

# **SOUTH AUSTRALIAN SUBMISSION TO THE COMMONWEALTH GRANTS COMMISSION ON APPROACH TO DISAGGREGATION (ISSUES PAPER CGC 2006/02)**

## ***Introduction***

South Australia welcomes the opportunity to provide comments to the Commission on its general approach to disaggregation of assessments for the 2010 Review. In Issues Paper 2006/02, the Commission has asked for comments on particular issues, and these are addressed in turn below.

South Australia notes 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.

Further we note that whether achieved by a 'tops down' or 'bottoms up' approach, a reduction in the number of expenditure or revenue categories in itself achieves little in terms of greater simplicity and runs the risk of reduced reliability.

## ***Disaggregation in context***

States may wish to comment on the Commission's intentions to:

- continue to adopt a category approach to its assessments;
- construct expense categories on a functional or purpose basis using the ABS GFS collection as the prime data source; and
- construct revenue categories on a tax type basis using data collected direct from the States.

(CGC 2006/02 para 22)

## **SA Comments**

South Australia agrees that a category approach to assessments, based on State functions and tax types, should be continued. This approach has the advantage of reflecting what States actually do in both the provision of services and the collection of revenues, and as such should be more transparent, simpler and easier to understand than the alternatives suggested in the Issues Paper.

We also agree that the Commission should continue to use the ABS GFS data, supplemented by State data for the most recent assessment year, and State revenue data as its prime data sources for the standard budget. In both instances

the States are already required to compile the data for their own purposes and there is reasonable consistency between the States in functional classification of both expenses and revenues.

### ***How disaggregation might work in practice***

States may wish to comment on:

- the general approach the Commission envisages to follow in considering the appropriate category structure; and
- the proposed \$30 per capita threshold for determining when a disaggregated assessment is materially different from the more aggregated one.

(CGC 2006/02 para 38)

### **SA Comments**

South Australia considers that the general approach outlined in the Issues Paper, to start at the broad category level and then consider the case for assessments at each subsequent level of disaggregation below that level, is acceptable.

The proposed \$50 per capita average revenue or expense threshold is also a reasonable guide as to whether or not a category should be disaggregated but, as we have said before, it should not be used as the sole justification to eliminate or exclude a category for which disabilities can be both simply and reliably assessed. Small expenditure categories such as the First Home Owners Scheme, which warrant an actual per capita assessment because policy is strictly uniform across States, is the best example of the point being made.

However, the proposed \$30 per capita threshold for determining whether a disaggregated assessment is 'materially different' from the more aggregated one is quite a different matter. It is far too large and has the potential to seriously compromise the equalisation process by arbitrarily excluding potential assessments that redistribute a significant amount.

Further, it does not appear to aid simplification to apply a two-step process of first doing assessments for a number of categories on a 'fit for purpose' basis, and then moving to an assessment of categories on a more aggregated basis if the outcome is not 'really' wrong. In effect, this amounts to a 'bottoms up' approach and leads to an increase in the assessment work rather than a simplification.

To put the size of this proposed threshold in context, \$30 per capita represents over \$200 million for NSW and over \$45 million for South Australia.

We understand the Commission's intention is to reduce the number of expenditure assessments, but it must be very careful to ensure that it does not achieve perceived simplicity at the expense of justified equalisation of material differences in States' ability to provide services.

If the Commission is intent on a two-step process and applying a distribution per capita threshold we suggest \$5 per capita would be appropriate.

### **Expense assessments**

The Commission would welcome preliminary views from States on:

- the logic of its proposed approach to disaggregation;
- the proposal to commence the disaggregation of expenses with the four blocks of education, health, law and order and other services; and
- potential disaggregations of each block, together with a rationale for those suggestions.

(CGC 2006/02 para 57)

### **SA Comments**

South Australia considers that there is merit in beginning the approach to disaggregation with the major blocks of GFS expenditure, say at the 2 digit level, and then exploring below to assess whether there is merit in developing an assessment at the 3, or even 4, digit level.

