

Queensland Treasury Response to Commonwealth Grants Commission Issues Paper 2006/03:

Architecture of Horizontal Fiscal Equalisation: Principles and Interpretation

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1 INTRODUCTION

Queensland's response to the Commission's Issues Paper 2006/03 is based on the following key views.

- Within the Australian Federation, state and territory governments (states) have a sovereign right to govern in the best interests of their citizens. States are best placed to act in the best interests of their community, and in ways that best support community preferences in relation to social, economic and environmental outcomes. Furthermore, states are accountable to their citizens for their actions in relation to developing and implementing revenue and expenditure policy objectives.
- In accordance with the Inter-Government Agreement and consistent with state sovereignty and accountability, GST funding should continue to be untied.
- General support for the existing principle underpinning horizontal fiscal equalisation (HFE), ie that all states should have the capacity to be able to provide services of the same standard. In this regard, the GST (as a national tax) should be distributed according to the principle of HFE, based on the existing three pillars, in particular that:
 - the financial capacities of states, not their performance or outcomes, are equalised;
 - states are equalised to standards that reflect what they all do on average; and
 - a state's own policies or choices should not directly influence its grant.
- The way in which HFE is implemented in Australia:
 - is sufficiently dynamic to adequately reflect changing circumstances of the states; and
 - takes a comprehensive view of states' operating positions, covering both revenue raising capacity and expenditure disabilities.
- General support for the current work program on simplification embodied in the terms of reference for the 2010 Review of Methodology.
- General concern about a number of issues raised in the CGC's Issues Paper 2006/03, which not only extend beyond the parameters for the Heads of Treasuries work program agreed at the 2004 Ministerial Council and those agreed for the 2010 Review of HFE but also, if implemented, would run counter to the agreed objective of simplification.

2 OBJECTIVES FOR REVENUE DISTRIBUTION

State comments are sought on:

- *What should be the objectives of the distribution of GST revenue; and*
- *Whether different objectives would have implications for Commonwealth-State relations.*

In response, Queensland:

- Supports the view that the distribution of GST revenue should be structured to provide states with the fiscal capacity to provide services of the same standard. This objective is embodied in the current interpretation of HFE in the Australian context;
- Supports the view that while the allocation of GST revenue should provide states with the capacity to provide services of the same standard, states have the discretion to provide services and adopt policies to achieve social, economic and environmental outcomes for their community; and
- Supports the distribution of GST revenue as untied funding.

To seek to achieve a broader range of objectives through the distribution of GST revenue would likely lead to:

- More and potentially conflicting objectives;
- Lack of clarity about objectives;
- Increased complexity of, and increased judgement applied to, the assessment process;
- Blurred responsibility and accountability; and
- Reduced autonomy of the states.

3 THE DEFINITION OF EQUALISATION

State comments are sought on the desirability or otherwise of changes in the definition of the equalisation principle, including those aspects of it that relate to:

- *Whether the objective should be ‘equality’, ‘not appreciably different from’, ‘reasonably comparable’, assistance for only the financially weakest states or something else;*
- *Whether equalisation should be about equalising financial capacity or performance;*
- *Whether equalisation could encompass other considerations such as efficiency and how that might be achieved – could the concepts of efficiency and equalisation be part of an internally consistent definition or are they to a greater or lesser extent incompatible; and*
- *Any other aspects of the definition.*

In response, Queensland:

- Supports the current definition of fiscal equalisation, which has as its objective equalisation of the capacity for states to deliver services of the same standard;
- Supports the view that capacity equalisation should encompass both revenue and expenditure disabilities;
- Supports the view that it is unnecessary and potentially confusing to have an objective of “not appreciably different from” or “reasonably comparable to”. In essence, these concepts are relevant to issues such as complexity and robustness which are best dealt with implicitly in the work dealing with simplification and materiality thresholds being undertaken as part of the 2010 Review, rather than by changes to the definition of fiscal equalisation;
- Does not support the notion of equalising performance. Not only could this lead to GST revenue becoming conditional funding, thereby impacting on the autonomy of states, it could also lead to lack of clarity, conflicting objectives and increased complexity;
- Supports the current policy neutral use of average efficiency within the definition of fiscal equalisation. Seeking to encompass efficiency objectives into equalisation (other than the average of what states do) will lead to lack of clarity, conflicting objectives, increased complexity and will impact on the autonomy of states; and
- Would argue that incorporating efficiency objectives without accompanying effectiveness and equity objectives will produce a flawed performance incentive.

