

Commonwealth Grants Commission

DISCUSSION PAPER CGC 2001/11

**PROPOSALS FOR THE TREATMENT OF NEW DEVELOPMENTS IN
STATE FINANCES, AND DATA CHANGES RELEVANT TO
THE 2002 UPDATE OF RELATIVITIES**

September 2001

CONTENTS

<i>Chapter</i>	<i>page</i>
1. Introduction	1
2. Treatment of Commonwealth Payments	2
3. Commission's Treatment of the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations	11
How to Estimate Data Required to Calculate FAG Category Standards	12
How to Estimate Data Required to Calculate GST Category Standards	13
Whether the 2001 Update Estimates of GST Revenue Should Be Changed	14
4. Other Matters	16
Revenue Replacement Payments Paid in 2000-01	16
Non-government School Cost Factor	16
Primary Health Care Access Program	17
<i>Attachments</i>	<i>Page</i>
A. Terms of Reference	18

CHAPTER 1

INTRODUCTION

1. The Commission received the Terms of Reference for the 2002 Update from the Minister for Finance and Administration on 17 September 2001. A copy is at Attachment A.

2. This paper details how the Commission proposes to deal with:

(i) the requirements of the terms of reference; and

(ii) new issues arising for this Update.

3. It provides the Commonwealth and State Treasuries with an opportunity to comment on the Commission's proposals. It provides advice on:

(i) the proposed treatment of developments in Commonwealth-State financial arrangements;

(ii) the impact of the 1999 Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations; and

(iii) other matters.

4. The Commission asks that responses be provided by 12 October 2001.

5. In this paper, the term State(s) includes the Australian Capital Territory and the Northern Territory unless the context indicates otherwise.

CHAPTER 2

TREATMENT OF COMMONWEALTH PAYMENTS

1. The Terms of Reference for the 2002 Update ask the Commission to recommend per capita relativities for use in distributing a combined pool of GST revenue and health care grants among the States in 2002-03.

2. Clauses 4, 6 and 7 relate to the treatment of Commonwealth payments. Clause 4 requires the Commission to treat Commonwealth payments in the same way as they were treated in the 2001 Update.

3. Clause 6 enables the Commission, if necessary, to accommodate new developments in State budgets for 2000-01 and thereafter. It tells us to base our assessments on the same principles and methods of treating Commonwealth payments as those applied in similar circumstances in the *2001 Update*.

4. Clause 7 instructs the Commission to quarantine from its assessments:

- (i) the *FBT Transitional Grants for Hospitals* program;
- (ii) the *Roads to Recovery* program; and
- (iii) the *Intelligent Island* and *Connecting Tasmanian Schools* programs.

5. In each case, the quarantining will be implemented by excluding the receipt of the money and the expenditure of the funds by the States.