We think the approach should be aimed primarily at achieving accurate assessments, ensuring that disabilities faced by States in providing services continue to be recognised. Any trade-off with ease of calculation should only be made if there is no significant omission of legitimate disabilities.

To this end, we do not agree with the Commission's assertion that there is "no unifying theme" to the grouping of GFS expenditures that fall outside the three main (2 digit) classifications of Health, Education and Public Order and Safety. Within this group of 'other' expenditures there are a number of 2 digit GPC classifications that align closely with the service delivery responsibilities of distinct State Government Departments (which would be similar across jurisdictions) and for which there are significant disabilities currently recognised. For example:

- Social Security and Welfare (Dept of Families and Communities)
- Agriculture, Forestry, Fishing & Hunting (Dept of Primary Industries)
- Transport (Dept of Transport)
- Culture and Recreation (Dept of Environment and Heritage)

and, separate to the 2 digit classifications already identified, the 3 digit classifications of:

- Water Supply, Sanitation and Protection of the Environment

- Housing.

In order to make a proper assessment of States' needs, we consider that the Commission must, at the very least, start with the major 2 digit groupings identified above, plus the 3 digit groupings of Water Supply, Sanitation and Protection of the Environment and Housing, as these groupings broadly reflect the grouping of expenditure responsibilities by States in their delivery of services.

In addition, we note that for all these categories, significant needs are currently assessed for some States. The categorisation adopted for the 2010 Review must continue to recognise these needs.

While it is difficult to make more detailed comments on the potential disaggregation from the broad category groupings without yet knowing the approach the Commission is likely to take to the assessment of disabilities in the aggregated assessments, we offer some broad ideas on what the disaggregated expenditure assessment should look like.

#### *Education*

In line with the argument posed in the Issues Paper, it may be possible to start with the broad notion that education can be split between compulsory (pre-school, primary and secondary) and non-compulsory (university and VET) education.

It could then be investigated whether there is a material difference between the broad assessment of compulsory education and the sub-groups of pre-school, primary and secondary, government and non-government, or transport of rural school children. The same comparison would also need to be made between the broad non-compulsory education category and a separation into VET and universities.

#### *Health*

The Commission's health assessments are already at a considerably high level of aggregation, and represent the three broadly distinct categories of health services that State Governments are required to provide – those of inpatient services, non-inpatient and community health services, and population and preventative health services. These existing three health categories should form the basis of the Commission's disaggregated health assessment.

In determining appropriate factors for the calculation of health disabilities, the Commission must also be wary that it does not sacrifice accuracy in its assessments by moving away from the relatively reliable, but data intensive, cost weighted National Hospital Morbidity and Census Data to broader, more simplistic measures of demand and cost drivers.

### *Public Order and Safety*

As with the health assessments, it could be considered that the Commission's current disaggregation of public order and safety expenditures broadly matches the delineation of service providers in the States into the areas of police services, administration of justice, corrections and other emergency services. In accordance with the framework set out above, in particular the significant needs currently assessed, these existing categories should form the starting point for the Commission's disaggregated assessments.

### *Social Security and Welfare/Housing*

The 2 digit GFS classification of Social Security and Welfare accounts for over 7% of standard budget expenditure in 2004-05 and is sufficiently large, at around \$400 per capita, to justify its own 'expenditure group' within the Commission's aggregated assessment structure.

In further disaggregating the category, the Commission could distinguish between the provision of welfare services to the distinct groupings of children and families, aged persons and the disabled. It could also include the welfare housing function, which is commonly included by State governments with their welfare operations.

It is also important that these sub-groupings continue to be recognised separately in the assessments because of the differing levels of expenditure incurred on them by the States. To illustrate, in 2004-05 \$230 per capita was spent on aged and disabled welfare compared to \$90 per capita on family and child services, \$84 per capita on homeless and general welfare and \$68 per capita on (net) housing. To simply aggregate these functions into one broad category, without acknowledging their respective proportions of expenditure, would be unlikely to adequately recognise States' needs, particularly those States like SA with relatively large aged populations.

