Queensland Government

Queensland Treasury Response to Commonwealth Grants Commission 2015 Methodology Review

Responses to:

Commission Position Paper CGC 2013-05

Equalisation Objectives and Supporting Principles

Staff Discussion Paper CGC 2013-06S

Implementation and Methodological Issues

Staff Discussion Paper CGC 2013-08S

Draft Quality Assurance Strategic Plan

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1. COMMISSION POSITION PAPER CGC 2013-05 EQUALISATION OBJECTIVES AND SUPPORTING PRINCIPLES

Queensland's position

- Queensland supports retaining the operating and supporting principles of Horizontal Fiscal Equalisation (HFE) from the 2010 Review.
- As a general position, Queensland cautions against making widespread changes to the application of the supporting principles in this Review.

The timeframe for this Methodology Review has been truncated by the need to respond in a timely manner to the findings and recommendations of the GST Distribution Review. Whereas recent methodology reviews have been conducted over a period of several years, this Review has a timeframe of little more than 18 months.

This reinforces the need for the Review to be focused on the issues that will deliver the greatest improvements in methodology in the short time available. For Queensland, that means focusing on the review of individual assessments rather than the higher level objectives and supporting principles of the Commission's methodology. Queensland clearly outlined its views on those higher level issues in its submissions to the GST Distribution Review in which it was argued that the current HFE system places an overemphasis on equity, and concerns of efficiency, simplicity and transparency have not been given their due weight.

Given the Review's tight timeframe, Queensland supports this Review's focus being on methodological issues where significant improvements could potentially be made. With this as the focus, Queensland does not consider it practical to make significant changes to the architecture of HFE. For the purposes of this Review, Queensland therefore supports retaining the following key elements of the 2010 Review methodology:

- the operating principle (or 'definition', in the Staff Paper's terminology) of HFE for the purposes of the distribution of the GST, namely:

  > State Governments should receive funding from the pool of goods and services tax such that, after allowing for material factors affecting revenues and expenditures, each would have the fiscal capacity to provide services and the associated infrastructure at the same standard, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency.

- the supporting principles, namely that equalisation be implemented through methods that:
  - reflect what states do;
  - are policy neutral;
  - are practical; and
  - are contemporaneous.

Queensland would emphasise the importance of 'policy neutrality' as a supporting principle. HFE should not undermine or compromise the returns of government policy and the impact on the HFE process should not be allowed to be a significant consideration in the making of expenditure and revenue decisions by policy makers. The HFE process should remain in the background of policy making and it should be regarded as a failing of the system should it ever appear at the forefront. That this appeared to be the case at times in recent years with regard to the Mining Revenue assessment reinforces the need for the reform of that assessment.

While not one of the supporting principles, 'simplicity' should also be considered an important virtue of the HFE system. The HFE process can be a black box for most people, yet, through the large redistributions of GST it generates, it can significantly impact on the services and infrastructure delivered to them by their state governments. There is a risk that if the HFE system becomes incomprehensible to people it will lose their support.

The 2010 Review achieved a number of gains in simplifying the Commission's methodologies. Queensland cautions against creeping complexity in Commission methodologies that erode the gains of the 2010 Review. It is always tempting to add another complication to an assessment in order to refine the equalisation outcome, but these complications accumulate, clouding understanding and therefore eroding confidence in the system.

Several changes in the application of these supporting principles from the 2010 Review methodology are being proposed in the Staff papers. For example, it is being proposed to expand the scope of equalisation to include housing and urban transport public non-financial corporations. Another proposal is to modify the test of what constitutes average policy from one that accepts a policy as average if it has been adopted by a majority of states and it affects a majority of the tax base (to use tax as an example), to one that presumes that every tax raised by one or more states is part of the average policy. These changes are being proposed to make the assessments more comprehensive.

Queensland's views regarding these proposals are outlined in responses to the Staff papers. However, as a general position, Queensland would caution against adoption of widespread modifications in this Review. They carry the risk of both adding complication to the current system and producing unintended consequences.

The 2010 Review resulted in a number of significant changes to the Commission's methodologies that delivered improvements in outcomes and greater simplicity (for example, the capital assessments). These improvements were generally the result of careful analysis and extensive consultation. At the same time, however, the Review also created new problems for the assessment process in the years since (for example, the Mining Revenue assessment). It is possible that greater consideration and consultation may have provided early notice of some of these issues to the Commission.

Queensland would suggest any modifications require thorough analysis, consideration and justification and the reduced timeline for this Review may not allow for this in all cases. It may be more prudent not to introduce changes where there is insufficient time for thorough consideration and consultation. Such changes should instead be reconsidered in a future review when they can be subject to more thorough analysis and in concert with other possible modifications to the architecture of the HFE system.

2. STAFF DISCUSSION PAPER CGC 2013-06S IMPLEMENTATION AND METHODOLOGICAL ISSUES

MEASURE OF FISCAL CAPACITY AND THE 'SIMPLIFIED AND INTEGRATED' FRAMEWORK

Queensland's position

- Queensland supports the Staff position of retaining the current 2010 Review approach encapsulated in the current investment and net lending assessments, rather than adopting the 'simplified and integrated assessment framework'.

Clause 2(e) of the 2015 Review Terms of Reference requires the Commission to examine the merits of adopting a "simplified and integrated assessment framework". This makes reference to the GST Distribution Review recommendation for the replacement of the current investment and net lending assessments with the simplified and integrated assessment framework.

The current 2010 Review approach involves the direct assessments of capital requirements, the investment necessary to achieve them and the net lending (borrowing) needed to equalise state net financial worth.

The simplified and integrated assessment framework approach:

- is based on a modified operating statement framework which includes the deficits of state housing and public transport agencies;
- includes 'population growth needs, based on population growth dilution of net worth', which is general government infrastructure plus net financial worth; and
- 'scales up' the depreciation assessment by a user financial cost of capital element (that is, by the holding costs of capital).

Queensland's views, articulated more fully in the response to the 2015 Review Terms of Reference, are that the simplified and integrated assessment framework proposed by the GST Distribution Review is based on several misconceptions, holds no advantages over the current framework and should be rejected. In particular:

- the Investment and Depreciation assessments measure effects that are conceptually different and therefore, contrary to the claim made in the GST Distribution Review, the existence of these two separate assessments do not result in double counting;
- the current Net Lending assessment can accommodate the recognition of the capital needs of Public Trading Enterprises (PTEs) (for example, differences in states' capacities to earn a return on their holdings in PTEs). If it were shown that these exist – noting that the 2010 Review failed to identify them – measures of disabilities could be applied, in a similar way to the application of disabilities in the Investment assessment;

- the current capital assessments are, in themselves, relatively simple. Measures have already been taken to reduce their volatility and the capital assessments have, in fact, been less volatile than a number of other assessments;

- the proposed alternative framework provides no benefits beyond the current framework. Both the current and proposed alternative frameworks are consistent with the upfront inclusion of Commonwealth infrastructure payments, can incorporate population growth needs and, through the calculation of a population growth dilution of net worth, have elements of a balance sheet approach; and

- the operating balance approach of the proposed alternative framework is no more "accessible and familiar" than the balance sheet approach of the current framework. In any case, familiarity is not generally a criterion considered in methodology reviews and is therefore not considered relevant to this discussion.

Queensland supports the Staff position of retaining the 2010 Review approach encapsulated in the current Investment and Net Lending assessments

IMPLEMENTATION ISSUES FOR WHAT STATES COLLECTIVELY DO

Queensland's position

- Queensland supports the Staff position of continuing to base revenue and expense standards on population, revenue or service base weighted averages of 'what states do'.
- Queensland supports the retention of the current approach to determining average policy, that is, a revenue or service provision is considered average policy if it is implemented by a majority of states and affects a majority of the revenue base or service population.
- Queensland supports the Staff position of not adopting a 'spend-gradient' approach to interstate costs.

Revenue and expense standards

Queensland supports the Staff position of continuing to base revenue and expense standards on population, revenue or service base weighted averages of 'what states do', rather than applying simple averages or adjusting standards as a means of more actively encouraging efficiency.

The current weighted average approach is a better reflection of 'what states do', that is, the current practice of the states. The adjustment of standards to achieve certain policy objectives beyond HFE and its supporting principles would be a significant change in the practice of the Commission and presumably outside the 2015 Review Terms of Reference. However, external standards could be considered, albeit as a near last resort and preferably not in this Review given the short timeline, to help achieve policy neutrality or preserve incentives that would exist in the absence of HFE. This issue is discussed further in the discussion on the Mining Revenue assessment in Queensland's response to the Discussion Paper on Proposed Assessments.

Determining average policy

Under the current approach to determining average policy, a revenue or service provision is considered average policy if it is implemented by a majority of states and affects a majority of the revenue base or service population.

The Discussion Paper proposes the introduction of an alternative approach. Under the alternative approach to determining average policy, a revenue would be considered average policy if it were imposed by at least one state and the resulting redistribution met materiality thresholds. States that did not raise the tax would be considered to tax the relevant revenue base at a zero rate. A similar approach would apply to service provision.

Queensland understands that there may be some potential advantages in implementing such an approach. In some cases, it could make decisions clearer on whether a tax should be subject to a differential assessment. For example, the average policy in the application year for raising revenue from non-real duties has been difficult to determine in recent years, as a number of state governments have made revisions to their timeframes for abolishing this tax, and these decisions are not always known prior to annual updates. Queensland understands that under the alternative approach, non-real duties would continue to be assessed until enough states abolished the tax that its assessment was not material. In this case, the alternative may be simpler to implement.

However, Queensland considers that there are conceptual problems with the alternative approach and that in many cases it would not be simpler to implement.

At a conceptual level, efforts to develop a methodology that reflects the average policy of states should focus on determining the common practices of states. On this basis, the proposed alternative approach would not always produce a result that constitutes an "average" under the current approaches to assessments.

The alternative approach may also be difficult to implement in many cases, and has the potential to create greater complexity in assessments. It is often problematic for states to provide the data required to assess revenue capacity or service delivery needs reliably in areas they do not raise revenues or provide services. While this issue exists under the current definition, it would be exacerbated under the alternative as assessments would have a greater reliance on data that is not readily available and may not be reliable. It may also increase complexity in the assessments, as additional disabilities would be required to assess areas not provided by a majority of states.

If the alternative approach is to be applied strictly and consistently, it should extend beyond discrete revenues and services provided by less than a majority of states, to tax free thresholds and cases where less than a majority of states provide a subsidy for a service. For example, if one state has a lower tax free threshold than other states or abolished its tax free threshold, the revenue base below the threshold would be taxed by at least one state and should be differentially assessed if material. Similarly, if one state provides a subsidy (such as Queensland's uniform electricity tariff) not provided by other states, the need to provide that subsidy would need to be considered for differential assessment. In most cases such as these, making a differential assessment would not be practical. However, a differential assessment would be necessary for the alternative definition to be applied consistently.

Queensland supports the Commission retaining the 2010 Review approach to determining average policy in the 2015 Review on the basis that Queensland considers it to be a more conceptually sound way of determining an average, and it will be simpler to implement in many cases.

Equalisation of interstate costs on a 'spend gradient' basis

Clause 2(f) of the 2015 Terms of Reference reflects the GST Distribution Review's recommendation that the Commission investigate whether it is appropriate and feasible to equalise interstate costs on a 'spend gradient' basis.

The Review of GST Distribution Final Report provided little clarity on what was meant by 'spend gradient' or how this might be achieved, and included limited justification for equalising costs on such a basis.

The Discussion Paper notes that the 'spend gradient' approach has no support from states.

Queensland supports the Staff position of not adopting a 'spend gradient' approach to interstate costs.

IMPLEMENTATION ISSUES FOR POLICY NEUTRALITY

Queensland's position

- Queensland supports the Staff position of not proposing the reintroduction of elasticity adjustments in the 2015 Review.

Elasticity adjustments

There is a conceptual justification for elasticity adjustments being made in assessments. For example, high conveyance duty rates are likely to suppress property market activity and prices and therefore affect the assessment of the revenue base and the state's revenue raising capacity for conveyance duty. Policy neutrality considerations would require that this policy effect, if material, should be allowed for in the assessment. The GST Distribution Review, in its discussion on perverse incentives and efficiency losses potentially created by the current system, found that one area where there may be merit in further investigation by the Commission is in relation to the impact of tax rates on the size of state tax bases.[1]

As the Discussion Paper notes, there is a history of the Commission making an allowance for the impact of policy on the revenue bases of states and therefore the assessment of revenue

[1] GST Distribution Review, Final Report, October 2012, page 140.

capacity, although these adjustments were discontinued following the 2004 Review which concluded that:

> The Commission accepted that there was a conceptual case that State expenditure and taxation regimes affected the level of economic activity. However, to analyse this effect properly, the Commission would require a general equilibrium model of State economies, which it did not have. In the absence of such models, it was not convinced that selective elasticity adjustments would move equalisation in the right direction or by the right magnitude.[2]

Queensland supports the Staff position of not proposing the reintroduction of elasticity adjustments in the 2015 Review on the basis that this is not a priority issue and the rigorous analysis that would be required would not likely be possible given the tight timeframes of the Review. However, Queensland believes that this issue warrants further consideration, possibly in the context of the next review, and lends further justification for the use of broader revenue indicators to ensure greater policy neutrality.

IMPLEMENTATION ISSUES FOR PRACTICALITY

Queensland's position

- Queensland supports the proposal to increase the materiality threshold for disabilities, although other factors should be considered when deciding the inclusion or otherwise of an assessment.
- Queensland supports maintaining the uniform set of discounts, and reviewing where discounting has been used to ensure that the level used is appropriate (for example, the Interstate Wages and Transport Services assessments).
- Queensland supports extending the application of discounts to cases where they can be used to more effectively respond to methodological issues which the existing framework is unable to adequately deal with.

Materiality thresholds

The Discussion Paper proposes that the materiality thresholds for disabilities be raised to $30 per capita, and data adjustments to $10 per capita. It also suggests removing the category structure and redistribution thresholds.

Queensland supports the proposal to increase the materiality thresholds as these are likely to encourage the development of simpler assessments based on broad indicators. At the same time, it is important to ensure that the thresholds are not applied in a mechanical way. Materiality thresholds are a useful tool to prevent the assessments from becoming increasingly complex, but are one of a number of important considerations, such as reliability and the strength of a conceptual case. Queensland notes the intention in the Discussion Paper to not impose materiality standards in a mechanical way and that there are a number of assessments in the Discussion Paper on Proposed Assessments where materiality has been treated as secondary to other considerations, including:

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[2] Commonwealth Grants Commission, Report on State Revenue Sharing Relativities 2004 Review, Working Papers, Volume 3, Revenue and User Charges Assessment Issues, February 2004, page 261.

- the Net Lending assessment is proposed to be retained, even though it may not be material if housing and urban transport infrastructure is reclassified. This is on the basis that the Net Lending assessment is fundamental to the current process for implementing equalisation and the aggregate impact of the population growth disability will be material; and

- the Interstate Non-Wage assessment is proposed to cease, on the basis that costs not captured within the Regional Costs assessment cannot be measured reliably.

Queensland believes it is appropriate that materiality not be the deciding factor in these kinds of cases, particularly where reliability is doubtful. There are other instances where materiality should not be applied as a mechanical rule:

- where a disability does not meet materiality thresholds, but its redistribution is close to $30 per capita, the Commission should consider retaining the assessment if it is very reliable. One example of this may be the Insurance Tax assessment; and

- where the redistribution from a disability is likely to be highly variable between years, these disabilities should be retained as they may satisfy materiality thresholds in future updates. One example of this is the Natural Disaster Relief and Recovery Arrangements assessment.

Queensland also supports the proposal to remove materiality thresholds for category structure and redistribution. Category groupings are mainly presentational and materiality thresholds for categories do not improve the methodology or reduce its complexity when it is the disabilities that drive the assessments. Queensland also considers that it is important to consider the materiality of disabilities based on their aggregated materiality across categories.

The Implementation and Methodological Issues Discussion Paper also sought state views on whether a materiality threshold should apply to Commonwealth payments. Queensland does not consider there is an asymmetry in applying materiality thresholds to disabilities but not to Commonwealth payments. The grouping of Commonwealth funding (and therefore its size) under different agreements is somewhat arbitrary. Funding for a similar purpose could be provided in the form of small individual National Partnerships (NPs), or could equally be provided as part of a larger agreement with multiple outcomes. For example, the Water for the Future NP contains a number of sub-programs grouped under a single agreement. If smaller payments were not differentially assessed by the Commission, this may lead states to prefer to structure agreements with the Commonwealth as a larger number of smaller agreements. As Commonwealth funding to states is material as a whole, and choices around the grouping of funding into smaller agreements do not affect states' fiscal capacities, Queensland supports not applying a materiality threshold to Commonwealth payments.

Discounting

Currently, where a case for including a disability in a category is established but the Commission is unable to make a suitable assessment of its impact, due to data reliability or other difficulties, the Commission may decide to make an assessment but discount the impact. A discount may indicate that the Commission considers the direction of the redistribution from an assessment is appropriate, but are not confident of the magnitude of the redistribution. A uniform set of discounts is applied in the current methodology, set at the levels of 12.5 per cent (low), 25 per cent (medium) or 50 per cent (high). These are applied using judgement, proportional to the level of uncertainty held.

Staff are proposing that the uniform set of discounts be maintained, but to review where discounting has been used to ensure that it is still appropriate.

Queensland supports the Staff position that a uniform set of discounts be maintained. Establishing the levels of uncertainty generated by methodological or data quality issues is necessarily imprecise and based on judgement. Applying a uniform set of discounts where levels of uncertainty are judged to be “low”, “medium” or “high” is preferable to setting levels of discount individually for each category.

Queensland also agrees that the application of discounting be reviewed to ensure that it is still appropriate. In general, Queensland considers that caution should be exercised in removing existing discounts, and discounting should only be removed from existing assessments where concerns over the uncertainty of outcomes have been addressed. One area where an existing discount can be removed is the Net Lending assessment, where a discount was applied in the 2010 Review to recognise uncertainty about whether the population growth factor accounted for all non-policy influences. Other potential non-policy influences have been investigated in the Discussion Paper on Proposed Assessments and there does not appear to be evidence that these impact on states’ financial assets. The case for a discount to the Net Lending assessment is no stronger than for any other assessment that uses a broad indicator.

In cases where there is remaining uncertainty, Queensland supports retaining discounts. For example, the discounts applied to recurrent expense disabilities that are used in the Investment assessment should be retained. Even though the Discussion Paper suggests removing those recurrent disabilities that are not conceptually well linked to capital, there is still sufficient uncertainty in the magnitude of the impact of applying recurrent disabilities to capital requirements that the discount should be retained.

In the short timeframe for the 2015 Review, it may not be practical to fully review assessments or apply a clean-slate approach to assessments. However, Queensland considers that there are some assessments in the current methodology that require fundamental or significant revision, and that the outcomes produced by these assessments are unreliable. This includes the Interstate Wages and the Transport Services assessments. If the Commission considers that it is not practical to undertake a full revision, the levels of discount applying to the Interstate Wages and Transport Services assessments should be reassessed given the overall lack of confidence Queensland, and possibly other states, have in the outcomes of these assessments. A more thorough revision of these assessments can be undertaken in a future review.

Further, the Commission should consider extending the application of discounts to cases where they can be used to more effectively respond to methodological issues which the existing framework is unable to adequately deal with. For example, a discount to the Mining Revenue assessment is arguably the best way of responding to the offsetting mining expenditure and policy neutrality issues raised by this assessment. This is discussed further in the State's response to the Discussion Paper on Proposed Assessments.

IMPLEMENTATION ISSUES FOR CONTEMPORANEITY

Queensland's position

- Queensland supports the continuation of backcasting major changes in Commonwealth-State financial arrangements, but only if the changes can be made reliably and they are material.
- Queensland supports the Staff proposal to continue to use data which best reflect states' likely circumstances in the year of application.

Backcasting

The Commission employs a 'backcasting' approach whereby it adjusts historical data for major changes in Commonwealth-State financial arrangements in the application year.

Queensland appreciates the complications that this can sometimes create. The Discussion Paper gives the example of states' changing policy positions with regard to the abolition of duty on the sale of non-real business assets – backcasting accentuates the impact of the variability in what is regarded as 'average policy' for the application year.

Despite the occasional complication, Queensland supports the Staff's proposal to continue backcasting major policy changes because backcasting allows assessments to be more contemporaneous by allowing the assessment to more fully reflect the circumstances of the application year. However, Queensland agrees that backcasting should only be applied if the changes can be made reliably and they are material.

Use of non-annual and lagged data

The Commission's current practice is to use the most recent available data, which may involve revising data previously used.

Reflecting its concern that data revisions cause undue volatility in states' GST shares, the GST Distribution Review recommended:

> Where data are updated or released annually with a lag, or updated or released less frequently than annually, the CGC should allow the newly available data to only inform

> changes in States' circumstances in the most recent assessment year and not be used to revise previous estimates of earlier inter survey years (recommendation 6.2).[3]

Queensland's response to the Terms of Reference argued it is important that the Commission's assessments reflect the most reliable and up-to-date data available. This includes updating data in assessments affecting previous single year relativities where relevant data was not available at the time they were originally produced. Updating relativities for data that is lagged or updated less frequently than annually does not produce sufficient volatility in the assessment to justify accepting a less reliable or accurate outcome.

On this basis, Queensland supports the Staff proposal to continue to use data which best reflect states' likely circumstances in the year of application.

A GLOBAL REVENUE ASSESSMENT AND BROAD INDICATOR ASSESSMENTS

Queensland's position

- Queensland accepts that further consideration of the use of global and broad revenue indicators may need to be deferred to the next review.

Queensland understands that Staff have concerns with the use of global and broad revenue assessments. In the case of a global approach, these concerns are:

- equalisation is about the capacity of states to raise taxes rather than the capacity of communities to pay taxes;
- states cannot tax global revenue bases in reality;
- revenue raising disabilities differ for different taxes; and
- there are theoretical and data problems with global assessments.[4]

As discussed in Queensland's response to the terms of reference, Queensland believes there is merit in the consideration of the use of global and broader indicators. Queensland believes that serious consideration should be given to the use of a broad revenue indicator, such as household disposable income, to replace most if not all of the revenue assessments. Such an approach would result in significant simplification, have a strong economic justification and remove any grant design effects that exist with the current set of revenue assessments.

However, given the limited timeframe for this Review, Queensland accepts that further consideration of the use of global and broad revenue indicators may need to be deferred to the next review.

[3] GST Distribution Review, Final Report, page 97.

[4] Commonwealth Grants Commission, Discussion Paper CGC 2013-06S, *Implementation and Methodological Issues*, page 24, paragraph 106.

TREATMENT OF COMMONWEALTH PAYMENTS

Queensland's position

- Queensland supports retaining 'programs implemented at the behest of the Australian Government and which lead to above or unique state outcomes' as an example of payments which would not impact on the relativities.

The Discussion Paper suggests that conceptually all Commonwealth payments which impact on state finances should be included within the Commission's processes. In practice, the Commission will only consider those transactions which are readily identified (in scope payments). This covers transactions classified as payments direct to state treasuries, but other transactions of an indirect nature may not be identified. For example, transactions where the Commonwealth delivers a service in a state, which relieves the state of the need to provide that service, are difficult to extract from the general run of Commonwealth purchases.[5]

Staff propose the Commission decides the treatment of all in scope payments on a case by case basis using the following guideline:

> payments for usual State functions and for which expenditure needs have been assessed, including a deliberative equal per capita assessment, will impact the relativities.[6]

Examples of payments which would not impact on the relativities are provided, including:

- payments specified in the 2015 Review Terms of Reference that they should not affect the relativities (for example, reward payments under NP agreements);
- payments to fund a purchase by the Australian Government (for example, funding for essential vaccines for immunisation) which does not impact on fiscal capacities;
- payments through the states to local government or other third parties where the payment does not influence state fiscal capacities (for example, payments to non-government schools); and
- payments for which expenditure needs have not been able to be assessed by the Commission (for example, payments for the Secure Schools Program that assist at risk religious, ethnic and secular schools meet their particular security needs).[7]

Queensland notes that it is proposed to exclude from this list of examples 'programs implemented at the behest of the Australian Government and which lead to above or unique state outcomes'. This is a divergence from the 2010 Review which did include this as an example of a payment which would not impact on the relativities. The 2010 Review provided the example of a trial program which is not part of services delivered under average state policy as being included in this type of payments.

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[5] Ibid, page 27, paragraph 121.
[6] Ibid, paragraph 123.
[7] Ibid, page 28, paragraph 124.

Staff suggest that these payments are difficult to distinguish from others and should be identified in the Commission's Terms of Reference for the relevant Update.

It is appreciated that it may be difficult for the Commission to distinguish these payments from others and it is preferable that they be specifically identified in the Commission's Terms of Reference when they should not impact on the GST relativities. Despite this, the Commission's methodology should recognise the potential existence of such programs and that HFE principles require they should not impact on GST relativities, particularly if they are not part of services delivered under average state policy. However, if, in practice, such a payment cannot be reliably identified in the absence of a specific Terms of Reference directive, then it is reasonable if the Commission takes the position that the payment should affect the GST distribution.

3. STAFF DISCUSSION PAPER CGC 2013-08S DRAFT QUALITY ASSURANCE STRATEGIC PLAN

Queensland's position

- Queensland seeks a 'no surprises' approach to the 2015 Review process. For example, all major changes to the methodology should be thoroughly discussed with states, with an opportunity for states to provide input to their development.

Queensland appreciates the opportunity to comment on the Commission's draft quality assurance strategic plan.