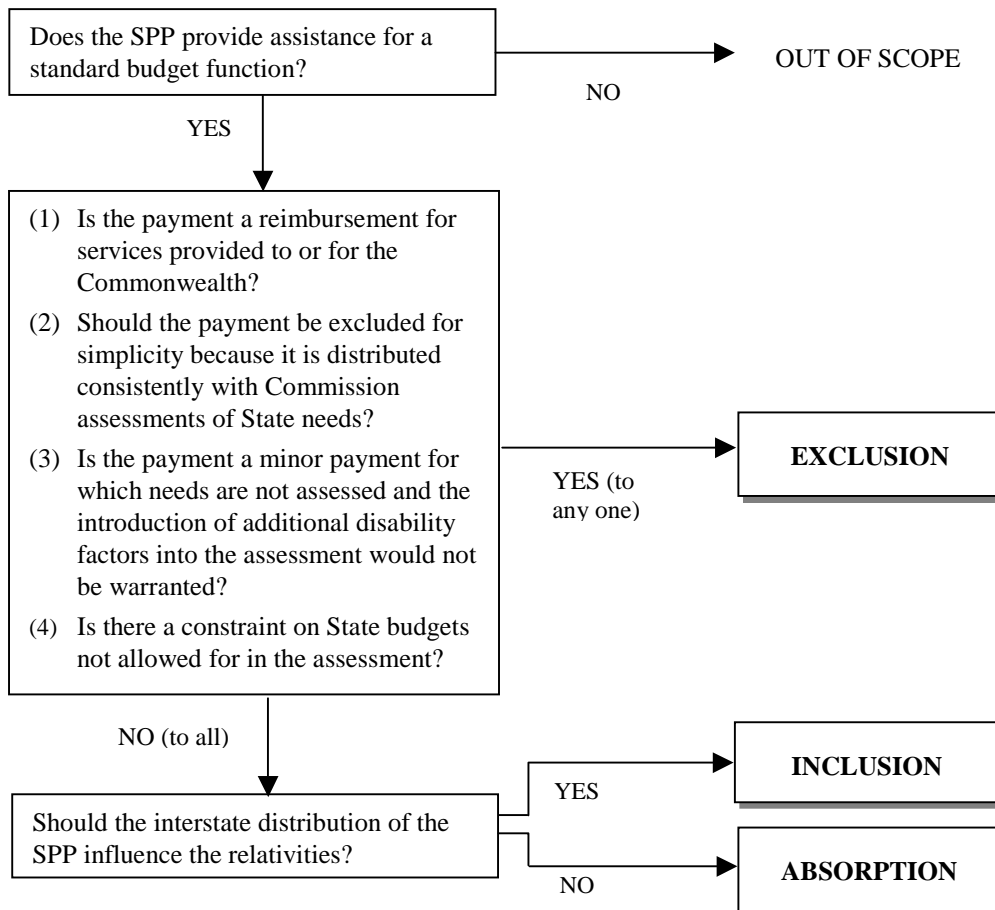
6. The following sections describe how we propose to treat new Commonwealth payments commencing in 2000-2001 or thereafter. The process used in reaching these proposals was established in the 1999 Review. It is set out in Figure 1.

Treatment of Commonwealth Payments Commencing in 2000-01, 2001-02 or 2002-03

7. ***Payments commencing in 2000-01.*** The Commission has examined Budget Paper No 3 for all Commonwealth payments which commenced in 2000-01 — the last year of the 2002 Update assessment period. It examined capital as well as recurrent payments because, on occasion, the Commission has considered a payment to be recurrent even though Budget Paper No. 3 classified it as capital.

8. Table 2-1 and Table 2-2 list recurrent and capital payments commencing in 2000-01 and our proposed treatment of them. None of the capital payments that began in 2000-01 will be treated as recurrent.

Figure 1 TREATMENT OF SPECIFIC PURPOSE PAYMENTS, 1999 REVIEW



9. **Payments commencing after 2000-01.** The Commission also examined payments which will commence after 2000-01 and will be paid in 2002-03 (the year in which the 2002 Update relativities will be applied) because such payments may be treated as if they had been paid in 2000-01. This is called ‘backcasting’ and is used when:

- (i) the new payment represents a major change in Commonwealth-State financial relations;
- (ii) the Commission is certain that the new payment will be made in the application year (2002-03); and
- (iii) sufficient information is available to backcast the payment for each State.

10. The relevant payments are shown in Tables 2-3 and 2-4. We do not intend to backcast any payments in the 2002 Update.

Table 2-1 NEW RECURRENT SPECIFIC PURPOSE PAYMENTS IN 2000-01, SHOWN IN *FEDERAL FINANCIAL RELATIONS 2001-02*, BUDGET PAPER No. 3