3.1 Application of Fiscal Equalisation

The application of fiscal equalisation is intended to give all states the financial capacity to provide services of the same standard for their populations while maintaining their flexibility to vary the service levels and tax imposition to best meet the needs of the community. Whether the same level (or standard) of service is actually provided is a matter of policy for each State. GST revenue is, and should continue to be, allocated on the basis of differential revenue capacity and expenditure needs – as determined by the CGC – that states experience in delivering a standard level of services.

3.2 Level of Fiscal Equalisation

There have been many comparisons between Australia's Commonwealth-State financial arrangements and those of other federations. Such comparisons have highlighted the relatively high degree of vertical fiscal imbalance (VFI) experienced in the Australian Federation, and the greater reliance by the Australian States on the Commonwealth for funding grants, when compared with other federations. Further, some studies have concluded that Australia practices a high level and relatively complex process of fiscal equalisation compared with other federations.

Queensland supports the current approach to fiscal equalisation, which takes into account both the revenue raising capacity and the expenditure disabilities of states, and has agreed to work with the Commission and other jurisdictions to simplify the equalisation process.

3.3 Capacity Equalisation and Performance Equalisation

The current allocation method for GST revenue is intended to give states the fiscal capacity to provide services of the same standard. It is unclear what the notion of performance equalisation actually means. If it means an objective of equalising the actual service delivery of jurisdictions, this would fundamentally change the nature of fiscal federalism in Australia which is based on sovereignty, responsibility and accountability of the states to determine the level, mix and quality of services to be provided to the community. Not only would this represent a fundamental change to the nature of fiscal federalism in Australia, any move to equalisation based on performance would pose a range of major difficulties and issues including:

- how performance benchmarks will be set;
- who will set the performance benchmarks;
- the availability of comparable and consistent data;
- appropriate recognition of non-policy related needs;
- benchmarks would be a measure of 'what states should do' rather than 'what states do', which will impact on the autonomy of states; and
- the likelihood that the resulting methodology would contain conflicting objectives, be more complex and require more judgement than the existing methodology.

The current equalisation method, which focuses on equalising the fiscal capacity of states to provide services of the same standard is appropriate. Any alternative based on performance equalisation is not appropriate and is not supported by Queensland.

3.4 Efficiency Considerations

In 2002 Monash University's Centre of Policy Studies (CoPs) was commissioned by New South Wales, Victoria and Western Australia to undertake modelling for the Garnaut/Fitzgerald inquiry into Commonwealth-State funding. The aim of this modelling was to investigate the efficiency consequences of changing the existing pattern of Commonwealth grants to the States. The CoPs report concluded that if GST revenue was allocated on the basis of a fixed amount of about \$100 million for minimum cost of government for each State (reviewed periodically by the CGC) with the remainder distributed on a per capita basis, then national welfare could increase by about \$170 million.

The modelling assumed that the current state taxation and expenditure policies are evidence of some states spending above community preferences because they receive higher than a population share of GST revenue, ie "*subsidised states spend too much on public services compared with the wishes of their communities*"¹. The modelling outcomes were therefore largely based on the assumption that (under GST revenue allocations closer to per capita share), those States which lost grants would reduce their expenditures accordingly and the States that gained grants would reduce their taxes.

Queensland Treasury engaged CoPs to repeat the equal-per-capita distribution scenario under a different set of assumptions about how States might respond to changes in their share of GST revenue. Specifically (and more realistically), it was assumed that states gaining additional revenue would not return all of the additional funds to the community by way of tax cuts, but would return only part of the additional revenues in the form of tax cuts. Conversely, those states experiencing a reduction in GST revenue would only partially reduce expenditure, and would (by and large) retain service levels by increasing state-based taxation. The results from this research demonstrated there would be a loss of \$620 million in national welfare which is considered a more realistic outcome.