Queensland supports the three objectives articulated in the draft plan, namely:

- to assure the Commission's stakeholders of the conceptual validity, reliability and accuracy of the relativities that will be used to distribute the GST to the states;
- to ensure the reporting of methods, decisions and results are transparent and in appropriate detail for their purposes; and
- to report on the effectiveness of QA processes implemented.[8]

Queensland emphasises the importance of transparency and participation in the Commission's processes for the achievement of state understanding and confidence in the system. In particular, Queensland urges a 'no surprises' approach to the 2015 Review process. For example, the financial impacts of all major proposed changes to the methodology should be quantified and the proposals thoroughly discussed with states, with an opportunity for states to provide input to their development. As suggested in the earlier discussion of the Commission's Equalisation Objectives and Supporting Principles Position Paper, some of the issues arising from the 2010 Review may have been averted with a greater degree of consultation. Therefore, Queensland strongly supports the inclusion of the proposed actions under the "Inform the States on assessment development and decisions" strategy under Objective 2.

[8] Commonwealth Grants Commission, Discussion Paper CGC 2013-08S, *Draft Quality Assurance Strategic Plan*, page 24, paragraph 106.

The publication in Commission reports, including the 2015 Review Draft Report, of the fiscal impacts of proposed methodology changes is another important way for states to better understand the implications of Commission proposals. This will ensure that there is a common understanding of what is proposed, and that differences among states and with the Commission are the result of different views of what constitutes appropriate methodology rather than different interpretations of what the proposals are and their financial and other implications.

Queensland Government

Queensland Treasury Response to Commonwealth Grants Commission 2015 Methodology Review

Response to:

Staff Discussion Paper CGC 2013-07S

Proposed Assessments

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INTRODUCTION

Queensland welcomes the opportunity to respond to the Discussion Paper on Proposed Assessments prepared by the Staff of the Commonwealth Grants Commission[1] for the 2015 Methodology Review.[2] The release of this Discussion Paper, along with the Commission Position Paper on Equalisation Objectives and Supporting Principles, the Staff Discussion Paper on Implementation and Methodological Issues and the Draft Quality Assurance Strategic Plan (Queensland's responses to these latter three papers are presented in a separate response), gives states and territories[3] a clearer picture of the intentions of the Commission and Commission Staff[4] in relation to this Review.

The timeframe for this 2015 Review has been truncated by the need to respond to the findings of the GST Distribution Review. The GST Distribution Review was at least in part the result of issues that arose from the methodology adopted by the 2010 Review for the Mining Revenue assessment, which was harmful to the credibility of the equalisation process. Whereas recent methodology reviews have been conducted over a period of five years, this 2015 Review has a timeframe of little more than 18 months.

This reinforces the need for the 2015 Review to be focused on the issues that will deliver the greatest improvements in methodology in the short time available. For Queensland, that means focusing on the review of individual assessments rather than the higher level objectives and supporting principles of the Commission's methodology. Queensland has previously articulated its views on those higher level issues in its submissions to the GST Distribution Review.

The tight timeframe of the 2015 Review also creates risks for the Commission. Where significant changes are being contemplated, comprehensive analysis and consultation are necessary to ensure that the changes will deliver what is being sought, without unintended consequences. The 2010 Review resulted in a number of significant changes to the Commission's methodologies that delivered improvements in outcomes and greater simplicity (for example, the capital assessments). At the same time, however, the 2010 Review also created new problems for the assessment process in the years since (for example, the Mining Revenue assessment). It is possible that greater consideration and consultation may have provided early notice of some of these issues to the Commission.

Therefore, Queensland emphasises the importance of transparency and participation in the Commission's processes for the achievement of a better assessment methodology, as well as greater state understanding of and confidence in the HFE process. In particular, Queensland urges the Commission to adopt a 'no surprises' approach to the Review process. For example, the financial impacts of all major proposed changes to the methodology should be quantified and the proposals thoroughly discussed with states, with an opportunity for states to provide input to their development.

[1] From here on, the 'Commonwealth Grants Commission' is referred to as 'the Commission'.
[2] From here on, the 'Methodology Review' is referred to as 'the Review'.
[3] From here on, 'states and territories' are referred to as 'states'.
[4] From here on, 'Commission Staff' is referred to as 'Staff'.

The 2010 Review delivered gains in simplifying the overall assessment methodology. Therefore, it is important that the current review process does not allow any unnecessary greater complexity to creep back into the assessment process, eroding the gains of the 2010 Review.

While this submission provides responses to most of the proposals in the Discussion Paper, Queensland draws the Commission's attention to a small number of key assessments that constitute the State's highest priorities for this Review.

- **Mining Revenue assessment.** As expressed in its submission to the GST Distribution Review and its response to the 2015 Review Terms of Reference, Queensland considers the simplest and most appropriate way to respond to most of the issues that the mining states have raised in relation to the Mining Revenue assessment is to apply a discount to the assessment. This is the Canadian approach, where a 50 per cent discount is applied.

  It appears that Staff are not currently considering a general Mining Revenue assessment discount, but will focus on the existing assessment framework and examining if it will explicitly recognise mining related disabilities in several existing expenditure assessments.

  While such an approach is sound in theory, Queensland has concerns regarding the Staff's proposed category-by-category approach to mining expenditure, as it:

  - simply incorporates mining expenditure into the current assessment structures – instead, a clean-slate approach to the assessment methodologies is required, which may not be practical in the 2015 Review timeframe;

  - does not properly allow for the recognition of less easily measured components of mining related expenditure; and

  - does not allow mining related expenditure to be fully assessed where there is a conceptual case but data issues make it difficult to develop an assessment methodology.

  Instead, Queensland proposes that mining related expenditure be assessed collectively in the Other Expenses category using a broad indicator, as it is the most practical way of assessing both the more and less easily measured components of mining related expenditure.

  In relation to the Mining Revenue assessment, Queensland supports a single aggregated minerals structure as being preferable to the current high-low rate grouping structure or a more disaggregated mineral grouping structure. A single aggregated minerals structure would greatly enhance the policy neutrality of the assessment and reduce the potential for grant design inefficiencies while still assessing each state's relative capacity to raise revenue from mining activities.

- **Transport assessment.** Queensland considers there are significant issues with the current assessment of transport services and that the methodology should be thoroughly revisited. Given the limited timeframe for the 2015 Review, Queensland acknowledges there is limited capacity for the assessment to be overhauled entirely at this time. However, given the significant conceptual, methodological and data-based issues with the assessment, Queensland considers a discount of at least 25 per cent to the assessment is necessary.

- **Interstate Wages assessment.** With the relationship between public and private sector wages observed in the Commission's model having weakened significantly, the current methodology for the Interstate Wages assessment can no longer be regarded as providing a reliable measure of the drivers of wage pressures for state public sector labour markets. Queensland believes a more thorough and fundamental analysis should be undertaken of the validity of the assessment and, until this is done, does not support incorporating additions to the assessment in the 2015 Review. Until there is time for further work to be undertaken in the next review, the discount to the assessment should be increased from the current low level of 12.5 per cent to 50 per cent.

This response to the Discussion Paper is structured in three sections: Queensland's highest priority issues; other priority issues; and other issues. An appendix lists Queensland's positions by Discussion Paper chapter.

Queensland looks forward to working with the Commission during the remainder of the 2015 Review to resolve issues, provide further material and, where possible, develop new approaches to these and other assessments.

1. QUEENSLAND'S HIGHEST PRIORITY ISSUES

MINING ASSESSMENT

The Mining Revenue category includes mining royalties levied on mining production. The Commission assesses mining in three categories: grants in lieu of royalties, high royalty rate minerals (comprising oil and gas, lump iron ore, export coal and bauxite) and low royalty rate minerals. The first category is assessed on actual revenue received, while the latter two are based on value of production data.

The high and low rate category structure was introduced at a late stage in the 2010 Review and without the usual degree of consultation with states. Possibly as a result of this, the assessment has experienced problems.

Unlike other categories, the outcome of the mining assessment is heavily influenced by the policies of individual states. These policy neutrality issues result in part from the mining revenue base being concentrated in a small number of states, but much of the potential for grant design effects is caused by the two-rate structure of the current assessment. An example of the way the current mining assessment adversely impacts on policy neutrality is the assessment of Western Australia's iron ore fines.

In a series of stages beginning in 2010, Western Australia increased its royalty rate on iron ore fines to align it with the royalty rate applied to lump iron ore. This resulted in the rate on iron ore fines increasing from a low concessional rate of 3.75 per cent to the 7.5 per cent rate applied to lump iron ore. Given the two rate mining assessment structure adopted during the 2010 Review, this rate increase would have resulted in iron ore fines moving to the high royalty rate group and a perverse situation in which Western Australia would lose more revenue though the equalisation process than it gained through additional royalties as a result of its policy decision. Subsequently, the Commission received terms of reference directing it not to change the treatment of iron ore fines before the next methodology review. After the 2015 Review, both continued use of a terms of reference directive to mend the assessment and iron ore fines remaining in the low royalty rate group will be inappropriate.

The potential for minerals to move from one group to the other is only the most obvious problem afflicting the Mining Revenue assessment. More generally, the concentration of the mining revenue base leads to grant design effects, as changes in the rate of a mineral has the potential to significantly impact on the average royalty rate for that mineral category and therefore the GST distribution.

Moreover, the Mining Revenue assessment fails to adequately consider the offsetting effect of government mining industry related expenditures and less easily measured costs on the financial benefits of states' mining revenues, and acts as a disincentive for governments to develop their mining industries.

Queensland agrees with the Commission that the consideration of the appropriate assessment of mining royalties requires the consideration of a number of complex questions and welcomes the Commission's recognition of the benefit of close consultation with the states.

Application of a discount

Ideally, the Commission would assess mining revenue on a net basis. This would reduce the mining revenue of states, and their assessed capacity to raise revenue, by the expenses and other costs they needed to incur to grow their revenue capacities. This ideal approach is not practical in the Commission's methodology, due to issues such as the lumpy nature of capital expenditure supporting the mining industry, and the difference in timing between expenses and the resulting revenues. Also, it is sometimes difficult to measure or quantify the impact on states of a large mining industry, particularly in areas such as opportunity cost and risk.

As Queensland argued in its response to the 2015 Review Terms of Reference, its first preference for addressing the problems with the Mining Revenue assessment is for a discount to be applied, that is, the redistribution of GST arising from the assessment be reduced by the level of the discount. This is a practical means of recognising that mining states incur expenditure and risks as well as derive revenue from their industries. As detailed in Box 1, mining royalties are different from other state revenue sources, and this should be recognised in the Commission's assessments. An appropriate discount would also go some way towards reducing the grant design effects of the current assessment, which create a disincentive for governments to develop the mining industry and apply royalty rates that deliver the desired return for the state. A discount is the simplest and most objective way for the Commission to exercise judgement in this area.

Box 1 – Differences between mining royalties and other state revenue sources

Previous submissions made by Queensland to the 2015 Methodology Review and the GST Distribution Review have discussed the unique attributes of the mining industry and the state revenue generated by the industry, which should be recognised in the Commission's assessments:

- **The mining industry is concentrated in a few states.** Where only a small number of states have significant costs arising from industry support, regulation, business development and associated infrastructure, it is likely their impact on relative fiscal capacities will be material. The Queensland Government incurs significant direct expenditures in mining regions and areas that have linkages to mining regions. For example, the cost of administration alone (mining department head office costs) for the mining sector was $120 million in 2011-12. Other costs are difficult to quantify despite having a significant impact on state budgets, such as opportunity cost and risk.
- **The mining assessment redistributes a state asset.** As Pincus and Ergas[5] point out, royalties are payments for the extraction of an exhaustible resource, whose offset is a reduction to the jurisdiction's assets. In redistributing the financial benefits of the royalty through the GST, a state asset is also being redistributed. This is fundamentally different from the rest of the revenue assessments, which deal predominantly with state taxes. Conceptually, mining revenue may be more similar to the proceeds of asset sales (which are not redistributed) than to state taxes.
- **Mining development can be problematic.** The economic bases of most state revenue sources – paid employment, property market values and activity, and vehicle ownership and use – are not subject to difficult policy choices by government. In the main, government decisions have impact only at the margins of these economic bases. In contrast, the development of the mining industry often requires difficult policy choices to be made. Mining operations can have large environmental and social impacts and often trade-offs are required against other industries, such as agriculture and tourism, and other land uses, such as residential housing.
- **The incentive to develop the mining industry needs to be preserved.** The mining industry creates economic benefits, particularly increases in employment and wages, and increased government revenue from both mining royalties and the economic activity generated by the industry. These economic benefits are shared across the nation. The current Commission assessment of mining diminishes much of the revenue benefits to governments but does not recognise the costs. The risk to the national interest is that HFE reduces the incentives to a state government of supporting the development of the mining industry to such a degree that the industry will not receive the support that it should be receiving, to the detriment of the nation.

In the Discussion Paper, Staff acknowledge that the current approach towards the mining assessment "will require the Commission to exercise a large degree of judgement" in reaching a final assessment methodology. In this context, it would be difficult to consider any resulting assessment as entirely reliable and robust. The use of discounts is both appropriate and necessary in situations where there is doubt about the reliability of the method chosen.

[5] Pincus, J and Ergas, H *Reflections on Fiscal Equalisation in Australia*, Submission to the GST Distribution Review, 2011

Queensland considers that an appropriate starting point for this review would be a 50 per cent assessment of Mining Revenue assessment, consistent with Canadian findings. While there may be differences between the Canadian and Australian systems of taxation, federal fiscal relations and equalisation, a 50 per cent discount would recognise that a starting point of complete equalisation for mineral resources is not suitable in light of the multiple impacts of easily and less easily measurable factors.

A review of the Mining Revenue assessment and mining related expenditure should not ignore the less quantifiable factors discussed in this submission, and the potential impact of the Commission's equalisation process on incentives for mining industry development. The conceptual case for the recognition of these less easily measured costs is at least as sound as the case for a Cultural and Linguistic Diversity disability, where the effects are equally difficult to measure and the Commission has applied its judgement to make an assessment.

If the Commission chooses not to apply a discount to the mining revenue assessment, but to instead recognise mining related expenditure needs through the expenditure categories, it must ensure that all needs relating to mining industry development are recognised. Potential approaches to recognising mining related expenditure needs are addressed in the response to the Mining Related Expenditure chapter of the Discussion Paper.

MINING REVENUE (CHAPTER 6)

Queensland's position

- Queensland supports an aggregated mining revenue assessment, which would greatly enhance the policy neutrality of the assessment and negate the potential for grant design inefficiencies while still assessing each state's relative capacity to raise revenue through mining royalties.
- Queensland does not support a move to an 'external standard' at this time as it would be a departure from the Commission's usual approach of assessing state fiscal capacity based on 'what states do'. Significant justification would be required to depart from this approach.

The impact on policy

The Discussion Paper requests states' assistance to ascertain how states may act on the incentives that would be inherent in a mineral by mineral assessment, possibly by drawing on the recent decisions by some states to raise their royalty rates. In the Discussion Paper, Staff note that under a mineral by mineral assessment a state could "increase its GST share by reducing its own royalty rate, but [that state] would be worse off in terms of its own budget revenues". Staff acknowledge that these inherent grant design inefficiencies are the result of a concentration of the revenue base in a small number of states and would allow a state to directly influence its own GST share. Such an outcome is ultimately in contravention of the principle of policy neutrality, a guiding principle of HFE.

As with a government's management of fiscal policy more generally, the decision to alter a royalty rate is the result of the consideration of a number of complex and dynamic factors. These factors can include underlying economic fundamentals affecting the profitability, relative or otherwise, of a particular mineral. It is also unlikely that such a decision would be made without consideration of the government's broader budgetary position. For example, the decision to alter a royalty rate may be in response to new or changing expenditure requirements, changes to the performance of other government revenue streams or the need for fiscal repair.

Implications for the mining assessment are relevant factors that would be taken into consideration, along with a variety of factors, in a decision to change a royalty rate. In any case, the presence alone of incentives in the mining assessment is enough to call into question the validity and appropriateness of a mineral by mineral assessment. The problems resulting from the mining assessment adopted during the 2010 Review has harmed the credibility and validity of the equalisation process. A mineral by mineral assessment will offer no guarantee that unforeseen circumstances or developments similarly jeopardise the legitimacy of the equalisation process.

Problems with the current mining assessment and the perverse incentives it creates have added further complexity to the consideration of revenue raising policy. The decision by Western Australia to adjust its iron ore fines royalty rate discussed earlier and the resulting treatment in terms of the mining assessment is a recent example of the considerable and damaging policy neutrality issues related to the mining assessment.

In the Discussion Paper, Staff have sought states' views on the issue of non-neutrality and the incentives states face in relation to the assessment of mining revenue. Queensland considers that, given concerns regarding policy neutrality, the most appropriate course of action is to design a mining revenue assessment that achieves a more appropriate balance between policy neutrality and an assessment of fiscal capacity based on 'what states do'.

The Discussion Paper suggests two broad approaches to achieving this: mineral grouping, although not necessarily along the lines of that adopted in the 2010 Review; or a move to an 'external' standard for royalty rates.

Mineral grouping

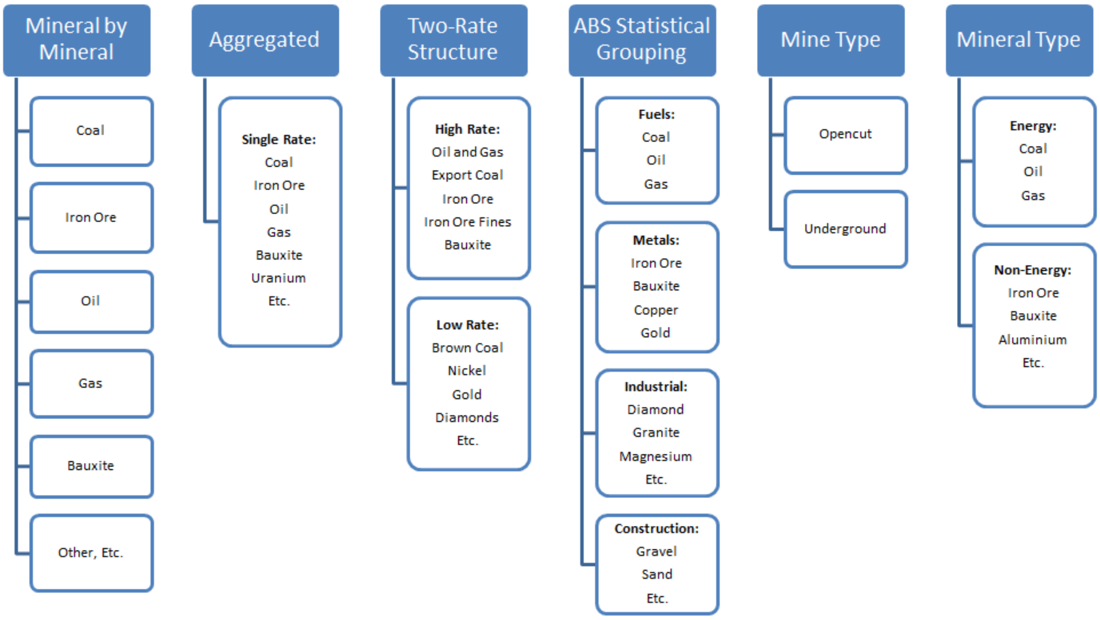
In considering the mining assessment and appropriate mineral groupings, Staff consider that "the main issue is finding an appropriate balance between fiscal capacity, what states collectively do and policy neutrality."

Recommendation 7.2 of the GST Distribution Review's final report recommended the Commission and states develop a new mining assessment that would "avoid excessively large GST share effects, such as when a commodity moves between groups under the current assessment". The 2015 Review Terms of Reference ask the Commission to have regard to recommendations of the GST Distribution Review when developing a new mining assessment.

Queensland believes a mining assessment based on a single aggregated minerals structure (refer Figure 1 for possible mineral groupings) would strike a more appropriate balance between fiscal capacity, 'what states do' and policy neutrality, as well as directly address

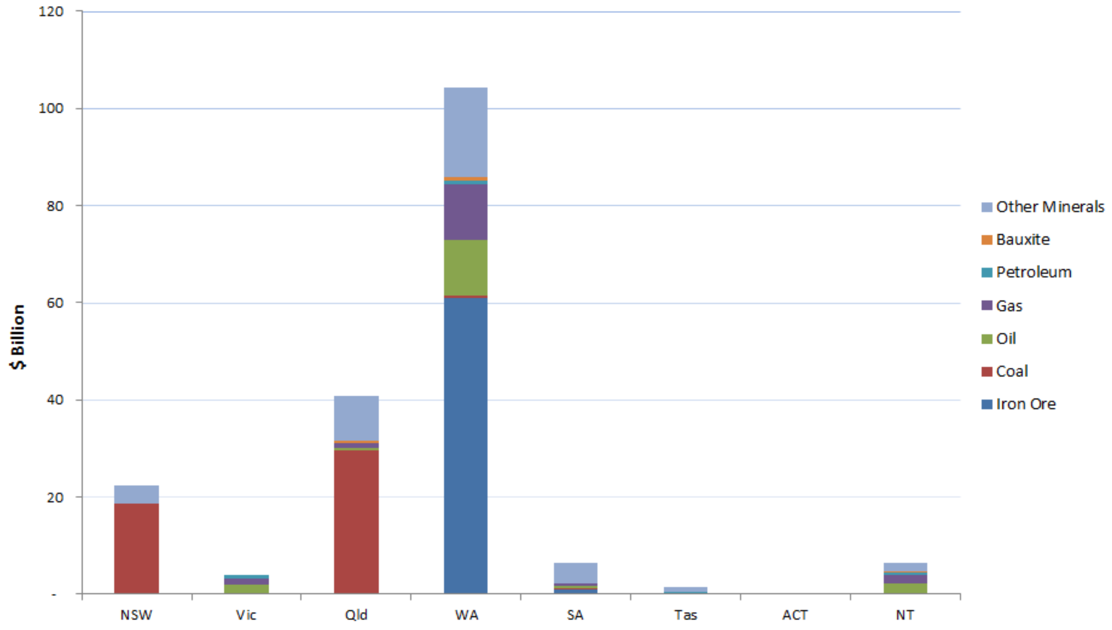
Recommendation 7.2. This approach would greatly enhance the policy neutrality of the assessment and reduce the potential for grant design inefficiencies while still assessing each state's relative capacity to raise revenue through mining royalties. It would also remove the potential for minerals to move between groups. Such an assessment would prove more resilient and adaptable in managing potential changes in royalty rates and broader mining industry developments that may occur between reviews.

Figure 1 – Possible Mineral Groupings



Past discussions of mineral groupings in the mining assessment have often involved references to a hypothetical mineral by mineral assessment as a baseline for comparison. The high degree of policy influence in a mineral by mineral grouping makes it unsuitable for use by the Commission, either as an assessment methodology or as a baseline for comparison. A mineral by mineral assessment essentially is a reflection of individual state policies for setting mineral royalty rates, given the concentration of particular minerals in individual states (Figure 2). A methodology that is designed to capture the policy neutral mining revenue capacities of states should not be expected to produce a result similar to that produced by the actual policies of individual states. This is not a benchmark that is considered in any other revenue assessment. Further, Queensland is concerned that using such a baseline to evaluate the efficacy of various mineral groupings could result in the arbitrary assignment of minerals to groupings to achieve a particular outcome. This would constitute a significant departure from 'what states do'.

Figure 2 – Mining Value of Production by State and Mineral



Source: Australian Bureau of Statistics, Mining Operations, Australia (Cat No: 8415.0)

Staff have suggested in the Discussion Paper that the Commission is likely to seek an assessment that achieves a balance between policy neutrality and assessing fiscal capacity based on 'what states do'. A mineral by mineral assessment would allow a state to take actions to directly influence its GST share and contravene the principle of policy neutrality. This would not achieve the balance between policy neutrality and assessing fiscal capacity that Staff deem appropriate. The more disaggregated the assessment structure, the more prone it becomes to policy neutrality issues and more frequent grant design issues given that certain mineral bases are dominated by one or two states. A disaggregated grouping such as that used by the Australia Bureau of Statistics in statistical releases would also be subject to this effect.

An actual per capita (APC) assessment has also been suggested by some states. APC assessments are usually employed when the policies of all states are assumed to be the same and any difference in revenue raising capacity would be solely the result of differences in state circumstances. The significant variations in state revenue policies and revenue raising efforts make such an assumption invalid. An APC assessment would be heavily influenced by individual state policies and therefore would not address policy neutrality concerns.

Other mineral groupings being considered include those based on mine type or a separate mineral classification such as hydrocarbons and non-hydrocarbons. Such groupings do not reflect the basis on which states levy royalties and would represent an entirely arbitrary basis on which to assess revenue. Groupings on these bases would represent a significant departure from assessing what states collectively do and the established framework for assessing revenues.

If an aggregated mining revenue assessment is rejected, it may be preferable to retain the current two-rate structure (with iron ore fines appropriately in the higher rate group) but address its shortcomings in dealing with cases where there are significant changes to royalty rates. At least the methodological shortcomings of a two rate mining assessment are well understood and the grouping has some relationship to 'what states do'.

If the two rate structure were to be retained, a remedial arrangement would be required to ensure the assessment structure addresses potential mobility of minerals between mineral groups rather than a reliance on terms of reference directives. It is conceivable that provisions in the methodology could be established to adequately address changing royalty rates between reviews and guarantee an outcome consistent with the overarching principles of equalisation. A discount to the assessment should be considered to further reduce the prevalence of policy neutrality concerns inherent in the assessment. Queensland considers that such a proposal would require considerable consultation with the states if a reliable and robust assessment is to be developed.

External standard

In addition to investigating other ways to deal with policy neutrality issues, Staff propose to consider the use of an 'external standard' for the mining revenue assessment. An external standard such as international royalty rates or historic Australian royalty rates would be used.

Queensland believes that adopting an external standard in the 2015 Review could result in numerous methodological issues because it would be a radical departure from current Australian equalisation practice. However, Queensland is interested in detailed information regarding the specific design and implementation of the 'external standard' currently under consideration, as it may be an avenue that could be explored further in a future review, when a sufficient amount of time would be available to give the proposal full consideration.

