

SOUTH AUSTRALIAN COMMENTS ON DISAGGREGATING EXPENSES AND REVENUE (ISSUES PAPERS CGC 2006/06 AND 2006/07)

Introduction

South Australia provides the following comments on the proposals for aggregating assessments for the 2010 Review put forward in CGC Discussion Papers 2006/06 and 2006/07 and discussed at the staff level conference on 7 September 2006.

As noted at the conference, South Australia continues to stress that the guiding principle for the Commission's assessments remains horizontal fiscal equalisation. As such, while supportive of the Commission's efforts to explore simplification of its assessments, we expect it to continue to give priority to achieving its overriding objective of equalisation to the greatest extent possible.

Consistent with the detailed argument in our April submission on disaggregation and our August submission on sociodemographic composition disabilities, we remain of the view that the materiality thresholds are misguided. If they are to be deployed, we maintain that a \$10 per capita distribution threshold for each disability characteristic is too high.

Materiality thresholds should certainly be no higher than \$3 per capita for either disability characteristics or minor adjustments. If \$3 per capita is material for the purposes of minor adjustments, then it would be reasonable to expect that the same applies for the difference between a proposed disability factor and an EPC assessment.

EXPENSES

Education

- We accept the two-category framework for the assessment of schools education and tertiary education outlined at the conference, as recorded in the minutes for that meeting.
- We are also supportive of classifying student transport expenses in Education. SA can identify these expenses.
- We note that, when the assessment approach is considered in detail, any proposal to use eligible population rather than enrolments will need to take into account a resemblance to 'community equalisation'. In this regard, the relative size of State expenditures on government and non-government education will be of importance.

Health, welfare, housing and community amenities

- In accordance with the outcome of the September conference, we are open to consideration of one health category in place of the two categories (admitted patients; and community, public and non-admitted services) proposed in the Discussion Paper.
 - However, it is essential that the health assessments, however categorised, continue to recognise the differential impact of age on State costs – 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. The differing age structures in the States are of material impact on health costs and must continue to be assessed.
- While supporting consideration of a single category, the question is why abandon the present method for inpatient (admitted) services, which is acknowledged as having good data and is arguably the best current expenditure assessment. We note the Commission staff are now suggesting the possible use of a multifactor resource allocation based model (such as that employed by NSW), which is unlikely to be any less complex than the existing AIHW based model.
 - We agree with the Commission's assertions (para. 67) that reliable data on the use and cost of providing admitted patient services are available, that the present inpatient assessment is data intensive but is reliable, and that it appears that a better way forward would be to examine how the present assessment of disabilities could be simplified.
 - In particular, as previously discussed in Data Working Party processes, it appears that a reduction in the cross-tabulations of data can be achieved without material impact on the assessments.
- In relation to community, public and non-admitted services, demand factors may be similar to the admitted patients category, but these are greatly compounded by cost of treatment factors related to age (in an exponential fashion with increased age, as noted above regarding hospital services). This cost effect may not be as strongly present for non-admitted services. In addition, other factors may be more relevant to the community, public and non-admitted services category eg lack of Commonwealth-funded GP services in rural and remote areas. (Note that we do not consider the number of GPs in urban areas as impacting on State needs.)
- With respect to the proposed Welfare, Housing and Community Amenities category, the Commission must not ignore that the costs associated with the **supply of water** are both material (approximately \$70 per capita in 2004-05)

and impacted upon by significantly different factors to those affecting welfare and housing services.

- This would seem to indicate that a separate category is needed. We note that expense data are easily identified (at the 3-digit level classifications of Water Supply and Sanitation, and Environment Protection).
- We note also that the welfare assessment needs to take account of the fact that States spend far more on services for the aged and disabled than for any other population segment (\$230 per capita in 2004-05 on aged and disabled welfare services compared to \$90 per capita on family and child welfare and \$84 per capita on homeless and other welfare). We have no preference as to whether this means a separate assessment is required or that a suitable weight can be employed within the combined welfare category.