Commonwealth Payment	Description of Program	Estimated Amount Paid in 2000-01 (\$m)	Proposed Treatment in 2002 Update	Reason for Treatment
<i>Public Order and Safety</i>				
Commonwealth Heads of Government meeting - payment to Queensland Police	Payment to Queensland Police for security arrangements relating to Commonwealth Heads of Government meeting in Brisbane, in October 2001.	2.424	Exclusion	Out of Scope – Commonwealth Function (Decided by Commission during the 2001 Update, but no expenditure in 1999-2000.)
<i>Health</i>				
Fringe benefit tax (FBT) transitional grants for hospitals	The FBT cap to apply to public and not-for-profit hospitals will be \$17 000 of grossed up taxable value per employee. To assist with the transition to this cap, grants are to be made to public and not-for-profit hospitals from 2000-01 to 2002-03.	78.727	Exclusion	Quarantined by the Terms of Reference. (The SPP will be excluded. The expenditure it finances will be excluded from the Hospitals category.)
<i>Social Security and Welfare</i>				
National Illicit Drugs Strategy	This initiative will provide funding to State governments to provide services to families where a person is suffering from the effect of illicit drug use.	1.131	Inclusion	This National Drug Strategy is an ongoing program. It was previously included under the National Public Health broadbanding arrangements and treated by the Inclusion method. (See 1999 Review Report, Vol II Page 266.)

Table 2-1 NEW RECURRENT SPECIFIC PURPOSE PAYMENTS IN 2000-01, SHOWN IN *FEDERAL FINANCIAL RELATIONS 2001-02*, BUDGET PAPER No. 3 (continued)

Commonwealth Payment	Description of Program	Estimated Amount Paid in 2000-01 (\$m)	Proposed Treatment in 2002 Update	Reason for Treatment
<i>Housing and Community Amenities</i>				
Oceans Policy	To set in place a framework for integrated and ecosystem-based planning and management for all ocean uses in areas under Australia's jurisdiction.	1.128	Exclusion	Out of Scope. This is a Commonwealth function.
Newcastle Structural Adjustment Fund	Assistance for the generation of sustainable private sector employment in the Newcastle region following the closure of BHP Steel in Newcastle.	0.735	Exclusion	Structural adjustment program of the Commonwealth. The State is acting as an agent of the Commonwealth. A similar program was excluded in the 1999 Review.
<i>Recreation and Culture</i>				
Brisbane Goodwill Games 2001	Funding will cover the cost of the Goodwill Games Volunteer Programme.	3.000	Exclusion	Allocation reflects need. Olympic Games contributions were treated in same manner.
<i>Agriculture, Forestry and Fishing</i>				
Citrus Market Diversification	The Citrus Market Diversification Programme was established by the Commonwealth in 1994 to help the citrus industry improve its international competitiveness and long term growth prospects. This program was previously included in the Rural Adjustment Scheme.	0.211	Exclusion	Payments under the Rural Adjustment Scheme are treated by exclusion and the terms of reference tell us to apply the same treatment.

Table 2-1 NEW RECURRENT SPECIFIC PURPOSE PAYMENTS IN 2000-01, SHOWN IN *FEDERAL FINANCIAL RELATIONS 2001-02*, BUDGET PAPER No. 3 (continued)

Commonwealth Payment	Description of Program	Estimated Amount Paid in 2000-01 (\$m)	Proposed Treatment in 2002 Update	Reason for Treatment
West 2000 Plus	To provide support over three years to NSW for projects to improve the Natural Resource Base management and farm productivity in the Western Division. This program is a successor to the WEST 2000 Rural Partnership Program, run for the last two years as part of the Rural Adjustment Scheme.	1.374	Exclusion	Payments under the Rural Adjustment Scheme are treated by exclusion and the terms of reference tell us to apply the same treatment.
Farm Assistance	The Central North-East South Australian Farm Assistance Programme is intended to address the longer term structural issues faced by the region. The focus of the programme will be to develop the region's economic capacity and self reliance by facilitating sound business decisions, encouraging sustainability and promoting innovation.	1.000	Inclusion	Similar to services provided by States under extension schemes.
Queensland Trawling Industry Restructure Package	Commonwealth contribution towards a structural adjustment package for the East Coast Trawl Fishery in the Great Barrier Reef World Heritage Area. Funding is intended to achieve a significant reduction in fishing effort (of around 15%) in the World Heritage Area and contribute to the protection of world heritage values.	10.000	Exclusion	A structural adjustment to permanently remove fishers from within the Great Barrier Reef Marine Park. This is a Commonwealth initiative and should be excluded.