Even in a future review, the move to an 'external standard' would generally be considered a departure from the Commission's usual approach in assessing 'what states do', something that is acknowledged by Staff in the Discussion Paper. Queensland considers that significant justification would be required to depart from an assessment of state fiscal capacities based on 'what states do'.

Discount

The Discussion Paper suggests the Commission will consider whether a discount of the mining assessment is warranted following its determination of the assessment method to be used in the 2015 Review. Queensland considers there is strong justification for a discount of the mining assessment:

- Staff acknowledge that the current approach towards the mining assessment "will require the Commission to exercise a large degree of judgement" in reaching a final assessment methodology. In this context, it would be difficult to consider any resulting assessment as entirely reliable and robust. The use of discounts is both appropriate and necessary in situations where there is doubt about the reliability of the method chosen.

- If the Commission decides not to recognise mining related expenditure needs through the expenditure categories, a discount would be necessary. There is conceptual merit in recognising the direct link between expenditure to support the mining industry development and the increased fiscal capacity derived from the associated royalty revenues.

- A discount is the most simple and practical way of reducing any grant design effects of the final assessment method as well as any potential impact the equalisation process might have on the incentives states have in supporting mining industry development.

MINING RELATED EXPENDITURE (CHAPTER 22)

Queensland's position

- If a discount is not applied to the Mining Revenue assessment, mining related expenditure should be assessed collectively in the Other Expenses category using a broad indicator. This is the most practical way of assessing both the more easily and less easily measured components of mining related expenditure.
- Queensland is concerned that the category-by-category approach in the Discussion Paper:
  - requires a clean-slate approach to assessment methodologies, which is not possible in the 2015 Review timeframe;
  - does not properly allow for the recognition of less easily measured components of mining related expenditure; and
  - does not allow mining related expenditure to be fully assessed where there is a conceptual case but data issues make it difficult to develop an assessment methodology.
- If the Commission decides to assess mining related expenditure in individual categories, materiality of the assessments should be evaluated collectively, and the components of mining related needs that are difficult to measure should still be recognised. Mining related expenses in different categories should be assessed together under a broad indicator wherever possible.

Approach to recognising mining related expenditure needs

The Discussion Paper suggests the possible recognition of mining related expenditure and economic development expenses across a range of categories, including Services to Industry, Roads, Services to Communities and Infrastructure. While Queensland supports the Commission continuing to investigate options for individual category assessments, there are a number of general observations and specific concerns about using such an approach to assessing mining related expenditure. Queensland suggests an alternative approach that assesses mining related expenditure collectively in the Other Expenses category.

Issues with existing assessment factors

In many of the categories where it is proposed to include a mining related expenditure component, the existing assessment methodology does not appear to align well with the addition of a mining factor. The short timeframe for the 2015 Review, which makes a broad clean-slate approach impractical, means that the recognition of mining related disabilities may be restricted by the current methodology, for example:

- In the Services to Industry assessment, the option being considered uses the same indicators as the current assessment, with the weighting of the business development equal per capita (EPC) component and the differential factors based on a survey conducted during the 2010 Review. As discussed later in this section, mining related expenditure needs would not be measured effectively by the existing factors, and the weightings created in the 2010 Review are not reliable.

- The roads component of the Investment assessment is structured around the population growth disability. While an appropriate way of assessing most roads expenditure, this may not be an appropriate way of assessing mining related roads investment needs. A clean-slate approach to these assessments is required to ensure mining related expenditure needs are properly recognised, but this will not be possible due to the time limitations of the 2015 Review.

Recognition of the conceptual case in the absence of a reliable dataset

The category-by-category approach, that is, assessing mining related expenditure across a range of assessment categories, also does not allow for the recognition of disabilities that have a significant impact on mining states but do not fit easily into the current assessment framework. For example, the recognition of opportunity cost and risk associated with investment in mining related services and infrastructure are not recognised appropriately.

The development and regulation of mining in Queensland has proceeded as a partnership of industry and government, with government playing an important role in the provision of economic and social infrastructure. Some costs may be recovered by the government over time if they are directly industry related. However, there is a real opportunity cost for governments in undertaking the initial capital expenditure. Governments face budget constraints and spending on mining related infrastructure means less infrastructure spending in other areas, including social infrastructure such as hospitals and schools. The opportunity cost of this use of limited funds is a real cost to government and the community.

While the Discussion Paper suggests comparing the cost recovery horizons of different kinds of assets, this does not properly address the issue. Long average cost recovery horizons may exacerbate the opportunity cost of investing in mining related assets, but states that must provide infrastructure that is not required in other states still experience an additional opportunity cost, regardless of cost recovery timeframes. While there is an opportunity cost related to any kind of investment, only resource-rich states make these additional mining related investments and face the opportunity costs associated with them. The current framework does not allow for the recognition of these additional opportunity costs.

It is also difficult to see how a category-by-category approach will be able to recognise the impact of past investment on current revenue raising capacity. Under the approach suggested by the Commission, this would involve the measurement of above average effort or unrecognised need that was present under past methodologies. Difficulties with this approach are discussed in more detail later in this section, but the recognition of the impact of past policies is another instance of there being a strong conceptual case for an assessment which does not fit easily into the existing assessment framework.

In many instances, there is a strong conceptual case that mining industry development impacts on states' fiscal capacities, but little or no data is available on which to base an assessment. This includes the potential impact of inefficient capital utilisation. It is conceptually sound that fast-growing states bear a higher risk of inefficient capital utilisation, particularly for mining regions. The continuation of the mining boom is not guaranteed. World demand for Australian resources is dependent on a number of factors, including international economic conditions and the development of alternative producers.

Mining states must bear the risk that the assumptions on which infrastructure planning was based may fail to eventuate, leading to an over-allocation of resources to mining regions and a relatively higher level of inefficient capital utilisation. This effect would be exacerbated where infrastructure is provided on a pre-emptive basis in expectation of future growth. Western Australia has made the conceptual case for infrastructure being provided on a pre-emptive basis in previous submissions, and Queensland believes this issue should be taken into account in developing a methodology for recognising the impact of mining-related development on state fiscal capacities.

However, Queensland is not aware of a reliable dataset that would allow the effect of inefficient capital utilisation to be measured, and note that Staff have also not been able to identify a dataset. At the same time, it is clear that these costs and risks are linked to mining, and that their fundamental driver is the existence of a large mining industry. Queensland agrees that if service based economies face similar costs and risks in different ways, these should also be recognised. However, Queensland is not aware of any state having made a case for such a disability in an area other than mining.

Queensland's preferred approach

In circumstances where there is a strong conceptual case that mining states face costs not borne by other states, but these costs cannot be easily measured within the Commission's assessment framework or no reliable dataset is available to make an assessment, Queensland believes it is reasonable for a judgement-based assessment to be made of the size of the effect.

A judgement-based assessment would be more consistent with HFE than not making an assessment, noting that the Commission has used its judgement in the past to estimate the quantum of expenditure where reliable data was not available. For example, in the 2010 Review assessment of cultural and linguistic diversity (CALD), where the Commission believed there was a strong conceptual case but much of the data required was of limited reliability and quality, the Commission used judgement to determine an appropriate assessment.

In cases such as mining-related expenditure in the Services to Industry, Services to Communities or Roads assessments, reliable data for the size of the expenditure may be available, but states' relative needs may not be measured well by the factors in those categories or may not be considered to be material within individual categories.

Queensland considers that the most practical way of assessing both the more easily and less easily measured components of mining related expenditure is through aggregating all relevant expenditure and making an assessment under a broad indicator as part of the Other Expenses assessment. A combination of Government Finance Statistics (GFS) data and the data provided by states as part of the 2015 Review data requests could be used to measure the quantum of expenses, where these can be easily measured. The less easily measured component could be estimated using a method similar to that used for CALD in the 2010 Review.

<u>Options for a broad indicator</u>

A range of options exist for a broad indicator of the impact of the mining industry on state expenditure, including state shares of mining investment, the number of mining businesses and factor income from the mining sector. Queensland considers that the most appropriate choice is a measure of private sector investment in the mining industry. Such an indicator would ensure the policy neutrality of the assessment, and would recognise that state expenditure is likely to be concentrated in the investment phase of a mining development, in terms of regulation, administration and planning, business development, and supporting infrastructure. Data on private new capital expenditure for the mining industry is available from the Australian Bureau of Statistics (ABS) publication 5625.0, which includes reliable data on state shares of investment. Where data is not available in some years for Tasmania and the Northern Territory, the ABS data could be supplemented with data from the Bureau of Resources and Energy Economics on mining construction projects.

Materiality

At the very least, the materiality of assessing expenditure that is more easily measurable and identifiable from Government Finance Statistics (GFS) and state data requests should be examined collectively. This is consistent with general Commission practice to establish the materiality of a disability across state expenditure areas to recognise its overall effect on states. In this case, the underlying need for additional expenditure is the existence of a significant mining industry. While the Discussion Paper suggests that the expenditure could potentially be assessed using a variety of different indicators in different categories, it must be recognised that these factors have a common underlying driver.

Options discussed in the Staff Discussion Paper

The Discussion Paper takes the approach of investigating potential assessment methodologies for mining related expenditure in each individual category that may contain these expenditures. As described above, Queensland does not believe this will produce a methodology that fully recognises the needs of states with large mining industries. However, if the Commission decides to pursue this approach, Queensland's comments on the proposals for individual categories are below.

Assessment of direct mining related expenditure in individual assessment categories

<u>Services to Industry</u>

The Discussion Paper suggests that mining industry regulation, development and support expenses be assessed in the Services to Industry category. Based on currently available GFS data, the Discussion Paper analysis uses a figure of $531 million (or 8% of category expenses) as total state mining related expenditure in this category. Queensland considers that the 4-digit GPC data this estimate is based on does not include a large proportion of mining related expenditure that would appropriately be categorised as mining related expenditure in Services to Industry. For example, the 4-digit GPC data for Queensland records minimal expenditure from agencies that would be expected to incur significant expenditures in this area, including the Department of Natural Resources and Mines and the Department of Environment and Heritage Protection. As discussed in Queensland's response to the 2015 Review Terms of Reference, the cost of administration alone for the mining sector was $120 million in 2011-12. If 4-digit GPC data is to be used to identify mining related expenditure, further investigation is required to ensure that the data is reliable for all states.

The Discussion Paper suggests that recognition of mining related expenditure in Services to Industry would take the form of an adjustment to the current assessment, with regulation and business development expenditure from mining split from other industries and separately assessed. The indicators used in the assessment would be the same as those currently used (total factor income and the number of businesses), with the mining industry separately identified. Weightings for different indicators would be based on the results of the 2010 Review state survey for Services to Industry.

Queensland has some concerns with this approach:

- The results of the 2010 Review state survey are unreliable, as it sought state line agencies' opinions on whether their program expenses were mainly driven by the number of businesses or the overall amount of business activity. The quality of the information these judgements were based on and the comparability of state approaches to estimating their survey responses was not controlled in the survey. The opinions of agencies are not acceptable substitutes for a rigorous, data-based approach to calculating weightings for the drivers of expenditure. It is likely that the proportions of regulation and other expenditure will have changed in recent years due to red tape reduction efforts in many states, leading to changes from the weightings used in the 2010 Review.

- It is assumed that mining related expenses are driven by the same factors used to assess overall regulation needs in the 2010 Review. An alternative factor that should be included in this assessment is the level of investment. Similar to other mining related expenditure, it is reasonable to think that regulation expenditure would be more concentrated in the investment phase of mining development. However, Queensland recognises that it is likely that there will be insufficient time to thoroughly investigate, develop and consult with states regarding this issue in the 2015 Review.

- In the Discussion Paper, Staff indicate business development expenditure is to be assessed EPC, because there is no clear case for deciding that one state needs to spend more than another. In the 2010 Review, this decision was made because of difficulties defining the average policy or underlying drivers. However, in the case of mining business development expenditure, it is clear that only states with mineral resources would ever need to provide support to mining businesses in this way. If an assessment of mining related expenditure is to be made in the Services to Industry category, mining business development expenditure should not be EPC, but should be assessed differentially alongside regulation expenses.

If the Commission decides not to assess all mining related expenditure in the Other Expenses category, it may still be simpler to group the Services to Communities, Services to Industry and data collected as part of the Regulation and Administration expenses data request together, as they are likely to have similar drivers. All of these categories could then be assessed under a single broad indicator. As discussed earlier in this submission, Queensland believes a suitable broad indicator would be new mining investment.

Services to Communities

The Services to Communities category includes expenditure on community development and amenities, and an assessment in this category would examine the impact of a large mining industry on community development needs. As described in the section above, it may be simpler to group mining related Services to Communities expenses with expenses from some other categories, even if the Commission decides not to assess all mining related expenditure in the Other Expenses Category.

Queensland supports the assessment of mining related expenditure that is part of the Services to Communities category using new mining investment. This would appear to be a suitable broad indicator of the need to fund additional community amenities, as conceptually, mining sector investment is well-aligned with the need to develop mining communities. Population growth in relevant communities could also be used, as suggested in the Discussion Paper, but this is likely to only be a reliable indicator for the kinds of expenses in the Services to Communities category (and would not be a reliable indicator for areas populated predominately by fly-in/fly-out and drive-in/drive-out (FIFO/DIDO) workers)

The Services to Communities category also includes the additional expenditure incurred by states for environmental protection related to the mining industry. For example, there are currently over 15,000 abandoned mine sites across Queensland. The state government manages risk associated with abandoned mines, including rehabilitation and minimising environmental harm. An assessment of mining related expenditure in Services to Communities would also need to ensure that environmental expenses are recognised.

Regulation and administrative costs linked to major infrastructure projects

Queensland and other states are currently in the process of collecting data from agencies on regulation and administrative costs associated with major infrastructure projects. When the data collection process is complete, further comments on the practicality and reliability of identifying expenditure data in the GFS will be able to be provided.

The Discussion Paper suggests that the level of investment could possibly be used as the broad indicator of need for these expenses. Queensland supports further investigation of this indicator and suggests that the dataset in ABS publication 5625.0 could be used to make an assessment. The Commission could also consider smoothing the level of investment indicator over a number of years to limit the impact of annual fluctuations.

Roads

The Commission has issued a data request seeking information on the road network servicing economic centres, such as mines or ports, as many of these may not meet the current population threshold for inclusion in the rural road network. Such population centres could then be added to the rural road network, so that their associated maintenance costs can be recognised. Queensland supports this approach to assessing road maintenance expenses.

For roads investment, Queensland is concerned that it will be difficult to appropriately assess capital needs for economic development roads in the current Investment assessment. In the Infrastructure chapter of the Discussion Paper, it is suggested that the population growth factor is an appropriate assessment of roads investment needs if the main purpose of these is upgrading existing roads, but that the factor may be less appropriate if the main purpose is to build new roads. Queensland considers this to be a reasonable conclusion for roads connecting population centres, and notes that the purpose of the majority of roads investment in Queensland in recent years has been to upgrade existing roads.

However, this reasoning does not apply to roads investment that is driven by economic development, particularly for the mining industry where roads investment requirements are not strongly linked to population. Where the purpose of roads is to provide essential transport infrastructure to facilitate economic development, this will not be driven by population growth. Even if the purpose of roads investment is upgrading the quality of existing roads, the need for investment would not be driven by population growth, but is more likely to be driven by industry-related factors, such as the level of investment.

Queensland's direct expenditure on roads that service the mining industry is significant. Over the last few years, Queensland has spent around $460 million on the construction and improvement of roads and bridges that directly service the mining industry, both for the transport needs of the mines themselves and for the drive-in/drive-out workforce. These expenses are not cost recovered.

While Queensland supports assessing general roads investment using population growth, the population growth factor may not be relevant to economic development roads investment. As population growth forms the basis for the Investment assessment, the most practical alternative may be to separately identify economic development roads investment expenditure, or develop a reasonable estimate of it, and assess it separately from other roads capital expenditure. The practicality and reliability of such an approach needs to be investigated after data is provided from states on roads servicing economic centres.

Other Mining Related Expenditure

<u>FIFO/DIDO workers</u>

Queensland considers that there is a conceptual case for arguing that states with higher numbers of FIFO/DIDO workers incur additional expenditure and have additional pressure on their infrastructure. While the current assessments give states the capacity to provide services to each resident anywhere in the state, there would still be a fixed cost component of providing services that would be duplicated for areas populated predominately by FIFO/DIDO workers. This may be a particular issue for community services where the fixed cost of providing services to a particular area is high, such as electricity. Unfortunately, comprehensive data on these costs are not readily available.

Another issue is differences in the service use levels of FIFO/DIDO workers and the rest of the population. The Discussion Paper suggests that it is difficult to decide whether the overall cost of a FIFO/DIDO worker is higher than the rest of the population, as these workers may impose higher costs when off duty, but lower costs when on duty. While comprehensive data on differences in the use patterns of FIFO/DIDO workers and the rest of the population is not readily available, there is evidence suggesting that a higher FIFO/DIDO workforce would lead to a higher use of state services.

The inquiry into the use of FIFO/DIDO workforce practices in regional Australia, conducted by the House of Representatives Standing Committee on Regional Australia[6] detailed the negative social impacts of FIFO/DIDO arrangements on workers, including excessive alcohol and drug use, depression and violence amongst FIFO/DIDO workers. These negative social impacts are likely to lead to increased use of state-provided services, for example, police and justice services. The Discussion Paper did not identify what other factors affecting FIFO/DIDO workers may exist that would offset the higher service use expected from these

[6] *Cancer of the bush or salvation for our cities? Fly-in, fly-out and drive-in, drive-out workforce practices in Regional Australia*, House of Representatives Standing Committee on Regional Australia, February 2013.

influences. Queensland would appreciate any further information the Commission has on these offsetting factors.

The difficulty in measuring the impact of FIFO/DIDO workers on state services needs, despite the conceptual case, lends support for an aggregated assessment of mining related expenditure needs under a broader indicator in the Other Expenses assessment category. As described above, this is Queensland's preferred approach.

Recognising the impact of past and current state mining industry development policies on mining revenue bases

The development of mining in Queensland has proceeded as a partnership of industry and government, with government playing an important role in the provision of infrastructure and services to support the industry. State government contributions to industry development impacts on states' capacities to raise revenue from mining, and this should be recognised in the Commission's assessments.

The Discussion Paper discusses some of the difficulties with measuring the impact of state policies around mining industry development on states' mining revenue bases. At the November Staff conferences, a framework was outlined for identifying these costs, which involved:

1. Defining the average effort and identifying above average effort.
2. Estimating the effect of above average effort on the current revenue base.
3. Adjusting the current revenue base.

Queensland understands that this framework is designed as a step-by-step approach to solving this issue. The difficulty with using a framework that requires the definition of above average effort levels is that differences in states' effort are generally taken to be the remainder of differences in state expenses, once relative needs have been accounted for. In the case of past investment, where needs were not assessed, the only reasonable way of defining effort would seem to be to assume that all differences in state expenditure arose through differences in effort levels. Otherwise, there does not seem to be a way to apply the framework suggested without judgement. It is also likely that ascertaining the level of revenue that arose from this above average effort would also require a degree of judgement.

An alternative view is that mining investment represented average policy at the time for resources states, but relative needs were not assessed by past Commissions. It could be argued that this should not be accounted for because it is not general Commission practice to adjust the current distribution for gaps that may have existed in past assessments. However, the extent to which past investment represented above average effort or unrecognised need is difficult to measure reliably and is essentially a matter of opinion. This issue cannot be put aside on the basis that the investment was an issue for past Commissions when the revenue arising from these investments is still subject to assessment.

Once again, despite there being a conceptual case, it will be difficult to explicitly define the level of past unrecognised need or revenue derived from above average effort, and Queensland has so far been unable to do so. If a methodology for assessing the impact on the mining revenue base is not developed (and a discount is not applied to the mining revenue assessment), the impact of past policy should form part of a single aggregate allowance made in a broad assessment in the Other Expenses category.

TRANSPORT (CHAPTER 19)

Queensland's position

- The Transport Services assessment faces considerable conceptual, methodological and data related issues that merit a discount of at least 25 per cent to the assessment.

The current Transport Services category includes mainly state operating and capital subsidies to providers of transport services. It also includes departmental expenses. The category is dominated by urban public passenger transport subsidies.

The Commission's assessment covers the expenses directly incurred by the general government sector and subsidies to Public Non-Financial Corporations (PNFCs) and private providers.

The assessment consists of 3 components:

- The urban subsidies assessment is based on the proportion of the population living in urban centres, the size of those centres and what on average states pay to subsidise centres of different sizes. The 2010 Review concluded that large cities, such as Sydney and Melbourne, received a significantly higher per capita subsidy than smaller cities.

- The non-urban operating subsidies assessment is based on the proportion of state populations that live outside capital cities.

- Capital subsidies are assessed equal per capita (EPC).

For the 2015 Review, the Discussion Paper proposes leaving the structure of the Transport Services category largely unchanged, but to expand its scope to assess PNFC expenses directly rather than through general government subsidies.

Queensland considers there are significant issues with the current assessment of Transport Services. Given the limited timeframe for the 2015 Review, it may not be practical to overhaul the assessment at this time, but the methodology should be thoroughly revisited in a future review. However, due to the significant issues with the assessment outlined below, Queensland considers a discount is necessary at this time to address the unresolved conceptual, methodological and data-based issues with the assessment.

The conceptual case

The conceptual case for the assessment is not strong. As indicated in the literature review in the Discussion Paper, there is little consensus on the drivers of transport services expenses, and the Staff's test of a multivariate model found other variables, such as the presence of rail and the flatness of the geography in cities with rail, to be more statistically significant than population. The predicted value for Brisbane in the multivariate model is closer to the observed value than the predicted value of the current model, suggesting there may be multiple factors influencing transport services expenses not captured by the Staff's simple linear model.

Methodological issues

Aside from the uncertainty with the conceptual case, Queensland's Office of the Government Statistician has undertaken technical analysis of the current methodology and the transport services regression model using the data supplied and has identified numerous issues, including:

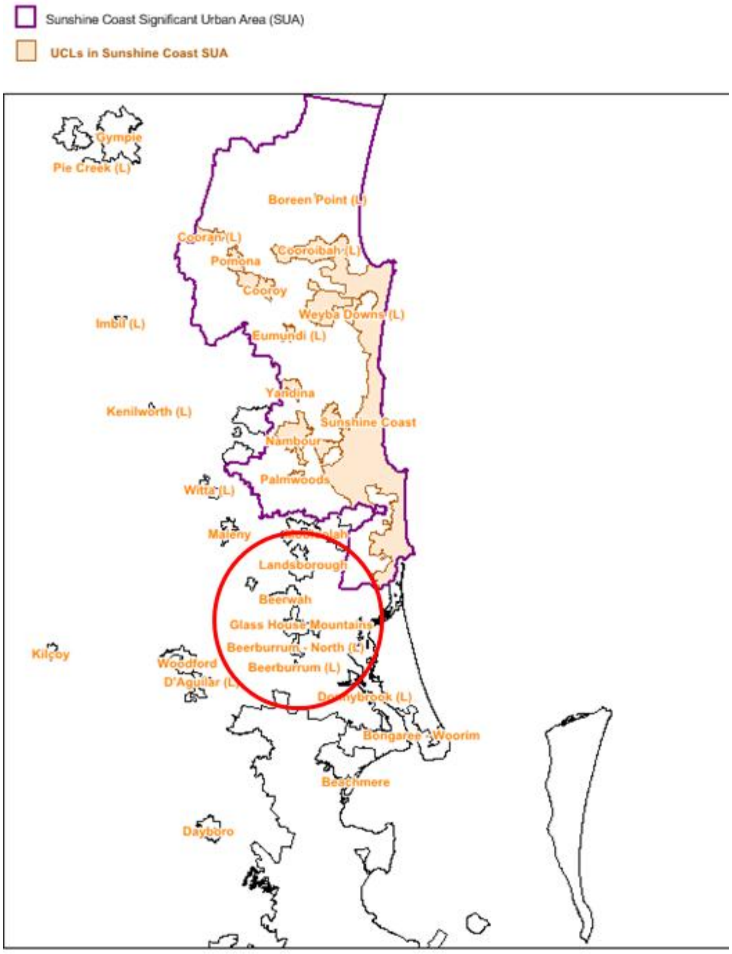
- data for the Gold Coast are not included in the model due to an error in the lookup array in the regression dataset spreadsheet;

- the regression uses non-rebased and recast estimated residential populations (ERPs) when revised data are available from the ABS. Using the recast ERPs results in two additional areas having populations of over 20,000 – Cessnock (NSW) and Ocean Grove-Pt Lonsdale (Vic); and

- the use of the ABS' Significant Urban Areas (SUA) for geographical areas fails to include important Urban Centre Localities (UCLs) where transport relationships exist. Some UCLs that have a transport relationship with Brisbane appear to have been excluded from population estimates due to the application of the SUA geography in the model. For example, a number of UCLs on the rail line between Brisbane and the Sunshine Coast such as Landsborough, Beerwah, Beerburrum and the Glasshouse Mountains have not been included in the population base because they do not fall into the Sunshine Coast SUA boundary.

Figure 3 shows the SUA of Sunshine Coast with the red circle overlay indicating the missing UCLs. The UCLs in this missing region alone include a population of approximately 20,000.