Law and order

- We remain supportive of two categories (Justice, and Public Safety and Emergency Management) as we are not convinced that it can fairly be said that the same factors (in particular young males and indigenous persons) affect all costs included. It seems to us that these factors would be overstated if applied to public safety and emergency management services, which are clearly provided for all citizens.
 - The 2004-05 standard for the Public Safety category is \$82 per capita and hence is material. The dissection of police expenses into two categories of Justice and Public Safety is not considered difficult – for SA, the split approximates 40:60, mirroring the Australia-wide split reported in the ROGS data. We note that there should be no suggestion, as was indicated at the September conference, that it would be necessary to obtain splits of police officers' time. Rather, we understand that all States should hold data split by relevant branch or operating units. In any event, any lack of precision in the split of the two categories will be less of a problem than the alternative of applying factors wrongly to total Police expenditures.
 - If Police expenses are not allocated, we would advocate that at least the fire protection and other public safety expenses should be assessed separately.
 - In assessing the Justice category, the Commission must recognise that a broad indicator, such as the proportion of young males and Indigenous persons, will not accurately reflect the differing intensity of use within those broad groups due to sociodemographic or location related influences.

Transport

- This group seems to pose the most assessment difficulties. Nevertheless, we support further investigation of the one category option, given the continuing conceptual and data problems of the current separate assessments of roads and urban transit.
 - The broad indicators discussed at the September conference, including density, populations eligible for concessions and freight task, are worthy of further investigation.
 - Separate comments will be provided on the issues raised at the Roads working party meeting of 8 September.

Services to industry

- It is essential that the actual State practice of spending more on services to agriculture than other industries is recognised in the assessments. The use of one category for services to industry ignores the fact that States spend far more on services to agriculture than other industries.
 - For 2004-05, States on average spent \$101 per capita on services to primary industries, \$16 per capita on mining, \$23 per capita on tourism and \$11 per capita on manufacturing industry. 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.
 - We note that the effect of the current assessment for Primary Industries is certainly material.
 - We acknowledge the criticism of the numbers of agricultural establishments data presently used in the assessment. While we think conceptually it is desirable to allow for the numbers of establishments as well as the value of their output (reflecting the demand for services by individual enterprises), all broad indicators of the extent of primary industries in the States are worth examination. At the September conference, we suggested factor income and value of agricultural production as possible measures in addition to the establishments data.
- The Western Australian suggestion for combining services to industry with economic and environmental services is not supported for the same reasons – unless recognition is made within such an aggregated category for the higher spend on agricultural support.

Other services

- An EPC assessment for such a large range of services ignores disabilities currently assessed for the culture, national parks and natural disasters categories. We continue to have reservations about the size of the materiality thresholds posited by the Commission.
- Debt charges (net) should be considered as a separate category from the functional areas in this grouping.

REVENUE ASSESSMENTS

- We first note that it is generally recognised that the complexity problems encountered in the Commission's assessments are almost wholly on the expenditure side. The revenue assessments are already very limited in number, in contrast to the expenditure assessments – there are presently just 11 taxation categories and two other revenue categories. As we have said before, it follows that major surgery is not justified in terms of disaggregation of the present revenue structure – we acknowledge that some minor changes could be made, such as aggregating the various motor vehicle categories, while it is likely that assessments of both financial transaction taxes and stamp duty on shares will no longer be needed by the time of the 2010 Review.
- One of the pillars of equalisation is that the assessments reflect what States do. Any global measure of revenue capacity falls foul of this pillar, and subglobal measures may also – their use needs to be closely evaluated on a case by case basis.
 - Global and subglobal revenue indicators measure a tax base that in theory could/should be accessed by the States, rather than the base that is actually used by them. Such methods are moving away from the ideal of reflecting what States actually do and focusing on what States could do. They would in effect provide a measure of capacity to raise revenue from a tax base that bears little resemblance to the one actually used by the States.
 - To properly reflect what States actually do, we remain of the view that it is best to use as capacity measures the base actually taxed – anything else is second-best. We accept though that in some instances subglobal measures provide a reasonable proxy.
 - We don't accept, as the CGC discussion paper does, that there are incentive effects from the present assessments and that sub-global measures 'would be an economically more efficient base'.
- Hence we oppose the one category option put up by the Commission. We note that no State supported this option at the September conference. In addition to

the in-principle objections above, we observe that the use of econometrics obscures and complicates the assessments rather than simplifying them.