Table 2-2 NEW CAPITAL SPECIFIC PURPOSE PAYMENTS IN 2000-01, SHOWN IN *FEDERAL FINANCIAL RELATIONS 2001-02*
BUDGET PAPER No. 3

Commonwealth Payment	Description of Program	Estimated Amount paid in 2000-01 (\$m)	Proposed Treatment 2002 Update	Reason for Treatment
<i>Health</i>				
Federation Fund - Queensland Institute of Medical Research	Commonwealth contribution to the cost of establishing the Comprehensive Cancer Research Centre at the Queensland Institute of Medical Research.	10.000	Out of Scope	The payment is for capital works which are outside the scope of the Commission's assessments.
<i>Recreation and Culture</i>				
National disaster memorials	To provide funding, in conjunction with State governments, to commemorate the impact of major disasters on the community and the human effort in dealing with such disasters.	0.050	Out of Scope	The payment is for capital works which are outside the scope of the Commission's assessments.
<i>Fuel and Energy</i>				
Renewable remote power generation	To provide a rebate for the installation of renewable energy generation technologies in areas of Australia currently reliant on diesel for electricity generation. Funding is based on the relevant amount of diesel fuel excise paid in each State by public electricity generators.	2.524	Out of Scope	The payment is a Commonwealth program and, as such, is outside the scope of the Commission's assessments.

Table 2-3 NEW RECURRENT SPECIFIC PURPOSE PAYMENTS IN 2001-02 AND 2002-03, SHOWN IN *FEDERAL FINANCIAL RELATIONS 2001-02*, BUDGET PAPER No. 3

Commonwealth Payment	Description of Program	Estimated Amount in 2001-02 or 2002-03 (\$m)	Proposed Treatment	Reason for Treatment
<i>Social Security and Welfare</i>				
Native Title	For expenditure under part 9 of the Native Title Act 1993. Funding is to assist States implement a consistent framework for dealing with native title issues and meeting native title compensation costs.	11.000	Deferred	Payments have not yet been made under this program. In its 2001 Update Report, the Commission decided to defer a decision on the treatment of this payment until State agreements have been reached and payments made.
Transition to Independent Living Allowance*	Provides a one-off payment for young people leaving supported care, to defray up-front costs associated with setting themselves up in independent living arrangements.	0.897	Exclusion	Out of Scope. This is a Commonwealth function.

* Payments that commence in 2002-03. All other payments commence in 2001-02.

Table 2-3 NEW RECURRENT SPECIFIC PURPOSE PAYMENTS IN 2001-02 AND 2002-03, SHOWN IN *FEDERAL FINANCIAL RELATIONS* 2001-02, BUDGET PAPER No. 3 (continued)

Commonwealth Payment	Description of Program	Estimated Amount in 2001-02 or 2002-03 (\$m)	Proposed Treatment	Reason for Treatment
<i>Agriculture, Forestry and Fishing</i>				
Skilling farmers for the future	A new program to integrate and enhance the existing FarmBis and Property Management Planning Programs and incorporate the wild catch fishing industry. It will facilitate farmer self reliance and promote a positive approach to change and a culture of continuous improvement by providing financial assistance to improve skills in business and resource management. Exclusion was applied to the previous programs because they were financed by National Heritage grants which were quarantined by the terms of reference. This program is not financed by National Heritage grants.	15.913	Inclusion	Similar to services provided by States under extension schemes.
Roads to Recovery – Unincorporated Areas	The roads to recovery program provides funding for roads in rural, regional and metropolitan areas. The focus of the program is the renewal of local roads as an essential element of Australia’s social and economic infrastructure.	2.000	Exclusion	Quarantined by the Terms of Reference. (The SPP will be excluded. The expenditure financed by the SPP will be excluded from the Roads category.)

