

# **COMMONWEALTH GRANTS COMMISSION**

## **COMMISSION DISCUSSION PAPER: INITIAL VIEWS ON ASSESSMENT STRUCTURE AND APPROACHES (CGC 2006/11)**

### **NEW SOUTH WALES TREASURY SUBMISSION**

**March 2007**

#### **INTRODUCTION**

The 2010 Review Terms of Reference direct the Commonwealth Grants Commission to simplify the existing assessment structure. This will require a major change to the assessment structure and will necessitate an iterative process.

A top-down, clean slate approach entails the use of broader measure and is consistent with the desire to achieve a more simplified structure, while still achieving equalisation.

Under a top-down approach, the assessment structure should be determined by interpreting broadly 'what states do' in terms of their revenue raising and service provision responsibilities.

The degree of disaggregation under this simplified approach should be significantly less than in the current structure which has around 40 expenditure categories and 13 revenue categories. Within this category structure, there is a very range of disability factors further increasing the complexity of the assessment task.

It has been estimated that the current assessment framework covers 37 revenue component assessments and 359 expense component assessments.

The assessment structure that is proposed in this Discussion Paper includes 7 revenue categories and 12 expense categories. This is a significant reduction on the previous structure. However, the reduction in size and complexity also needs to be applied to the number of factors that are calculated.

There will not be any significant reduction in the size or complexity of the assessment framework if the number of categories declines, but there is no significant reduction in the number of factor assessments. This underpins the importance of using broad indicators in the assessments.

New South Wales also wishes to reiterate our comments made in previous submissions that we do not believe that the current assessment should be used as a benchmark in developing the revised assessment framework. The revised framework needs to be developed using the clean slate, top down approach.

## **REVENUE ASSESSMENT**

NSW Treasury supports basing revenue categories on a broad tax type approach and the Commission's proposal to divide revenue bases into taxable and non-taxable components.

We also do not object to the 7 revenue categories.

### **Payroll Tax**

Compensation of employees (COE) is our preferred indicator of the payroll tax base. We agree to the removal of government administration, health, and education from COE and to adjust for the size of businesses.

New South Wales has concerns about the proposed use of weights derived from data sourced from ABS Business Register, June 2001.

The proposed weights appear arbitrary, and there is no indication of their accuracy or appropriateness. There is no indication of how these weights might change over time, as industry structure changes or as the relative importance of different industries changes in the various States.

The current indicator used in the payroll tax assessment makes use of the compensation of employees data, but this is adjusted to allow for the payroll tax threshold and the public sector/private sector split. The Commission needs to provide more information as to why the revised approach is being suggested, how appropriate it is and whether there is any proposal to update the weights over time.

The Commission should also consider the issue of whether the revenue bases should be policy neutral or policy free. A policy free revenue base for payroll tax would have no allowance for thresholds, or any other exemptions which States may apply. The policy neutral approach would attempt to derive the average state policy on thresholds and any other exemptions and apply that average to the base.

The results of these approaches could differ significantly.

The approach proposed for payroll tax (and a number of the other revenue assessments) in the Discussion Paper appears to be somewhere between policy free and policy neutral. This issue should be considered further by the Commission so that the States can make a more informed decision on the implications of the different approaches. A consistent approach should be adopted across the revenue categories.

### **Land Tax**

We agree that land values may not be sufficiently policy-neutral indicators and that further review is needed for this tax base.

New South Wales has argued in previous submissions to earlier methodology reviews that differences in the rate of land tax between the States can be reflected in land values. This capitalisation of land tax can affect the interstate differences in land values, along with other demand and supply issues.

The affect of interstate differences in land tax rates should be investigated by the Commission before any final decision is made on the appropriate base for land tax.

New South Wales also notes that the tax rate structure that is applied to the land tax base reflects a policy choice by the States. New South Wales applies a flat rate land tax above the threshold; most other States apply a progressive tax rate above the threshold. New South Wales also has one of the highest thresholds. The application of adjustments for both the threshold and rate progressivity doubly disadvantages New South Wales. The value distribution adjustment should not be applied.