- As indicated in previous submissions and at the conference, our biggest objection to the five-category option, using broad subglobal base measures, is the absence of allowances for the **value distribution of transactions** (including thresholds).
 - One crucial aspect of the present tax-by-tax assessments is the recognition given that it is not only the total size of revenue base which differs across States and leads to differences in capacity to raise revenue from a tax. These differences also reflect the distribution of the tax base – differences in value distributions in the presence of progressive tax structures (which all States typically apply) are a very important element of need for the smaller States.
 - Any method which removes this element of difference from the assessments is therefore only partially achieving equalisation.
 - This is readily illustrated by a simple example of two States with exactly the same total revenue base (however measured). In the presence of universally applied progressive tax rates, one State which has more of its total base skewed to the higher value end will have a marked revenue-raising advantage compared to the other State with greater lower valued components. Unless this is recognised in the assessments, equalisation will obviously not be achieved.
 - The Commission asks if broader indicators of capacity adequately and reliably capture the main differences between States in their capacity to raise revenue or if they are inconsistent with the equalisation principle. We suggest that omitting the value distribution element makes the conceptual case that broad indicators do not measure up.
 - We see tax-free thresholds as a sub-category of progressive rate structures, albeit involving a lesser degree of progressivity than is the case for land tax and conveyance duty. Nevertheless, to fully achieve equalisation and to reflect what States actually do, thresholds should also continue to be allowed for by the Commission.
- We now turn to the broad measures proposed for the five or six revenue categories option.

Payroll tax

- Private sector compensation of employees data or wages and salaries data are acknowledged as good proxies of what States actually tax, and are thus worthy of further examination.
- Allowance should continue to be made for a tax-free threshold.

Mining revenue

- We are open to an examination of alternatives, including total factor income and total profitability of the mining sector, along the lines described in the Discussion Paper. A key determinant will be the reliability of data.

Land revenue

- SA continues to support the use of the actual tax base (ie value of land) as the revenue base – because of the progressive tax rates imposed by all States and the material effect involved, it will also be necessary to take account of the effect of differential value distributions.
 - The present processes for reporting and verifying land value data are supported.
 - It is feasible to provide data on residential land values other than principal place of residence (SA provides such data presently).

Transactions taxes

- We do not see it as practical to derive a meaningful subglobal measure of this aggregated category and we therefore favour a separate assessment of conveyances, insurance and motor vehicle taxes.
- As with land tax, we support the use of the actual tax base (ie the value of conveyance transfers) for the conveyances assessment, again with account taken of the effect of differential value distributions because of the progressive tax rates imposed by all States.
- For insurance taxes, we favour the use as now of insurance premiums for general, life and compulsory third party insurance.
- There may be a case for combining the three motor vehicle taxes (heavy vehicle registrations, light vehicle registrations and stamp duty on registrations and transfers) provided a suitable base can be identified. The CGC suggests that gross stock of vehicles be explored as a base measure. To correctly identify the base for duty on motor vehicle transfers, the numbers of vehicle sales/transfers (or at least the change in vehicles on register) are required.

Miscellaneous revenues

- We support a continued differential assessment of gambling taxes, which are significant taxes for all States. We acknowledge the past debate about a suitable base and do not resile from our oft-stated contention that actual gambling spend is the best measure (with an easily calculated adjustment for the Western Australian policy of no poker machines).
 - However, if this is not considered suitable, we would support the use of a broader expenditure indicator such as Recreation and Culture expenditure

from the National Accounts as this is obviously further removed from any possible State policy influence. We consider this measure to be a superior measure to Gross Household Disposable Income as it makes some allowance for differences in expenditure patterns, the crucial element missing from the GHDI base.

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