Commonwealth Grants Commission 2015 Methodology Review

Tasmanian Government Submission

July 2013

Tasmania
Explore the possibilities

Contents

Executive Summary

Tasmania appreciates the opportunity to contribute to the Commonwealth Grants Commission 2015 Methodology Review. This submission contains Tasmania's position on: the principles and architecture of the GST distribution; the priority issues as outlined in the 2015 Review Terms of Reference (ToR); and other issues of priority for Tasmania.

Principles and Architecture

Tasmania is of the view that the GST Distribution Review Panel exhaustively considered the principles and architecture of the GST distribution. The Panel's Final Report effectively endorsed the 2010 Review definition and architecture. The 2015 Review ToR reinforce this. Tasmania sees no useful purpose in further debate of principles and architecture within the limited time available for the 2015 Review.

Tasmania endorses the 2010 Review materiality thresholds (subject to indexation) as internally consistent and rejects the "false precision" premise as justifying higher real thresholds.

Similarly, Tasmania endorses the 2010 Review practice of rounding to five decimal places as appropriate and the Commission's ongoing use of lagged and updated data, and rejects the prioritisation of grant share stability over equalisation in this context.

National Education Reform Agreement

ToR 6 requires the Commission to ensure that its Schools assessment method will not "unwind" the National Education Reform Agreement (NERA) funding arrangements and that non-participating states will not be advantaged through their non-participation. Application of ToR 6 is contentious as it weakens HFE by constraining the Commission's treatment options for NERA funding. Further, the precise method and its integration within the Commission assessment framework remains open to interpretation.

Critical interpretative issues include: the needs assessment basis; the expenditure standard; and treatment of Commonwealth funding. Its implementation will also be problematic due to fundamental incompatibilities between the NERA School Resourcing Standard (SRS) funding allocations (minimum standard and positive loadings) and the Commission's methodological approach. It will require the Commission to consider its

overall treatment of education funding and expenditure, including for non-government schools.

Pragmatically, potential method approaches the Commission could consider include: replace the Commission's own assessments of disadvantage with the NERA loadings, potentially augmented by additional Commission factors; exclude (treat APC on both the revenue and expenditure sides) the Commonwealth funding component for each state that is based on SRS loadings but, consistent with the Commonwealth Treasury advice, equalise the "base" funding; or adopt a "subtraction" approach similar to that for the 2010 Review assessment of Community and Other Health.

The subtraction approach appears the most able to reconcile NERA and Commission funding incompatibilities.

Welfare and Housing

Tasmania supports revising the 2010 Review Welfare and Housing method to reflect the changes in states' roles and responsibilities and related revenue and expenditures, with the exception of Western Australia (in line with ToR 3(e)).

Tasmania endorses the broad approach to the National Disability Insurance Scheme (NDIS) assessment, as outlined in the 10 April 2013 Commission Paper and related model, subject to certain caveats. Key caveats include the approach to determining average policy (whether or not this requires a majority of states needs to be further debated) and the assumption that, in full NDIS, participating states will no longer provide disability support services. States will need to continue to provide services to NDIS-ineligible clients.

Given the uncertain data viability of the Family and Child Services component of the Welfare and Housing assessment, Tasmania considers that this is a priority data issue for progression notwithstanding the compressed timeframe available for the 2015 Review.

Roads and Transport Services

Regarding the Roads and Transport Services assessments, Tasmania supports the development of a new transport infrastructure assessment as required under ToR 2(c). However, the new assessment framework will need to be internally consistent with the capital infrastructure framework more broadly. The Data Working Party work on the Roads

and Transport Services assessments could inform considerations for a new transport expenditure assessment.

Tasmania opposes the development of a framework for the discounted treatment of transport infrastructure payments as inappropriate as it is seeking to address (in an arbitrarily selective fashion) the effect (GST payment share instability associated with capital infrastructure payments) rather than addressing the cause (the 2010 Review Capital methodology).

Capital Expenditure

Tasmania supports the review of the Capital assessment framework and has favoured a holding cost approach, rather than the current assessment of capital needs. Tasmania supports investigation of a return to an operating statement assessment.

However, if the Commission were to retain the current capital assessment framework, then there are a number of conceptual issues that require review. These issues include: the direct approach to assessing states' capital needs; differential population growth needs assessment; and the possible double count in the assessment of net investment and depreciation as noted by the GST Distribution Review Panel.

Commonwealth Payments

Tasmania is broadly supportive of the 2010 Review Commonwealth Payments assessment framework, but considers explicit review is warranted in two specific areas.

Tasmania does not consider that the exclusion guideline "programs implemented at the behest of the Australian Government and which lead to above average or unique state outcomes" is functioning effectively. This has resulted in a rise in quarantining through ToR as states do not have confidence that the Commission will properly recognise payments in accordance with this guideline.

The "lumpiness" of the 2010 Review capital payments treatment is resulting in year-to-year volatility in states GST receipts, resulting in material budget flexibility issues. The Commission should consider, as part of its broader review of the treatment of capital, equalising capital payments over a longer timeframe, rather than as a lump sum in the year of receipt.

Mining Revenue and Expenditure

Tasmania interprets ToR 2(g) (requiring a new Mining Revenue assessment) as an instruction to the Commission to consider GST Distribution Review Recommendations 7.1 and 7.2 within the normal context of a methodology review with no presumption as to the outcome. Tasmania is not, at this point, advocating a specific mining revenue approach.

Of concern to Tasmania would be approaches that further diminished the capacity of the Mining Revenue method to reflect differences in relative revenue raising capacities. In this context, Tasmania opposes single rate, or effective single rate, and APC models proposed by some states within the GST Distribution Review context.

On the expenditure side, Tasmania supports the 2015 Review consideration of the appropriate treatment of mining expenditure on a first principles basis and consistent with HFE.