Table 2-4 NEW CAPITAL SPECIFIC PURPOSE PAYMENTS IN 2001-02 AND 2002-03, SHOWN IN *FEDERAL FINANCIAL RELATIONS 2001-02* BUDGET PAPER No. 3 ^(a)

Commonwealth Payment	Description of Program	Estimated Amount paid in 2001-02 or 2002-03(\$m)	Proposed Treatment	Reason for Treatment
<i>Housing and Community Amenities</i>				
Additional \$7000 First Home Owners' Scheme	The Commonwealth is funding an additional \$7000 First Home Owners Scheme grant for all eligible first home owners contracting between 9 March and 31 December 2001 to buy or build a new home.	90.000	Exclusion	The additional subsidy is a Commonwealth initiative. The States are acting as agents for the Commonwealth.
<i>Fuel and Energy</i>				
Photovoltaic Rebate Programme (PVRP)	To provide rebates to householders and community groups who install photovoltaic equipment to make electricity from sunlight for domestic use.	8.656	Exclusion	The payment is outside the scope of the Commission's assessments.

(a) Both payments relate to 2001-02.

CHAPTER 3

COMMISSION'S TREATMENT OF THE INTERGOVERNMENTAL AGREEMENT ON THE REFORM OF COMMONWEALTH - STATE FINANCIAL RELATIONS

1. The Terms of Reference ask us to provide two sets of per capita relativities:
 - (i) FAG per capita relativities — which could be used to distribute a combined pool of FAGs and health care grants; and
 - (ii) GST per capita relativities — which would be used to distribute a combined pool of GST revenue grants and health care grants.

2. The GST arrangements came into effect in 2000-01, the last year of assessment period for the 2002 Update. This has implications for the processes by which the Commission obtains the data required for its assessments in those categories that are influenced by the new tax arrangements. In those categories:
 - (i) the financial information reported by the States for all five years of the 2001 Update assessment period (1995-96 to 1999-2000) related to a FAG environment — thus the standards used to derive the FAG relativities were based on reported data for all five years¹ and the Commission estimated the standards for the GST relativities for all five years by backcasting the effects of the new tax arrangements using IGA estimates obtained from the Commonwealth;
 - (ii) in the 2002 Update, the financial information for the four years 1996-97 to 1999-2000 relates to a FAG environment and that for 2000-01 relates to a GST environment. Consequently:
 - standards used to derive the FAG relativities will be based on reported data for four years and IGA estimates obtained from the Commonwealth will be used to exclude the effects of the new tax arrangements from the figures for 2000-01; and
 - standards used to derive the GST relativities will be based on IGA estimates for four years and data reported by the States for 2000-01.

¹ Except that the unavailability of detailed expenditure data for 1999-2000 meant that much of the expenditure detail had to be estimated. Those estimates were reflected the pre-GST arrangements.

3. There are three issues to consider for the 2002 Update:
 - (i) how to estimate data required to calculate FAG category standards for 2000-01;
 - (ii) how to estimate data required to calculate GST category standards for 1996-97 to 1999-2000; and
 - (iii) whether the 2001 Update estimates of GST revenue used in the calculation of GST per capita relativities should be changed.

How to Estimate Data Required to Calculate FAG Category Standards

4. For the 2002 Update, the Commission intends to calculate:
 - FAG category standards for 1996-97 to 1999-2000 by using State reported financial data (as we did for the 2000 and 2001 Updates); and
 - FAG category standards for 2000-01 by backcasting IGA estimates.
5. Table 3-1 lists:
 - the FAG-related data that we need to estimate for 2000-01; and
 - the methods we propose to use to estimate the data (these are based on the agreed IGA procedures).

Table 3-1 2002 UPDATE — PROPOSED METHOD OF ESTIMATING
FAG-RELATED DATA FOR 2000-01^(a)

Change	Missing Data and Proposed Method of Estimation	How the Data Will Be Used
Replacing FAGs with GST revenue grants	Revenue which would have been paid as FAGs in 2000-01. Use the IGA estimate of 2000-01 FAGs.	To estimate the FAG pool for 2000-01.
Reductions in Gambling Taxation	Revenue which would have been raised from gambling in 2000-01. Use the IGA estimate of revenue foregone in 2000-01.	The estimated amount will be added to reported gambling taxation revenue to give the FAG standard for 'Gambling Taxation'.
Abolition of Revenue Replacement Payments	Revenue which would have been paid to States as RRP in 2000-01. Use the IGA estimate of revenue foregone in 2000-01. Revenue which would have been paid by States as off-road diesel subsidies. Use the IGA estimate of off-road diesel subsidies in 2000-01.	The estimated amount of RRP which would have been paid to the States will be the FAG standard for each RRP category. The estimated amount of off-road diesel subsidies that would have been paid will be excluded from the FAG standard for the RRP - Petroleum category.
Abolition of accommodation taxes	Revenue which would have been raised from accommodation taxes. Use the IGA estimate of revenue foregone in 2000-01.	The estimated amount will be included in the FAG standard for the 'Other Taxes' category.
Abolition of Wholesales Sales Tax equivalent regime	Revenue which would have been raised had the WST tax equivalent regimes not been abolished. Use the IGA estimate of revenue foregone in 2000-01.	The estimated amount will be included in the FAG standard for the 'Contributions from Trading Enterprises' category.