These results highlight problems inherent in the notion that improvements in national economic efficiencies can be gained through changing the distribution of GST revenue.

¹ Ross Garnaut, Vince Fitzgerald, *Review of Commonwealth-State Funding – Final Report*, 2002, page 143.

4 INTERPRETING THE EQUALISATION PRINCIPLE

4.1 Capacity Equalisation

State views are sought on:

- *whether capacity equalisation should be interpreted as the capacity of state governments or the capacity of state governments, state communities and other governments to provide services that are broadly the responsibility of states;*
- *if the interpretation should be broadened, how might it be done?; and*
- *whether the issue of capacity equalisation, which is currently implemented by equalising the per capita deficit on the operating accounts of State governments, should be equalised on the basis of other concepts, such as the net debt or the net wealth of State governments?*

In response, Queensland:

- Supports the interpretation of capacity equalisation through the inclusion of non-state government providers which provide services that are the responsibility of the states and funded by the states – for example the state government contribution to private education;
- Does not support the inclusion of private service provision which is not funded by state governments – for example community funding for private education; and
- Supports the continuation of capacity equalisation through equalising the per capita deficit on the operating accounts of state governments.

The capacity of state governments to provide services relies on third party service providers. In many cases state governments provide services by engaging private sector service providers to deliver selected services, for example in the areas of health and welfare and corrections.

Inclusion of services funded by the community has the capacity to make the equalisation process more complex. Further, there may be problems related to the collection of comparable and consistent data from private sector agencies which operate on a charitable basis.

The key measure of sustainability of service provision is the net operating balance of government. Relevant balance sheet measures such as debt, financial assets and physical assets feed into the operating balance in the form of interest revenue, interest costs, depreciation, dividend returns on equity investments, etc.

It follows therefore that capacity equalisation is best achieved by equalising the per capita deficit/surplus on the operating accounts of state governments through a revenue adjustment to the operating account which recognises states' different needs in the distribution of the GST revenue pool.

4.2 Internal Standards or What States Do

State views are sought on:

- *Whether the current interpretation of standards as an average of the policies of all states should be changed to standards based on what some states do or to external standards based on a desired level of service or tax policy or a desired level of efficiency in service delivery, What might be the implications of such changes and how might decisions on the appropriate standard be made?*
- *Should ‘what states do’ be interpreted very broadly, in terms of state policy objectives or in terms of the many services states provide to achieve those policy objectives? How might the Commission establish the policy objectives? How might cost differences states face in achieving a policy objective be measured?*
- *Currently, the ‘same effort to raise revenue’ is interpreted as applying the same definition of the revenue base and the same rates of tax, but should it be interpreted broadly to encompass the same policies for creating a growing of the tax base as well as those for taxing it? If so, could that be done in a simple and robust way?*
- *The current average standard approach implies all states notionally provide services in the same way. Is this appropriate given their different circumstances? Are there practical alternatives?*

In response, Queensland:

- Supports the current interpretation of standards as an average of the policies of all states;
- Supports the continuation of measuring expenditure standards as the average per capita expenditure;
- Supports the continuation of measuring revenue standards as the average revenue per capita; and
- Supports the use of average efficiency for service delivery which is implicit in the current method of calculating average expenditures.

4.2.1 Average Policy

The current method of using the average expenditure and revenues of all states as a proxy for average policy can be measured using GFS data. Alternatives to this approach would be more difficult to measure and would very likely require the CGC to make more assumptions and judgements than it currently does, which would add complexity and uncertainty to the current process.

Using internal standards based on what is done by the financially strongest or the middle ranking states, or using internal standards based on a state which is considered more efficient in its service delivery would raise significant issues of concern including:

- grant design issues (ie capacity of the benchmark state(s) to alter equalisation outcomes by its policy actions);
- whether the benchmark state(s) are reasonably reflective of service issues faced by all states; and
- inherent problems in seeking to measure efficiency in isolation of service quality dimensions, equity considerations, etc.