Location

In relation to a 'spend gradient approach' (ToR 2(f)), Tasmania does not have a formed view on the interstate cost assessments as they relate to Australia's population settlement patterns and therefore macroeconomic efficiency. This is a complex issue subject to much academic debate. While Tasmania welcomes discussion on this issue, we are more concerned about on-going conceptual and data issues with the current Location assessment methods.

Administrative Scale

The ultimate objective of the Data Working Party Administrative Scale project is a new data collection for the 2015 Review Administrative Scale assessment. This project appears to have stalled since August 2012 and the planned 2013 data collection did not proceed. Tasmania considers this is a priority issue for the 2015 Review and urges the Commission to relaunch the data collection project as soon as possible.

Indigeneity

Tasmania considers the Commission's decision to use unmodified 2011 Census data to be appropriate given that there is no viable alternative to the Census data to measure the

Indigenous population, nor a reliable way of measuring the propensity for self-identification by which to modify the Census dataset.

Tasmania does not consider that changes in the propensity for self-identification as Indigenous invalidates the current assessment approach, nor that the changing characteristics of the population is, in itself, a reason to assume that the current methodology is inadequate.

The Staff Discussion Paper, titled *2012-04 Relative Indigenous Disadvantage,* undertakes a preliminary analysis of potential alternative approaches to assessing Indigenous disadvantage. In response, Tasmania is yet to be convinced that any material differences that are not captured under the current methodology either should or could be measured in a reliable manner.

Chapter One: Principles and Architecture

Key points

The GST Distribution Review Panel exhaustively considered the principles and architecture of the GST distribution. The Final Report effectively endorsed the 2010 Review definition and architecture. The ToR reinforce this.

Tasmania:

- sees no useful purpose in further debate of principles and architecture within the limited time available to the 2015 Review;
- endorses the 2010 Review materiality thresholds (subject to indexation) as internally consistent and rejects the "false precision" premise as justifying higher real thresholds;
- endorses the 2010 Review practice of rounding to five decimal places as appropriate and rejects the "false precision" premise for more rounding; and
- endorses the Commission's ongoing use of lagged and updated data and rejects the prioritisation of grant share stability over equalisation in this context.

2015 Review assessment principles and architecture

Invariably, the starting point for any Commission methodology review is the equalisation principle and its interpretation.

The 2015 Review differs from its predecessors only in so far as the debate around the equalisation principle and its interpretation has effectively already been had through the GST Distribution Review, in advance of the issuing of the 2015 Review ToR.

Tasmania does not see a useful purpose in the Commission engaging in further debate around either the HFE principle and its interpretation or the broad architecture of the assessment framework, notwithstanding the likelihood that some states will still seek to do so.

The Commission has previously expressed the view that if governments want the Commission to implement a different distribution principle than the one used by the Commission they must provide explicit instructions to this effect[1].

The GST Distribution Review was, in this context, a political response to arguments from certain states for the HFE distributive principle to be augmented by economic efficiency distributive considerations.

The GST Distribution Review Panel considered – exhaustively – the arguments of the larger states and certain other stakeholders for the inclusion of other objectives and a lesser form or less precise form of equalisation than that effectively implemented through the 2010 Review equalisation approach. The Panel concluded:

> In our view, many of the concerns about HFE have turned out to be overstated, while others have reflected either the practical limitations of the system, or a matter of judgement about the result, rather than a proposition capable of technical proof. Still other concerns have, in the Panel's view, represented symptoms of the present economic times rather than problems with HFE per se. This does not mean they can be ignored, but it does mean that they need to be considered in the proper context, and the responses to them need to be appropriately restrained.[2]

In relation to specific proposals to do 'less equalisation' the Panel found:

> that none of the approaches canvassed would be simpler, more transparent or improve efficiency. They would all require additional steps in the CGC's process, and additional steps would require additional explanation about how the distribution was determined, making the process less transparent.[3]

In relation to specific proposals to perform equalisation in a 'less precise' way the Panel noted it was:

> initially drawn to the prospect of 'broad indicators' as a potential way to achieve the goal of reaching similar outcomes through simpler processes. Ultimately, however, we found this goal to be elusive. While there is no end of 'simpler' ways to allocate

[1] Refer, for example, paragraph 5, Chapter 3, *CGC Report on Revenue Sharing Relativities, 2010 Review, Volume 1*; and page 62, *GST Distribution Review Final Report*

[2] Page v, *Foreword from the Panel, GST Distribution Review Final Report*

[3] Page 5, Executive Summary, *GST Distribution Review Final Report*

> Commonwealth grants to States, very few could be adopted within the constraints of our Terms of Reference.[4]

In relation to the issue of "comparable" or "materially the same" relativities the Panel's conclusions support the current practice of equalisation as reflected in the definition adopted by the Commission in the 2010 Review. That is, no dilution of the existing HFE objective.

The 2015 Review ToR have been developed against the background context of the *GST Distribution Review Final Report* findings and recommendations.

The 2015 ToR explicitly state that:

> In preparing its assessments, the Commission should:
>
> (a) take into account the Intergovernmental Agreement on Federal Financial Relations (as amended) which provides that the GST revenue will be distributed among the states in accordance with the principle of horizontal fiscal equalisation.

The 2015 ToR further recognise that the Commission should 'aim to have assessments that are simple and consistent with quality and fitness for purpose of the available data' and 'ensure robust quality assurance purposes'.

Tasmania interprets the 2015 ToR, in association with the findings and recommendations of the *GST Distribution Review Final Report,* to mean that:

> State governments should receive funding from the pool of goods and services tax revenue 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.[5]

That is, the Commission's 2010 Review definition of the HFE distributive principle. Similarly, Tasmania interprets the *GST Distribution Review Final Report* and 2015 Review ToR to support the ongoing use of 2010 Review assessment principles ("what states do", policy neutrality, practicality and contemporaneity) as architectural underpinnings and

[4] Page 6, *Executive Summary, GST Distribution Review Final Report*

[5] Paragraph 34, page 34 of the *Report on GST Revenue Sharing Relativities – 2010 Review, Volume 1*

2010 Review materiality and data reliability assessment guidelines as a starting benchmark for the 2015 Review.

Continuation of the 2010 Review assessment principles and architecture into the 2015 Review context does not negate the adoption, for example, of a broader indicator approach within a specific assessment method – for example, mining revenue – but leaves this, appropriately, to be considered on merit, consistent with the approach of previous reviews.