### *Agriculture, Forestry, Fishing and Hunting (Primary Industries)*

Given the importance of the agricultural sector to States, considerable resources are allocated to the provision of regulatory and land management services to this sector. Expenditure on this function is also easily identifiable at the 2 digit GPC level, totalling over \$100 per capita in the Commission's 2004-05 primary industries assessment (which is more than double that of the other three service to industry categories combined).

More importantly, the present primary industries assessment recognises the significant disability faced by some States in the provision of this important service, and this needs to be continued in the 2010 Review assessment.

### *Culture and Recreation*

Culture and Recreation is another distinct area of expenditure classified at the 2 digit GPC level that aligns closely with State Government disaggregation of service provision responsibilities (ie, Departments of Environment and Heritage, and Arts and Recreation), is of sufficient magnitude (\$130 per capita), and has significant cost disabilities for some States, thus warranting investigation by the Commission as a separate category.

### *Transport*

The 2 digit GFS classification of Transport and Communication is also of considerable magnitude, over \$500 per capita, and can be reasonably easily disaggregated into the categories of roads and transit (urban and non-urban, or both combined). It also covers distinct services provided by State Governments, those of road construction/maintenance and public transport, both of which should be assessed separately, and for which significant cost disabilities are evident for some States.

### *Water Supply/Sanitation and Protection of the Environment*

The supply of water, regulation of water providers and users and protection of water resources, is of increasing importance to the States, particularly in areas where water resources are scarce. The Commission should continue to recognise the considerable cost differences faced by States in this area by continuing to undertake an assessment that encompasses the expenditures in the 3 digit water supply and sanitation and protection of the environment categories.

### *Other Categories*

The 8 suggested groupings above account for close to 80% of the 2004-05 standard budget. If the Commission intends to continue its separate assessments of superannuation and depreciation, the coverage increases to close to 90%.

For the remaining expenditures, which tend to have little in the way of a unifying theme, we suggest that the Commission could, as it currently does in the general public services category, assess for broad differences in the cost of service provision such as administrative scale, dispersion and input costs.

## Revenue assessments

The Commission would welcome views of States on the proposed approaches to disaggregating revenue assessments and the illustrative disaggregations discussed in this paper.

(CGC 2006/02 para 66)

### SA Comments

One of the pillars of equalisation presently recognised is that the assessments reflect what States do. Any global or subglobal measure of revenue capacity falls foul of this pillar.

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.

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.

We suggest, in terms of paragraph 64 of the Issues Paper, that omitting this element would, alone, make the conceptual case the Commission requires that broader indicators of capacity 'do not adequately and reliably capture the main differences between States in their capacity to raise revenue or that they are inconsistent with the equalisation principle as it is to be interpreted in the 2010 Review' (assuming it is the same as presently defined).

We also 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. 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.

Nevertheless, the Issues Paper includes a possible disaggregation of tax revenue as follows:

- economic rent or profit-based taxes (mining revenue and possibly gambling taxes)
- wealth-based taxes (land revenue)
- income or wages-based taxes (payroll tax, gambling taxes)
- transaction or turnover-based taxes (eg, conveyances, insurance taxes and vehicle transfer duty).

It is not clear what the implication of this grouping is. Presumably it is not being proposed that vehicle transfer duty be assessed on the basis of real property conveyances and vice versa. However, we provide the following comments:

- Mining revenue is not profit-based or rent-based.
- Royalties are based on the value of product as it leaves the mine gate (in the case of minerals) or the wellhead value (in the case of oil and gas). Limited deductions are allowed.
- The transaction or turnover-based revenue category would encompass the majority of State taxes apart from payroll tax and land tax.

We conclude that the potential classification proposed does not at all reflect what States actually do, that it would be very difficult to obtain a meaningful indicator to cover such a disparate range of taxes as that classified under the transactions or turnover heading, and that it ignores (on the face of it) the important element of need reflected in value distributions, as described above.

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