4.2.2 Technical Efficiency

Assessing a desired level of service efficiency is fraught with problems. Some states may be more efficient in service delivery owing to natural characteristics – for example a small state with large centres of population should be more efficient at delivering services than a large state with many small centres of population. As a result, it would be difficult to separate such natural efficiencies from those efficiencies potentially resulting from service design.

The Steering Committee for the Review of Government Service Provision² has been undertaking (and has published) work on performance benchmarking of government services since it was established in 1993. The Committee's latest report highlights the need to take a comprehensive view of performance, acknowledging the trade-offs inherent in the different dimensions of performance, in particular efficiency, effectiveness and equity.

In this context, if fiscal equalisation were based on a “*desired level of efficiency in service delivery*” this must of necessity require the specification of a desired level of effectiveness and a desired level of equity. It is Queensland's view that it would be totally unrealistic to expect the fiscal equalisation process to deal with all three dimensions in a simple, transparent and robust way.

Furthermore, even if it were possible to overcome these problems, it would be equally difficult, if not impossible, to equalise funding based on a “*desired level of efficiency in service delivery*” without compromising states' responsibility and discretion to provide services and adopt policies to achieve social, economic and environmental outcomes for their communities.

² Steering Committee for the Review of Government Service Provision, 2006, *Report on Government Services*, Commonwealth of Australia

4.2.3 External Standards

Using external standards based on some ‘ideal’ level of service poses many questions about where one would source the external standards, and the applicability of translating overseas experience to the Australian environment. If normative standards for service delivery are set by the CGC, states’ autonomy would be compromised in relation to determining policies for service delivery. What states do is the best measure of community preferences and should remain the cornerstone of the fiscal equalisation process.

The notion that the CGC might focus on measuring cost differences between states in relation to achieving policy objectives is also fraught with danger. Besides being in conflict with the pillar that a state’s own policies or choices should not directly influence its grant, a likely outcome of this notion is that states could put forward numerous policies with a view to attracting funds, through the equalisation process, to achieve them. Rather than adding this dimension to equalisation, it is preferable for the CGC to simply continue to assess what states actually do, rather than assess the costs of what states claim they would like to do.

4.3 Policy Neutrality

States views are sought on:

- *Should a concept of policy free be applied? Is there evidence that equalisation creates incentives for particular behaviour by states? If there is, what alternative approaches might be adopted to remove the incentives? Conversely, should equalisation provide positive incentives for states to act in a particular way and, if so, what behaviours should be encouraged and how might it be achieved?*

In response, Queensland:

- Supports the concept of policy neutrality and considers that all jurisdictions frame policies to deliver a range of outcomes for the community, rather than with a view to potential GST revenue outcomes.

While it may be technically possible for states to influence their grant shares at the margin by changing their expenditure/tax mix, there is no evidence that this is a real factor in the setting of expenditure and revenue policies. The reality is that the policy focus for all states is on economic development, service provision and sound fiscal management rather than on possible outcomes of the CGC’s processes.

Similarly, it is technically possible that a policy change in a large state has the capacity to change the average, simply because expenditures by large states have a greater influence on the average. Nonetheless, the Commission’s averaging methods minimise the effects of policy changes to tax regimes and in any event the outcomes of such policy changes take a long time to have any impact on relativities.

4.4 Should there be More Pillars

State views are sought on:

- *Should efficiency, simplicity, robustness, transparency and stability or predictability be included as pillars of equalisation? Why? How?*
- *Whether including efficiency as a pillar (based on either the broad interpretation of allocative efficiency or the narrower interpretation of the technical efficiency of service provision), would be consistent with fiscal equalisation? If so, how might it be done in a simple and reliable way?*

In response, Queensland:

- Believes that the current three pillars (or underlying principles) of equalisation serve the purpose of fiscal equalisation very well; and
- Believes that simplicity, transparency, robustness and stability are secondary objectives and/or aspects to be considered in the process of applying the three pillars of fiscal equalisation.