It also recognises that the materiality and data reliability assessment guidelines may change – for example in response to ToR 2(a) – but sets a starting benchmark against which such changes can be evaluated on merit within a Review context.

This continuation is also consistent with the starting benchmark for the 2015 Review, which, in contrast to the "clean slate approach" of the 2010 Review, takes the 2010 Review methods as continuing except where explicit new 2015 Review methods are developed.

To the extent that the *GST Distribution Review Final Report* recommended specific methodology changes, these are the subject of explicit ToR recommendations and should be evaluated on their own merits within a 2015 Review context.

The appropriateness of the current materiality thresholds

The ToR 2(a) requires that the Commission consider the appropriateness of the current materiality thresholds.

This is a broader, and in Tasmania's view, more appropriate instruction than the actual wording of recommendation 3.1 within the *GST Distribution Review Final Report* itself.

Recommendation 3.1 states:

> To ensure the system is not driven to become falsely precise, the Panel recommends that materiality thresholds for the next methodology review be set at:
>
> - category total expense or revenue average of $200 per capita;
> - category redistribution $120 per capita for any State;
> - disability $40 per capita for any State; and

- data adjustments $12 per capita.

Recommendation 3.1 was made within a context where the Panel was seeking to make explicit recommendations which it considered could 'act as resistance against the tension created by the contested nature of the current system which can lead the CGC to adopt processes and/or assessments that are overly (or falsely) precise'.[6]

Tasmania disagrees with Recommendation 3.1 and considers that the Panel stepped outside its remit and into issues of methodological detail, appropriately the province of the methodological review, in making such a recommendation.

At a first principles level, we do not consider that this recommendation actually adds any value in terms of providing "resistance" against complexity/excessive precision in a context where the Commission already has established materiality thresholds and processes within the 2010 Review methodology.

At the practical assessment level, this recommendation imposes an arbitrary mechanical increase without attention to the actual holistic achievement of equalisation or internal consistency.

Tasmania supports the ToR instruction as providing the more appropriate context for Review consideration.

In terms of 2(a) Tasmania supports the real terms indexation of the existing materiality thresholds consistent with the Commission's previously flagged intention.

However, we adamantly oppose further arbitrarily increasing these thresholds. We do not agree that the Commission's assessments are "falsely precise", that the existing materiality provisions are inadequate, or that a robust case for further simplification has been made in this context.

The 2010 Review aggregation process took a top-down holistic approach and established the current category and disability structures and related materiality thresholds as internally consistent, co-dependent structures. This aggregation process resulted in simplification at the expense of a lesser degree of equalisation as evidenced by large scale reductions in both categories and disabilities assessed and by the fact that some 45 per cent of states

[6] Page 59, *GST Distribution Review Final Report*

own-source revenue and 20 per cent of expenditure is now treated on an equal per capita basis. Tasmania accepted these 2010 Review structural changes, and the related materiality and data reliability assessment guidelines, as a necessary price for enduring simplification and preservation of HFE into the future.

Pragmatically, we question whether, even if a false precision case were to be accepted, an increase in (real) materiality thresholds could be implemented outside of a full-scale top down holistic re-evaluation of all assessment categories and disability factors. That is, to create materiality thresholds which are internally consistent with the assessment structures is a time-intensive, large-scale exercise. There is not sufficient time to undertake the type of review of materiality thresholds that would be required, given the limited time available for the 2015 Review, the substantive issues that must be addressed, and the second order importance of this issue in that context.

The appropriateness of continuing to round relativities to five decimal places

ToR 2(b) requires the Commission to consider the appropriateness of continuing to round relativities to five decimal places.

The underlying Recommendation 3.2 states 'To ensure the system does not appear to be falsely precise, the Panel recommends that relativities produced from the CGC's process be rounded to two decimal places in the annual Updates and Reviews'.[7]

As with Recommendation 3.1, in Recommendation 3.2 the Panel was seeking to make a recommendation which could 'act as resistance against the tension created by the contested nature of the current system which can lead the CGC to adopt processes and/or assessments that are overly (or falsely) precise'[8].

Tasmania does not accept the starting premise that the system is "falsely precise", but even ignoring this issue, Tasmania would oppose such a change.

Independently of whether this is expressed as per ToR 2(b) or as per Recommendation 3.2, Tasmania considers that a presentational change in the way relativities are currently

[7] Page 11, *GST Distribution Review Final Report*

[8] Page 59, *GST Distribution Review Final Report*

reported is not merited – it would detract from equalisation and fail to achieve the Panel's stated objective.

That is, this would have no impact on the underlying calculation methods (which is the source of contention) but (at the two digital level at least) could result in material but arbitrary variations in year-on-year outcomes for particular states.

While it is expected that over the long-term these differentials would average out, there would be, nevertheless, arbitrary positive or negative variations within any given year between the underlying calculated equalisation GST outcome and the (rounded) GST revenue actually receipted.

Instead of proving effective in reducing contestability, Tasmania considers that such a change is more likely to increase it. The premise on which the recommendation is predicated ("false precision") remains a source of contention but the rounding would have real but arbitrary equalisation consequences for individual states. It cannot be justified as a simplification as it is purely presentational, nor does it achieve processing efficiencies as the difference in computational effort between a three digital or five digital GST outcome is infinitesimally small. Finally, it is unclear in whose eyes, if any, the system perception would be changed and the purported gains made.

The use of updated or lagged data

ToR 2(d) requires that the Commission consider the use of data which are updated or released annually with a lag or updated or released less frequently than annually.

This derives from Recommendation 6.2 which states:

> 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[9].

The underlying intent of the Panel recommendation is improved stability of GST shares.