Figure 3 – Sunshine Coast UCLs missing from SUA

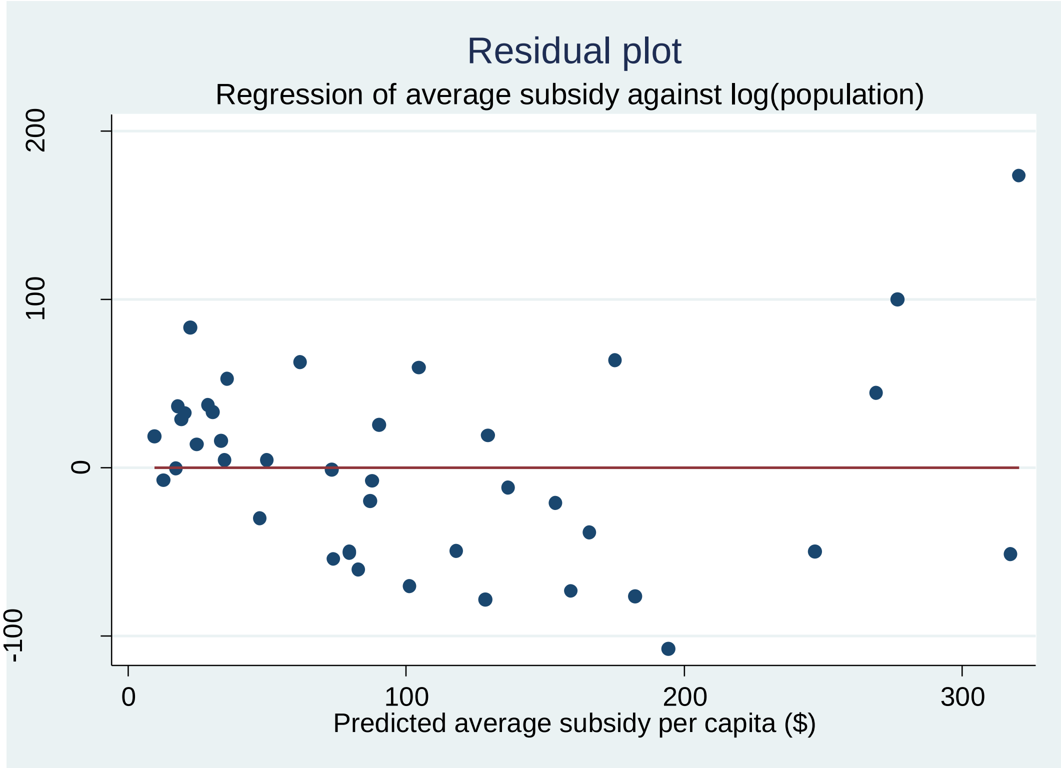


Source: Queensland Government Statistician analysis

The methodology used to construct the model is not statistically robust and gives very little information about the reliability and plausibility of the model. Important information such as residual distribution, influential data points and confidence limits around the predicted subsidies is missing.

The underlying assumption of a linear model is a linear relationship between the dependent and independent variables (average subsidy per capita and population respectively). Average subsidy per capita is not normally distributed, and while nonlinear transformation of the population data satisfies the linear relationship to some extent, an examination of the residuals shows that, while not extreme, some systematic errors are made by the model when predicting either very small or very large subsidies. Figure 4, a plot of residuals against predicted average subsidies, shows that while the residuals for subsidies between $100 and $200 per capita are randomly distributed around zero, those at the very lower and upper ranges are not.

Figure 4 – Plot of residuals against predicted subsidies



Source: CGC provided data, Queensland Government Statistician analysis

Relying on R^2 values alone to assess the model representativeness does not give any information about the fit and influence of individual points. Post estimation model testing shows that Sydney exerts a high amount of influence on the model and is a notable outlier. This suggests the assessment may not be policy neutral, as public transport expenses in Sydney have a relatively large influence on the outcome of the model. Further, testing indicates the four largest population centres exert considerable leverage on the model. The size of the residuals increases with population size – the model fit is poorer for high values. This implies that the model is least reliable for assessed expenditure for larger capital cities, which have the most impact on the redistribution from the assessment. Sensitivity testing however, shows that if modelling is restricted to non-Capital City areas (excluding 5 of the 41 points), the amount of variance accounted for by the model is in fact quite small (R^2 of 0.357). Further, examination of the 95 per cent confidence limits around the model coefficient for population indicates a high level of potential variability in outcomes.

The Government Statistician ran two variations of the model to further examine its sensitivity, comparing the aggregation of Brisbane, the Gold Coast and Sunshine Coast data before running the model versus aggregating the results. For comparability, these runs used the outdated ERP data as supplied. Pre-aggregating the regions results in a predicted subsidy $118 million higher than modelling the Brisbane, Gold Coast and Sunshine individually, as shown in Table 1 below. This demonstrates that minor changes to underlying assumptions result in significant changes to outcomes.

Table 1 – Impact of methodological assumptions on transport modelling

	Predicted subsidy $ per capita	Predicted subsidy $M
Brisbane	277	551
Gold Coast	194	97
Sunshine Coast	154	39
Combined South East Queensland	250	687
Pre-aggregated total	293	805
Difference	43	118

Source: CGC provided data, Queensland Government Statistician analysis

Even if there were no statistical issues with the regression and it is accepted that there is a correlation between population and transport services expense per capita, there is not enough of a supporting conceptual case to suggest that increased population is the primary cause of these expenses. Although a consultant found a correlation between expenses and population with the limited data available when the analysis was undertaken, Queensland considers the model's high sensitivity to small changes in assumptions and the absence in the model of factors other than population that have been found to be statistically significant indicate the assessment is not a robust assessment of the primary drivers of transport services expenses.

PNFC data

As part of the 2015 Review, the Commission has decided to expand the scope of fiscal equalisation and treat urban transport services, including those provided through PNFCs, as a general government function.

Queensland considers the use of PNFC data increases complexity with no corresponding increase in the reliability of the assessment and may actually reduce the reliability of the assessment. At least in Queensland, there are issues with PNFC data in accurately classifying expenses as urban or rural and comparing PNFC data across years. Other states likely face similar issues with PNFC data, and there are likely to be issues with the comparability of the data between states.

Discount to the assessment

Queensland acknowledges that there is insufficient time to develop a new Transport Services assessment for the 2015 Review, and the Commission may argue that the current assessment achieves a better HFE outcome than no assessment of transport services. However, given what Queensland believes are considerable conceptual, methodological and data driven issues with the assessment leading to uncertainty over the effect of the model, Queensland believes a discount to the assessment of at least 25 per cent is necessary.

Non-urban subsidies assessment

Western Australia has suggested the non-urban subsidy factor should be adjusted to recognise distance between population centres as a disability, arguing that compared to Victoria and Tasmania, it needed to cover a much larger area to service a similar level of population in remote areas, which prevented it from achieving economies of scale.

Queensland supports further investigation of a non-urban subsidies assessment to recognise distance between population centres, and considers that an existing measure of dispersion may be appropriate. The Discussion Paper suggests rural road length or the regional costs factor could be used. Queensland considers rural road length is a more appropriate measure than the regional costs factor, as roads are more directly related to the transport task.

TRANSPORT INFRASTRUCTURE (CHAPTER 20)

Queensland's position

- Queensland considers the same conceptual, methodological and data issues that apply to the Transport Services assessment apply to the proposed Transport Infrastructure assessment.
- Queensland supports the Commission continuing to treat Commonwealth payments for transport infrastructure as impacting the relativities where needs are assessed. If the Commonwealth and states agree that certain payments should not impact the relativities, this can be addressed though the terms of reference.

The 2015 Review Terms of Reference ask the Commission to have regard to the recommendations of the GST Distribution Review (October 2012) to:

> *develop a new transport infrastructure assessment. This should include, if appropriate, a framework to identify payments for nationally significant transport infrastructure projects which should affect the relativities only in part and options for providing that treatment* (Recommendation 6.1).

In the current assessment, most Commonwealth payments for roads construction have an impact on relativities, but the recognition of the national network roads needs in the Investment assessment means that only 50 per cent of payments for the construction of national network roads had an impact on the relativities. This approach reflects concerns that the state and local roads disabilities do not fully capture the national roads needs in each state.

In contrast, the need to hold differential amounts of most other transport infrastructure is not assessed, and no differential requirement to hold other transport infrastructure is recognised. Only changes due to population growth have an impact on the relativities. While some states may need to hold, say, more rail assets than the average, this only means that the composition of their financial wealth differed from the average.

Commonwealth payments for transport infrastructure other than roads, including payments for rail, are regarded as wealth transfers to the states and redistributed on an equal per capita (EPC) basis. Any payments which are not distributed to states on an EPC basis therefore impact on the relativities.

Staff interpret the 2015 Review Terms of Reference as requiring the development of an assessment of infrastructure expenditure relating to roads provided by the general government sector and other transport services which are provided by subsidised Public Non-Financial Corporations (PNFCs).

Proposed new urban Transport Investment assessment

The Discussion Paper proposes to develop an urban Transport Investment assessment in much the same way as the Roads Investment assessment. It would be included in the overall Investment assessment and have the same three types of disabilities assessed, that is:

- population growth;
- quantity of stock disabilities; and
- cost disabilities.

For population growth and cost disabilities, Staff propose to use the methods used in the Investment assessment.

For the quantity of stock disabilities, the preference of Staff is to assess transport infrastructure specific use disabilities, using a similar approach to that currently used for the urban operating subsidies. The Discussion Paper proposes an assessment of transport investment based on a factor derived from the relationship between the value of public transport assets and city size.

Queensland's concerns with the Transport Services assessment discussed in the previous section relate to the approach proposed for an urban transport investment assessment. Queensland considers there is considerable uncertainty over the drivers of transport expenses in the conceptual case, and numerous issues with the model used in the methodology. The methodology used to construct the model is not statistically robust and gives very little information about the reliability and plausibility of the model, and is missing information such as influential data points and confidence limits around the predicted values.

Although the relationship between public transport assets and capital city size is stronger than the observed relationship for urban operating subsidies, the model relies on even fewer data points to derive the trend. The Investment assessment can be sensitive to fluctuations in capital stock disabilities between years. Given Queensland's concerns with the comparability and reliability of PNFC data across years, the Commission must ensure the use of this data does not adversely affect the reliability of the assessment. If the proposed public transport assets model is to be used to calculate the quantity of stock disability, it should similarly be discounted by at least 25 per cent.

Appropriate treatment of Commonwealth transport infrastructure payments

The 2015 Review Terms of Reference ask the Commission to consider the development of a framework to identify payments for nationally significant transport infrastructure projects which should affect the relativities only in part and options for providing that treatment.

In the Discussion Paper, the proposed assessment of the investment and depreciation needs of urban transport PNFCs will now mean that GST will be reallocated to allow states to purchase differential per capita quantities of urban transport infrastructure, including rail. It is suggested when this approach comes into effect the GST distribution will capture a large part of the needs states experience in providing urban transit infrastructure investment. Queensland supports treating transport infrastructure payments so that they impact the relativities where the Commission is able to fully assess state needs.

The Commission currently applies a special needs assessment for 50 per cent of the spending relating to the National Network of Roads (NNR) payment because the other disability factors did not fully recognise state NNR needs. The effect of this assessment is that 50 per cent of the payment has no impact on the relativities. Queensland considers this is appropriate in the case of NNR payments because they are easily identifiable and can be consistently treated. However, if there are other transport infrastructure payments where needs may not be assessed, they may be more open to interpretation as to their purpose and national significance.

Staff propose their preferred approach for Commonwealth payments where needs are not assessed is for the payment or a part of it to not impact on the relativities. If for particular reasons not relating to HFE, the Commonwealth and the states jointly agree that certain payments should not impact on the relativities, then these could be specified in Commission terms of reference.

Queensland supports the Commission's preferred approach and considers that decisions on whether certain infrastructure payments should not impact on relativities are better made through agreements between governments outside of the CGC process, given the difficulties in developing a consistent framework to apply to these payments and designating projects of national significance.

INTERSTATE WAGES (CHAPTER 28)

Queensland's position

- The discount to the assessment should be increased from 12.5 per cent to 50 per cent due to the increasing unreliability of the assessment.
- Relative capital city wages are not an appropriate measure of the drivers of interstate wages and should not be adopted as the basis for the assessment.

The current Interstate Wages assessment uses private sector wages as a measure of interstate differences in the pressures on public sector wage levels. The Commission's assumption is based on "the theory that private sector wage levels are freely determined by market driven influences and that public sector wages face these same pressures"[7]. Private sector employers pay different wages for comparable employees in different states due to differences in cost of living, the attractiveness or otherwise of the location, or competition for labour. The Discussion Paper suggests that, as private sector wages are largely beyond the control of state governments, differences in private sector wage levels can be used as a policy neutral measure of public sector wage differences.

Queensland considers the current methodology for the Interstate Wages assessment is not a reliable measure of the drivers of wage pressures for state public sector labour markets. Queensland believes a more thorough and fundamental analysis should be undertaken of the validity of the assessment and, until this is done, does not support making changes to the assessment in the short timeframe of the 2015 Review.

The conceptual case for the use of average private sector wage differentials between states is not strong and the supporting evidence for the conceptual case is statistically flawed. The assessment has a large impact on the GST redistribution despite being overly reliant on the assumption that relative private sector wages are a reliable proxy for wage pressures faced by states to link the conceptual case to the weak relationship shown by the data. While earlier years of the dataset used in the model suggested the possibility of some correlation between private sector wages and public sector wages, the relationship has deteriorated to the point where it is almost non-existent.

While the drivers of private sector markets may have some influence on public sector wage settings, there is little certainty that relative private sector wages are a reliable proxy. Coupled with the conceptual and methodological issues, the ABS 2009 Survey of Education and Training (SET) dataset on which the current methodology is based has become increasingly outdated.

Staff have suggested the ABS will release a Characteristics of Employees (COE) dataset that will allow the model to be updated with new data. However, the data will not be available until the 2016 Update. Before this data is available, the Discussion Paper proposes to narrow the current assessment to model differences in private sector wages in state capital cities only. This is based primarily on the introduction of further assumptions about how public sector wages are set, and will further increase the redistribution of GST by the assessment. These changes are proposed without supporting evidence that they form a more reliable and robust assessment of interstate wages.

Queensland considers it inappropriate to make changes that build on the current assessment and carry a large distributional impact without addressing the underlying issues of the assessment. This should wait until the new dataset is available and a more reliable assessment can be developed in a full review. Until this time, the discount to the assessment should be increased from the current low level of 12.5 per cent to 50 per cent.

[7] Staff Proposed Assessments Discussion Paper, page 236, paragraph 43.

The issues with the current and proposed assessment are outlined in the following sections, and include:

- the conceptual case relies on the demonstration of a significant statistical relationship between private sector and public sector wages. This relationship no longer exists;
- justification for the proposed change to a capital city wages model relies on unconvincing assumptions; and
- the dataset used in the model is now five years old, significantly impacting the reliability of the assessment.

Private sector wages as a proxy

The relationship between public and private sector wages observed in the Commission's model has weakened significantly. When the current Interstate Wages assessment was established in the 2010 Review, 2005 was the latest SET dataset available. The Commission found a relationship between public and private wage levels with a goodness of fit (R^2) of 0.6049. An updated version of SET was released in 2010 based on 2009 data and incorporated into the methodology in the 2011 Update. However, the 2009 data only showed a relationship with an R^2 of 0.1393, which is not a statistically significant relationship.

The highly competitive labour market that existed in Australia before the Global Financial Crisis (GFC) may have resulted in public wage setting in a particular state being more strongly influenced by local private sector wage levels (and their drivers) and public sector wage levels in other states. That said, government policy has always been an important factor in setting public sector wages.

A case study of the remuneration of Queensland Health workforce, discusses in Box 2, supports the notion of a national labour market and highlights the importance of policy choice, as well as other factors such as employee conditions and entitlements, as the primary drivers of public sector wage setting. Prior to 2005, the perception that Queensland health staff were paid less than other states was a strong motivation for increasing Queensland wages relative to other states for the next several years.

Box 2 – Case Study: Remuneration of Queensland Health Workforce

The September 2005 independent *Queensland Health Systems Review Final Report* discussed the issue of remuneration and entitlements of clinical staff. The Report found that[8]:

- "Clinical staff identified a range of issues impacting on retention. This included a perception that Queensland clinical staff earn less than their interstate counterparts. However, non-salary issues were clearly presented as being more significant in determining whether to remain in the public sector. .. Broadly, clinicians reported feeling undervalued and marginalised from a system with unmanageable workloads, lack of management support, lack of clinical input into decision making including budget allocations, insufficient time for teaching, research and professional development, budget constraints impacting on quality of clinical care, limited opportunities to develop collegiate networks within and across professional groups and poor organisational culture.
- "Remuneration and entitlements are determined through whole of government enterprise bargaining processes. Often enterprise negotiations are escalated to the highest levels in government, thus diminishing the worth of the enterprise concept. Such arrangements leave very limited discretion within Queensland Health and at the district level to negotiate individual employment arrangements. To some extent, standardised entitlements are helpful in that they contain uncontrolled escalation of salary costs through competition between districts.
- "It is important for remuneration and entitlements to be fair and just and competitive with other states to position Queensland Health as an attractive employer. This is not presently the case."

In response to recommendations in this report, the Queensland Government announced a health action plan in October 2005, including a commitment to 'improve recruitment, retention and training and to suitably reward and recognise our staff, $633 million is provided over the period 2008-09 for enterprise bargaining agreement with Queensland Health medical officers and $100 million for Visiting Medical Officers. Funds have also been allocated for an initial four per cent wage increase for nurses and other staff.'[9]

Queensland adopted a policy of moving wages towards the national average wage during a period of relatively favourable fiscal conditions. Since the GFC, general labour market conditions have weakened as a constraint on government wages policy and deteriorating fiscal circumstances have required governments to impose greater discipline on employee expenses growth. In Queensland's case, the current Government adopted, and is achieving, its 2012 election commitment of a 3% employee expenses growth target.

The Queensland Public Service Commission explains a reduction in the Government's wage settlement offer in terms of fiscal capacity rather than labour market response:

> *Queensland's fiscal circumstances required the government to formulate a fiscal strategy and an associated wages policy for the Queensland public sector to ensure restraint is exercised over employment expenditure. Government regularly reviews this wages policy to account*

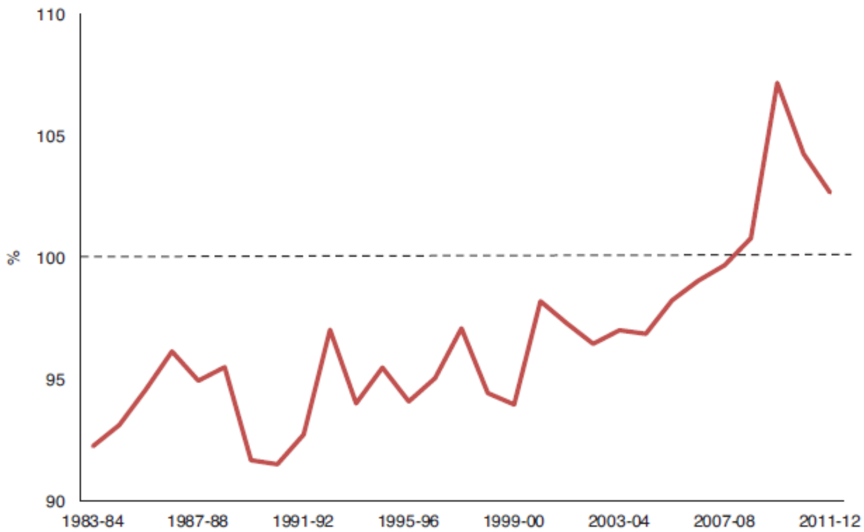
[8] http://www.hqcc.qld.gov.au/About-Us/Documents/Report%20-%20Queensland%20Health%20Services%20Review%20-%20Forster%20-%20Final%20-%20September%202005.pdf

[9] http://www.budget.qld.gov.au/budget-papers/2005-06/health-action-plan.pdf

for changes to the state's fiscal circumstances. Following a review in February 2013, government's wages policy was reduced to 2.2 per cent per annum.[10]

Growth in Queensland public sector wage levels has risen and fallen relative to other states, as shown in Figure 5, in line with the changing influence of labour market factors, the need for fiscal restraint and policy choice.

Figure 5 - Queensland public sector wages relative to the average



Source: ABS 6248.0, 5206; and Queensland Commission of Audit

The discussion above demonstrates the complexity of public sector wage determination and the potential for private sector wage factors to be of varying importance as a driver. The falling R^2 in the statistical relationship between private and public sector wages may simply be direct evidence of a weakening in the actual relationship as other factors have grown in importance. The degree of need for fiscal constraint and governments' policy decisions to respond to that need may now be a more significant factor than private sector wage factors.

Statistical analysis

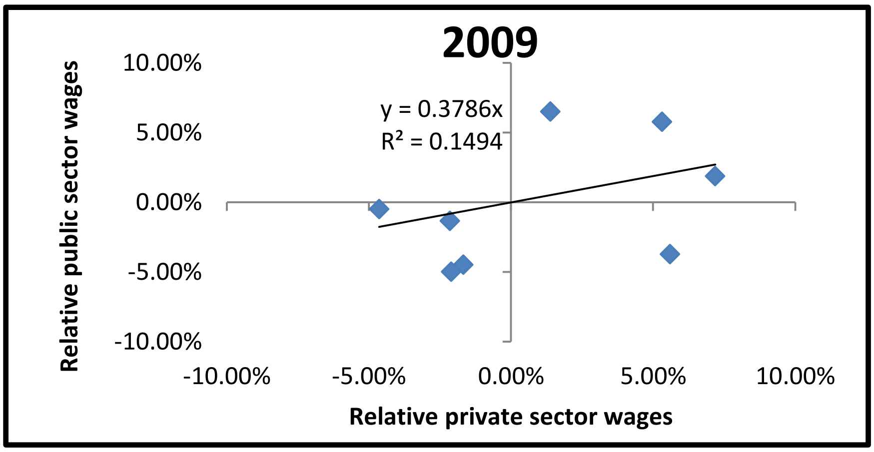
Queensland's Government Statistician has undertaken a technical analysis of the SET data modelling and considers the Staff's analysis overstates the measured goodness of fit because it ignores the significant measurement error associated with both the private sector and public sector relativities. The relativities are survey estimates which each carry a standard error and level of uncertainty. If these were factored in, the measured goodness of fit would be much smaller than those presented in the Discussion Paper. The Government Statistician considers the SET data provide only weak support for the assumption that there is a positive correlation between private and public sector wages.

[10] http://www.psc.qld.gov.au/publications/awards-and-agreements /state-gov-dept-certified-agreement-2013/faqs.aspx

Staff considered two explanations for the weakening of the relationship between private and public sector wages, including a lag in the responsiveness of public sector wage setting, primarily in Western Australia, and whether there has been a move towards a national labour market. Staff argue Western Australia has made a policy choice to exercise greater wage restraint than average, and when Western Australia is removed from the model the variance also decreases. Staff suggest Western Australia's public sector wages are gradually increasing towards parity with the private sector, and imply this indicates the relationship between private and public sector wages will strengthen again over time.

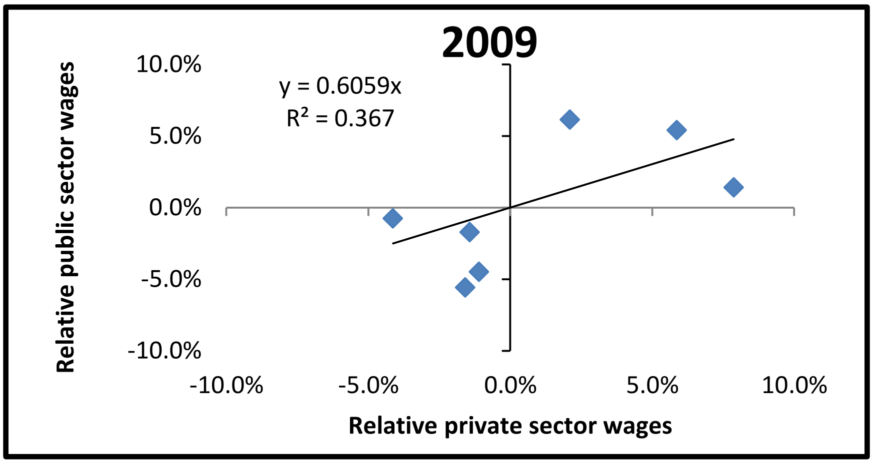
Queensland Government Statistician analysis indicates that Western Australia in the 2009 SET data is clearly an outlier with respect to the distribution of state and territory pairs for previous SET datasets. However, even with Western Australia removed from the plot, the slope of the fitted line and the R^2 value (unadjusted for measurement error) are much lower than those for the previous iterations of SET, with a slope of 0.60 and an R^2 of 0.37 as shown in Figures 6 and 7.

Figure 6: Relative Private and Public sector wages, 2009 SET (WA included)



Source: CGC provided data, Queensland Government Statistician analysis

Figure 7: Relative Private and Public sector wages, 2009 SET (WA excluded)



Source: CGC provided data, Queensland Government Statistician analysis

Queensland considers that the Discussion Paper analysis relies on numerous assumptions and guesswork. It is an assumption that Western Australia has exercised wage restraint as a policy choice and the Staff wages model will return to a strong statistical relationship following a lag. As discussed earlier, there is no reason to expect this to occur, as it will involve a policy choice at a time when policy priorities such as the need for fiscal restraint may predominate.

Capital city wages

Staff have proposed to base the interstate wage model on capital city wages rather than whole of state wages for the 2015 Review. The justification for this change is that they have found, at least for some parts of the public sector, states set wages through the negotiation of state-wide agreements. Staff argue their analysis of SET results is consistent with this finding. It is suggested this is not consistent with the current wages assessment and an assessment based on capital city wages better reflects state wide wage setting.

While states do negotiate state wide agreements for some parts of the public sector, the analysis in the Discussion Paper relies on a series of assumptions to support the argument that capital city wages are a better proxy for interstate wages.

Staff argue that states set wages at a level at which they can recruit and retain staff in most locations, and refer to a discussion with Centrelink regarding the relocation of a national call centre from Western Australia to Tasmania that did not lower its wage position but made it easier to fill positions. Staff argue that 'In order to recruit and retain staff in most areas Centrelink presumably sets a wage at, or close to, that of the highest wage region. This presumes states follow a similar process to determine and maintain state-wide wages.'