States and the Commonwealth have already agreed on a terms of reference to guide the work leading up to the 2010 Review, focussed on simplicity, transparency and improving data quality. If achieved, these agreed goals will inevitably improve stability, robustness, and predictability.

The question of allocative efficiency has been discussed under section 3.4 above. Modelling undertaken by the CoPs group at Monash University showed there is no evidence that the change to fiscal redistribution in Australia being sought by some states will result in improved economic outcomes for the nation.

As outlined in section 4.2.2, seeking to include technical efficiency as a pillar without also including effectiveness and equity principles would be highly problematic. This would also raise the potential issues of conflicting objectives as well as the more fundamental implications for fiscal federalism of seeking to achieve performance objectives through fiscal equalisation. It would be unrealistic to expect the fiscal equalisation process to be able to deal with these issues in a simple and reliable way.

Furthermore, in its 2006 Update, the Commission has provided evidence to effectively refute the notion that there are any impediments or disincentives to states pursuing technical efficiency improvements. Assertions that the HFE process provides disincentives for states to pursue efficiency improvements have been raised and debated many times, but no credible evidence has ever been put forward to support the assertions.

4.5 The Scope of HFE

State views are sought on:

- *Whether equalisation should take account of the non-state provision of services normally provided by states;*
- *Whether equalisation should be confined to ‘merit goods’ of some concept of core state functions and taxes, such as education, health, law and order. If so, how might ‘merit goods’ or another concept of core functions be defined and applied?*
- *Whether equalisation should cover all activities of state governments in providing services and raising taxes and charges – that is, should equalisation cover expenses incurred and revenues raised by state trading enterprises as well as those recorded in the general government sector operating statements;*
- *Whether the range of disabilities assessed should be confined to disabilities that reflect interstate differences in the use of services – that is, disabilities that reflect differences in the unit cost or providing services should be omitted; and*

- *Whether disabilities that reflect the effects of the location where services are delivered should be omitted.*

In response, Queensland:

- Does not support the inclusion of non-state provision of services normally provided by the states, but does support their consideration on the impact of state provision;
- Does not support the assessment of ‘merit goods’ only, as this is likely to result in partial equalisation;
- Supports the inclusion of all activities of state governments, but not the operating expenditure and revenues of state trading enterprises;
- Supports the inclusion of dividends and other revenues from state trading enterprises;
- Supports disabilities being assessed for both demand and cost difference; and
- Supports the inclusion of location specific disabilities.

4.5.1 Non-State Service Provision

Non-state service provision should be included in the standard budget only if state governments provide funding for such services. For example, non-government schools are currently included in the standard budget to the extent of state funding. Further, where a state government chooses to purchase services from the private sector under a purchaser-provider arrangement rather than provide its own services, these expenditures should also be included in the standard budget. For example, some states purchase correctional services from private sector providers.

4.5.2 Merit Goods

A standard budget which includes the expenditures and revenues of states’ operational budgets has the capacity to provide a high level of fiscal equalisation. Basing the assessments solely on ‘merit goods’ would not only result in partial fiscal equalisation but would also create problems in relation to defining what should be included in ‘merit goods’.

The current principle of ‘what states do’ ensures that equalisation is based on those state services required and needed by the community. Using a sub-group of services provided by state governments would not reflect the reality of the service needs and expectations of the community that the states are seeking to meet.

Using a sub-group of services would also have implications for the CGC’s assessment of revenue capacity. For example, would the revenue used to provide non-merit goods be included, or identified and excluded?

4.5.3 State Trading Enterprises

The inclusion of state trading enterprises is unnecessary as:

- the sector is well defined and is clearly separate from the general government sector;
- the net flows such as dividends and community service obligations are included in the Commission’s assessments;
- there are significant structural differences across states; and
- state trading enterprises are subject to competitive neutrality agreements under the National Competition Framework which supports transparency and separation from the General Government sector.

