



COMMONWEALTH GRANTS COMMISSION

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DEVELOPMENT OF THE STANDARD BUDGET

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1. The standard budget defines the expenditures and revenues included in the equalisation process. It also classifies them into groups (or categories) of similar activities – an essential first step in the comparisons of State finances the Commission must undertake.

2. The classifications used in the standard budget (which determine the structure of the standard budget) can be derived on the basis of:

- (i) what is best for equalisation – State activities would be classified in a way that best assists the identification and measurement of advantages and disadvantages in providing services and raising revenue; or
- (ii) data availability - the classifications would be developed around the financial data that are available.

3. The scope and structure of the 1999 Review standard budget were based on a comprehensive approach to equalisation which supported the identification of the disabilities faced by the States in providing services.

4. Since the 1999 Review, the Commission has experienced problems in compiling its standard budget. These problems have arisen because of changes in the way States manage and report their finances, and the response of the ABS to those changes.

5. Unless all States and the ABS commit to the collection and presentation of more comprehensive and comparable data, the current comprehensive approach to equalisation can not be sustained. For comprehensive and effective equalisation, the data must cover all the activities of State governments and be accurate, comparable between States and consistent over time¹.

6. There is no alternative to the process by which the Commission receives financial data from the States through the ABS. If a commitment to improved data can not be made by all States and the ABS, the category structure in the standard budget will have to change to reflect the data that will be available. At the extreme, this could mean constructing the 2004 Review standard budget using a broad purpose classification produced by the ABS², such as the Uniform Presentation Framework (UPF) that the Commonwealth and the States have agreed to support.

7. This would be a major change in approach. It would result in changed revenue shares, the magnitude of which could be large, possibly in the order of several hundred million dollars.

¹ It should also contain sufficient detail and descriptive information to facilitate checking.

² Some changes in the structure of the standard budget may be made as a result of investigations conducted during the 2004 Review, including the work on simplification of assessments. However, such changes would reflect deliberate decisions about the merits of alternative approaches to assessments and are unlikely to be as extensive as those that would result from adopting the broad ABS purpose classification.

The 1999 Review

8. During the 1999 Review, the Commission and the States agreed that the Commission would obtain State transaction data from the ABS Government Finance Statistics (GFS) and Government Finance Estimates (GFE) collections and, where necessary, supplement them with data collected from States. The GFS/GFE data were provided at a detailed level and with considerable supporting descriptive information, which allowed the Commission to analyse individual transactions, thereby ensuring similar items were treated consistently in all States.

9. The Commission adopted a category structure that contained about 40 expenditure categories and 20 revenue categories, based largely on the data obtained from the ABS. The Commission considered its classifications better supported the assessment processes than the ABS purpose classification system. For example, the ABS system did not support an Aboriginal Community Services category which redistributed \$90 million among the States, or an Urban Transit category which redistributed \$60 million.

10. ***What has changed since the 1999 Review?*** Since 1999, there have been large changes in the way States manage and report their finances, including:

- (i) the move to accrual reporting;
- (ii) the devolution of data holdings to agencies;
- (iii) reductions in the detail routinely available to State central agencies and the ABS regarding individual transactions; and
- (iv) a change in the timing and accuracy of the ABS GFE data for the most recently completed financial year³.

11. ***Data Problems.*** In introducing the changes, there have been teething issues with the introduction of accrual reporting, changes in the conceptual approach to intra- and inter-sector consolidations, and the tendency for agencies to describe transactions more generally. These have resulted in a deterioration in the accuracy and comparability (both between States and over time) of the data and a reduction in the Commission's ability to support its classifications. For example:

- (i) As part of the move from cash to accrual reporting, the States and ABS seem to have moved from producing data on a net expenditure basis to producing data on a gross expenditure approach. This change increased reported total expenditure by about 45 per cent between 1997-98 (the last year of cash reporting) and 1998-99 (the first year of accrual reporting). This change in the figures does not reflect a change in the real impact of the transactions on State budgets. It would have a

³ The GFE data for the most recently completed financial year are now generally estimates prepared at the time of the State budgets (hence they reflect actual transactions for about nine months of the year and estimates for the other three months) whereas for many States they used to be unaudited end of year outcomes.

large impact on the relativities, if there were no changes to assessed disabilities.

- (ii) Transactions which the Commission has previously classified to specific categories (for example, education) are being classified to general categories (such as General Public Services). This will also affect the relativities because the disabilities assessed in the specific and general categories are quite different.
- (iii) A higher number of transactions are being classified to ‘other’ categories (for example, Other Education not Definable by Level).

12. ***Timeliness Problems.*** The changed timing of the collection of GFE data means that expenditure and revenue data for the most recent year are not available in time for the Commission to include them in its processes. For the 2000 and 2001 Updates, the Commission has responded to these changes by:

- sourcing revenue data to State budgets;
- adopting an ‘estimate and replace’ approach for expenditure data — data for the final year are estimated in one update and replaced by actual data in the following update.

13. This approach affects the relativities. The Commission estimated that the effect of replacing expenditure estimates for 1998-99 with actual data resulted in a redistribution of about \$100 million.

What are the Implications of the Changes?

14. Some of these problems are probably transitional, but the loss of the detail the Commission relied on to verify comparability of the data and to establish some of its categories seems to be permanent. The changed timing of the GFE data also seems to be permanent.

15. In recent Updates, the Commission has adopted approaches to minimise the effects of these developments — for example, the ‘estimate and replace’ approach. It has also used the limited supporting information available and estimation procedures to remove the effects of the change in the basis of reporting from net expenditures to gross expenditures and revenues. However, the Commission has concerns about whether such approaches produce relativities that are sufficiently reliable, and does not think these approaches are sustainable in the longer term.