[9] Page 15, *GST Distribution Review Final Report*

The origin of the Panel recommendation is understood to be concerns which Victoria raised with Panel members about the 2011 Update impact of updated SET data used in the calculation of the interstate wages component of the Location factor.

As the SET data was only released on a four yearly basis and the Commission used interpolated annual data for years between SET releases, this required that the new SET information be reflected not only in the new incoming assessment year but also in changes to earlier assessment years interpolated data. This resulted in material, unexpected re-distribution effects in the 2011 Update.

Tasmania opposes Recommendation 6.2.

The implicit trade-off for improved stability of GST shares is diminished accuracy in the measurement of states underlying relative circumstances.

As a matter of principle, the Commission must continue to work on the basis of the best available data to be used in each Update for all assessment years. To do otherwise would be to knowingly distort the achievement of HFE.

That is, data updates in earlier assessment years due to lagged data releases are not something the Commission could or should avoid. Retaining data in the earlier assessment years which has since been invalidated may benefit one or some states and contribute to GST share stability but it can only come at a cost to another or other states whose relativity outcome(s) will understate their actual relative circumstances.

The Commission assessment process assesses states' need for GST revenue after taking into consideration their revenue raising capacity, other revenue sources and expenditure needs.

To make stability of GST shares the ultimate distributive objective is to negate the holistic context in which these GST shares are derived. That is, movement in GST shares reflects movements in state circumstances and shows a distributive system which is functioning appropriately rather than a system which is not.

While stability of grant share is an implicit objective as recognised through the three-year averaging process, it needs to be balanced against other competing distributive objectives.

Recommendation 6.2, in Tasmania's view, skews that balance too far in favour of stability over equalisation which is the ultimate objective.

Chapter Two: Treatment of Schools Education within a National Education Reform Agreement context

Key points

- ToR 6 requires the Commission to ensure that its schools assessment method will not unwind the NERA funding arrangements and that non-participating states will not be advantaged through their non-participation.
- Interpretation of ToR 6 will be contentious – it weakens HFE by constraining the Commission treatment options for NERA funding but remains open to interpretation as to precise method and its integration within the Commission assessment framework.
- Critical interpretative issues include the needs assessment basis, expenditure standard and treatment of Commonwealth funding.
- Implementation will be problematic due to fundamental incompatibilities between the NERA SRS funding allocations (minimum standard and positive loadings) and the Commission approach.
- It will also require the Commission to consider its overall treatment of education funding and expenditure, including for non-government schools.
- Pragmatically, potential method approaches the Commission could consider include:
    - replace the Commission's own assessments of disadvantage with the NERA loadings – potentially augmented by additional Commission factors;
    - exclude (treat APC on both the revenue and expenditure sides) the Commonwealth funding component for each state that is based on SRS loadings but, consistent with the Commonwealth Treasury advice, equalise the "base" funding; or
    - adopt a "subtraction" approach similar to that for the 2010 Review assessment of Community and Other Health.
- The subtraction approach appears the most able to reconcile NERA and Commission funding incompatibilities.

ToR 6 states:

> 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 funding arrangements. The Commission will also ensure that no State or Territory will receive a windfall gain through the GST Distribution from non-participation in NERA funding arrangements.

This effectively replicates clauses 76 and 77 of the NERA provisions.

ToR 6 will constrain the Commission in its treatment of the NERA funding arrangements. That is, it undermines the principles of HFE by imposing restrictions on the Commission that limit its ability to perform its role of equalisation. In so doing it compromises the internal integrity of the current HFE process.

As a long term defender of HFE principles, Tasmania was not an advocate for this ToR and opposed it in the draft stages before the ToR became final. However, the ToR are now final, and the Commission is bound to operate within its terms of reference notwithstanding that ToR 6 will be problematic to reconcile within the Commission HFE framework.

In this context, this submission seeks to provide constructive input as to "how" the ToR requirements may be integrated into the 2015 Review context at least cost to HFE.

The fundamental starting point in terms of this is the interpretation of ToR 6.

Commonwealth Treasury has indicated in recent HoTs forums that it considers the first part of the ToR to give effect to the principle that:

> it would not be desirable for the CGC to override [the NERA] disadvantage assessments with a different balance of disadvantage factors in its assessments.... However, consistent with the recent HoTs Deputies discussion, the treatment of base funding should be considered as part of the upcoming Methodology Review[10].

With regard to the second part of the ToR, Commonwealth Treasury interprets this to mean that 'any additional funding flowing to a participating state will not – as a consequence of the HFE process – be equalised towards a non-participating state'[11] but notes the

[10] Commonwealth Treasury paper – *National Education Reform Funding – HFE Treatment*

[11] ibid

mechanism to give effect to this is left to the Commission to determine within the 2015 Review context.

Even with these Commonwealth Treasury clarifications of intent, there remains ambiguity and the potential for varying interpretations.

There is, in principle, clarity as to what is meant by “base” funding and “disadvantage” funding within the SRS model, but in practice distinguishing “base” funding and “loadings” funding components may well be problematic.

That is, while the starting base is the calculation of the SRS total funding requirement for all schools within a state in the given year, this is then offset against the amount that would have been funded in that state in the absence of NERA (total state funding – both Commonwealth and state – to all schools) defined against the State’s 2011 funding baseline (indexed). The gap between the two defines the “additionality”. After accounting for any private funding (fees and so forth) the net additionality is then funded 65 per cent Commonwealth, 35 per cent state. This makes identifying the base funding component versus the loadings component a complex task potentially open to dispute.

Other issues relevant to a Commission perspective include that the starting baseline and related additionality are in themselves policy contaminated measures reflecting state-specific funding choices and policies, not simply differential servicing needs as measured through SRS loadings. That is the 2011 baseline necessarily reflects differential state choices with respect to education funding and embeds these in the future funding outcomes. In addition, at least until 2019 (and in all likelihood beyond) the SRS total funding requirement for any given year, *t*, is specific to each participating state as it is based on a state-specific transition pathway which defines the total maximum funding envelope in year *t* for that state.