(a) Since Financial Institutions Duty and Stamp Duty on On-market Shares were not abolished until 1 July 2001, actual revenues are available for 2000-01. They will need to be estimated in the 2003 Update when 2001-02 becomes part of the assessment period.

How to Estimate Data Required to Calculate GST Category Standards

6. For the 2002 Update, the Commission intends to calculate:
 - GST category standards for 1996-97 to 1999-2000 by backcasting IGA estimates (as we did for the 2000 and 2001 Updates); and
 - GST category standards for 2000-01 by using State reported financial data.
7. Table 3-2 lists:
 - the GST-related data that were estimated in the 2001 Update; and
 - the methods used to estimate the data, which were the methods agreed by the Heads of Treasuries as part of the IGA process.
8. The same methods will be used in the 2002 Update.

Table 3-2 2001 UPDATE GST RELATIVITIES — METHODS OF ESTIMATING THE 1999-2000 EFFECTS OF GST ARRANGEMENTS

Change	Method
Replacing FAGs with GST revenue	Trend the 2000-01 IGA estimate of GST revenue using the rate of growth of FAGs.
Abolition of Financial Transaction Taxes	Actual revenue collections removed.
Abolition of Stamp Duty on quoted transfers of Shares and Marketable Securities	The standards were calculated by subtracting the IGA estimated revenue from on-market transfers of shares and securities duty from the Stamp Duties on Shares and Marketable Securities category.
Reductions in the level of Gambling Taxation	The category standard was reduced following discussions with the States. The reduction was calculated as one eleventh of gambling expenditure (data obtained from Gambling Statistics). The 1998-99 estimate of revenue foregone was increased by the growth in revenue collections in 1999-2000, because gambling expenditure data were not available.
Abolition of Revenue Replacement Payments	Standard set to zero
Abolition of Accommodation Taxes	Actual revenue collections removed.
Abolition of Wholesale Sales Tax equivalent regime	Revenue was estimated as one third of the IGA estimate of \$338 million. ^(a)
Introduction of First Home Owners' Scheme	Standard expenditure estimated by multiplying ABS numbers of First Home Owners by \$7000.
GST Administration Costs	Standard expenditure was estimated as half the IGA estimate deflated by growth in GST revenue grants. ^(b)
Subsidies – Petroleum Products	Subsidy data provided by States.
Subsidies – Alcohol Products	Subsidy data provided by States.

(a) One third because the IGA estimate was spread equally over three years beginning in 2000-01.

(b) Half because the 2000-01 estimate relates to two years of costs.

Whether the 2001 Update Estimates of GST Revenue Should Be Changed

9. In calculating the GST relativities for the 2001 Update, the Commission also estimated the GST revenue that might have been collected in the years preceding 2000-01. These estimates were calculated by trending the then latest IGA estimate of GST revenue for 2000-01 (\$26.3 billion) back into the assessment years, assuming it had grown at the same rate as FAGs. Table 3-3 shows the 2001 Update estimates of GST revenue.

Table 3-3 GST REVENUE ESTIMATES, 2001 UPDATE

	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000
	\$b	\$b	\$b	\$b	\$b	\$b
2001 Update Data	20.560	21.714	22.462	23.270	24.419	25.174

10. For the 2002 Update, actual GST collections for 2000-01 will be available. The estimated GST revenue collected in 2000-01 shown in Budget Paper No 3 is \$24.1 billion. This is less than our estimated 1999-2000 GST revenue (\$25.1 billion). It is also less than the IGA estimate for 2000-01 that was used in the trending process (\$26.3 billion). One reason for the low Budget Paper estimate is that it is a cash rather than an accrual estimate, and relates to collections for only part of the 2000-01 year. The Budget Paper cash estimate for 2001-02 is \$27.5 billion and this is based on collections for twelve months.