### **Stamp Duty on Conveyances**

NSW supports investigating the use of more objective, broader measures for this revenue base.

However, there are significant limitations on the coverage of secured housing finance loan commitments. This series does not capture commercial activity and does not cover housing transactions that are not financed by a loan (for example, equity financed loans).

We question the use of weights for gearing behaviour on the following grounds. It is not clear how the proposed weights were derived. Nor is it clear how these weights may vary over time in response to changes in the property market.

### **Insurance**

Total insurance premiums appear to be a reasonable indicator.

### **Mining**

NSW considers profitability is a better measure than an output based measure such as value of production because it takes into account differences in costs of production and industry structures.

### **Motor Vehicles**

The use of new vehicle sales and stock of vehicles on register in each State appears to be reasonable broad indicators of this revenue base.

Any weights that are to be used in this assessment would need to be clearly appropriate and to include some form of updating mechanism. Their derivation would require clear analysis.

## **Miscellaneous**

We support an equal per capita assessment for this category.

## **EXPENSE ASSESSMENT**

NSW Treasury supports basing expense assessments on functions as defined by the government purpose classifications used in government finance statistics.

In Paragraph 11, the Commission also stated that a separate stream of work on common factors will be undertaken. Subject to the strength of the conceptual case of the common factors and their measurements, these influences would be applied to all relevant categories, in addition to the factors discussed in this paper.

All common factors should be subject to the same degree of analysis and data quality standards that are being applied to the category assessments. Theoretically, it should be irrelevant whether common factors are calculated as part of individual assessments or separately.

In Paragraph 16, the Commission stated '*it is prepared to use judgement to improve equalisation provided it is convinced there is a conceptual case, the effects are material, and it has confidence in the available data*'. We argue if judgement needs to be made, then it is better to err in the direction of simplification, as the extent of equalisation is not easily measurable.

For the assessment of expenses, the broad indicators would generally be the population cohorts that most intensively use the relevant government services with relatively few adjustments to account for other factors.

## **Education**

We agree with the Commission's proposed two group category and the use of the relevant population cohorts as broad indicators.

There may be a case to allow for the effect of employment status on post-secondary education population cohorts. Changes in workforce structures and related employment practices may well encourage students to pursue higher education to improve their job prospects.

The inclusion of effects other than population cohorts, however, should only be based on quantitative evidence, not on judgement and have passed the materiality and reliability tests.

New South Wales is concerned about the range of disability factors that the Commission is considering in paragraphs 55 and 57. The simplification agenda requires simplification

in the number and range of factors as well as in the category structure. The broad indicators should be the initial basis for the assessment. Any further factors should not be considered until the broad indicator has been used.

The current assessment is not a benchmark for the 2010 review.

### **Health, Welfare, Housing and Community Amenities**

The three group category proposed by the Commission appears reasonable at this stage.

We note that while the ABS advised that data (admitted patient services and non-admitted patient services in acute care institutions) in the two 4-digit GPCs are of fair accuracy but they are sometimes derived from Treasury estimates (Paragraph 64), in the 2007 Update, the ABS has some queries concerning the classification of some of these data.

- Admitted Patient Services

We note the Commission's intention to use cost-weighted hospital separations to account for population groups on the mix of hospital services used and their costs (Paragraph 81). Unless analysis has demonstrated the effects are material, we would prefer not to introduce the use of cost weights that would unduly complicate the methodology.

This is consistent with paragraph 79 which states that the approach will "focus on simplifying the existing assessment by restricting the number of cost drivers to those that can be conceptually justified, measured reliably and are material."

- Community and Other Health Services

We do not object to leaving patient transport expenses in the community and public health services category (Paragraph 66). This would also be consistent with the present GFS classification and avoid adjusting data at the 4-digit GPC level.

NSW considers a health needs model, as opposed to a minimum level service model, is the more appropriate in assessing community and other health services (Paragraph 85).

The health needs approach directly measures users of community and other health services, which we consider is the major driver of differences in the use of health services. The use of broad indicators such as population with adjustment for say age groups may well adequately capture interstate differences in the quantity of services used.