The Discussion Paper suggests there are significant differences in private sector wages between capital cities and the rest of the state, with private sector wages higher in capital cities, while public sector wages are more homogenous based on 2009 SET data. Presuming states set wages close to that of the highest region, Staff argue that if New South Wales set wages at one per cent above the national average (New South Wales' average difference from the national average) it would not be able to compete for staff in the Sydney labour market where private sector wages are four per cent above the national average. Therefore, private sector capital city wages are a more appropriate measure of interstate wage differences.

While states may pay one wage rate for teachers or nurses across the whole state, Queensland considers there is no supporting evidence to suggest that this wage rate is based on private sector wage levels in the capital city. There are numerous factors influencing this wage setting, such as the fiscal environment in the state, the strength of parties involved in enterprise bargaining and wage levels for similar positions in other states. To assume that a single factor – private sector capital city wages – is the primary determinant of public sector wage setting with no evidence does not seem to justify such a significant change to the methodology. The earlier discussion on the factors driving public sector wage setting in Queensland demonstrates the complexity of public sector wage determination.

A case study of teacher wage setting, discussed in Box 3, shows little support for the assumptions in the Discussion Paper. While states do set teacher wages in state-wide agreements, these agreements consider a range of factors affecting teacher pay and conditions throughout the state, with no consideration of the 'highest wage region'. Although Queensland does consider the need to fill positions, it considers measures necessary to encourage staff to fill less desirable regional and remote positions rather than those in Brisbane. Queensland considers the leap in logic from state-wide wage setting to capital city wages being a better measure of public sector wage setting to be little more than judgement. With around half of Queensland's government schools located in rural and remote areas, it could equally be assumed that the need to fill these less desirable positions impacts on teacher wages across the whole state in state-wide agreements.

Box 3 – Teacher Wage Setting

Queensland's experience with wage setting for teaching positions suggests Queensland faces very little pressure from private market forces in setting the state-wide teacher wage, and in particular, very little influence from capital city private sector wages:

- Queensland employs around 40,000 full-time equivalent teachers, around two thirds of the teachers employed in Queensland. Teachers account for around 20 per cent of Queensland's total workforce.
- There is no evidence of a shortage in the supply of teachers. Teaching positions in Brisbane are consistently filled, and Queensland actively applies a number of measures to encourage teachers to work in more remote locations. Graduates earn points towards desirable city positions through regional placements.
- Over 50 per cent of Queensland schools are located outside of metropolitan areas.
- Enterprise bargaining negotiations in recent years have typically focused on issues such as employment conditions and policy issues rather than considerations of labour market forces. Negotiations for the 2012 enterprise bargaining agreement focused on teacher progression, beginning teacher issues, workload, and the impact of moving Year 7 from primary to high schools.

These factors suggest Queensland has a significant level of monopsonistic power over teacher wages. Labour market forces, including the private labour market, have little meaningful influence on teacher pay. As the state government employs the majority of teachers and does not face difficulty in filling positions, there is little salary competition between the private market and the public sector for staff.

At least in Queensland, the need to encourage teachers to work in regional areas, particularly with over half of state schools located outside of metropolitan areas, contradicts the Staff assumption that states must set wages at the capital city rate in order to fill positions across the state. Due to workforce preferences and the large supply of teaching graduates, Queensland has implemented policies such as the Remote Area Incentives Scheme (RAIS) because there are too few positions available in cities compared to the number of graduates seeking these positions. The RAIS provides special compensation, incentive and leave benefits to teachers in remote areas.

Queensland considers in the case of teachers, and likely in many other sectors of the public sector workforce, the primary drivers of wage setting are policy choice and budgetary concerns, with very little influence of private sector wages, particularly capital city wages. More evidence is necessary before Queensland considers capital city private sector wages to be a reasonable proxy of interstate wages.

Queensland considers the analysis in the Discussion Paper has made no real link between the anecdote of the relocation of an Australian Government call centre and the presumption that states set wages close to that of the highest wage region. The Interstate Wages assessment uses private sector wages as a proxy for factors affecting public sector wages outside of policy choice, rather than an attempt to assess 'what states do' in practice. The Commission is making an assumption that it is average policy for states to set wages close to that of the highest region, without evidence this is the case. Building this assumption in to the assessment methodology is inherently contradictory to the conceptual case for the Interstate Wages assessment.

The use of capital city wages in this way inherently implies that all employees outside of capital cities are overpaid and without state-wide wage setting they would be paid significantly less. It is highly unlikely that a state government would accept this is the case.

State specific regional wage loadings

As part of the discussion of capital city wages in the Discussion Paper, it is acknowledged that some states must pay regional loadings to public sector employees outside of capital cities. Queensland provides regional loadings through policies such as the Remote Area Incentive Scheme discussed in Box 3. Staff propose that a state specific regional loading be assessed for states with high regional wages based on the difference between the rest of state private sector wage level and the capital city private sector wage level. The proposed regional cost gradient provides some benefit to Western Australia, but redistributes GST from other states that also provide regional loadings. This contradicts the purpose of including a regional cost gradient, and does not address the significant flaws in the proposal to move to a capital city wages assessment discussed in the previous section.

2. OTHER PRIORITY ISSUES

INFRASTRUCTURE (CHAPTER 24)

Queensland's position

- Queensland supports:
  - retaining the population growth factor used in the current methodology;
  - applying recurrent disabilities to the Investment assessment unless they do not appear well-linked to capital requirements but retaining the low level discount;
  - applying the general location disabilities and disabilities derived from the Commission's consultant report to the Investment assessment; and
  - combining recurrent disabilities using the average proportion of infrastructure stock by purpose, but only if the data are shown to be reliable.

The infrastructure assessments allow for the impact on state fiscal capacities of the infrastructure (buildings, equipment) states need to provide services. The infrastructure assessments are:

- the Investment assessment, which allows for the impact on fiscal capacities of the need to acquire extra infrastructure each year; and
- the Depreciation assessment, which allows for the impact on state fiscal capacities of the existing infrastructure used each year.

Investment

A state's assessed investment is the amount it would need to spend if it is to finish the year with the average per capita stock of infrastructure, adjusted for its disabilities, assuming it started the year in a similar position.

The assessment allows for the effects of:

- the state's population growth on the quantity of infrastructure it requires to provide the average services;
- changes over the year in demographic and other factors affecting the per capita quantity of infrastructure a state requires to provide average services; and
- interstate differences in the costs per unit of infrastructure.

The introduction of the current direct assessment of Investment was a major methodological improvement of the 2010 Review. Queensland supports the recommendation in the Discussion Paper to continue to use the existing methods to recognise that population growth affects state needs for infrastructure. The current methodology recognises that states require comparable per capita stocks of physical assets to have the same capacity to provide services. For a state with a high population growth to maintain the average level of service provision and infrastructure per capita, it will require additional capital funding.

Queensland considers the current direct method of assessing capital requirements identifies the demands that rapid population growth places on states and the need for infrastructure investment to keep pace with population growth. Queensland supports the current direct assessment as it appropriately delivers funding in a timely and contemporaneous manner that provides states with funding when it is most needed, namely when non-replacement or new capital has to be physically built or purchased. Equalisation is best achieved by providing states that have above average capital needs with funding at the time that capital costs are incurred. This direct assessment methodology best reflects ‘what states do’.

Use of recurrent disabilities

The current methodology applies the disabilities of the recurrent expenditure assessments to the capital assessment, to estimate state differences in the per capita stock of infrastructure required to provide services. A low level discount (12.5 per cent) is applied to recognise that not all recurrent disabilities may fully apply to infrastructure requirements. The Discussion Paper suggests continuing to use recurrent disabilities, but to remove disabilities that do not appear to be well linked to capital requirements.

Queensland supports the continued use of recurrent disabilities to estimate differences in infrastructure requirements. In most cases there is a clear conceptual link between the recurrent disabilities and the capital required to provide services. For example, states with populations that have higher use rates for services will require additional infrastructure to support these services, as well as incur additional recurrent costs. It is also far simpler to apply the same disabilities to recurrent and capital expenditure than to calculate separate capital disabilities.

Queensland also supports removing recurrent disabilities from the Investment assessment where there is no clear conceptual link between the disability and infrastructure requirements. The Discussion Paper lists disabilities where the link to infrastructure may be limited (Table 24-2), and most of the conclusions in this table appear to be reasonable. One possible exception is the Indigenous and low socio-economic status (SES) cost weights in the Schools and Post-Secondary Education assessments. A potential cause of higher costs for particular groups of students is smaller class sizes, which would in turn affect infrastructure requirements. Further investigation is required to determine whether these disabilities may impact on infrastructure as well as recurrent expenditure.

The Discussion Paper also suggests that removal of disabilities that are not well linked to capital requirements could mean that the low level discount is no longer required. Queensland supports retaining the low level discount. While there is a good conceptual link between most of the recurrent disabilities and capital requirements, the magnitude of the impact on states’ requirements is still based on recurrent expenditure rather than capital. Even after some disabilities are removed, there is still sufficient uncertainty in the application of recurrent disabilities to the capital assessment to warrant a low level discount.

Capital specific disabilities

The Discussion Paper outlines a number of possible factors that could potentially be included in the assessment to measure capital specific cost disabilities. These included a capital city cost index, such as the cost indices calculated by Rawlinsons, and a physical environment factor based on a 2013 consultancy report.

From the different factors raised in the Discussion Paper, Queensland considers that there are two options that would account for relevant factors affecting the cost of new produced assets and not involve double counting of these factors:

1. combine the general location factors used in the Commission's methodology with a factor derived from the consultant's physical environment report; or
2. combine the interstate Rawlinson's index with the regional weightings from the same publication.

Both options would encompass the same kinds of influences. The first option would recognise the impact of wages, regional location and the physical environment on infrastructure costs. In the second option, Rawlinson's interstate index would allow for the impact of wages differences and potentially some environmental factors on the cost of assets, but would need to be combined with the Rawlinson's regional weights to ensure that the cost of new produced assets is fully recognised in areas other than the capital city, and that measures of regional impacts and interstate impacts are consistent with each other. Otherwise the cost factor could significantly underestimate the cost of providing infrastructure in regional or remote areas.

Queensland's preference is to recognise wages and regional location influences using the recurrent location factors, and to recognise the impact of the physical environment using the consultant's report. This appears to be a better alternative for the following reasons:

- The Rawlinsons index does not focus on the kinds of infrastructure that make up the majority of states' produced assets. Rawlinsons compiles data on the relative construction costs for a range of different buildings, including state government-type assets such as educational or health facilities, but also including banks, hotels, industrial, residential and retail buildings. Queensland notes that the relative state costs indices vary significantly for different types of asset and does not consider that a general Rawlinsons index will be a reliable measure of relative state costs. A more fit-for-purpose index could possibly be created from Rawlinsons data by weighting the relative costs of state government type assets by the average proportion of different types of assets in states' stocks, but this would be complex and it is unclear if the necessary data would be available to create such an index.

- It is important that the Infrastructure assessment continues to recognise the impact of regional costs, and that this be done in a consistent way. If Rawlinsons factors are adopted for capital cities, the assessment should also use their regional cost factors. This may require some judgement as regional cost factors are not available for every location. It is unclear whether these can be reliably combined to produce a general remoteness factor that can be applied to all areas. It also seems likely that they reflect influences other than remoteness, such as the physical environment in different regions. The Commission's general regional location factors are preferable, as they are available for every location and will not require the use of judgement.

- The physical environment consultancy report was specifically developed to support a Commission assessment of state government infrastructure investment. While some physical environment considerations may be incorporated in the Rawlinsons index, the consultant's approach is likely to be more fit-for-purpose.

- The potential for policy influence in the Rawlinsons data is concerning. Different building standards and approval processes may add significantly different levels of costs to construction. The Rawlinsons index is not designed to be a policy neutral measure of the underlying costs to states. It is designed to give an indication of the actual cost differentials of construction in states, which reduces its suitability for use in a Commission assessment.

The inclusion of capital specific disabilities, especially if Rawlinson's cost indices are used, will require significantly more analysis by the Commission before their use could be shown to constitute a definitive improvement, and not merely additional complexity, to an assessment that is already working well. It is suggested that this may not be a good use of the Commission's time, given the higher priorities it has in the short time for the Review. If the Commission wishes to pursue this issue, it may be better to defer its consideration for a future review when the issues can be more thoroughly examined.

Combining recurrent disabilities

The Discussion Paper suggests combining recurrent disabilities using the average proportion of infrastructure stock dissected by purpose. Queensland considers this proposal to be reasonable, provided states are able to provide reliable data on the stock of infrastructure by purpose. Some states were not able to provide this data in the 2010 Review.

Roads investment

For rural roads investment not related to economic development needs, Queensland supports continuing to base the assessment on population growth. The majority of Queensland's investment in recent years has been to upgrade existing roads rather than to add new lengths of road to the network. A population growth parameter is likely to be a suitable indicator of need for the upgrading of the road network. However, the population growth disability may not be the primary driver of investment related to economic development needs. This is discussed further in Queensland's comments on mining related expenditure.

In the 2010 Review, the Commission adopted the view that, while Commonwealth payments for the construction of national network roads should affect state fiscal capacities, part of the Commonwealth support for these roads and the consequent investment is influenced by Commonwealth considerations which are not captured in state based disability measures. These include the need to develop an efficient national transport network to facilitate national economic growth and productivity gains in the long-term. It was decided that 50 per cent of these Commonwealth payments and the related expenditure should not impact on the GST distribution.

Queensland supports continuing to recognise national policy influences on roads investment by excluding 50 per cent of Commonwealth payments for national network roads and the investment they fund. Neither data nor a reliable methodology is currently available to create an alternative measure of national policy influences.

NET LENDING (CHAPTER 25)

Queensland's position

- Queensland supports retaining the Net Lending assessment, as the total impact of the population growth disability is material.
- Queensland supports removing the 25 per cent discount currently applied to the Net Lending assessment.

The current assessment of Net Lending is based on population growth, recognising that states with higher than average population growth require higher levels of investment in financial assets to maintain the average level of financial assets per capita. Population growth is applied to the stock of net financial assets to derive assessed net lending, in the same way it is used to derive assessed investment in the Infrastructure assessment. No additional disabilities are applied.

In the Discussion Paper, it is suggested that all housing and transport infrastructure be assessed in the Infrastructure assessment in the 2015 Review. This would mean that a proportion of equity in Public Non-Financial Corporations (PNFCs) that is currently assessed as a financial asset in the Net Lending assessment would instead be assessed in the Infrastructure assessment, and disabilities relating to housing and urban transport infrastructure would be applied in addition to the population growth factor. The resulting reduction in the size of the Net Lending assessment could mean that it will no longer meet materiality thresholds.

Queensland has no objection to treating housing and urban transport infrastructure as part of investment in other infrastructure (in the Investment assessment), rather than as net financial assets in the Net Lending assessment, provided reliable data is available to support this approach and suitable assessments can be developed.

Queensland supports retaining the Net Lending assessment regardless of the category's materiality. The Implementation and Methodological Issues paper suggests removing materiality thresholds for categories, and focusing on materiality thresholds for disabilities. Queensland supports this proposal and believes that Net Lending should continue to be assessed, as the population growth disability is material in total across the Net Lending and Investment categories.

Queensland also supports removing the 25 per cent discount applied to the Net Lending assessment in the 2010 Review. The main purpose of implementing a discount in the 2010 Review was uncertainty about whether all non-policy influences had been assessed. However, issues around other potential disabilities for asset revaluation and borrowing costs have been re-examined in the Discussion Paper and there does not appear to be evidence that these impact on states' financial assets, other than through differences in states' policies. As evidence has not been found of material disabilities other than population growth, it seems appropriate to remove the 25 per cent discount.

SCHOOLS EDUCATION (CHAPTER 8)

Queensland's position

- Queensland supports:
  - retaining the pre-compulsory enrolments adjustment if it is material;
  - the regression method outlined in the Discussion Paper for deriving cost weights for schools expenses, based on data from the Australian Curriculum, Assessment and Reporting Authority (ACARA); and
  - continuing to assess Commonwealth payments for non-government schools so that they do not affect the relativities.
- Queensland considers that the Service Delivery Scale (SDS) assessment should focus on areas where these influences are most prevalent, and is not convinced that changes to the definition of service delivery scale areas are warranted.

Enrolments

In the current methodology, the Schools Education assessment is based on government schools enrolments, with adjustments to account for the impact of different state policies for school starting ages and post-compulsory schooling years. The Discussion Paper suggests that in the 2015 Review actual enrolments be used as the broad measure of use for all years of schooling, reflecting the convergence of state policies for enrolment ages.

While state policies have become standardised for school leaving ages, some policy differences appear to remain for school starting ages. Even if state policies become increasingly standardised as a result of the Early Childhood Education National Partnership agreement, there is the potential for policy differences to have a material impact in the 2015 Review. Queensland supports using actual enrolments for later years of schooling (removing the separate measurement of post-compulsory enrolments used in the 2010 Review), but supports retaining the pre-compulsory enrolments calculation used in the current methodology if it is found to be material.

Student cost weights

The Discussion Paper outlines the Staff analysis of ACARA data and the cost weights implied by states' expenditure on high cost groups. Queensland supports the method outlined for calculating cost weights for schools. Queensland is not currently aware of issues with the ACARA dataset that would affect its suitability for use in the Schools Education assessment. The ACARA dataset appears to be fit for purpose and likely to be more comparable and reliable than alternatives, such as updating schools cost weights through a state data collection, particularly in the time available in the 2015 Review to collect such data.

However, Queensland is not convinced that the definition of SDS areas should be changed from areas 50km or more from a town of 5,000 people to areas 20km or more from a town of 5,000 people, and the cost weight adjusted accordingly. This decision was based on regressions from ACARA data, with areas 20km away producing the highest R^2 value. However, the four regressions on different service delivery scale areas produced very similar R^2 values, ranging from 0.468 to 0.485. Redefining the definition of service delivery scale areas to include a wider population may dilute the cost weights used in the assessment and not reflect the additional costs in areas where service delivery scale has the most impact. If a change to the definition (and resulting cost weight) is implemented, further work needs to be done to investigate which definition is the best indicator of where service delivery scale influences are most prevalent.

The service delivery scale component is also addressed in Queensland's comments on the SDS assessment.

Non-government school students

In the Discussion Paper, state views are sought on how a state's total funding for non-government school students will be determined after the introduction of education reforms. Queensland does not believe the average policy for state funding of non-government schools after the implementation of education reforms can be clearly determined at this time. As discussed in the next section, Queensland supports interpreting the "no unwinding" clause in the 2015 Review Terms of Reference as not applying to state allocation models. Under this interpretation, the "no unwinding" clause would not have any implications for the assessment of state funding to non-government schools.

Queensland also supports continuing to assess Commonwealth payments for non-government schools so they will not affect the relativities.

NATIONAL EDUCATION REFORM AGREEMENT (NERA) (CHAPTER 9)

Queensland's position

- In principle, Queensland supports the Commission assessing Schools Education under reform arrangements using a model based on 'what states do', where expenses and related Commonwealth payments are assessed using the Commission's general methods. This is most consistent with HFE.

Queensland notes that, since the release of the Discussion Paper, there have been some changes to schools funding arrangements. States (including Queensland) that had not previously reached agreement with the former Federal Government on the National Education Reform Agreement (NERA) have now reached agreements with the Federal Government for schools funding arrangements over the forward estimates period, or are to receive Commonwealth funding based on the new arrangements. The Federal Government has also signalled its intention to amend the command and control aspects of the *Australian Education Act 2013*. There is still some uncertainty around the final arrangements for schools education reform, particularly as these amendments are yet to be defined.

Queensland has provided comments below on the interpretation of the 2015 Review Terms of Reference instruction for the NERA (Clause 6) and in-principle comments on the options raised in the Discussion Paper. Whether or not specific options are suitable for assessing Schools Education under the reform arrangements is likely to become clearer as the 2015 Review progresses. Queensland will provide further comments as arrangements for schools funding are finalised for all states.

Interpreting the 2015 Review Terms of Reference

Clause 6 of the 2015 Review Terms of Reference states that:

> *The Commission will ensure that the GST distribution process will not have the effect of unwinding the recognition of educational disadvantage embedded in the National Education Reform Agreement (NERA) funding arrangements. The Commission will also ensure that no State or Territory receives a windfall gain from non-participation in NERA funding arrangements.*

The Discussion Paper suggests that the "recognition of educational disadvantage" referred to in the 2015 Review Terms of Reference relates to Schooling Resource Standard (SRS) loadings, not to additional base funding. It also suggests that the "recognition of educational disadvantage" applies to loadings in Commonwealth payments to government schools, not to the loadings used by states in their own allocation models.

Queensland supports the interpretation of Clause 6 as applying only to loadings, not to base funding. Additional base funding that is provided on a per student basis, regardless of the level of student disadvantage, cannot be considered to be provided in recognition of disadvantage. Queensland also supports the interpretation of Clause 6 as not applying to the loadings used in states' own allocation models, as these are a matter of state policy.

However, Queensland does not consider that the loadings used to calculate Commonwealth contributions to education should be treated by the Commission as being in "recognition of educational disadvantage". The degree to which states' allocation of funding to schools is based on their own allocation models, rather than the SRS, is fundamental to implementing Clause 6. Queensland considers that the "not unwinding" section of the clause would only be applicable to the SRS loadings used to calculate Commonwealth payments if states were required to allocate the funding to schools under the same model. As participating states retain the responsibility under education reform agreements to allocate funding to schools under individual allocation models (which recognise factors affecting the level of disadvantage), the Commonwealth contribution is essentially equivalent to general funding for schools, and should not be considered in the Commission's methodology as a payment for the "recognition of educational disadvantage".

This being the case, a standard Commission assessment of state own-source funding based on 'what states do' would recognise the additional funding provided by states to high cost or disadvantaged groups, redistribute GST towards states that had greater need based on the average allocation model, and would not have the effect of unwinding any recognition of disadvantage contained in the agreement.

The Discussion Paper also notes that, at an operational level, the Commission must decide to what extent it should interpret the "no unwinding" clause, and suggests that if there is no material unwinding, this would be consistent with Clause 6. Queensland supports this suggestion, as it is reasonable and practical to apply the same materiality thresholds to implementing Clause 6 as are applied in the rest of the Commission's methodology.

Assessing Schools Education

The Discussion Paper describes three options for assessing Schools Education under reform arrangements:

1. An exclusion model, where the portion of the Commonwealth payment relating to loadings and the expenditure it finances is excluded. The Commission's assessment is then applied to states' own education expenses and Commonwealth base funding.
2. A model based on 'what states do', where expenses and related Commonwealth payments are assessed using the Commission's general methods.
3. A model based on the SRS, where states' assessed expenditure would be determined by their share of the total SRS requirement.

Queensland's preferred option at this stage is the model based on 'what states do', as this is the model that most appropriately achieves HFE while being consistent with the 2015 Review Terms of Reference. The assessment for Schools Education put forward in the Discussion Paper (discussed in the section above) recognises the additional expenditure required for disadvantaged groups, based on the average state policy. As discussed above, Queensland considers that the "no unwinding" clause does not apply to the loadings used to calculate Commonwealth payments. Under this interpretation, the model based on 'what states do' would "not have the effect of unwinding the recognition of educational disadvantage".

If the Commission decides that "no unwinding" refers to loadings in Commonwealth payments, Queensland considers that the use of similar factors (such as Indigeneity and low SES) in the Commission's methodology and the Commonwealth's calculations is sufficient to ensure that the recognition of disadvantage in Commonwealth payments is preserved. A model based on 'what states do' may also be a more practical alternative, as it can be implemented using data that is currently available, and does not rely on details of the education reform arrangements which may need to be estimated, such as Commonwealth payments attributable to loadings.

The exclusion model is also a reasonable alternative in principle, if the Commission decides that "no unwinding" in the 2015 Review Terms of Reference applies to loadings in Commonwealth payments to government schools. However, the specific exclusion of the Commonwealth loading payments and related expenses may create some difficulties in the assessment. It is unclear at this stage whether the proportion of the Commonwealth payment attributable to loadings will be able to be identified for all states in their agreements with the Commonwealth, so these may need to be estimated.

Queensland is also concerned that the exclusion of a proportion of Commonwealth payments has the potential to create a bias in the assessment. Under the original NERA model, the proportion of schools funding provided by the Commonwealth was influenced by the current funding levels of schools. If this is also a feature of the final reform agreements with states, the exclusion model may not fully reflect HFE.

Queensland does not support the third option, which would base the assessment on the SRS, as it would not reflect 'what states do', but rather one view of what they 'should do'. States' shares of the SRS will not reflect their expenditure requirements under average policy. Even under the original NERA discussions, states were to transition to SRS over the application years for the 2015 Review, so an assessment that used the full SRS would not have been effective in ensuring that there was "no unwinding" of the agreement. Queensland does not believe this option is a viable alternative, regardless of how the 2015 Review Terms of Reference are interpreted.

Treatment of non-participating states

The 2015 Review Terms of Reference direct the Commission to ensure that no state receives a windfall gain through the GST distribution from non-participation in NERA funding arrangements.

The Discussion Paper suggests two options for ensuring non-participating states do not receive a windfall gain. These are by:

- imputing an additional amount of Commonwealth funding for non-participating states; and

- allocating actual payments made on the basis of state shares of the total NERA funding entitlement.

If some states were not to receive Commonwealth funding for schools reform, Queensland considers that the simplest method of ensuring these states do not receive a windfall gain is to impute an additional amount of Commonwealth funding that those states would have received under reform arrangements. This is consistent with the Commission approach to the treatment of non-participating states in past agreements, such as the national health reforms.

If the Commission decides to exclude Commonwealth payments attributable to loadings from the assessment, an amount attributable to loadings should be estimated and excluded from the Commonwealth funding (or imputed Commonwealth funding) for all states.

PUBLIC HOSPITALS (CHAPTER 11)

Queensland's position

- Queensland supports a more direct assessment of emergency and outpatient services in principle.
- Queensland supports the use of Independent Hospital Pricing Authority (IHPA) data for the assessment, noting there may be issues in the initial years of the health reforms.
- Queensland requests further consultation with the Commission and states on progress with the assessment before the release of the draft of the 2015 Review.

