS: Thanks, Michael. You didn't indicate whether you had a view on SPPs.

MR WILLCOCK: Look, we have really only got a very sort of shadowy view, we haven't got a firm view per se. I suppose there is for us something that we would have to think a bit more about where the current arrangement at least means that we have got – you know what SPPs you're talking about when you're dealing by  
35 inclusion. If you're moving to an absorption process we're just wondering about how certain we will be about the quantum of SPP funding. It is often of course the case that the quantum of SPP funding has been relatively predictable but there can be changes as governments decide to shift its own priorities.  
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And so I suppose we'd just like to think a bit more about effectively, I suppose, just  
45 how it would be done, what moving to a wholesale treatment by absorption of all SPPs, what that would involve.

MR MORRIS: Thanks, Michael.

MR WILLCOCK: And I suppose there's also a thing too, that if you do move from five to three years that actually does partly address some of the concerns under Contemporaneity in itself, and is that sufficient to move from inclusion to absorption potentially, I don't know. It may have much sort of wider ramifications or  
5 implications, but we don't know necessarily what it might do.

MR MORRIS: Thanks. Well, there's one thing we can take off the table here and now I think, and that is any change in respect of Contemporaneity ahead of 2010. There's clearly no interest in that and we have no mandate or capacity to do anything  
10 about it unless we're directed through terms of reference, and that now seems quite clearly not to be going to happen. So the issue of an accelerated implementation, and even accelerated consideration of Contemporaneity, seems to be off the table until 2010, or in a process sense, in our draft report in 2009 to you. So I think that's  
15 off the table.

Moving from five to three years, a five to three year assessment period, remains on the table but not as a done deal. But I think it is sufficiently on the table to indicate to us that we should ask the staff, and indeed your officers too, to start developing the issues for consideration. I would be very interested to see the sort of work that  
20 New South Wales is doing. We need to get a good handle on this, it's not something we should do lightly and the Commission really doesn't want to be in a position of chopping and changing all the time. But we do feel that the changing relative fiscal circumstances of the states are such that we are obliged to look very carefully at this issue.

I think we will continue to look at the issue of SPPs to consider whether that is a sensible thing to do. I am not sure that it would make that much difference given the relatively small amount of adjustments that are made in relation to SPPs. But I think we should have a closer look at that. I mean at the moment it's just an idea, let's  
30 have a closer look at it to see whether it would actually make any difference, and there'll be plenty of opportunity for you to tell us what you think about that. The transitional arrangements would clearly be in issue, but it's a different issue I think.

There is a question of principle about whether you should do certain things in order to make the GST distribution more contemporaneous. And when you have decided that, you then have to think now do I need – now do I need to think about how I implement this and whether some transitional arrangements are appropriate. I think they're two separate questions and I don't think you answer the first question by saying well the transitional arrangements are a bit sticky so we had better not do it,  
40 that seems to me to be the wrong way around. In the late 80s there was – the late 80s, transitional arrangements to phase in new relativities. It has been done before, it can be done, and I don't – although that is the sort of thing you would raise as being scary, I don't really think its' that scary, it's quite possible to do it.

So we won't have this discussion again, unless you ask for it, until we meet to consider the draft report in 2009, August or somewhere thereabouts. If we actually have a discussion in that context, if we actually have a discussion of Contemporaneity with what the agenda's likely to be on that day, I'd be very, very

surprised, but you know it's nice to be surprised. So are my colleagues reasonably content with that resting place; Tim?

5 MR MARNEY: Sorry, if I can just make one point in light of your comments. It's clear to me that out of any form of nuclear holocaust the only two surviving creatures would be cockroaches and Contemporaneity, because this issue isn't going to go away. But what I'm not getting clear out of it is what are we trying to achieve; what are the outcomes that we are trying to improve on or change or achieve by shifting, or considering the issue of timeframes and Contemporaneity. I take the point that the  
10 first question is, what is the ideal timeframe, and then we look at the transition issues, but it may be that in periods of rapid change and relativities the answer to your second question around how do you transition may require us to go back to the first question about is this the right thing to do and is it the right time to do it. So I just raise that on a circular process, or an iterative process that would be necessary.

15 MR MORRIS: Sure. The objective, or the principle for the Commission is not difficult, the principle is how can we best deliver a distribution of the GST, the appropriate shares to the states in the application year, that's the objective. And the further away we are from that the more difficult it is to garner a larger number of  
20 stake holders who think the system is working properly. That is the end of the items that we had listed on the agenda. I indicated that if there were other matters that opportunity would be provided. As I said I haven't had any forewarning of any, but if there are any other matters that states would like to raise please do so.

25 Well, if there are none, thank you very much. We appreciate the time that you have made available, we're glad that we could back to back it with other business that you have together. We have more papers coming out to you, location, early in the new year. We then enter the workplace discussion phase from the Commission's point of view. You may well shudder at the amount of work that's involved for you, we are  
30 week on, week off, over a 16 week period to do these. So it is not as though we're having a free ride here in any of this. We don't need to talk about the workplace discussions and how we think they can be made most effective, I think we have pretty much done that and Commission staff and your officers are pretty much on par with all of that.

35 We have spoken during the course of the morning about the distribution of further papers, we will try to spread them over the year to the extent possible. I just can't recall off hand – do we have a conference towards the end of the year or do we reckon we will have seen enough of each other?

40 MR SPASOJEVIC; Next year?

MR MORRIS: Next year.

45 MR SPASOJEVIC: I think we're leaving this lot open, but we'll make a call closer to the time.

MR MORRIS: We'll see - from our perspective, we'll see how we feel whether we think there'd be value in getting together to discuss where we're up to, and of course you will have your own views about whether that would be useful as well. So thank you very much. If there's no further business, the meeting is adjourned.

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**MATTER ADJOURNED at 1.18 pm INDEFINITELY**