16. The existing level of detail in the standard budget structure can not be continued unless the States collectively agree to make additional data available. If this is not done, the Commission will need to consider changes in the structure of the standard budget that would reduce the number of categories of expenditure and revenue.

17. The most obvious approach would be to adopt the ABS purpose classification system. In concept, this classification system could classify expenditures and

revenues at three levels of increasing detail (major groups⁴, groups and subgroups). However, the accuracy of financial data is a large problem at the ‘subgroup’ and possibly the ‘group’ levels. Conversely, at the ‘major group’ level, it would not be possible to fully reflect the disabilities that cause the differences between States in the cost of providing services.

18. As an example, Table 1 shows the categories that might be available at each level for education. While the ABS classification system is comprehensive, practical difficulties associated with preparing the expenditure data increase with increases in the level of detail, such that data at the subgroup level are unlikely to be accurate or comparable across States. There is greater confidence in revenue data at the group and subgroup level because they are collected and reported under separate heads of tax.

Table 1 ABS CLASSIFICATION OF EDUCATION EXPENDITURE

Major Group	Group	Subgroup
Education	Primary and Secondary Education	Primary Education
		Secondary Education
		Primary and Secondary Education nec
	Tertiary Education	University Education
		Vocational Education and Training
	Tertiary Education nec	
Pre-school Education and Education Not Definable By Level	Pre-school Education and Education Not Definable By Level	Pre-school Education
		Special Education
		Other Education Not Definable By Level
Transportation of Students	Transportation of Students	Transportation of non-urban Students
		Transportation of Other Students
	Education nec	Education nec

19. If confidence in the data provided by existing processes were the sole criterion for deciding the category structure, the structure in Table 2 is what could arise (on the expenditure side this structure is essentially the UPF). The number of expenditure categories would reduce to 15 and the number of revenue categories to 12.

⁴ The major group level is the basis of the Uniform Presentation Framework that the Commonwealth and States have agreed to support.

Table 2 CATEGORY STRUCTURE DECIDED SOLELY ON DATA QUALITY

Expenditure Categories	Revenue Categories
General Public Services	Payroll Taxes
Public Order and Safety	Land Taxes
Education	Financial Institutions Transaction Taxes
Health	Stamp Duties on Shares and Marketable Securities
Social Security and Welfare	Taxes on Gambling
Housing and Community Amenities	Taxes on Insurance
Recreation and Culture	Heavy Vehicle Registration Fees and Taxes
Fuel and Energy	Other Vehicle Registration Fees and Taxes
Agriculture, Forestry, Fishing and Hunting	Stamp Duty on Vehicle Registration
Mining, Manufacturing and Construction	Other Taxes
Transport and Communications	Interest Earnings
Other Economic Affairs	Royalty Income
Public Debt Transactions	
Superannuation ^(a)	
Other Purposes	

(a) Although there is not a separate major group for Superannuation, it is supported by the ABS classification system.

20. Such a highly aggregated approach to expenditure categories would affect the type of equalisation that could be achieved. Under this approach there would be:

- (i) one education category, which would combine the existing pre-school education, primary and secondary government education, primary and secondary non-government education, vocational education and training, higher education and transport of rural school children categories;
- (ii) one health category, which would combine the existing hospitals, nursing homes, mental health, community health and public health categories;
- (iii) one public order and safety category, which would combine the existing police, administration of justice, corrective services and public safety categories;
- (iv) one transport and communications category, which would combine the existing roads, urban transport, concessions for non-urban passenger transport and concessions for freight transport categories;
- (v) no Concessions categories; and
- (vi) no Aboriginal Community Services category.

21. Adoption of a category structure like that outlined in Table 2 would make it necessary to change existing assessment methods to use broader measures of disabilities. This would lead to potentially large changes in revenue shares.

22. Experience indicates that the variety of services in some of the 'major groups' are affected by quite different disabilities (for example, the demand for school services is very different from that for VET), which is why the standard budget structure has been more detailed than the major groups. Equalisation would be better served if the structure of the standard budget for the 2004 Review continued to be more detailed than the ABS 'major group' level. However, doing so will require the support of all States in providing the data required.

23. Under any approach based on ABS classifications, all States will have to provide separate data to support 'special' categories (such as Urban Transit and Aboriginal Community Services).

24. ***Timeliness of Data.*** Unless there are changes in data collection procedures, it is most unlikely that actual data for the most recently completed financial year will be available in time for it to be included in the calculations for the 2004 Review and subsequent updates. In the absence of these data, the parties should consider whether:

- (i) a continuation of the 'estimate and replace' approach is acceptable; or
- (ii) it would be better to omit the most recently completed financial year from the assessments.

25. Omitting the most recently completed financial year would mean the relativities would be more out-of-date, but they would be based on more accurate data.

Where to From Here?

26. The Commission asks Heads of Treasuries to note its concern that changes in data availability since the 1999 Review appear likely to require it to review and revise the structure of the standard budget. It seeks guidance from Heads of Treasuries on whether:

- they accept that, in the future, the standard budget and its construction will be determined by data availability, with consequent reductions in the extent to which disabilities reflect the drivers of State expenditure and the implications for equalisation that implies; or
- they would be willing to improve data comparability, consistency and timeliness, so that the Commission could use ABS data below the 'major group' level.

27. It is recommended that a working group be established to consider how the data required to support the standard budget could be best obtained. Any such working group should include officers from the Commission, State Treasuries (including officers from the intergovernmental areas and the area responsible for managing and reporting State finance data to the ABS) and the ABS.