Health services are currently assessed in the Admitted Patients and Community and Other Health Services assessment categories.

The drivers of the assessment are derived using Australian Institute of Health and Welfare (AIHW) data on admitted patient services, calculating national average costs for population groups cross-classified by:

- age;
- Indigenous status;
- socio-economic status (SES); and
- location of patient residence.

Assessed costs are derived by applying these national average costs to the number of people in the corresponding population groups in each state. The costs for each population group are added to derive total hospital-based costs for each state.

New Public Hospitals assessment and structure

In August 2011, the Council of Australian Governments (COAG) agreed to the implementation of the National Health Reform Agreement, which will deliver reforms to the organisation, funding and delivery of health care services. The most relevant changes for the Commission's assessment are the move to a nationally consistent approach to activity based funding (ABF), also referred to as 'casemix' funding. Under the ABF approach, each activity/service within the hospital will be classified and costed, with the establishment of the IHPA to determine the nationally efficient price. Each episode of care in every hospital would be allocated a National Weighted Activity Unit. These data, along with the patient's personal details, would be used to calculate national average costs for population groups cross-classified by age, Indigenous status, SES and location of patient residence. Assessed hospital-based costs would then be derived by applying these national average costs to the number of people in the corresponding population groups in each state.

Staff propose that the new whole-of-hospital approach to costing allows emergency department and outpatient services, which are currently assessed in the Community and Other Health Services assessment category, to now be combined with Admitted Patients for a new Public Hospitals assessment category, and a separate residual Community Health assessment category.

Queensland considers that the proposed restructuring of the health assessments is reasonable in principle. Queensland supports the development of an assessment that better reflects the national health reforms, and it would appear appropriate to incorporate emergency department and outpatient services in a new public hospitals assessment, given the focus on activity based funding and new data that will become available through the National Health Reform Agreement reforms.

While Queensland supports a more direct assessment of emergency and outpatient services in principle, further work on the detail of the assessment, in consultation with states, is necessary before Queensland can fully support the Public Hospitals assessment.

Independent Hospital Pricing Authority data

While the IHPA data will not be comprehensive by the end of the 2015 Review, Queensland considers it is the most suitable and reliable data for the assessment going forward. The emergency department and particularly outpatient services data will be less complete and reliable than the admitted patients data in the initial years of the health reform, so it will be necessary to consider whether the results of those assessments appear to be reliable. Notwithstanding issues with the early years of the data, Queensland considers the problems do not prohibit the use of the data for the 2015 Review.

Interim assessment approach

The Public Hospitals assessment intends to utilise IHPA data for the three proposed components of the assessment; admitted patient services, emergency department services and outpatient services. However, particularly in the early years of the reform, detailed ABF data for some small hospitals will not be available for emergency department and outpatient services as they will be block funded. As the Discussion Paper notes, this may bias the assessment of small hospitals.

The proposed interim approach is to apply the same user profile and cost profile of larger hospitals to block funded small hospitals, with an adjustment if necessary to align with the

Australian Institute of Health and Welfare (AIHW) data currently used. Queensland and other states with a relatively regionalised population tend to have a relatively large number of small hospitals in regional and remote areas that will be blocked funded in the 2014-15 national public hospital funding model. Hospitals in regional and remote areas tend to have different population profiles to larger hospitals in more urban areas. Staff should investigate whether the interim approach could bias states with a higher proportion of regional and remote small hospitals if the population profiles of these hospitals are assumed to be similar to larger ABF hospitals.

Population group factors

Staff propose maintaining the factors affecting service use and cost in the Admitted Patients category in the 2010 Review, but to reduce disaggregation of age from seven groups to five.

Queensland considers the factors applied in the 2010 Review remain appropriate for the Public Hospitals assessment. While Queensland generally supports the use of a $30 per capita materiality threshold if it leads to simplification, Queensland considers it is too early in the review to disaggregate age into five groups rather than seven. Although Staff have found the 0 year old and 85+ age groups redistribute less than $30 per capita individually based on data from the current admitted patients assessment, these groups should be retested with the IHPA data the Commission intends to use in the 2015 Review, including for emergency department and outpatient services.

Impact of the private sector

Alongside the population group factors, Staff have proposed to assess an economic environment factor to measure the impact of the private sector as a substitute for state funded health services.

While it is a reasonable concept that private health services are a partial substitute for public service provision, it is difficult to measure the effect without considerable judgement. In particular, Queensland is concerned that there has not been sufficient investigation of the factor and its impact to support applying it to 60 per cent of emergency department and outpatient services at this time, as 60 per cent appears to be somewhat arbitrarily based on emergency department presentations in public hospitals. Although the survey found around 55 per cent of emergency department presentations in public hospitals are for services that could have been treated by private GPs, it is unknown what portion of these are actually substitutable. There are a range of reasons that a patient may present to an emergency department rather than a private GP, such as:

- a condition requiring treatment outside of GP clinic hours;
- unknown severity of a condition; and
- income constraints.

Calculating a factor based on the number of GP-type services provided in each state or a measure based on GP throughput may measure substitutability to some extent, but its reliability will likely be unknown.

There is limited academic work on the degree of substitutability of private and public health services. Moslehi and Yew (2012)[11] found the degree of the substitution effect of private and public health expenditure to be limited in Australia compared with other OECD countries.

Given the uncertainty over the form of the economic environment factor and the Public Hospitals assessment more broadly, Queensland requests further consultation between the Commission and states as the assessment develops and before finalisation of the draft report of the 2015 Review. If there is insufficient time to fully develop the factor, and consult with states, use of the factor should be deferred until a future review.

WELFARE (CHAPTER 13)

Queensland's position

- Queensland supports:
  - assessing Western Australia's aged care services equal per capita (EPC);
  - further investigation of using geographical data to derive a socio-economic status (SES) breakdown of family and child services use; and
  - assessing the remainder of general welfare services using the proportion of the population in the lowest Socio-economic Index for Individuals (SEIFI) quintile.

Aged care services

Under the National Health Reform Agreement, the Commonwealth has assumed responsibility for aged care services. This agreement has now been signed by all states other than Western Australia. Queensland notes that clause 3(e) of the 2015 Review Terms of Reference instructs the Commission to continue to assess aged care services as state services for states that have chosen to retain these responsibilities. However, the assessment is not material for the one state it would apply to (Western Australia), and retaining it would create unnecessary complexity. Queensland supports assessing Western Australia's aged care services on an EPC basis. Queensland also supports backcasting the change to the provision of aged care services, as it represents a major change in federal financial relations.

Family and child services

Queensland supports the further investigation of using geographical data from the Australian Institute of Health and Welfare's (AIHW) child protection unit record system to derive a location breakdown of service users, and linking this to ABS Socio-economic Index for Areas (SEIFA) data to obtain an SES breakdown of family and child service use. This is

[11] Shuyun May Li, Solmaz Moslehi and Siew Ling Yew *Public-Private Mix of Health Expenditure: A Political Economy Approach and A Quantitative Exercise* (2012)

preferable to the 2010 Review approach, which was based on data from one state and partial data from another, and as such was not policy neutral.

Queensland also supports the further investigation of whether remoteness impacts on demand for family and child services, and materiality testing of a location disability using the AIHW geographical data.

General welfare services

The Discussion Paper suggests moving electricity and water concessions expenses to the Welfare category, and continuing to assess them using the number of concession card holders in each state. Queensland has no objection to moving the water and electricity concessions assessments from the Services to Communities category to the Welfare category.

Queensland supports assessing the remainder of general welfare services using the proportion of people in the bottom quintile of the ABS SEIFI. While this requires the use of judgement, SEIFI is conceptually well linked to state requirements for general welfare expenses. In this instance, SEIFI may be preferable to SEIFA as data on the use rates of the population in different areas is not available, and the use of SEIFI ensures that the low SES population is recognised in the assessment.

DISABILITYCARE AUSTRALIA (CHAPTER 14)

Queensland's position

- Queensland supports a "blended" approach to the assessment of disability services during the transition period for the DisabilityCare Australia arrangements.
- A decision on the approach to this assessment after full implementation of DisabilityCare should be delayed until after the Productivity Commission Review, due in 2017.

In the 2010 Review, disability services were assessed as part of the Welfare and Housing assessment, based on national average use rates of disability services by disability pensioners, and recognising different use rates for Indigenous and non-Indigenous populations. The implementation of DisabilityCare Australia arrangements during the application period for the 2015 Review mean that the assessment of disability services must be revised to appropriately recognise differences in state capacities under the new arrangements. This will involve consideration of three stages: the trial phase, transition, and full implementation.

In the trial phase, the Commonwealth and states will contribute funding to trial the new arrangements at sites in different states. It is likely that the Commission will be instructed in the 2014 Update Terms of Reference to treat Commonwealth payments and their associated expenses as having no impact on the relativities, which will in turn mean that a no impact treatment will be required by the 2015 Review Terms of Reference (under Clause 3d).

Assessment approach in the transition phase

The transition phase is expected to run from July 2016 to June 2019, with states reaching full implementation in different years and potentially transitioning at different rates. During the transition, states and the Commonwealth will make contributions to DisabilityCare as it is phased in, and states will continue to provide current disability services as required. The Discussion Paper outlines two options for the assessment during the transition period:

- a "blended" approach, with concurrent assessments of state needs in relation to both current disability services and DisabilityCare; or

- a "switch" approach, with the current assessment switching to a DisabilityCare assessment at the point where DisabilityCare is judged to become average policy (when a majority of clients have moved to the new arrangements).

Under both methods, current disability services would be assessed using the 2010 Review approach, and DisabilityCare would be assessed using the proportion of the total number of people ultimately to be covered by DisabilityCare in each state.

Queensland remains supportive of a "blended" approach to assessing disability expenses during the transition to DisabilityCare. During this period, services in a majority of states will be provided under both current services delivery models and DisabilityCare. An assessment that recognises both forms of service provision will better reflect 'what states do' than a "switch" approach.

Queensland also supports assessing the DisabilityCare component using each state's proportion of population who will eventually be covered by the scheme, rather than state shares of people who have transitioned to the scheme in any given year. This is policy neutral and consistent with the assessment of non-DisabilityCare expenditure during the transition period, which is based on state shares of disability pensioners (rather than the number of people not transitioned to DisabilityCare). Queensland also supports treating the National Disability Specific Purpose Payment and payments associated with DisabilityCare consistently as impacting on the relativities.

Assessment approach after full implementation

After full implementation of DisabilityCare, the Discussion Paper suggests that state needs for DisabilityCare contributions could be assessed actual per capita (APC). Queensland suggests instead delaying consideration of the assessment of full implementation until there is more certainty around the costs associated with DisabilityCare and state funding arrangements. These do not appear to be sufficiently clear at this stage to determine that an APC assessment will be appropriate from 2019-20. It is expected that the costs of the arrangements will become clearer over the course of the trials.

The Productivity Commission (PC) is due to review scheme costs, including jurisdictional capacity, changes in the agreed escalation parameter and the most appropriate ways to manage any potential cost overruns before full implementation. This review will report to

COAG by the end of 2017. Any changes made to the scheme in light of the PC review findings may affect whether an APC assessment is appropriate.

It may be preferable for the Commission to delay its decision on the most appropriate treatment of DisabilityCare expenses under full implementation until the PC review is complete. Queensland also supports delaying consideration of residual state service delivery until DisabilityCare is close to full implementation.

SERVICES TO COMMUNITIES (CHAPTER 16)

Queensland's position

- Queensland supports the proposal to assess needs for water and wastewater subsidies to uneconomic providers using the population living in communities with population from 50 to 1,000 in remote and very remote areas.
- Queensland supports the proposal to no longer recognise needs relating to water availability and quality.
- Queensland proposes further consideration and consultation on the approach to assessing electricity subsidies following analysis of data being provided by states as part of the 2015 Review data requests.
- Queensland does not object to the proposal to relocate state concession expenses on water and electricity subsidies to the Welfare category.

The Services to Communities category includes expenses on essential and support services that states provide to their communities. Expenses fall into a range of categories including water and wastewater subsidies, electricity subsidies, water and electricity concessions, community development and amenities expenses and protection of the environment expenses.

Utilities subsidies assessment

Electricity subsidies and water and wastewater subsidies are currently assessed separately to reflect the Commission's view during the 2010 Review that these expenses have different drivers. The water and wastewater subsidies assessment recognises needs relating to water quality, availability, location and community size. Electricity subsidies are assessed separately to recognise the higher needs of populations living in remote areas.

Staff consider that the drivers of expense needs relating to water, wastewater and electricity subsidies are sufficiently similar that they can be assessed in a single utilities subsidies assessment. In determining average policy on utilities subsidies, Staff consider that subsidies fall into two main categories: subsidies paid to all residents, and subsidies to smaller communities reflecting the higher cost of service provision or uniform tariff policies[12]. Staff consider that subsidies that are paid to all residents should be assessed equal per capita (EPC). Subsidies paid to small communities are to be assessed differentially, using the

[12] For water and waste water subsidies, another category is subsidies for special projects, to be assessed equal per capita.

population living in communities with population from 50 to 1,000 in remote and very remote areas.

Water and wastewater subsidies

The 2010 Review assessment of water and wastewater subsidies recognised that average state policy is to provide subsidies to water providers in small communities and in areas of poor water quality and availability. A differential assessment of need was based on remoteness combined with an adjustment to incorporate the proportion of the population living in areas with poor water quality or availability. Data from the Macquarie Atlas was used to identify geographic areas of disparate water availability and quality. This data is incomplete and lacks the required detail necessary for a reliable and robust assessment of need. Although there may be a conceptual case for assessing needs relating to the availability or quality of water, it is difficult to find reliable data that is fit for purpose. Any water assessment that appropriately recognises both availability and quality factors is likely to be highly complicated. Queensland supports the Staff proposal to no longer recognise that water availability and quality have an impact on water subsidies.

Data provided by Western Australia, Northern Territory and South Australia indicate that there is a large increase in water subsidies per capita as community population decreases. The current indicator of need for remoteness uses the relative proportion of a state's population residing in Urban Centres/Localities (UCLs) with populations between 200 and 1,000 living in remote and very remote locations. Data in the Discussion Paper indicates that water services are provided in communities with populations below 200. Staff propose to assess these additional needs using the population living in communities with population from 50 to 1,000 in remote and very remote areas. ABS data is available to capture this level of detail. Staff consider that this will better capture needs of communities with populations of less than 200. Queensland notes that this will increase the detail and complexity of the assessment. Queensland supports the proposal to assess needs for subsidies to uneconomic providers using the population living in communities with a population from 50 to 1,000 in remote and very remote areas if it can be shown to be material.

Electricity subsidies

The assessment of electricity subsidies recognises needs relating to service provision in remote and very remote locations. As per the determination of average policy for the proposed utilities subsidies category, electricity subsidies would be split into two subsidies – those paid to all residents and those paid for the provision of services in small communities where cost recovery cannot be achieved. Staff propose recommending the Commission estimate state total subsidy expenses paid to all residents on the basis of a derived average per capita subsidy in large centres with populations over 50,000 residents and applying it to all communities. The remaining subsidies would be identified as subsidies for the provision of uneconomic services. This proposed assessment will be based on state provided data as part of the 2015 Review data requests.

Queensland is currently investigating the availability and reliability of data relating to expenses on, and subsidies for, the provision of electricity, water and wastewater services. It is understood that this data will form the basis of the differential assessment. Queensland is experiencing difficulty responding to the request given the nature of service provision in this area, particularly regarding data on the provision of electricity services and related subsidies. Identifying subsidy and service provision expenses that would fall under the definition of "uneconomic services" is particularly problematic. Actual data is unavailable and providing estimates will require considerable judgment. Separating expenses and subsidy data according to community size would prove equally difficult.

Given these concerns, Queensland suggests that the consideration of the approach to assessing electricity subsidies should be delayed until an in-depth analysis of data provided by states as part of the 2015 Review data requests has been conducted. Accurate and reliable data is required to properly assess the proposed methodology. Given the limited time available for the 2015 Review there may be insufficient time available to develop a reliable and robust assessment. In this case, Queensland would support continuing to assess electricity subsidies according to the methodology adopted during the 2010 Review.

Simplification

Water and wastewater and electricity subsidies are currently assessed separately. Staff consider that the drivers of expense needs relating to water, wastewater and electricity subsidies are sufficiently similar that they can be assessed in a single utilities subsidies assessment. Queensland considers that further work is required on the proposed assessment for electricity subsidies and the data that will form the basis of the assessment. Queensland supports consideration of simplification of the assessment following a resolution and agreement on the proposed approach to assessing electricity subsidies.

Concessions

As part of the 2010 Review methodology, state concession expenses were assessed differentially in the Services to Communities category to recognise that states with larger shares of Commonwealth pensioner concession card and health care concession card holders had to spend more on concessions. As other income supplements and concessions are included in the Welfare category, Staff are proposing to relocate state concession expenses on water and electricity subsidies to the Welfare category. Queensland does not object to this proposal.

REGIONAL COSTS (CHAPTER 30)

Queensland's position

- Queensland supports the use of Australian Curriculum, Assessment and Reporting Authority (ACARA) data for an updated schools regional costs factor.
- The schools and police regional cost factors should continue to be averaged for a general regional costs factor.
- The police regional costs factor should continue to apply to all components of the Justice Services category.

The Regional Costs assessment category attempts to recognise the increased costs of delivering services to more remote regions. The Commission calculates a schools gradient, police gradient (applying to the Justice Services category), and a general gradient.

The general gradient is the simple average of the schools and police gradient. This general gradient is applied to:

- Community and Other Health Services;
- Welfare and Housing;
- some elements of Other expenses; and
- rural roads expenses within the Roads assessment.

Changing the remoteness classification

As part of the 2015 Review, the Commission propose changing the remoteness classification for this and other assessments from a commissioned state based version of the Accessibility/Remoteness Index of Australia (SARIA) to the Australian Bureau of Statistic's general ARIA that is not modified to account for state borders and capital cities. This is on the basis that ARIA was considered the simplest reliable geography, and that there may be benefits in using a geography that is used by a larger number of data producers.

Queensland considers SARIA is a better index of remoteness for comparing states, and supported the development of a 2011 version of SARIA that maintains the 2006 SARIA criteria in Queensland's initial response to this issue. There do not appear to be compelling reasons to alter the SARIA methodology. This issue is discussed further in Queensland's comments on Population (Chapter 36).

ACARA data and extrapolating to other services

The Commission proposes using new data available from the Australian Curriculum, Assessment and Reporting Authority (ACARA) to calculate the schools regional costs gradient in the 2015 Review. Queensland is not aware of any serious issues with the ACARA data and it would appear to be suitable to assess regional costs for schools as it is more comparable and reliable than a state data request.

The Discussion Paper suggests that Staff do not consider there has been an improvement or standardisation of state police data and propose that the police regional costs gradient should be discontinued in favour of using only the new ACARA schools gradient.

While the ACARA data may be high quality, there does not seem to be any supporting evidence that the schools cost gradient better reflects regional service costs generally than the police data. The 2010 Review chose an average of police and schools data because it best reflected the gradient observed for other categories by states who provided regional data for them. While the availability of better schools data improves the quality of the regional costs factor, it does not follow that the police gradient should now be abandoned.

Queensland supports the current practice of utilising an average of the police and school gradients for a general regional costs gradient.

Additionally, Victoria questioned the extrapolation of police cost weights to the whole of the Justice Services assessment, and it has been proposed that it will be applied only to police services within the Justice Services assessment for the 2015 Review. Similar to Queensland's position on the general cost weight, there does not appear to be a significant reason to abandon the 2010 Review methodology and the conceptual case for applying regional cost weights to expense categories more generally. Queensland supports continuing to apply the police regional costs gradient to the whole of the Justice Services category.

Comparability of remote communities

As discussed earlier, Staff are proposing that for the 2015 Review the interstate wages assessment be based only on capital city wage levels. Stemming from this decision, Staff propose assessing a state specific regional loading for states with high regional wages based on the difference between the rest of state private sector wage level and the capital city private sector wage level.

Queensland does not support the use of capital cities as the basis for the Interstate Wages assessment, as outlined in this submission's discussion of that chapter. Queensland considers that the proposed methodology change is not an improvement to the assessment and, therefore, the state specific regional loading factor also does not constitute an improvement. This factor distributes GST away from all other states to Western Australia, suggesting that Western Australia is the only state that faces higher costs to attract workers to remote regions, which contradicts the conceptual basis of the factor and other evidence that states other than Western Australia face these costs.

Size of discount

Queensland supports the removal of the discount to the schools regional cost factor with the introduction of higher quality ACARA data, and supports the continuation of the 12.5 per cent discount to other categories.

SERVICE DELIVERY SCALE (CHAPTER 31)

Queensland's position

- Queensland supports the use of Australian Curriculum, Assessment and Reporting Authority (ACARA) data to calculate the schools service delivery factor.
- Queensland does not support the narrowing of the application of service delivery scale (SDS) or the change of definition for service delivery scale areas without further supporting evidence for the changes.

Service Delivery Scale assessment is intended to reflect the additional costs of providing services to small isolated communities where services are provided but inputs per user cannot be fully utilised and are not used as productively as in other areas. The Commission currently considers SDS affected costs in areas which were 50 km from centres of 5,000 people.

This increase in costs in SDS areas are measured using school and police data and an extrapolation is made from these services to the Community and Other Health Services and Welfare and Housing categories.

For the 2015 Review, Staff proposes not applying the SDS factor to the Community and other health services category, and applying the factor only to family and child services within the new Welfare category. While Queensland understands Staff have undertaken analysis they consider supports a narrowing of the application of the SDS factor, this evidence has not been detailed in the Discussion Paper. Queensland considers SDS influences services across all areas, and without evidence to the contrary, considers not applying the factor to Community and Other Health Services assessment category reduces HFE.

Additionally, the Commission has proposed to use newly available ACARA data for the calculation of the cost weight for schools, and to use analysis of this data to adjust the definition of service delivery scale data. While Queensland supports the use of ACARA data to calculate the cost weight for schools, Queensland is unconvinced the proposed change to the definition of SDS areas is an improvement to the assessment. Staff propose the definition should be changed from areas 50km or more from a town of 5,000 people, to areas 20km or more from a town of 5,000 people. This is based on regressions on ACARA data with areas 20km away resulting in the highest R^2 value. However, the four regressions run by the Commission all have very similar R^2 values, ranging from around 0.468 to 0.485. Redefining the definition of SDS areas from those 50km away from a town of 5,000 to areas 2,000km away may dilute the cost weights used in the assessment without a corresponding increase in confidence in the new factor. As schools are only one part of the Service Delivery Scale assessment, further explanation is necessary before Queensland could support this change.

INDIGENEITY (CHAPTER 26)

Queensland's position

- Separate indexes of socio-economic status (SES) for Indigenous and non-Indigenous populations should only be used if there are clear advantages over using a single index and they can be implemented reliably.
- Queensland is concerned that the proposed index for Indigenous SES may not be reliable and that it will be difficult to develop cost weights that reflect 'what states do' in the timeframe for the 2015 Review. If issues with the separate Indigenous index cannot be resolved, Queensland supports continuing to use a single index to recognise the disadvantage levels of Indigenous and non-Indigenous populations.

The 2015 Review Terms of Reference asks the Commission to "develop methods to appropriately capture the changing characteristics of the Indigenous population". This stems from the increased proportion of the population being identified as Indigenous in the 2011 Census. Some states have suggested that the newly identified Indigenous population may be less disadvantaged than the population that has previously identified as Indigenous and that this may not be recognised in the current methodology.

As described in Queensland's response to the 2015 Review Terms of Reference, the Australian Bureau of Statistics implemented an improved Indigenous Enumeration Strategy (IES) in the 2011 Census, designed to address potential barriers to the enumeration of the Indigenous population to improve the quality and accuracy of Census data. This included earlier and ongoing engagement, the provision of greater support where required and increased recruitment of field staff. Given that the ABS has implemented a revised strategy to improve the identification of Indigenous people in the Census, it cannot be assumed that the population newly identifying as Indigenous are less disadvantaged than the previously identified population. It could be that the IES used in the 2011 Census was more successful in enumerating the most disadvantaged Indigenous populations.

However, it is appropriate to investigate whether differences in the level of disadvantage of Indigenous populations are being fully recognised by the general Socio-economic Index for Areas (SEIFA) index currently used as the standard indicator of SES in the Commission methodology. Where the SEIFA score of an area is driven by the majority non-Indigenous population, it is possible that this is not completely representative of the SES of the Indigenous population, which in most areas is likely to be a minority.

The approach put forward in the Discussion Paper is to apply separate SES indexes to the Indigenous and non-Indigenous populations. This may, in principle, ensure that differences in the SES of Indigenous people are fully recognised. However, separate measures of Indigenous and non-Indigenous disadvantage, which would be applied across a range of categories, would add significant complexity to the methodology. Before such a change is made, it is important to ensure that it has clear advantages over the current methodology, and can be implemented reliably in the short timeframes for the 2015 Review.

General approach to measuring SES status – area based measures

Queensland supports using area based approaches to measuring SES, both for Indigenous and non-Indigenous populations. These are the most practical way of measuring the relative disadvantage levels of populations.

In choosing an area based measure, it is important to ensure that the areas on which the measure is based are reasonably homogeneous. The Discussion Paper concludes that the quintile assigned to an area will summarise the SES distribution within that area and hence capture the heterogeneity of SES within a region. While this is true, it does not necessarily mean that the additional expenditure associated with the low SES population will be appropriately assessed in the Commission's methodology if areas are not homogenous. For example, if an assessment assigns a low SES cost weight only to the bottom quintile of areas, this will only recognise additional needs for low SES populations if they happen to reside in a bottom quintile area. Even though the low SES populations of other areas will be reflected in the overall SES score of those areas, additional needs for these populations may not be recognised unless the majority of the population in an area is low SES.