4.5.4 Cost and Demand Factors

The inclusion of differences in demand across states for services is important. For example, differences between states in the demand for school education, as well as differences between states in relation to the provision of private sector education both impact on the expenditure needs of states. Similarly, differences in the cost of service provision owing to circumstances outside a state’s control should also be included. To exclude cost differences (where they are significant and material) would result in partial equalisation.

4.5.5 Location Specific Disabilities

This issue was examined in the CGC’s 1990 Report on Issues in Fiscal Equalisation. Two questions were considered:

- does the assessment of location specific disabilities, through its effect on the degree of equalisation, affect economic efficiency?; and
- does the assessment of location specific disabilities produce grant design or substitution effects, ie does it involve a loss of policy neutrality?

The Commission’s 1990 report concludes that efficiency gains resulting from the removal of location specific disabilities would be marginal when compared with the cost to fiscal equalisation if location specific disabilities are not assessed.

In relation to the second question, the CGC’s 1990 Report (page 106) concluded: “...with a limited number of exceptions, the design features of location-specific factors and categories are unlikely to influence a State’s decisions. The exceptions are those where the link between expenditure and the disability factor is so close as to raise the question whether there is too clear an incentive for increased expenditure.” The exceptions identified by the CGC were either modified or removed within the context of the 1993 Review.

Queensland supports the Commission's continued assessment of location specific disabilities. To disregard the additional costs of service delivery from location specific disabilities would have a highly detrimental effect on fiscal equalisation.

4.6 Averaging Relativities and their Application

State views are sought on:

- *Whether the current approach of applying historically derived relativities to the future remains the most appropriate way of implementing equalisation or whether other approaches should be considered. Comments should consider conceptual and practical implications of alternatives; and*
- *The trade-off between contemporaneity and stability of relativities – that is, if historical assessments are retained should they be averaged over 5, 3 or 1 years?*

In response, Queensland:

- Supports the continuation of using actual data to derive the relativities; and
- Supports the continuation of a five year averaging period.

4.6.1 Historical versus Contemporary Data

Any move away from using historical (real) data for assessment purposes would involve the CGC making projections about the relative fiscal capacities and expenditure requirements of states in future years. This would simply add a layer of complexity to the current process, and not necessarily guarantee improved results. Applying trends to historical data would prove problematic where revenues are subject to fluctuating economic cycles such as housing and mining.

4.6.2 Three Years versus Five Years Averaging

In its 1999 Review Report, the Commission noted:

- *the current process of calculating relativities based on historical data for five years would not deliver grants in a future year that would fully equalize the States in each future year;*
- *deriving reliable estimates of relativities based on projections of the economic and demographic circumstances of the States for the future year when the relativities would be applied is not feasible;*
- *the current processes achieve equalisation over the long run;*
- *a three year assessment period would also achieve equalisation over the long run and would produce relativities that are a little more up-to-date than the five year review period, but at the cost of less year to year stability; and*
- *frequent changes in the length of the assessment period would not produce equalisation over the long run.*

In the CGC's Discussion Paper 2002/2 *Contemporaneity and Equalisation over Time*, the CGC drew the following conclusions:

- *during 1988-89 to 2000-01, the yearly relativities are less stable than the three or five year average relativities;*
- *a state with a continuous downward trend in its relativity (its assessed requirement for assistance is falling), has average relativities above its yearly relativity. That is, the averaging processes and the time lag in the assessment process mean that the relativities do not fully reflect the State's improving economic performance;*
- *a state with a continuous upward trend in its relativity (its assessed requirement for assistance is rising), has average relativities below its yearly relativity. That is, the averaging processes and the time lag in the assessment process mean that the assessed relativities do not catch up with the declining relative economic circumstances of that State; and*
- *states which have cycles in their economic performance relative to other states may be placed in positions of fiscal equalization, over the long term.*

Neither a three nor a five year assessment period would produce relativities that fully match states' requirements for assistance in the year they are applied. However, a three year assessment period would produce relativities that are more up-to-date, especially if states experience long term trends in their relative economic capacity. But a five year assessment period would better smooth out the effects of data errors or transient events. These are similar observations to those that have been made in the past.

