

SOUTH AUSTRALIAN SUBMISSION TO THE COMMONWEALTH GRANTS COMMISSION REGARDING INITIAL VIEWS ON ASSESSMENT STRUCTURE AND APPROACHES (DISCUSSION PAPER CGC 2006/11)

South Australia provides the following comments on the CGC's discussion paper for the 2010 Review 'Initial Views on Assessment Structure and Approaches'.

The CGC has vigorously demonstrated a top down/clean slate approach to the issue of category structure. As the Commission says (para 4), that approach is aimed at helping it make simpler assessments that are reliable and consistent with fiscal equalisation.

If it transpires that the category structure eventually adopted for the 2010 Review closely resembles (perhaps is identical in some components) the category structure previously adopted, this should not be regarded as a failing on the part of the Commission. Fitness for purpose and the need for transparency will and should constrain the results of any proposed 'broad' interpretation of what States do (para 10) motivated by simplification.

There are a number of indicative proposals in the Commission's Initial Views paper which are in the nature of interim or work-in-progress outcomes from the Commission staff applying the tops down and materiality heuristic. We understand that there is scope for modification of the indicative proposals having regard to strength of conceptual case, reliability of data and overall quality and defensibility of Commission assessments.

We note that not assessing needs for a substantial proportion of State government revenues and expenditures irrespective of the quality of assessment available for components of that proportion could result in unwarranted dilution of equalisation.

We have previously commented on the dubious logic of first making an assessment of need and then not employing that assessment on grounds of materiality of redistribution arising from that assessment – particularly where the materiality threshold is a high \$10 per capita. Further, the Commission has not yet explained how the category structure is to be respecified should a needs assessment for a particular component move above or below the materiality threshold from year to year.

REVENUE

As noted previously, South Australia does not consider there is a need to make changes to the existing revenue categories. The base measures and data available in estimating revenue sources are, in general, of good quality and we do not consider that there are compelling reasons for changes to data sources and aggregation of existing revenue categories.

Value distribution in consideration of land tax/conveyances

- In previous submissions many States including South Australia argued the importance of reflecting common policies regarding progressive rates and thresholds applied to land tax and conveyances.
- We note in this discussion paper that the CGC has accepted the importance of acknowledging exemptions and thresholds applied by all States, but the Commission argues that value distributions should be ignored. This is on the basis that the way in which each State structures a tax appears to be a matter of policy and subject to noticeable variability. We contend this point, noting that all States adopt progressive tax rates, just as all States use tax thresholds or zero tax brackets. Variability exists for both zero tax brackets and positive tax brackets.
- It is noted that the dominant feature of the conveyance duty tax structure is not a zero tax bracket range but a progressive set of positive tax bracket ranges (see attached chart showing the current average conveyances duty tax rates for the six States). This demonstrates that in each case average tax rates increase as property values increase. Taking a simple average tax rate as the standard thus ignores the revenue raising advantage of States which have more higher-valued transactions.
- This is acknowledged in the CGC's 2007 Update Working Papers (Revenue p.13) regarding the value distribution adjustment for conveyances in the present assessment: "... all States had multiple rates of duty that progressively increased with the value of transactions. Thus, a State with an above average proportion of transactions in the higher value ranges had a revenue raising advantage."
- The CGC's new indicative proposal to reflect only the average effect of progressive tax rates in its assessments disregards the different revenue raising capacities of States that arise from the differing distributions of taxpayers. It is not only the total size of revenue base which leads to capacity differences; the distribution of the tax base is also of material impact – a State which has more of its tax base skewed towards the higher value end of the distribution will have a significant revenue-raising advantage over a State with a distribution skewed towards the lower end of the tax base. The CGC's proposed averaging of progressive tax rates eliminates this element of difference in States' revenue raising capacities and therefore does not meet the equalisation criterion.
- The new indicative proposal is said to be consistent with interpreting what States do broadly. There is no mandate for such a course as it ignores the actual tax policy decisions taken by State governments to implement progressive tax structures involving several tax brackets rather than proportional tax structures or those involving only a zero rate tax bracket.