Index for measuring relative disadvantage for the Indigenous population

The Discussion Paper suggests that relative Indigenous disadvantage could be measured using the Indigenous Relative Socio-Economic Outcomes (IRSEO) index, developed by the Centre for Aboriginal Economic Policy Research (CAEPR). Queensland has suggested further investigation of this index in past submissions, as it is specifically designed to capture Indigenous disadvantage. However, Queensland has some concerns with its use in the 2015 Review.

Queensland's main concern with IRSEO is that the size of the geography on which the index is based means that areas are not homogenous. IRSEO is based on Indigenous Areas, of which there are around 400, and many are geographically large. Queensland considers there is some evidence to suggest that Indigenous Areas are not sufficiently homogenous. Comparing the SEIFA scores of areas with the IRSEO scores of areas demonstrates that all IRSEO quintiles contain a significant proportion of people that would be classified as "most disadvantaged" under the SEIFA index. Although the proportion of this population is much higher in the "most disadvantaged" IRSEO quintile (around 95 per cent), it is still significant in the "2nd least disadvantaged" quintile (40 per cent) and even in the "least disadvantaged" quintile (20 per cent). It seems likely that IRSEO is not properly recognising the disadvantage level of a significant proportion of the Indigenous population, simply because they are being grouped into broad Indigenous areas with less disadvantaged people. Queensland is concerned that if IRSEO is implemented, the assessments will not appropriately recognise the disadvantage level of these populations.

If the Commission decides to develop a methodology that uses IRSEO as a separate measure of Indigenous disadvantage, there is also more work to be done to ensure that IRSEO is an improvement over using a single SEIFA measure for the whole population. For example, it is yet to be established that it is average state policy to have materially higher per capita expenditure on more disadvantaged than less disadvantaged areas, as measured by IRSEO. For IRSEO to be used, there must be a clear relationship between IRSEO rankings and average state expenditure, or the methodology will not reflect 'what states do'. It is not known at this stage whether reliable data is available to do this.

It will also be important to ensure that expenditure data used to establish cost weights is also based on IRSEO areas. Because IRSEO measures the relative disadvantage of Indigenous people, it is likely that even the populations in its "least disadvantaged" quintile are disadvantaged compared to the non-Indigenous population, and that states incur higher costs for these populations.

There are also a number of risks associated with implementing IRSEO. There may be insufficient time in the 2015 Review to ensure that IRSEO can be implemented reliably. It is also unclear whether CAEPR will continue to produce updated versions of IRSEO, which may affect the Commission's ability to use the most up-to-date population data in its assessments.

At this stage, Queensland is concerned that issues around the heterogeneity of areas, the risks with IRSEO and potential difficulties with developing cost weights in the short timeframe for the 2015 Review may outweigh the benefits of implementing IRSEO. If these issues cannot be resolved, Queensland supports continuing to use a general SEIFA index to measure SES for the Indigenous and non-Indigenous populations. It may be that while neither the general SEIFA nor IRSEO is a perfect measure of Indigenous SES status, the general SEIFA index may be a more reliable and simpler alternative.

Index for measuring relative disadvantage for the non-Indigenous population

Queensland supports the use of a non-Indigenous SEIFA to measure the relative disadvantage of the non-Indigenous population, if an Indigenous-specific index is used to measure the relative disadvantage of the Indigenous population.

However, as discussed above, the use of separate Indigenous and non-Indigenous indexes of disadvantage would add significant complexity to the assessment, and should only be used if there are clear benefits to separate indexes, and they can be implemented reliably.

3. OTHER ISSUES

PAYROLL TAX (CHAPTER 1)

Queensland's position

- Queensland supports the proposal to continue the assessment method adopted during the 2010 Review, including the adjustments to exclude the earnings of employees in the general government sector, defence force and embassies and payrolls below an average threshold.

The 2010 Review methodology assesses payroll tax revenue using ABS data on the Compensation of Employees (CoE) as a broad measure of the revenue base. A number of adjustments are made to the data on the basis that it is not average policy to tax various subsections of the labour force, including the general government sector, Commonwealth employees and those under the average tax free threshold. Taxes on the general government sector are considered an internal government transfer. Similarly, it is not average policy to tax the earnings of Commonwealth employees, including those in the defence force and embassies.

The 2010 Review considered a tax free threshold to be a central feature of payroll tax policy. All states employ an effective exemption of employers with relatively few employees from paying payroll tax. Accordingly, an adjustment based on ABS data on private and public sector wages and salaries was applied to exclude payrolls below the average threshold. Tax free thresholds continue to be average policy although the level of the threshold varies - in 2012-13, they ranged from $1.75 million in the ACT to $0.55 million in Victoria, with an average tax free threshold of just under $1 million. Removing the adjustment for a tax free threshold would result in the overstating of fiscal capacities of those states with proportionally more employment in small business. Analysis in the Discussion Paper indicates that the current threshold adjustment exceeds the proposed disability materiality threshold.

Queensland considers the tax free threshold remains an important feature of state payroll tax policy and 'what states do'. A threshold adjustment is necessary to assess a state's fiscal capacity on the basis of 'what states do'. The assessment is also based on reliable and robust data. Queensland supports the proposal to continue the assessment method adopted in the 2010 Review including adjustments for the earnings of employees in the general government sector, defence force and embassies as well as the adjustment to exclude payrolls below the average threshold. The threshold adjustment can be made reliably and has a material impact on the GST distribution.

LAND TAX (CHAPTER 2)

Queensland's position

- Queensland does not object to the Staff proposal to continue the Land Tax assessment method adopted during the 2010 Review.
- Queensland supports continuing to assess revenue from metropolitan levies equal per capita (EPC), separately from land tax.

Land Tax assessment data

The 2010 Review methodology assesses land tax revenue using taxable land value data sought from State Revenue Offices (SROs) as a measure of the revenue base. The Commission considered that revenues raised through metropolitan levies were different from other land taxes and were not average policy. An adjustment to exclude revenue raised through metropolitan levies from the assessment was made on this basis.

The issue of land tax data was considered in-depth during the 2010 Review. Valuers-General (VG) data was considered a more comparable, albeit imprecise, measure of how states levy land tax. However, VG data cannot provide information on aggregated land holdings of individuals and cannot identify non-taxable land such as principal places of residence.

State Revenue Office (SRO) data more directly reflects how states enact land tax, although a variety of interstate differences in the imposition of land tax reduce the comparability of the data. Among the issues affecting the comparability of data are interstate variation in threshold rates and aggregation of jointly held land, as well as the impact of state-specific land tax policy.

Queensland is unaware of improvements in VG data that would allow the identification of principal places of residence. While Queensland remains concerned about the comparability of SRO data and its use as the basis for the land tax assessment, it is acknowledged that the VG data does not contain all the information required for the Commission's current assessment methodology. In the absence of sufficient improvements in VG data and noting the short timeframes for the 2015 Review, Queensland supports the Staff proposal to continue the assessment method adopted during the 2010 Review with the proposed adjustments. Queensland supports the proposal to apply a medium discount to the assessment given the ongoing concerns with the comparability of SRO data.

Metropolitan levies

Metropolitan levies are an impost on land values for the purpose of funding the management and provision of public facilities in a defined metropolitan region. Western Australia raises revenue though a Metropolitan Regional Improvement Tax (MRIT) while Victoria has a similar Metropolitan Improvement Levy. During the 2010 Review, the Commission concluded that revenue raised through metropolitan levies was different from other land taxes and not average policy. On this basis metropolitan levies were excluded from a differential assessment and assessed EPC.

Staff have proposed that, where a tax is sufficiently similar to another state tax, they be assessed in a combined category. This proposal is outlined in Staff Discussion Paper *CGC2013-06S Implementation and Methodological Issues*. On the basis they consider them sufficiently similar, Staff propose that revenues raised though metropolitan levies be combined with land tax and assessed differentially.

Under the 2010 Review methodology, metropolitan levies would not be considered average policy. Queensland supports the Commission retaining the 2010 Review approach to determining average policy in the 2015 Review on the basis it is a conceptually sound way of determining an average. Therefore, Queensland does not support including metropolitan levies in the land tax assessment. If Staff proposals relating to the determination of average policy are accepted by the Commission, Queensland would need to reconsider the method outlined in the Discussion Paper for assessing metropolitan levies.

STAMP DUTY ON CONVEYANCES (CHAPTER 3)

Queensland's position

- Queensland supports retaining the methodology used in the 2010 Review for the Stamp Duty on Conveyances category.

The current Stamp Duty on Conveyances assessment is based on the value of property transferred in each state, including various adjustments to ensure that the assessment reflects average policy, including:

- the exclusion of corporate reconstructions and sales of major state assets (assessed equal per capita);
- an adjustment for the progressivity of tax rates; and
- adjustments for differences in the scope of transactions subject to duty.

Queensland does not believe there is a compelling reason to revisit this assessment in the 2015 Review, and supports the recommendation in the Discussion Paper to continue using the methodology for assessing Stamp Duty on Conveyances that was used in the 2010 Review.

Queensland provided updated information on the scope of transactions that stamp duty is applied to in its response to the data request for the 2014 Update, and does not consider that any of the changes made to Queensland's policies on the scope of transfer duty in recent years necessitate changes to the adjustments for scope in the assessment. Unless other states provide advice of material changes to the scope of transactions, Queensland does not believe these adjustments need to be changed in the 2015 Review.

A decision on the treatment of non-real property transactions, which is being progressively abolished by states, is likely to depend on the Commission's decision on the appropriate approach for determining average policy. It is likely that at least one state will continue to raise non-real duty in the application year for the 2015 Review. If the Commission applies the alternative approach for determining average policy suggested in Staff Discussion Paper

CGC2013-06 Implementation and Methodological Issues, non-real duty will be assessed if it is imposed by at least one state and an assessment is material. As discussed in the response to the Implementation and Methodological Issues Paper, Queensland supports retaining the 2010 Review approach, and believe that non-real duty should only be differentially assessed if it is raised by a majority of states (and applied to a majority of transactions) in the application year.

INSURANCE TAX (CHAPTER 4)

Queensland's position

- Queensland supports continuing the differential assessment of Insurance Tax adopted during the 2010 Review.
- Taxes on workers' compensation premiums are not average policy and should be excluded from calculations of the revenue base.

The Insurance Tax assessment adopted during the 2010 Review differentially assessed revenue collected through taxes on general, life and compulsory third party insurance. Workers' compensation insurance, reinsurance and fire and emergency services levies were excluded from the revenue base to provide an assessment that reflected average policy. Workers' compensation premiums were excluded on the basis that they were not subject to tax. Queensland and South Australia now levy taxes on workers' compensation insurance premiums.

Staff propose to include taxes on workers' compensation premiums in calculations of the revenue and revenue base and note that this may result in the assessment no longer being material. This proposal is based on the alternative test proposed in Staff Discussion Paper *CGC2013-06 Implementation and Methodological Issues* for determining average policy, where a revenue would be considered average policy if imposed by at least one state. Queensland supports retaining the 2010 Review average policy test, where a tax is only considered average policy if it is imposed by a majority of states. Under the 2010 Review approach, it would not be considered average policy to levy tax on workers' compensation insurance premiums, so Queensland supports continuing the adjustment to remove these from states' revenue and revenue bases.

Even if the adjustment is removed, Queensland considers an assessment of the Insurance Tax category to be warranted if it is only marginally below materiality thresholds on the basis that the assessment is reliable, policy neutral and based on good quality data. The assessment contributes to a more complete equalisation outcome and it is appropriate that it should remain subject to a differential assessment. It would not be appropriate to assess Insurance Tax in the other revenue category for the same reasons.

MOTOR TAXES (CHAPTER 5)

Queensland's position

- Queensland supports continuing the assessment method for Motor Taxes adopted during the 2010 Review.

The Motor Tax assessment is based on the differential assessment of three revenue categories including light vehicle registrations, heavy vehicle registrations and stamp duty on transfers. The assessment is policy neutral, reflects 'what states do' and is based on robust and reliable data. Given the limited timeframes for the 2015 Review, Queensland does not consider the Motor Tax assessment a priority for the Review and supports the proposal to continue the assessment method adopted in the 2010 Review.

OTHER REVENUE (CHAPTER 7)

Queensland's position

- Queensland supports the investigation of a differential assessment of gambling revenue possibly using a broad indicator such as household disposable income in a future review.
- Revenue from fire and emergency services levies should continue to be assessed in the Other Revenue category on an equal per capita basis.
- That Staff investigate an assessment based on gross state product (GSP) as a broad indicator of revenue raising capacity for user charges. An assessment should be included if it is found to be material following consideration of data issues and the appropriateness of a discount.

Gambling revenue

Given the reduced timeframes for the 2015 Review, there is insufficient time for further investigation into the drivers of gambling revenue and the construction of a direct assessment incorporating the outcomes of that investigation. Queensland considers that a conceptual case exists for the differential assessment of gambling tax, given that states raise substantial revenue through gambling taxation and are likely to have differing capacities. However, any attempt to construct a robust and reliable methodology with which to assess these differing capacities has been highly problematic.

Queensland considers a differential assessment based on a broad indicator such as household disposable income would be feasible and result in a better equalisation outcome. The 2004 Review utilised a broad indicator to assess gambling revenue and, if adopted, a discount could be applied. Queensland supports continuing the assessment approach adopted during the 2010 Review of assessing gambling revenue equal per capita. Queensland considers that a future review should include further investigation of a differential assessment of gambling tax revenue, as a conceptual case does exist for such an approach.

Fire and emergency services levy

The Queensland Government raises revenue for fire and emergency services through a levy on rentable properties. The levy is applied to all rentable properties at progressive rates according to property type and classification based on location and proximity to fire and emergency services.

Fire and emergency services levies are collected by all states except the Northern Territory, who funds fire and emergency services through consolidated revenue. The particular design and implementation of levies vary among states. Table 2 outlines variations in state policies towards fire and emergency services levies.

Table 2: State fire and emergency services levy design

	VIC	NSW*	QLD	WA	SA	TAS	ACT	NT**
Fixed fee	✓			✓	✓		✓	
Property location/ classification	✓		✓	✓	✓		✓	
Proximity to services			✓	✓				
Capital value					✓	✓		
Gross rental value	✓			✓			✓	
Unimproved value	✓						✓	
Region specific levy (metro /rural)	✓				✓			
Levy on insurance		✓				✓		
Levy on motor vehicles					✓	✓		

*New South Wales is currently implementing reform of funding arrangements for fire and emergency services.

**Northern Territory funds fire and emergency services through the general government consolidated revenue and does not enact a fire and emergency services levy.

Revenue collected through fire and emergency services levies is sufficiently different from land revenue that assessing it as part of the Land Tax assessment would be inappropriate and would not be an assessment of 'what states do'. The diversity in practical application of levies among jurisdictions does not provide a clear determination of average policy or an underlying revenue base.

Given the reduced timeframes for the 2015 Review and the work required in identifying a reliable and material assessment, Queensland supports continuing to assess revenue from fire and emergency services levies in the Other Revenue category, on an equal per capita basis. It may however be appropriate to revisit this revenue category in future reviews as a conceptual case for a differential assessment does exist.

User charges

States collect revenue from the sale of goods and services relating to a broad range of charges, fees, fines and licencing arrangements. Similar to other classes of revenue currently assessed in the Other Revenue category, the determination of average policy towards user charges is problematic. Given the diversity of user charges, designing assessments based on use rates by certain population groups is also not feasible.

Staff have investigated the use of a broad indicator as the basis for a differential assessment and found that GSP or equivalised income are indicators of capacity. Analysis of ABS data presented in the Discussion Paper shows that a relationship exists between user charges and both GSP and equivalised income, however GSP is shown to have a stronger relationship.

Staff identified some problems with both datasets if used as a basis for the assessment. GSP data is likely to overstate the capacity of the ACT as data includes government contributions to GSP. User charges that apply to businesses may not be chargeable to the Commonwealth. Similarly, GSP data for Western Australia includes offshore oil and gas that is likely to have little correlation with user charges capacity. Equivalised income data for Northern Territory does not cover rural areas and is therefore incomplete.

Queensland considers that, while a conceptual case may exists for the assessment of user charges, a direct assessment is not feasible under the current timeframes of the review. The use of a broad indicator is a methodologically valid and simple alternative. Analysis indicates the GSP is the more accurate indicator of capacity. Queensland supports further investigation into an assessment of user charges using GSP as a broad indicator. Adjustments to GSP data for Western Australia and the ACT should be investigated to increase the validity of the assessment. If the resulting assessment is material following consideration of the appropriateness of a discount, the assessment should be adopted.

POST-SECONDARY EDUCATION (CHAPTER 10)

Queensland's position

- The current methodology for assessing Post-Secondary Education expenses is functioning well and changes are not required for the 2015 Review.
- Queensland has no objection to assessing all Vocational Education and Training (VET) expenses in this category if these can be moved reliably from the Services to Industry category to the Post-Secondary category.

The 2010 Review methodology for Post-Secondary Education assessment recognises that post-secondary education is mainly used by the 15-64 age group. Adjustments are also made for differences in the use rates and cost weights of different population subgroups, recognising Indigeneity, remoteness and language spoken at home. The Discussion Paper does not recommend making major changes to this category, but suggests that:

- VET expenses that are currently assessed in the Services to Industry category be moved to this category;

- data be collected from the states on the costs of courses to determine if a cost weight should be applied to private Registered Training Organisations (RTOs); and
- cost weights from the 2010 Review be updated.

Queensland considers that the current assessment for post-secondary education is functioning well and does not require revisiting, other than to update the cost weights used in the assessment. However, Queensland does not object to the Commission assessing all VET expenses in this category, if these can be moved from the Services to Industry category reliably. Queensland also notes that the Commission is collecting data on the costs of courses provided by private RTOs and other VET providers to determine if a cost weight is necessary and will provide comments on this issue once the data has been collected and advice provided to states.

COMMUNITY HEALTH (CHAPTER 12)

Queensland's position

- Queensland supports directly assessing residual expenses relating to community health centres, public health activities and mental health in a separate Community Health Services category.
- Queensland supports the proposed socio-demographic composition (SDC) factors for assessing service use and cost including Indigeneity, age, socio-economic status (SES) and remoteness. Queensland also supports the removal of a gender disability unless it can be shown to be material.
- Queensland supports the staff proposal to use Independent Hospital Pricing Authority (IHPA) and Australian Institute of Health and Welfare (AIHW) data to estimate a use and cost profile from community health services.
- Specific design issues of an economic environment factor using GP throughput should only be investigated following further consideration of the impact of non-state providers of community and public health services.
- Queensland supports the proposed economic environment factor for assessing the impact of Office of Aboriginal and Torres Strait Islander Health grants on expense requirements.

As part of the 2015 Review proposed assessment, emergency department and outpatient service expenses are to be included in the Public Hospital assessment. These expenses were previously included in the Community and Other Health assessment and will leave residual expenses relating to community health centres and public health services. Queensland supports the Commission's proposal to assess these in a separate Community Health Services category.

The subtraction model adopted during the 2010 Review assumed that services provided by non-state providers were fully substitutable for those available in state funded institutions. While this may have been a reasonable assumption when applied to a broad variety of expenses in the Community and Other Health assessment, the assumption becomes less valid as the assessment is narrowed. Under a narrower assessment it would be difficult to identify and isolate non-state services that substitute for state services. Queensland supports in principle the proposal to adopt a direct assessment.

The 2010 Review methodology recognised inter-state differences in the age, gender, Indigeneity, remoteness and SES of their populations. Given the natural overlaps in the type of service provision, Staff assume that the SDC characteristics that drive hospital service use are broadly similar to those that drive the use of community health services. For the sake of consistency, Staff propose to assess the same SDC characteristics as those used in the Public Hospitals category. These include age, Indigeneity, SES and remoteness. Queensland broadly supports these factors for assessing service use and cost.

Gender is currently assessed as a component of the SDC disability. The smaller size of the proposed category, along with the proposed increase in materiality thresholds, means that including a gender disability is unlikely to be material. Queensland supports including a gender disability only if it is proven to be material.

Data

During the 2010 Review it was established that there was insufficient national data available to create use and cost profiles for community health care services according to the chosen population characteristics. Proxy data from a variety of sources including the AIHW, the Australian Bureau of Statistics's National Health Survey (NHS) and the Department of Health and Ageing (DHA) was used to construct a use and cost profile for various population groups.

The AIHW *Expenditure on health for Aboriginal and Torres Strait Islander People 2010-11* provides estimates of health funding and expenditure for Indigenous and non-Indigenous populations for various health services. This data shows that the use of community health and public health services by Indigenous populations is twice that of their public hospital use. Given this, the use of IHPA data as a proxy for community health service use is likely to significantly underestimate Indigenous use. Staff propose combining IHPA data on all public hospital costs with AIHW data to develop a user profile of state provided health services. Queensland supports the use of AIHW data to provide a better measure of Indigenous use of community health services.

Hospitals services tend to be used more heavily by the very young and the very old while community health services tend to be used by a broader age demographic. Staff consider that IHPA data is therefore likely to have an age bias when used as a proxy for community health services. Staff propose including the age profile of GP services in the assessment as it is shown to provide a better measure of use of community health services by age. Queensland notes that, while there may be a conceptual case for this adjustment, evidence presented in the Discussion Paper is anecdotal. An evidence-based demonstration of the differential use rates of hospital services compared to community health services by age would be preferable.

Care should be taken to ensure proxy data is fit for purpose and that any adjustments are appropriate and necessary. Queensland supports combining IHPA and AIHW data to ensure the use and cost profile provides a better measure of Indigenous use and cost. Queensland supports further investigation of an adjustment based on GP services use data to determine if it provides a better measure of use of community health services by age.

Impact of the private sector

Staff consider that there is considerable substitution between state and non-state provided services in this category raising, by example, services provided by GPs and community health centres. However, it is noted that low SES populations are likely to rely on state-provided services out of necessity. While it is conceptually reasonable that private health services are a partial substitute for public service provision, it will likely be difficult to measure the effect without considerable judgement. There is limited academic work on the degree of substitutability of private and public health services. As noted earlier, Moslehi and Yew (2012)[13] found the degree of substitution effect of private and public health expenditure to be limited in Australia compared to other OECD countries. Queensland considers that further investigation into the nature and strength of the substitution relationship between state and non-state provided health services is required to ensure the validity of an economic environment factor.

Staff are investigating an economic environment factor based on the number of GP-type services provided in each state or a measure based on GP throughput, using the same data as used in the emergency department of the public hospitals category. Queensland considers specific design issues of an economic environment factor should only be investigated following further consideration of the impact of non-state providers of community and public health services.

The Office of Aboriginal and Torres Strait Islander Health (OATSIH) provides grants for health, substance use issues, social and emotional well-being and mental health services delivery. Grants are provided to organisations that are largely Aboriginal and Torres Strait Islander community controlled or managed. Currently, the actual distribution of these grants is assessed as the Commission concluded that they reduced the need for state provided services. This was discounted by 12.5 per cent to recognise that not all services are fully substitutable. Staff propose calculating an economic environment factor based on actual OATSIH grants to each state, subject to a 12.5 per cent discount to recognise that not all services are substitutable. Queensland supports the proposed OATSIH based economic environment factor.

[13] Shuyun May Li, Solmaz Moslehi and Siew Ling Yew *Public-Private Mix of Health Expenditure: A Political Economy Approach and A Quantitative Exercise* (2012)

HOUSING (CHAPTER 15)

Queensland's position

- While the proposed Housing assessment is generally sound, Housing should not be treated as a priority for the review.
- Queensland supports the proposed Housing Expense assessment including the use of low income, Indigeneity and location as drivers in the socio-demographic composition assessment.
- The proposed Housing Revenue assessment adds additional complexity to the assessment. Queensland does not object to this proposal if it is proven to give a materially different outcome to the approach adopted in the2010 Review.
- Queensland supports treating the Remote Indigenous Housing National Partnership Payment so that it does not impact the relativities.
- Queensland supports staff further investigating the validity and reliability of a differential assessment of First Home Owners Scheme (FHOS) expenses.

While Queensland has few concerns with the proposed changes to the housing assessment, it is noted that the contracted timeframes of the review permit only limited time for the consideration of methodological issues outside of those deemed priorities. Queensland considers methodological issues relating to the Housing assessment fall under this classification.

Housing expenses are currently assessed in the Welfare and Housing category based on the Commission's view that welfare and housing services are affected by the same drivers. The net housing expenses assessment recognised differential state needs relating to Indigeneity and the social-economic status (SES) of their populations. FHOS grants were assessed actual per capita as they were considered common policy. The Commission decided that the Remote Indigenous National Partnership Payment should not impact relativities as these payments were deemed to fund improvements to assets not owned by the state.

Staff propose treating housing services, including those provided by Public Non-financial Corporations (PNFCs), as a general government function. It is their view that housing services have few commercial features and have more similarities to services provided by the general government sector reliant on government funding. The proposed assessment would assess housing services as a separate category comprising gross expenses, revenue and FHOS, while housing investment and depreciation would be assessed in the investment and depreciation categories as with other services.

While Queensland understands the basis for the structure of the proposed assessment, it is noted that the housing assessment is not considered a priority for this review.

Housing Services Expenses assessment

Staff propose continuing to recognise interstate differences in the socio-demographic composition (SDC) of state populations that affect expenses, including income and Indigeneity. It is proposed that the impact of location also be recognised.

Queensland supports the continued use of low income and Indigeneity (use and cost) as drivers in the SDC assessment for gross housing expenses. Data on social housing use rates by Indigeneity and location presented in the Discussion Paper demonstrates that an assessment of location is both warranted and based on sound and reliable data. Queensland supports the staff addition of location in the SDC factor calculation.

The current cost weight for Indigeneity of 25 per cent is based on State Owned and Managed Indigenous Housing (SOMIH) data over seven years to 2007-08. Despite a number of states no longer providing SOMIH, Staff propose retaining the 25 per cent cost weight for Indigenous households for the 2015 Review. Queensland notes that, across the four states that still have SOMIH, the ratio of expenses per dwelling occupied by Indigenous people to non-Indigenous people was 1.3 in 2010-11 and 1.39 in 2011-12. Queensland considers that, where possible, the most up-to-date and reliable data should be used. The Indigenous cost weight should reflect the most recent and available data, as it is both reliable and robust.