Nor are the 2019 end points necessarily consistent across states. For example, in Tasmania’s case, in 2019, the projected SRS total aggregate funding quantum will reach 95 per cent of the total SRS target funding level profile for this state – what happens from 2020 onwards remains unspecified at this point in time.

It should also be noted that the SRS is purely an aggregate state funding model. It is not a resource allocation model. In practice, state governments retain discretion to allocate

funding to individual government schools in accordance with their internal state resource allocation models (in Tasmania's case the Fairer Funding Model), subject to meeting maintenance of effort and minimum growth indexation targets.

This was a critical concession the Commonwealth had to make in order for states to agree to participate in the NERA as the resource allocations generated by the SRS model do not accord with states' own internal assessments of individual schools relative funding needs based on localised knowledge and hence historical funding bases.

As bilateral negotiations of NERA arrangements are continuing between Commonwealth and some states, it is difficult to assess the full impact of NERA on the Commission assessment until the negotiations with all states are finalised. There is also a longer term uncertainty associated with the 2013 election outcome as the Opposition's stated intent is to undo the current agreements and start again should they be elected.

Disregarding these post-election uncertainties, and assuming the NERA remains funding policy, the Commission will need to continue to assess GST needs in relation to Schools Education. Schools Education cannot be "taken outside" of the Commission assessment framework as NSW has tried to suggest in recent HoTs forums.

In aggregate, states fund some 70 per cent of total (public) schools education funding and the Commonwealth the remaining 30 per cent. It is also the case that there are significant differences in state education needs profiles for both government and non–government schools (regardless of whether this is assessed on the basis of NERA SRS loadings, Commission "needs", or states own resourcing models). It is not pragmatically feasible to assess Schools Education within the 2015 Review on an EPC basis.

Nor does the ToR support an APC assessment approach (i.e. APC treatment on both the revenue and expenditure sides) based on the Commonwealth Treasury interpretation of the ToR treatment of base funding.

The NERA arrangements also include non-government schools as part of the loadings-based funding model, ultimately leading to a significant increase in state government funding for non-government schools.

These changes will require the Commission to consider its overall treatment of education funding and expenditure, particularly for non-government schools. The possibility of some

states being non-participants in NERA may also necessitate a two-tiered Commission assessment approach.

However, at the most basic level, and ignoring non-participation complications, there are fundamental inconsistencies between the two approaches that may prove irreconcilable within the existing HFE treatment context.

NERA takes as its starting point a minimum funding standard and then adds positive loadings for disadvantage.

While on the surface, the NERA “loadings” address broadly similar areas of disadvantage as those that the Commission currently adjusts for in its expenses assessment, it includes some areas of disadvantage that the Commission has previously considered and found to be either:

- non-material, such as English language proficiency;
- not reliably measurable, such as students with disabilities; or
- measured using a different data source, such as the location based on SARIA rather than ARIA.

NERA funding is also based on actual schools such that its funding allocations are, in Commission terms, “policy contaminated” in this context. For example, actual school locations, size, structure (in terms of placement of years six and seven within primary or secondary), and participation in non-compulsory years (pre year one and post year 10) vary between states, in part, due to policy differences.

The NERA loadings are also arguably incomplete in that they do not recognise differences in wage structures, student transport costs, and certain other costs between states which also materially impact education delivery costs.

In contrast, the existing Commission assessment is based on a national average expenditure standard. It assesses needs around this average as being either positive or negative (i.e. above or below unity). It also makes a more complete assessment of needs in terms of recognition of additional factors such as interstate wage differentials, transport of school children and administrative scale small state disabilities. It seeks to use a policy neutral assessment base which means, in terms of schools, not necessarily recognising all

schools as unavoidably necessary; adjusts pre-compulsory and post-compulsory participation rates to remove state-based policy influences and so forth.

The task of reconciling what seems at the outset to be fundamental inconsistencies between the Commission approach and the SRS loadings model is further complicated both by the political nature of the funding deals that have been struck, and the apparent inconsistencies in the funding needs generated by the SRS model and state education agencies expected funding outcomes based on localised knowledge.

Overall, this does not engender confidence in the SRS as a GST allocation model notwithstanding ToR 6.

Pragmatically, potential method approaches the Commission could consider include:

- replace the Commission's own assessments of disadvantage with the NERA loadings, possibly augmented by additional Commission factors. This is the approach that would be the most directly consistent with the Commonwealth Treasury statement of intent. However, even ignoring confidence issues with the SRS allocations, this is problematic in a context where the two resourcing models are based on fundamentally different standards and could not be expected to produce the same outcomes. To require the Commission to move to a Schools minimum standard base within a methodology predicated on a national average standard would have ramifications that extend well beyond the education assessment.

- exclude (or treat APC on both the revenue and expenditure sides) the Commonwealth funding component for each state that is based on SRS loadings but, consistent with the Commonwealth Treasury advice, equalise the "base" funding. This could involve some needs augmented assessment. While this would be less obviously problematic compared to the first approach, it is not clear that either NERA or HFE would be effectively achieved through this approach (due to the fundamental inconsistencies between NERA and Commission assessment approaches as outlined earlier).

- adopt a "subtraction" approach similar to that for the 2010 Review assessment of Community and Other Health. This method would assess each state's total

education expenditure need and then deduct amounts funded from non-state government sources, including the Commonwealth, to determine the residual GST funding needs of each state government. A priori, this type of approach could fit well with the NERA funding allocation model which is broader than simply state government schools. It has the potential to reconcile HFE and NERA outcomes within a workable framework while not "unwinding" the NERA Commonwealth funding allocations.

At this point Tasmania would suggest that the subtraction approach is conceptually the most viable of these three options.

However, this glosses over debate regarding the overall needs assessment basis (SRS or CGC) at the foundation of assessing education need and whether this would effectively satisfy Commonwealth Treasury's stated intent.