11. GST revenue estimates should reflect a full year of revenue collections, because the 2002 Update relativities will be applied to a pool that contains a full year of GST revenue collections. We propose to calculate GST revenue estimates for each assessment year by deflating the 2001-02 figure of \$27.5 billion, or any more recent estimate of that figure that becomes available from agreed IGA estimates.

12. Table 3-4 shows the GST revenue estimates produced when we deflate the 2001-02 Budget Paper estimate (\$27.5 billion). It also shows the differences between these estimates and those used in the 2001 Update are likely to be small.

Table 3-4 GST REVENUE ESTIMATES, ALTERNATIVE METHODS

	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-01
	\$b	\$b	\$b	\$b	\$b	\$b
2001 Update Data	21.714	22.462	23.270	24.419	25.174	26.303
Estimates based on trending the 2001-02 Budget Paper Estimate	21.890	22.644	23.459	24.617	25.379	26.443
Difference	0.176	0.182	0.189	0.198	0.205	0.140

CHAPTER 4

OTHER MATTERS

1. This Chapter covers assessment matters where changes are required because of changes in data availability, or to correct errors, as allowed under the Update guidelines.

Revenue Replacement Payments Paid in 2000-01

2. Under the IGA, revenue replacement payments ceased to be payable on 30 June 2000. However, due to lag conditions, a small payment was made in 2000-01. This payment related to collections raised in 1999-2000.

3. In calculating the FAG relativities for 2000-01, the actual revenue will be replaced by a notional full year payment. In calculating the GST relativities, revenue replacement payments will be omitted in all assessment years.

Non-government School Cost Factor

4. The cost factors in the Non-government Schools assessments in the 2001 Update were based on the Education Resources Index (ERI) because most States based their subsidies to non-government schools on that index. It has been used to distribute Commonwealth funding to non-government schools for many years. In the 1999 Review, the Commission said that if the Commonwealth changed the method of distributing recurrent grants to non-government schools, it would need to consider amending the cost factors, especially if the States also changed their methods.

5. In its 1999 Budget, the Commonwealth announced that the method of funding for non-government schools would change in the quadrennium 2001 to 2004. The ERI has been replaced by an index based on the relative socio-economic status (SES) of each school community. Schools due to receive increased funding under the SES model are having the increases phased in over four years. Schools due to receive less have been guaranteed at least the amount they previously received under the ERI.

6. In the 2001 Update, the Commission decided to continue to base the non-government schools cost factors on the ERI. This was because it was used by the Commonwealth, and most States, to distribute payments to schools in the 2000 calendar year and because Commonwealth grants to the States for non-government schools would

not be greatly effected in 2001-02 (the year in which the 2001 Update relativities applied) as a result of the phasing arrangements.

7. The Commission intends to continue with factors based on the ERI method for the 2002 Update because:

- the Commonwealth's phasing-in of the SES arrangements will mean limited changes in 2000-01 to non-government school grants;
- many States are continuing to use the ERI, or similar, method to distribute their own grants to non-government schools; and
- these arrangements are transitional as a number of States are reviewing the distribution methods they will adopt in the future.

8. For practical reasons, the Commission will use the factor calculated for 1999-2000 for 2000-01 as student data for all States are no longer available at the ERI level.

9. The Commission will continue to monitor State methods of distributing funds to see whether a change in method is appropriate for the 2003 Update.

Primary Health Care Access Program

10. The Commonwealth, through its Office of Aboriginal and Torres Strait Islander Health, makes a number of payments to States and other bodies for primary health care for Indigenous people. In the 1999 Review, the Commission considered that those payments were comparable to SPPs and decided to treat them by inclusion because:

- (i) Indigenous health is an area of State responsibility and the States incur expenditures on the provision of services; and
- (ii) the Commission was able to directly assess the differential use and cost of services by remote Indigenous persons.