Data

Splitting the welfare and housing joint assessment established during the 2010 Review allows for the consideration of alternative data sources. Data collected by Australian Institute of Health and Welfare was previously the basis of the Housing and Welfare assessment. 2011 Census data is also being considered for the proposed assessment.

Queensland notes that, on balance, Census data are more comprehensive across all social housing types and will provide a more reliable measure of the Indigenous population as it relates to the assessment. An assessment based on Census data would be more robust and reliable and achieve a better equalisation outcome. Queensland supports the proposal to use Census data as the basis for this assessment.

Housing Revenue assessment

The 2010 Review methodology assessed housing expenses net of revenue, which largely consists of rental receipts. The Commission considered that drivers of service use have the same but offsetting impact on the amount of rent paid. The staff investigation into drivers of rent paid indicates that Indigeneity, income and location should be included in an assessment. Census data indicates that, on average, Indigenous households paid more rent than non-Indigenous households. Queensland notes that this finding does not reconcile with states' general experience and suggests that further work is required to clarify this relationship and test the reliability of the data used.

Staff propose assessing housing revenue on the basis of assessed numbers of households, adjusted to recognise differences in rents paid by Indigeneity, income and location. The proposed approach to assessing housing revenue appears to be methodologically sound, although it may not produce a materially different outcome than the net expenses assessment adopted in the 2010 Review. Queensland maintains some concerns regarding the data used in the analysis of factors affecting rental payment and it is noted that this would reduce the simplicity in the assessment. Given the limited timeframes for the 2015 Review, this issue should not be considered a priority.

Remote Indigenous Housing National Partnership payment (NPP)

Through the Remote Indigenous Housing NPP, the Australian Government committed to spend $4.4 billion over 10 years from 2008-09 to improve conditions and the ongoing maintenance of housing in remote Indigenous communities. This agreement expects state housing authorities to become the major deliverer of housing for Indigenous people in remote areas. While state housing authorities have been transferred responsibility for service provision, the ownership of housing has not undergone the same transfer.

During the 2010 Review, the Commission considered that funding provided through this NPP delivered upgrades and improvements to assets not owned by state governments, at the behest of the Commonwealth Government. Applying the methodology for treatment of Commonwealth Payments to the states, it is appropriate that payments under this NPP have no impact on the relativities as the funding is provided to deliver upgrades and improvements to assets not owned by state governments.

Assessment of capital needs for housing

Queensland supports the proposed assessment of capital housing stock and depreciation including the use of the SDC factor to estimate assessed capital housing stock and depreciation expenses.

First Home Owners Scheme

During the 2010 Review FHOS expenses were assessed on an actual per capita (APC) basis as all state's policies were considered the same. The 2008 IGA gave states increased scope to change the eligibility and caps applying to FHOS grants. A number of states have since changed their eligibility criteria for FHOS grants as well as the sizes of grants offered. Staff consider that state policies in relation to FHOS criteria have changed sufficiently to justify removing the APC assessment.

Staff have proposed that a differential assessment use the proportions of states' actual numbers of first home buyers. Data for the assessment would be adjusted for state tax expenditure on exemptions and concessions, after which the assessment would be included if shown to be material. It is not clear that reliable and comparable data detailing state expenditure on exemptions and concessions is available. While Queensland supports investigating the proposed assessment, it is noted that such an assessment would likely suffer from policy contamination. Given the significant potential problems with the assessment and the data required, it is likely that a discount would be necessary. A discount may result in the assessment failing to reach materiality thresholds. The proposed assessment would introduce further complexity to the housing assessment. Staff should consider the validity, reliability and materiality of the proposed assessment following further investigation.

JUSTICE SERVICES (CHAPTER 17)

Queensland's position

- Queensland supports continuing the 50 per cent equal per capita assessment of police services in the absence of more reliable data.
- Queensland supports the investigation of the 2014 Australian Institute of Criminology's (AIC) police custody survey to investigate its use for criminal court and Indigenous cost weights, and the potential reduction in the discount on police custody data.

The current Justice Services category assesses the amount each state needs to spend to deliver the average level of police, court and corrective services. The primary factors that drive the assessment include a state's relative proportion of population who engage with the justice system more frequently, such as:

- young males;
- Indigenous people; and
- people from a low socio-economic status background.

The Commission currently assesses 50 per cent of police services based on state populations and 50 per cent based on the factors above, arguing that not all expenses on police services are influenced by the level of criminal activity in a state. Western Australia has asked the Commission to review the split as part of the 2015 Review.

Queensland continues to consider the 50/50 split of police expenses between community policing and specialised policing to be a reasonable compromise for the assessment in the absence of more reliable data for an accurate split, and given the contradictory views of states in the 2010 Review.

Additionally, Western Australia suggested the 25 per cent discount applied to police custody data used in the assessment of specialised policing expenses should be reduced because the reasons given for its use may not be justified. Commission staff suggested the AIC 2014 police custody survey may provide updated and more detailed data that could be used to review the discount.

Queensland supports the examination of upcoming AIC police custody survey data, and considers that if the data is found to be of higher quality than the draft survey used in the 2010 Review, and noting the new survey covers 12 months rather than a one month period, a reduction of the 25 per cent discount may be warranted.

Commission staff propose to examine the AIC survey data to investigate whether it can be used as a basis for introducing a discount or cost weight for criminal court data, as well as its use for introducing Indigenous cost weights.

Queensland supports investigating the usefulness of the data for criminal court and indigenous cost weights if it is found to be sufficiently robust and comparable. However, Queensland is uncertain of the benefit of examining the data as a basis for the introduction of a discount to criminal court data in the absence of further justification for doing so, as a discount was found to be unnecessary in the 2010 Review.

ROADS (CHAPTER 18)

Queensland's position

- Queensland supports further work on the physical environment factor and updating the Roads assessment for the 2011 Census.
- Queensland does not support further work on a state roads spatial network for the 2015 Review.

Staff have raised three issues relating to the Roads assessment in the Discussion Paper:

- as part of the response to examining mining related expenditure, identifying roads connecting economic centres (for example, mines) that are not currently captured in the synthetic rural road network due to the economic centres not having a population of at least 400 people;
- the effects of physical environment on road maintenance costs; and
- whether the data request for state roads spatial data should progress to determine whether this could improve the current synthetic network for rural roads.

Mining related expenditure

Queensland is collecting maintenance cost data on localities not covered by the synthetic road network as requested by the Commission, and will provide further comment on this issue when the data is available.

Physical environment

Queensland supports further work on the physical environment factor, as there is a conceptual case that different physical environments would impact on states' roads expenses, and the Commission's consultant's report can be used as the basis for developing an assessment.

State roads spatial data

Aside from the Roads assessment not capturing expenditure on roads expenses supporting the mining industry, except to the extent it is co-located with sufficiently large population centres, the current synthetic road network is the best methodology currently available. Queensland agrees that a data request for this information will not be useful at this time.

Other issues

Queensland has no objection to the use of Urban Centres and Localities (UCLs) to determine urban/rural boundaries and the urban and rural road length disabilities in the 2015 Review. The Commission has indicated the impact on the assessment will be minor. Additionally, Queensland supports updating the Roads assessment for 2011 Census data and the average of the most recent six-year block of data from the Bureau of Infrastructure, Transport and Regional Economics (BITRE).

SERVICES TO INDUSTRY (CHAPTER 21)

Queensland's position

- Queensland supports the application of the general regional cost disability to the Services to Industry assessment.

The Services to Industry category covers state expenses incurred on the regulation, development and support of agriculture, forestry and fishing, fuel and energy, mining and minerals resources, manufacturing and construction, tourism and other industries.

The majority of the Services to Industry discussion in the Discussion Paper relates to mining related expenditure. Queensland's comments on this issue are in its discussion on the assessment of mining related expenditure. The treatment of vocational education and training expenses, also discussed in this chapter in the Discussion Paper, is addressed in the Post-Secondary Education section of this submission.

Queensland supports the Staff proposal to apply the general regional costs factor to regulation expenses. Where services to industry are provided throughout states, it is reasonable to expect regional location disabilities to affect these expenses in a similar way to other categories.

OTHER EXPENSES (CHAPTER 23)

Queensland's position

- Queensland supports retaining the current methodology for Other Expenses, with adjustments to natural disaster relief expenses if they are material and can be made reliably.

The Other Expenses category recognises the impact of location and cross border influences on general public services. The category also contains expenses not elsewhere assessed, such as net expenses under the Natural Disaster Relief and Recovery Arrangements (NDRRA), which are assessed actual per capita, and National Capital costs to the ACT.

Queensland supports retaining the current assessment of Other Expenses, which is functioning well and is not in need of review. The Discussion Paper suggests introducing adjustments to the NDRRA net expenses for those states whose insurance arrangements differ from the average, to ensure the comparability of the data. If reliable data is available and the impact is material, Queensland supports these adjustments in principle.

ADMINISTRATIVE SCALE (CHAPTER 27)

Queensland's position

- Queensland supports continuing to use the existing quantum for Administrative Scale, and using Australian Bureau of Statistics (ABS) state and local government final consumption expenses deflator to update the quantum.

Queensland supports the proposal to not develop a new method of measuring the quantum of administrative scale expenses. This would require substantial work and there is not sufficient time in this Review, when other assessments are of higher priority.

Prior to the 2015 Review, the Data Working Party investigated options for measuring the quantum, but collecting consistent data from states proved highly problematic. While Queensland does not consider a regression approach to be sufficient to measure the quantum of administrative scale expenses, such an approach may be useful in verifying the existing quantum.

The Discussion Paper includes the results of two regressions for schools education expenses, one based on GFS data and one based on Productivity Commission data. These appear to provide broad support for the existing quantum. This being the case, an attempt to re-measure the quantum from state-provided data would redirect effort from other areas of higher priority without yielding much benefit. A future review with sufficient time would be the appropriate place to examine more fully the Administrative Scale quantum. In the short timeframe for the 2015 Review, Queensland supports indexing the existing quantum.

Queensland supports continuing to apply the ABS state and local government final consumption expenses deflator to update the quantum of administrative scale expenditure. This is preferable to the other indexation method discussed in the Discussion Paper, which uses judgement to weight the Consumer Price Index and Labour Price Index in a composite index.

INTERSTATE NON-WAGE COSTS (CHAPTER 29)

Queensland's position

- Queensland supports the Commission's proposal to cease the Interstate Non-Wage Costs assessment.

The Interstate Non-Wage Costs assessment comprises the interstate freight assessment and the interstate travel assessment. No comprehensive, comparable data were available to develop a reliable policy neutral measure of the interstate non-wage disability for the 2010 Review. However, the Commission considered that a better equalisation outcome would be achieved by building an assessment covering these areas of cost difference than not considering them.

Queensland supports the Staff proposal to cease the Interstate Non-Wage Costs assessment and agrees that given the reliability and data issues, assessing some of the disabilities would not be closer to achieving HFE. Although there may be a conceptual case for interstate nonwages costs in general, given the short timeframe of the 2015 Review it may be preferable to revisit the assessment on a clean-slate basis in a future review.

NATIVE TITLE AND LAND RIGHTS (CHAPTER 34)

Queensland's position

- Queensland supports not making changes to the Native Title assessment methodology in the 2015 Review.

Native Title and Land Rights related expenses are currently assessed actual per capita, recognising that state spending is the result of Commonwealth legislation and policies. Queensland supports not making changes to the Native Title assessment methodology in the 2015 Review. The Discussion Paper suggested that Native Title expenses be identified in aggregate in the Other Expenses category, rather than across individual categories. This may simplify the presentation of the assessment, but will not affect the methodology.

CULTURAL AND LINGUISTIC DIVERSITY (CHAPTER 35)

Queensland's position

- Queensland supports the Staff proposal to review its analysis of Cultural and Linguistic Diversity (CALD) data with Victoria.

In the 2010 Review, the Commission accepted the conceptual case for inclusion of a disability reflecting the additional expenses incurred by states in providing services to migrants with low English fluency.

Queensland understands that the CALD assessment was implemented in the 2010 Review as the Commission believed there to be clear evidence for a conceptual case for CALD disabilities, and some supporting evidence from a study of the costs of treating patient groups in Victorian hospitals. As reliable data was not available to make an assessment in each individual category where a CALD disability was expected to apply, a single aggregate allowance was assessed in the Other Expenses category.

The Discussion Paper notes that the Commission's analysis of data provided by Victoria on admitted patient separations does not appear to support the findings of the study used in the 2010 Review as evidence for a CALD disability. Queensland supports the Commission's proposal to review its analysis with Victoria.

POPULATION (CHAPTER 36)

Queensland's position

- Queensland supports retaining the State Accessibility/ Remoteness Index of Australia (SARIA) as the Commission's standard measure of remoteness.

The current methodology uses SARIA to determine the remoteness and accessibility of areas based on their distance from the state capital city and other service centres of different sizes within a state. This is designed to recognise that state capital cities are the major focus of service delivery in a state, and that state services are generally provided to residents of that state, rather than other states.

Queensland supports using the 31 December estimates for total population level estimates, and using financial year population growth in the capital assessments, as this is a better conceptual fit with the structure of the capital assessments than calendar year growth. Queensland also notes that the use of estimated resident population data means that mobile population such as fly-in/fly-out (FIFO) workers will not be measured, but that alternatives (such as the population at the time of the Census) may not be reliable or practical.

Queensland supports, in principle, the proposal to use standardised age groups in the 2015 Review, provided these do not interfere with using the optimum age groups in category assessments.

Queensland does not support the Commission decision to adopt the Australian Bureau of Statistics remoteness areas (i.e. the Accessibility/Remoteness Index of Australia (ARIA) as the standard classification of remoteness) and believes it would be preferable for SARIA to continue to be used in the 2015 Review. As described in Queensland's response to Staff Discussion Paper CGC 2013-01:

- The SARIA/ARIA methodology is designed to measure the distance residents must travel to access certain types of services; it is assumed that city size is a proxy for the kinds of services that may be accessed. Treating smaller capital cities as Category B services centres therefore implies that some aspects of service delivery (distinct from administrative scale expenses) are not provided in states that do not contain a Category A city. This does not seem likely, but if it were accurate, it would need to be addressed in the Commission's methodology.

- It is inconsistent for the remoteness measure to recognise that residents of states may access services in other states (the assumption that state borders are permeable) and for a cross border disability to only be recognised for Canberra and the surrounding areas of New South Wales.

Queensland supports using UCLs as the general measure of urban population. Further comments are provided on category specific criteria in the Roads, Transport Services and Services to Communities categories.

APPENDIX: SUMMARY OF QUEENSLAND POSITIONS

CHAPTER 1 – PAYROLL TAX

- Queensland supports the proposal to continue the assessment method adopted during the 2010 Review including the adjustments to exclude the earnings of employees in the general government sector, defence force and embassies and payrolls below an average threshold.

CHAPTER 2 – LAND TAX

- Queensland does not object to the Staff proposal to continue the Land Tax assessment method adopted during the 2010 Review.
- Queensland supports continuing to assess revenue from metropolitan levies equal per capita, separately from land tax.

CHAPTER 3 – STAMP DUTY ON CONVEYANCES

- Queensland supports retaining the methodology used in the 2010 Review for the Stamp Duty on Conveyances category.

CHAPTER 4 – INSURANCE TAX

- Queensland supports continuing the differential assessment of Insurance Tax adopted during the 2010 Review.
- Taxes on workers' compensation premiums are not average policy and should be excluded from calculations of the revenue base.

CHAPTER 5 – MOTOR TAXES

- Queensland supports continuing the assessment method for Motor Taxes adopted during the 2010 Review.

CHAPTER 6 – MINING REVENUE

- Queensland supports an aggregated mining revenue assessment, which would greatly enhance the policy neutrality of the assessment and negate the potential for grant design inefficiencies while still assessing each state's relative capacity to raise revenue through mining royalties.
- Queensland does not support a move to an 'external standard' at this time as it would be a departure from the Commission's usual approach of assessing state fiscal capacity based on 'what states do'. Significant justification would be required to depart from this approach.

CHAPTER 7 – OTHER REVENUE

- Queensland supports the investigation of a differential assessment of gambling revenue using a broad indicator such as household disposable income in a future review.
- Revenue from fire and emergency services levies should continue to be assessed in the Other Revenue category on an equal per capita basis.
- Queensland supports staff investigating an assessment based on gross state product as a broad indicator of revenue raising capacity for user charges. An assessment should be included if it is found to be material following consideration of data issues and the appropriateness of a discount.

CHAPTER 8 – SCHOOLS EDUCATION

- Queensland supports:
  - retaining the pre-compulsory enrolments adjustment if it is material;
  - the regression method outlined in the Discussion Paper for deriving cost weights for schools expenses, based on data from Australian Curriculum, Assessment and Reporting Authority; and
  - continuing to assess Commonwealth payments for non-government schools so that they do not affect the relativities.
- Queensland considers that the Service Delivery Scale assessment should focus on areas where these influences are most prevalent, and is not convinced that changes to the definition of service delivery scale areas are warranted.

CHAPTER 9 – NATIONAL EDUCATION REFORM AGREEMENT (NERA)

- In principle, Queensland supports the Commission assessing Schools Education under reform arrangements using a model based on 'what states do', where expenses and related Commonwealth payments are assessed using the Commission's general methods. This is most consistent with HFE.

CHAPTER 10 – POST-SECONDARY EDUCATION

- The current methodology for assessing Post-Secondary Education expenses is functioning well, and changes are not required for the 2015 Review.
- Queensland has no objection to assessing all Vocational Education and Training expenses in this category if these can be moved reliably from the Services to Industry category to the Post-Secondary category.

CHAPTER 11 – PUBLIC HOSPITALS

- Queensland supports a more direct assessment of emergency and outpatient services in principle.

- Queensland supports the use of Independent Hospital Pricing Authority data for the assessment, noting there may be issues in the initial years of the health reforms.
- Queensland requests further consultation with the Commission and states on progress with the assessment before the release of the draft of the 2015 Review.

CHAPTER 12 – COMMUNITY HEALTH

- Queensland supports directly assessing residual expenses relating to community health centres, public health activities and mental health in a separate Community Health Services category.
- Queensland supports the proposed socio-demographic composition factors for assessing service use and cost including Indigeneity, age, socio-economic status and remoteness. Queensland also supports the removal of a gender disability unless it can be shown to be material.
- Queensland supports the staff proposal to use Independent Hospital Pricing Authority and Australian Institute of Health and Welfare data to estimate a use and cost profile from community health services.
- Specific design issues of an economic environment factor using GP throughput should only be investigated following further consideration of the impact of non-state providers of community and public health services.
- Queensland supports the proposed economic environment factor for assessing the impact of Office of Aboriginal and Torres Strait Islander Health grants on expense requirements.

CHAPTER 13 – WELFARE

- Queensland supports:
  - assessing Western Australia's aged care services equal per capita;
  - further investigation of using geographical data to derive a socio-economic status breakdown of family and child services use; and
  - assessing the remainder of general welfare services using the proportion of the population in the lowest Socio-economic Index for Individuals quintile.

CHAPTER 14 – DISABILITYCARE AUSTRALIA

- Queensland supports a "blended" approach to the assessment of disability services during the transition period for the DisabilityCare Australia arrangements.
- A decision on the approach to this assessment after full implementation of DisabilityCare should be delayed until after the Productivity Commission Review, due in 2017.

CHAPTER 15 – HOUSING

- While the proposed Housing assessment is generally sound, Housing should not be treated as a priority for the review.
- Queensland supports the proposed Housing Expense assessment including the use of low income, Indigeneity and location as drivers in the socio-demographic composition assessment.
- The proposed Housing Revenue assessment adds additional complexity to the assessment. Queensland does not object to this proposal if it is proven to give a materially different outcome to the approach adopted in the2010 Review.
- Queensland supports treating the Remote Indigenous Housing National Partnership Payment so that it does not impact the relativities.
- Queensland supports staff further investigating the validity and reliability of a differential assessment of First Home Owners Scheme expenses.

CHAPTER 16 – SERVICES TO COMMUNITIES

- Queensland supports the proposal to assess needs for water and wastewater subsidies to uneconomic providers using the population living in communities with population from 50 to 1,000 in remote and very remote areas.
- Queensland supports the proposal to no longer recognise needs relating to water availability and quality.
- Queensland proposes further consideration and consultation on the approach to assessing electricity subsidies following analysis of data being provided by states as part of the 2015 Review data requests.
- Queensland does not object to the proposal to relocate state concession expenses on water and electricity subsidies to the Welfare category.

CHAPTER 17 – JUSTICE SERVICES

- Queensland supports continuing the 50 per cent equal per capita assessment of police services in the absence of more reliable data.
- Queensland supports the investigation of the 2014 Australian Institute of Criminology's police custody survey to investigate its use for criminal court and indigenous cost weights, and the potential reduction in the discount on police custody data.

CHAPTER 18 – ROADS

- Queensland supports further work on the physical environment factor and updating the Roads assessment for the 2011 Census.
- Queensland does not support further work on a state roads spatial network for the 2015 Review.

CHAPTER 19 – TRANSPORT

- The Transport Services assessment faces considerable conceptual, methodological and data related issues that merit a discount of at least 25 per cent to the assessment.

CHAPTER 20 – TRANSPORT INFRASTRUCTURE

- Queensland considers the same conceptual, methodological and data issues that apply to the Transport Services assessment apply to the proposed Transport Infrastructure assessment.
- Queensland supports the Commission continuing to treat Commonwealth payments for transport infrastructure as impacting the relativities where needs are assessed. If the Commonwealth and states agree that certain payments should not impact the relativities, this can be addressed though the terms of reference.

CHAPTER 21 – SERVICES TO INDUSTRY

- Queensland supports the application of the general regional cost disability to the Services to Industry assessment.

CHAPTER 22 – MINING RELATED EXPENDITURE

- If a discount is not applied to the Mining Revenue assessment, mining related expenditure should be assessed collectively in the Other Expenses category using a broad indicator. This is the most practical way of assessing both the more easily and less easily measured components of mining related expenditure.
- Queensland is concerned that the category-by-category approach in the Discussion Paper:
  - requires a clean-slate approach to assessment methodologies, which is not possible in the 2015 Review timeframe;
  - does not properly allow for the recognition of less tangible components of mining related expenditure; and
  - does not allow mining related expenditure to be fully assessed where there is a conceptual case but data issues make it difficult to develop an assessment methodology.
- If the Commission decides to assess mining related expenditure in individual categories, materiality of the assessments should be evaluated collectively, and the components of mining related needs that are difficult to measure should still be recognised. Mining related expenses in different categories should be assessed together under a broad indicator wherever possible.

CHAPTER 23 – OTHER EXPENSES

- Queensland supports retaining the current methodology for Other Expenses, with adjustments to natural disaster relief expenses if they are material and can be made reliably.

CHAPTER 24 – INFRASTRUCTURE

- Queensland supports:
  - retaining the population growth factor used in the current methodology;
  - applying recurrent disabilities to the Infrastructure assessment unless they do not appear well-linked to capital requirements but retaining the low level discount;
  - applying the general location disabilities and disabilities derived from the Commission's consultant report to the Infrastructure assessment; and
  - combining recurrent disabilities using the average proportion of infrastructure stock by purpose, but only if the data are shown to be reliable.

CHAPTER 25 – NET LENDING

- Queensland supports retaining the Net Lending assessment, as the total impact of the population growth disability is material.
- Queensland supports removing the 25 per cent discount currently applied to the Net Lending assessment.

CHAPTER 26 – INDIGENEITY

- Separate indexes of socio-economic status (SES) for Indigenous and non-Indigenous populations should only be used if there are clear advantages over using a single index and they can be implemented reliably.
- Queensland is concerned that the proposed index for Indigenous SES may not be reliable and that it will be difficult to develop cost weights that reflect 'what states do' in the timeframe for the 2015 Review. If issues with the separate Indigenous index cannot be resolved, Queensland supports continuing to use a single index to recognise the disadvantage levels of Indigenous and non-Indigenous populations.

CHAPTER 27 – ADMINISTRATIVE SCALE

- Queensland supports continuing to use the existing quantum for Administrative Scale, and using the Australian Bureau of Statistics state and local government final consumption expenses deflator to update the quantum.

CHAPTER 28 – INTERSTATE WAGES

- The discount to the assessment should be increased from 12.5 per cent to 50 per cent due to the increasing unreliability of the assessment.

- Relative capital city wages are not an appropriate measure of the drivers of interstate wages and should not be adopted as the basis for the assessment.

CHAPTER 29 – INTERSTATE NON-WAGE COSTS

- Queensland supports the Commission's proposal to cease the Interstate Non-Wage Costs assessment.

CHAPTER 30 – REGIONAL COSTS

- Queensland supports the use of Australian Curriculum, Assessment and Reporting Authority data for an updated schools regional costs factor.
- The schools and police regional cost factors should continue to be averaged for a general regional costs factor.
- The police regional costs factor should continue to apply to all components of the Justice Services category.

CHAPTER 31 – SERVICE DELIVERY SCALE

- Queensland supports the use of Australian Curriculum, Assessment and Reporting Authority data to calculate the schools service delivery factor.
- Queensland does not support the narrowing of the application of service delivery scale or the change of definition for service delivery scale areas without further supporting evidence for the changes.

CHAPTER 34 – NATIVE TITLE AND LAND RIGHTS

- Queensland supports not making changes to the Native Title assessment methodology in the 2015 Review.

CHAPTER 35 – CULTURAL AND LINGUISTIC DIVERSITY (CALD)

- Queensland supports the Staff proposal to review its analysis of Cultural and Linguistic Diversity data with Victoria.

CHAPTER 36 – POPULATION

Queensland supports retaining the State Accessibility/Remoteness Index of Australia as the Commission's standard measure of remoteness.