Revenue bases:

Land tax

- The CGC indicates in the discussion paper that it plans to 'fundamentally review' the use of land values as an indicator for land tax.
- We consider, however, land values to still be the best available measure of land tax capacity as they are reflective of the data that States actually use in determining land tax liabilities. In our view, the use of land values as an indicator has worked satisfactorily over a number of years with the added built-in check of land value data conducted by a consultant.

Conveyances

- The CGC's discussion paper proposes the adoption of secured housing finance loan commitments that will be adjusted for gearing behaviour to measure the conveyances revenue base. We do not consider this approach to be particularly simple – especially the adoption of artificial weights.
- Nor will it capture the actual tax base used which includes non-mortgage financed and business transactions.
- We note the statement that the proposed measure 'captures very well the cyclical nature of the conveyances base'. We presume this finding is based on a comparison with the number and value of transactions (ie the actual base used by the States). The question should then be asked: why use a proxy when the actual measure is available?
- We consider the existing methodology using data on the number and value of transactions taxed to be superior as it is a direct measure of what States actually do and is, therefore, more intuitive to interpret. We regard this as having been an effective method that has stood the test of time.
- We note that the conveyances duty assessment is the single largest source of redistribution of the Commission's assessments.

Gambling

- The CGC's discussion paper proposes that revenues from gambling, trading enterprises and other sources should be assessed together on an equal per capita basis.
- Revenues from gambling are a significant form of revenue for the States, which we contend should be properly assessed due to clear differences across States in their revenue raising capacities based on gambling propensity. We note that the present assessment based on 50% discounted HDI meets the CGC's indicative materiality threshold of \$10 per capita, and we contend that an amended assessment using

a more appropriate base measure may substantially exceed the threshold.

- We continue to support the use of either actual gambling expenditure data that can be adjusted to take into account Western Australia's policy of no poker machines, or a broader expenditure indicator such as Recreation and Culture Expenditure from the National Accounts.
- We request that gambling taxation be retained as a separate category. This does not rule out the Commission adopting an equal per capita assessment should that be justified following consideration of submissions on the matter.

Motor vehicles

- The CGC proposes the use of broad indicators including new vehicle sales and stock of vehicles on register in each State that will be weighted according to the contribution to revenue of the various types of vehicles (ie placing weights of 1 for light vehicles and 10 for heavy vehicles.).
- We consider the aggregation of heavy and light vehicles registrations and fees, despite their separate taxation regimes, combined with the use of weights to be an unnecessarily complex solution to produce an artificially aggregated result. Hence we are in favour of maintaining the disaggregation of heavy and light vehicles as a simpler presentation, and avoiding the use of weights in modelling.
- We also favour separate assessment of stamp duty on new registrations and transfers for the same reason.

Miscellaneous revenues – user charges

- The CGC says (para 49) that its current view is that charges for the use of services should be included in Miscellaneous revenues and assessed EPC. There is no discussion of the case for this conclusion and we ask that further consideration be given to this issue.
- In our view, the assessments for user charges should be considered on a case-by-case basis. We acknowledge the views given in the Issues Paper on housing revenues (para 75) and admitted patient fees (para 84) and concur with their proposed treatment.
- However, we think the other user charge assessments currently made on a differential basis should be further considered in detail before jumping to the conclusion that no needs are assessed. In particular, the assessments for property titles (clearly related to the valuation base in each State) and collections from fees and charges associated with regulatory activities and general government administrative functions should be examined –in the latter case a more appropriate assessment would be the use of a general economic indicator such as Gross State Product.

- We note that GSP is the indicator presently used for General Public Services user charges and that the assessment for 2005-06 for two States exceeded the CGC's materiality threshold of \$10 per capita.
- In any event we raise for consideration the possibility that the default setting for assessment of needs for miscellaneous revenues be GSP or household income rather than equal per capita.

EXPENSES

We note that it is difficult to comment comprehensively on all issues canvassed in the discussion paper until more detail is provided by the CGC on the underlying model and data. In particular, it is difficult to provide firm or detailed comments on the structure for expense assessments until the CGC firms up on the disability measures to be adopted and the sources of data.