For example, using a 2010 Review Commission total needs assessment approach but deducting NERA based funding allocations to determine the GST residual need, would determine overall funding allocations on a Commission-based disadvantage rather than a NERA-based disadvantage model. Arguably this could be interpreted as "overriding", even if it is not "unwinding", given the differences in the component elements.

In practice, it is already evident that the Commission is considering adapting its needs assessment methods, in part, in response to the NERA ToR. For example, while it does not appear to be a fundamental driver in the consideration of the replacement of SARIA by ARIA, it is evident that ARIA's consistency with the "location loading" component of the SRS model is a point in ARIA's favour within the Commission's deliberations. However, does this necessarily mean that there needs to be a total alignment between the ARIA based assessment of location needs and a NERA one? This is a matter of interpretation.

The practical viability of the subtraction approach rests on the assumption that each state's Commonwealth funded NERA allocation will not exceed its total assessed GST education funding – i.e. the subtraction method does not generate any net negative Schools Education GST outcome. This appears reasonable given the relative national funding portions but would need to be verified at the individual state level.

The treatment of non-participant states is a further complication – particularly in a context where the NERA remains a minority outcome. At this point it would be premature to assume an outcome in this respect. However, Tasmania would assume that the Commission will take an assessment approach to non-participant states similar to that outlined for the NDIS.

Chapter Three: Treatment of Welfare and Housing

Key points

- Tasmania supports revising the 2010 Review method to reflect the changes in states roles and responsibilities and related revenue and expenditures, with the exception of WA (in line with ToR 3(e)).
- Tasmania endorses the broad approach to NDIS assessment as outlined in the 10 April 2013 Commission paper and related model subject to observations and caveats as noted.
- Key caveats are the approach to determining average policy – whether or not this requires a majority of states needs to be further debated – and the assumption that, in full NDIS, participating states will no longer provide disability support services – states will need to continue to provide services to NDIS ineligible clients.
- Given the uncertain data viability of the Family and Child Services assessment component, Tasmania considers that this is a priority data issue for progression notwithstanding the compressed timeframe available for the 2015 Review.

Tasmania was supportive of the 2010 Review Welfare and Housing assessment method and considers that it provides the appropriate starting point from which to develop the 2015 Review assessment method.

The following assumes that the 2010 Review method is adopted as a starting base and considers how it should be revised to accommodate the 2015 Review circumstances.

At a minimum the 2015 Review will need to:

(1) consider the changes in roles and responsibilities initiated under the National Health Reform Agreement (NHRA) - as identified in clause D66(d) of *Schedule D, Intergovernmental Agreement on Federal Financial Relations (IGA FFR)*, from which clause 3(e) in the ToR derives;

(2) determine the appropriate treatment of the NDIS – as identified in clause 5 of the ToR; and

(3) address data issues within the Family and Children's services assessment component as identified by the Data Working Party.

Integration of roles and responsibilities?

Under the 2010 Review method, states are currently assessed to be responsible for delivering both specialist disability services and home and community care services to their entire resident population regardless of age. Residential care, regardless of age, is treated as a responsibility of the Commonwealth primarily.

However, under the NHRA-agreed changes in roles and responsibilities, from 2011–12 states have assumed full financial responsibility for all community-based and residential care for under 65 year olds (under 50 if Indigenous). The Commonwealth has assumed full financial responsibility for community-based and residential care for those 65 years old and over (50 years old and over if Indigenous). These arrangements have been structured such as to achieve overall revenue neutrality in each of the three years from 2011–12 to 2013–14 through a balancing adjustment to the Disability SPP. From 2014–15, the Disability SPP adjustment base will set at the 2013–14 level and then indexed for real per capita growth.

The *National Partnership Agreement on Transitioning Responsibilities for Aged Care and Disability Services* is the vehicle through which the financial detail of these arrangements is publicly documented.

For the 2015 Review, Tasmania does not believe that it would be consistent with the Commission's assessment principles nor, at a practical data level, sustainable, to continue to assess relative needs in relation to specialist disability services or home and community care services, based on the 2010 Review scoping of roles and responsibilities. This position is further reinforced by the need to establish the correct base from which to appropriately consider the future NDIS treatment.

Consistent with the assessment guidelines and the content of clause D66(d) IGA FFR, Tasmania considers the 2015 Review method will need to reflect these changes in roles and responsibilities within the relevant components of this category assessment both in terms of the changed demographics that underpin the assessment of relative needs and in the related treatment of expenses and the Disability SPP.

In making these arguments, Tasmania notes that the provision of home and community care services to under 65s remains a material expenditure responsibility for states and that states still need to provide public housing services to those over 65 as well as those under 65. A further complicating issue is the discretion for 50 and over Indigenous users of disability and home and community care services to elect to remain within the state system ("no wrong door" policy).

That is, in a demographic assessment context, Tasmania does not believe it will be as simple as "zeroing out" the aged care related line in the 2010 Review assessment method or removing a targeted group of pensioners (those 65 and over or 50 and over if Indigenous) from the recipient assessment framework.

In practice, reconfiguring this category assessment will require a re-evaluation of the relationships between ABS GFS expenditure components, Commonwealth pension/other payment recipients and relative service usage weights.

Western Australia is the only remaining non-participant state in terms of these roles and responsibility changes.

A possible way to integrate a continued needs assessment for Western Australia, as required by the clause 3(e) of the ToR would be through retention of a servicing needs profile based on Western Australia's entire category population rather than the revised profile as for other states based on the under 65 (or under 50 if indigenous) service population profile.

In terms of treatment of revenues and expenses, Tasmania considers that, consistent with the re-evaluation of the needs assessment base, the Commission should treat:

- state payments to the Commonwealth for residential care and packaged care for under 65 year olds (under 50 if Indigenous) by inclusion within the expenditure base as these are now an expenditure responsibility of states;
- payments by the Commonwealth to the states for specialist disability care for those 65 and older (50 and over if indigenous) – and the related state expenditure – such that they do not impact the relativities; and

- the Disability SPP should be assessed on an adjusted basis in all states except for Western Australia where it should be assessed on a full SPP basis consistent with the assessed service population base assumed above for Western Australia.