11. The 1998-99 Commonwealth budget introduced the Primary Health Care Access Program (PHCAP) to improve the access of Indigenous people to primary health care services. The expenditure was partly in lieu of MBS funds. It was based on the funds provided to non-indigenous people through MBS, adjusted for the greater health needs of Indigenous people and the higher costs of providing health services in remote areas.

12. In 1999-2000, PHCAP funding was less than \$5 million, with \$3.3 million for sustaining the Aboriginal Co-ordinated Care Trials and about \$1 million for expanding access to primary health care. The funds for new services are allocated to States and regions that have completed a health planning process. The allocation for PHCAP in 2000-01 was about \$10 million and was increased by \$20 to \$30 million in 2001-02.

13. While we recognise that PHCAP allocations contain funding partly in lieu of MBS, consistent with the previous treatment, we intend to treat the PHCAP allocations, along with the other Commonwealth funds for Indigenous health, by inclusion and to update the socio-demographic composition factor in the Community Health Services category.

ATTACHMENT A

TERMS OF REFERENCE FOR THE 2002 UPDATE

Mr Alan Morris
Chairman
Commonwealth Grants Commission
Cypress Court
5 Torrens Street
CANBERRA ACT 2612

Dear Mr Morris

I am writing to provide you with terms of reference which ask the Commonwealth Grants Commission to update the per capita relativities used to distribute Commonwealth payments to the States and Territories in 2002-03. They are attached.

Yours sincerely

JOHN FAHEY

Terms of Reference for the 2002 update of State Revenue Sharing Relativities

COMMONWEALTH GRANTS COMMISSION ACT 1973

I, John Fahey, Minister for Finance and Administration, pursuant to sections 16, 16A and 16AA of the *Commonwealth Grants Commission Act 1973*, refer for inquiry and report by 22 February 2002 the question of the per capita relativities used to distribute Commonwealth payments to the States, the Northern Territory and the Australian Capital Territory (collectively referred to as the States) in 2002-03. Notwithstanding the above, the Commission should provide the per capita relativities to the Commonwealth and the States by 15 February 2002.

2. The Commission's assessments of per capita relativities should be based on the review period 1996-97 to 2000-01 inclusive. Where possible, the Commission should use the latest available data.

3. The Commission should provide per capita relativities for determining the distribution of:

- (a) a combined pool of GST revenue grants and health care grants; and
- (b) a combined pool of FAGs and health care grants (based on the assumption of a continuation of the Commonwealth-State financial arrangements which applied in 1999-2000).

4. Subject to paragraphs 5 to 9, the Commission's assessments should be based on the application of the same:

- (a) principles;
- (b) items of revenue and government services;
- (c) methods of assessment of those items;
- (d) range and methods of measuring revenue and expenditure disabilities; and
- (e) range and methods of treatment of Commonwealth revenue payments

that the Commission used to calculate the per capita relativities in its *2001 Update*.

5. The Commission's assessments should take into account the IGA which was signed by Heads of Government in June 1999.

6. Where it is necessary to accommodate later budget developments, the Commission's assessments should be based on the principles, methods of measuring revenue and expenditure disabilities, and methods of treating Commonwealth revenue payments that conform to those applied in similar circumstances in the *2001 Update*.

7. The Commission should prepare its assessments on a basis consistent with the Commonwealth's intention that the per capita relativities should not be affected by the following specific purpose payments to the States:

- (a) the *FBT Transitional Grants for Hospitals* program;
- (b) the *Roads to Recovery* program; and
- (c) the *Intelligent Island* and *Connecting Tasmanian Schools* programs.

8. A separate assessment should be made of the special fiscal needs of the Australian Capital Territory.
9. The Commission should consult the Commonwealth and the States before deciding on any changes in methods considered appropriate to fulfil its obligations in respect of this terms of reference.
10. To the extent possible, the Commission should, upon reporting, provide all parties with details underpinning its calculations and assessments, and endeavour to meet requests for supplementary calculations.

JOHN FAHEY