Education

- We support the two-category approach and the Commission's proposal to use a population measure (ages 4 to 17 years) as the basic measure of use for school education whilst allowing for differences in the per unit costs of government and non-government students and the cost of providing services to students who are Indigenous, from low socio-economic backgrounds and who live in sparsely populated areas.

Post-secondary education

- We support the use of a population measure as an indicator for post-secondary education with adjustments to capture the State differences in the cost of providing post-secondary education, including differences in the propensity of people to attend post-secondary education facilities.

Health – admitted patients

- The CGC proposes basing its calculation on the current inpatient services assessment including admitted hospital patients and patients in mental health institutions and nursing homes for the aged.
- We support this proposal as a sensible outcome, given the wide recognition that the present assessment is based on excellent data. Nevertheless, we agree that some simplification of the present assessment can be made. It is essential, however, that the CGC continues to recognise the differential impact of age on State costs and therefore does not adopt an aggregate age measure. The differing age structures within States have a material impact on health costs and must continue to be assessed.
- A simple aggregated age measure will not suffice. The present inpatients services assessment recognises for example that 60-65 year olds demand more services and the services provided cost more than

for 50-55 year olds, and 70-75 year olds demand more services and the services provided cost more than for 60-65 year olds, and so on. It is crucial that this differentiation continues to be recognised.

Health – community and other health services

- We support the use of the health needs approach proposed by the CGC. This approach seems far more direct to us than the alternative put forward and enables an estimate of expenditure based on the health service needs of each State including population characteristics and health costs.
- This is preferable to an estimate that only encapsulates the minimum level of service, which assumes that the availability of non-State providers is the major driver (inversely) in the cost of State funded health service provision. We dispute this assumption as a general proposition – it is arguable that the level of non-State providers itself is reflective of the health (eg age) characteristics of the population served. Availability of non-State providers may be a factor in remote or regional areas but not urban.

Welfare and housing

- The CGC proposes an assessment based on total population with adjustments made between States based on the proportion of their populations deemed to be within the main user groups including youth, the aged, low income and indigenous persons.
- We support the use of these indicators but believe that the assessment should take into account the fact that the States spend a disproportionate amount on services for the aged and disabled compared to any other population group. An appropriate weight to allow for this is necessary to reflect what States actually do.

Services to communities

- We agree with the point made in the CGC's discussion paper that the likely cost drivers in the 'services to communities' category are water quality and availability, distance from the electricity grid and Indigeneity.
- We query, however, the conclusion made in the CGC's discussion paper that there would be immaterial differences between States in terms of the proportion of populations that would be eligible for concessions. We ask that this issue be examined further.

Law and order – Justice services

- We support the CGC's proposal to examine whether adjustments need to be made to population data to reflect differences in the quantity of services provided to different sub-groups and the unit-cost of providing the services to them, including for young males, Indigenous persons

and people living in remote communities. We further agree that separate consideration needs to be made for Civil Courts.

Law and order – Public safety and emergency management services

- We support the CGC's proposal to use State population without adjustment as an indicator for this category.

Transport – Roads

- We support the current work being conducted aimed at providing better estimates of roads needs.

Transport – Transport services

- We agree that the present Urban Transit assessment is complex and needs re-examination for the 2010 Review. The Commission's proposed examination of concession status and city size is supported.

Services to industry

- As raised by South Australia previously, we consider it essential that the practice of all States of spending more on services to agriculture than other industries is recognised in the CGC's assessments. To simply aggregate these categories with a corresponding broad industry indicator does not allow for the increased spending demand on those States with a concentration of primary industries. 'What States actually do' is to spend, for historical or other reasons, substantially more on support for agricultural industry and this should be reflected in equalisation outcomes.

Other services

- We support further work being conducted on 'capital-related' expenditures to determine if they have material effects on the relative fiscal capacities of the States.
- This should encompass an examination of whether nominal interest on superannuation liability together with interest earnings on superannuation assets should be assessed within a Debt Charges category.
- While we support functionalising of superannuation expenses, nominal interest on superannuation does not lend itself to such a treatment as only new service superannuation can be reliably attached to particular functions.
- Finally, we agree that it is not necessary to separately assess National Parks or Natural Disasters.

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Attachment

Average conveyance duty tax rates