Treatment of the NDIS

Tasmania is broadly supportive of the position outlined by the Commission in its NDIS-GST paper and illustrative model (circulated to states on 10 April 2013 by Catherine Hull). However, we make the following specific comments.

Assessment approaches

At the time of release of the Commission paper, only New South Wales had signed a Heads of Agreement committing to participation in the full NDIS. Since the release of the Commission paper, all bar one state (Western Australia) have now signed formal Heads of Agreement to participate in a full NDIS.

The signed Heads of Agreement follow a similar format and content, including as to contribution formula, but with differences between states as to date of transition commencement and date of full NDIS implementation. Nor within this transition timeframe is there a prescribed transition pathway. Instead this is left to states to determine individually in negotiation with the Commonwealth. Overall, the NDIS arrangements within the Heads of Agreement leave significant leeway for change in key parameters as information from the launch phase becomes available and transition unfolds.

Notwithstanding these uncertainties, the more relevant Commission model is clearly the second “more complicated scenario” (as outlined in paragraphs 18-29 of the 10 April 2013 paper).

Within this context, Tasmania considers that, while there is no common IGA at this point in time, there is a clear commitment from seven of the eight states to participate in the full NDIS such that, on an average policy basis (however defined), the NDIS transition commencement year is clearly 2016–17 (the ACT is the only participating state with a later start date). Similarly, the full NDIS start date is 2019–20 (of the participating jurisdictions the only states with earlier full scheme dates in their Heads of Agreement are New South Wales and South Australia).

Based on the Heads of Agreement content, Tasmania considers the observed NDIS expenditure of participating states in the transition years reflects policy choice rather than prescribed expenditure. While the Heads of Agreement specify a unit cost contribution base per participating NDIS client in transition (split 59.4 per cent state and 40.6 per cent Commonwealth), states retain discretion over how many clients are transitioned into the NDIS in any given transition year. In this context, states do have a policy choice as to their rates of transition and hence their NDIS expenditures in the transition years. From a policy neutrality perspective therefore, Tasmania supports the Commission determining average policy based on the average of observed state behaviours rather than actual expenditures in these transition years.

In practice, states will necessarily undertake both non-NDIS and NDIS expenditures on the NDIS potential population in parallel in each of the transition years. Pragmatically, transferring a human client base such as the NDIS eligible population from the existing state-based service arrangements to NDIS national agency based arrangements will take time and resourcing and can only be done through a staged process. Given this, Tasmania's expectation is that average policy will be to run both regimes in tandem across the transition years and that both NDIS and non-NDIS policies are likely to prove material over the transition period.

Tasmania reserves its position with respect to the identification of stages as outlined in paragraph 23 of the Commission paper being predicated on "states containing the majority of potential users".

The fact that seven of the eight states have now committed to the full scheme NDIS arguably obviates the need to make a call as to whether the underlying average policy basis is being determined by a majority of the weighted service population or this plus a majority of states.

However, the underlying implication of paragraph 23 of the Commission paper is that the former applies such that the definition of average policy could conceivably be determined by as few as two states (i.e. New South Wales and Victoria). This was not the assessment principle applied within the 2010 Review. Tasmania considers this issue needs to be further discussed within the 2015 Review as the mechanism to determine "average policy" is an important foundation principle.

Predicated on the base assumptions of the Commission model[12] and the trigger point for full NDIS scheme having been reached (however average policy is ultimately determined), Tasmania agrees that the state contribution of each participating state would be a policy neutral measure of each state's needs profile (that is, we support model (b) of the three conceptual models outlined in paragraph nine of the paper, as a conceptual assessment model for NDIS eligible populations post-transition).

In this context, it is noted that the actual state contribution arrangements under full NDIS, while based on a common state formula, do not actually equate to an annual EPC contribution for each state. Internal Tasmanian Treasury modelling shows that the consequences of the proposed five-yearly calculation of contribution shares, if left unrecognised within the Commission assessment context, would have material negative GST impacts for some states. That is, Tasmania considers that, once full NDIS is triggered, the Commission should treat participating states full scheme NDIS contributions as policy neutral measures of assessed need as outlined for model (b) paragraph nine.

Treatment of NDIS trials

As noted in paragraph 30, it has been determined that state-specific NDIS "launches" will not impact the relativities prior to the formal transition period commences in 2016–17.

Paragraph 31 then discusses the impact of NDIS launches on the transition period. Tasmania does not dispute that the launch cohorts and related expenditures should factor into the Commission assessment from 2016–17 and hence affect the consideration of whether a dual assessment system is in operation. However, Tasmania does not agree with the last sentence that "... it appears that a dual system would be average policy when transition starts". This statement appears to be predicated on the paragraph 23 presumption that average policy is determined by "states containing the majority of potential [NDIS] users".

[12] Paragraph seven of the Commission paper states "The coverage of NDIS is meant to be comprehensive and states which join would, after a possible transition period, have no disability service expenditure other than their contribution to the NDIS pool (in dollars or in kind). That contribution would be determined by a formula applying to all participating states, eg an equal per capita contribution. All [*in the following discussion of assessment approaches*] is conditional on that understanding."

As previously noted, while this may be a moot point in circumstances where seven of the eight States are participating states such that there is a majority of states in addition to a majority of weighted service populations, Tasmania considers that this policy presumes an approach to average policy determination for the 2015 Review that both departs from previous practice and has yet to be appropriately considered and debated.

Backcasting

Tasmania considers that as the NDIS is indisputably a major change in Commonwealth-State financial relations, the appropriate treatment from a first principles perspective is to backcast. Furthermore, first principles suggest that backcasting should be done with effect for the 2016–17 application year, as the first transition year, and reflect the expected average NDIS participation and expenditure proportions in 2016–17 back into the underlying assessment years.

However, Tasmania acknowledges that the Commission's capacity to do this will rely critically on states being able to provide robust estimates of their NDIS expenditures and NDIS service population coverage no less than eight months in advance of the actual application year (i.e. for the 2016–17 application year, the Commission would need this information by no later than October 2015).