The minimum level of service approach may be policy-influenced and would seem to be more data intensive.

- Welfare and Housing

We agree with the Commission's broad interpretation of the welfare, housing and community amenities as '*providing assistance to disadvantaged groups in society*' (Paragraph 70). This broad interpretation is entirely consistent with a more aggregated approach to assessing needs.

We also agree to the Commission's proposal to include only net housing expenses in this review (Paragraph 75) to take account of the average State practice of providing subsidies to housing providers.

We suggest indicators be adjusted to account for the substantial differences in the costs of living in each State for this category, such as the use of the ABS spatial CPI.

### **Law and Order**

NSW Treasury does not agree to disaggregate the law and order group into justice services and public safety and emergency management services for the following reasons.

- The splitting of police services into justice and non justice components is not consistent with GFS reporting classifications, and such a split would be based on judgement. The split would also require the use of Productivity Commission data, which the Commission admits that further analysis on the appropriateness of the 40/60 split would be required.
- Fire protection and other public safety expenses comprise a smaller part of law and order expenses. Splitting the category further complicates the assessment structure without a material effect on equalisation.

The law and order category may adequately capture interstate differences through the use of population as a broad indicator. Further adjustments to the indicators for male, urban, age group (either 10-29 or 17-25) can be tested for materiality.

NSW may be able to split police expenses between justice services and public safety and emergency management services, provided clear definitions are given for these categories.

- Civil Courts

According to the Productivity Commission's Report on Government Services 2007, total court administration recurrent expenditure less income (excluding fines) was around \$964 million in 2005-06. Of which \$328 million was from civil courts and \$504 million from criminal courts.

While this is a sizable amount, the Report indicates there is an issue of data comparability when comparing court expenditure across jurisdictions due to differences in State and Territory approaches in apportioning income and expenditure between civil and criminal

jurisdictions within court levels. There are also differences in the way court costs are recovered. In some States, governments determine the court fees, not court administrators. The structure of court fees can also vary between fees payable by individuals and corporations. For example, corporations in NSW are charged twice the applicable fee payable by individuals.

On the ground of simplicity and data reliability, NSW does not propose that specific allowances be made for civil courts.

## **Transport**

There appears to be a conceptual case for disaggregating the transport group, primarily due to the large differences in the nature of expenses on roads and on other transport services.

However, we reiterate our position that unless reliable, comparable data and suitable methodologies are available to support further disaggregation, the transport group should remain as a block. For this category, we support exploring the use of proxy measures such as population weighted distance and density of urban areas.

There remain fundamental problems with the roads subgroup. It is difficult to measure road length and road use in a policy-neutral way. This issue will need to be resolved in a satisfactory fashion before the assessment for this category can be finalised. The other transport services also suffer from data reliability.

- Roads

The Commission is currently exploring alternative means of measuring road length. One of which is based on a synthetic road network approach.

Preliminary results based on this approach, discussed at the March 2007 Roads meeting, indicate there is still much work to be done. NSW is particularly concerned with the substantial and counter-intuitive decline in NSW' relative shares of arterial road lengths, in particular for urban arterial roads under this methodology.

- Other Transport Services

We agree (Paragraph 117) that it is difficult to reliably quantify subsidies States pay to service providers and to identify and measure the main drivers of pricing and capital subsidies. In NSW, metropolitan bus operators are now funded through new Metropolitan Bus System Contracts. Changes in the contractual arrangements have made it difficult to accurately separate out the subsidies amounts.

To avoid the data problems mentioned, there is merit in the Commission exploring the use of broader measures, with adjustment for concession status and size of urban centres.

## **Services to Industry**

NSW does not object to the Commission's proposed two group category at this stage.

We agree further work is needed to identify major drivers of expenses on services to industry, and in particular, the regulatory and administrative components.

Depreciation, leasing costs, asset maintenance would be allocated to their relevant functional expense area. Debt charges would be included in the other services category and be assessed on an equal per capita basis.

We agree to the Commission's proposed discontinuation of the national parks and natural disaster relief assessment on the grounds of data reliability and materiality.