We are currently inclined to retain the five year assessment period.

Until the 1990 Report, general revenue relativities were calculated on a three year assessment period. States sought a five year assessment period and this was agreed to be the basis of assessing the relativities for the allocation of the 1990-91 financial assistance grants.

Queensland has supported retaining the five year period and continues to do so as it reduces volatility in states' GST revenue outcomes.

4.6.3 CGC Issues Paper 2006/04 - Contemporaneity

There are six options (which are not mutually exclusive) provided in the CGC's paper regarding the issues of contemporaneity:

1. Changing the treatment of SPPs from inclusion to absorption;
2. Shortening the assessment period from five to three or one years;
3. Giving greater weight to the most recent years of data;
4. Using state forward estimates for the application year;
5. Moving from a relative assessment of fiscal capacities to an absolute assessment; and
6. Full contemporary equalisation.

Queensland's views are:

Option 1 – treating SPPs by absorption, in a manner similar to the treatment of the health care grants, may increase the contemporaneity of assessments. Queensland is not averse to further examination of this option.

Option 2 – For the reasons noted above, Queensland does not support a move away from a five year assessment period.

Option 3 – Depending on the significance of the weights, this option has the same general effect as shortening the assessment period and will therefore lead to increased volatility in GST revenue outcomes which is not desirable. Secondly, as the most recent years of data are the least reliable, placing more weight on these data may also reduce accuracy. Queensland supports the continued use of equal weighting to each of the assessment years.

Option 4 – Queensland does not support the use of states' forward estimates. Data at the level of detail that would be required are not available.

Option 5 – Queensland is inclined to support further exploration of this approach. There is a potential to continue to use the current data and to base the allocation of GST revenue on absolute needs indexed over time rather than converting those needs to relativities. However, indexing is a critical issue that will need to be resolved.

Option 6 – Queensland does not support full contemporary equalisation on the basis it would decrease accuracy and increase volatility.

4.7 The Treatment of SPPs

o *State comments are sought on the current approach to dealing with SPPs.*

In response, Queensland:

- Supports the CGC's current approach to SPPs as they represent a revenue source to state governments to support the delivery of services included in the standard budget.

Including SPP payments in the CGC's assessments ensures they are – correctly – taken into account when assessing relative needs. Arguments asserting that including SPP payments in the CGC's assessments overrides Commonwealth policy objectives are not valid as states are still required to spend these funds according to Commonwealth policy objectives. Those SPPs where the CGC's treatment would override national objectives are generally listed for exclusion within the CGC's terms of reference.

As indicated above, Queensland is not averse to further examination of the notion that SPPs should be treated by absorption, as this may increase the contemporaneity of assessments.

5 IS EQUALISATION BEING ASKED TO DO TOO MUCH?

State comments are sought on:

- *Whether a set of relativities that was based on needs defined in terms of what is required to allow the underlying causes of certain disabilities (indigenous disadvantage, urbanisation etc) to be overcome would be 'appropriate'. If so, how might it be achieved and how could the Commission decide which disabilities should be addressed?*

In response, Queensland:

- Supports the CGC's views in paragraph 69 that equalisation is not meant to guarantee the provision of comparable access to services in all regions and that seeking to incorporate other outcome objectives in the fiscal equalisation process would be asking too much of the process which it has been agreed should be simplified rather than made more complex.

The current process for fiscal equalisation is not about equalising access to services for individual citizens, but rather about equalising the capacity of governments to provide services of the same standard. Moving from a system of fiscal redistribution to provide states with the fiscal resources needed to deliver a standard level of services – to a system of fiscal redistribution with an objective of achieving a specific set of policy outcomes – is a significant departure from the current methodological process for HFE. Effectively, this would represent a departure from 'what states do' to 'what states should do', which has the potential to compromise states' sovereignty, pose major design difficulties and lead to increased complexity and disagreement over the equalisation process.