Treatment of expenditure on NDIS-Ineligible clients

While the Commission's stated starting premise is that, in full NDIS, participating states would have no disability services expenditure other than their contribution to the NDIS pool (in dollars or in-kind), Tasmania considers it is evident in the wording of the more recently signed Heads of Agreement that there is no real expectation that this will be the case[13].

Independently, both the restrictive NDIS eligibility criteria and the comparatively small numbers projected by the Productivity Commission (on which the NDIS service population is based), when considered against other projections of disability service populations, indicate that there will be NDIS-ineligible clients whom the participating states will need to continue to service. How material this residual base will prove to be has yet to be established.

[13] Refer for example, to clause 36 of the Queensland or Victorian Heads of Agreement or South Australia's clause 33 or Tasmania's clause 32, in contrast to New South Wales December 2012 unequivocal clause 33.

Tasmania anticipates that the 2015 Review method will need to accommodate an ongoing dual system predicated on state service populations that include a mix of NDIS-eligible and NDIS-ineligible clients within the existing disability services/basic community service populations. That is, the dual assessment model outlined by the Commission in the body of the paper could be considered a subset of a larger dual assessment model, conceptually partitioned between an NDIS eligible client base who will be able to transition to full NDIS and a residual NDIS-ineligible base. The Commission paper's staged transition model currently only accommodates the NDIS eligible component.

Treatment of the Medicare Levy

One issue not covered in the Commission's 10 April 2013 paper is the treatment of the Medicare Levy as these funding arrangements were agreed later.

In full-scheme NDIS, the NDIS Medicare Levy arrangements mean participating states will receive their equal per capita share of the nationally allocated funding.

Prior to that, it is only once a state has a majority of its eligible NDIS population participating, that the state can begin to draw down on its Levy-funded entitlement.

The rate at which a state can draw down in these circumstances will be pro-rated based on the proportion of recipients participating at the end of the previous financial year.

Tasmania considers that the appropriate treatment of this revenue would be actual per capita, whether in the transition or subsequent years, consistent with the usual treatment of Commonwealth payments.

Data issues for Family and Children's Services

In the Family and Children's Services component of the Welfare and Housing assessment, as identified through the Data Working Party processes, new, broader-based data are required to support the ongoing assessment of the family and child services component under the 2010 Review-determined method. In absence of this, a method change will be required.

It is understood that Commission staff[14] had identified a suite of possible data options, notably:

- linking the AIHW's child protection unit record system currently under development to Centrelink unit record data;

- identifying the low SES share of users using ABS SEIFA data linked to the location information obtainable from the AIHW's new child protection unit data record system; or

- for states to collect income information from families of children currently subject to child protection investigations along the lines of the data currently collected by Victoria.

Commission staff indicated at the August 2012 Data Working Party that the third option (preferred by Commission staff), had been ruled out by the high level policy group, the National Framework Implementation Working Group. In consequence, Commission staff would liaise with Centrelink, FaHCSIA and AIHW to evaluate the feasibility of the first option. New South Wales and South Australia were also to investigate the potential for income data to be made directly available by their respective family and child service delivery areas. No subsequent information has been provided as to the current status.

Given the uncertain continuing viability of this assessment component, Tasmania considers that this is a priority data issue for progression notwithstanding the compressed timeframe available for the 2015 Review. It will impact our resource targeting for the next stages of the Review. We urge the Commission staff to provide a status update well in advance of the November 2013 officers' meeting.

[14] Refer Data Working Party meeting, August 2012 Annotated Agenda – most specifically Attachment F

Chapter Four: Treatment of roads and transport services

Key points

- Tasmania supports the development of a new transport infrastructure assessment.
- Tasmania observes that the new assessment framework will need to be internally consistent with the work of the capital infrastructure framework more broadly and that the Data Working Party work since 2010, through the Data Working Party on the Roads and Transport Services assessments, could inform considerations for a new transport expenditure assessment.
- Tasmania opposes the development of a framework for the discounted treatment of transport infrastructure payments as inappropriate. It is seeking to address (in an arbitrarily selective fashion) the effect (GST payment share instability associated with capital infrastructure payments) rather than addressing the cause (2010 Review Capital methodology).

The ToR 2(c) requires the Commission to have regard to the recommendations of the Final Report of the GST Distribution Review 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)

This ToR derives from Recommendation 6.1 of the *GST Distribution Review Final Report* which states:

> In recognition of the inter-related nature of the transport networks and the national benefits that accrue from increasing the efficiency of these integrated transport networks, the CGC should identify all Commonwealth payments relating to national network road infrastructure and rail based transport infrastructure.
>
> All identified payments should affect the relativities on a 50 per cent basis, to recognise their dual national/state purpose. To ensure that states that have previously received

rail based transport payments are not disadvantaged, this change in treatment should apply from the CGC's 2013 Update.[15]

The broad context in which the GST Distribution Panel made this recommendation was stability of state GST shares and a targeted 50 per cent discount of rail-related payments consistent with that currently applying to national network roads.

The ToR broaden this to development of a new transport infrastructure assessment, to include, if appropriate, a framework for treatment of nationally significant transport infrastructure payments.

A new transport infrastructure assessment

At this point in time, Tasmania does not have a formed view as to the structure of a new transport infrastructure assessment but makes the following observations.

Under the 2010 Review methodology, elements of state government transport related expenditure are assessed in five separate categories: Transport Services, Roads, Depreciation, Investment and Net Lending. Any new transport infrastructure assessment will have to maintain internal consistency between the Roads and Transport assessments and the Capital assessment framework (Investment, Net Lending and Depreciation).

That is, changes to the Capital assessment framework have implications for the Roads and Transport Services assessments (and vice versa) since road depreciation expenses are assessed in the Depreciation category and road construction expenses, i.e. new roads, are assessed in the Investment category.

Further, the Commission has previously noted that, equity injections (funded from accumulated net lending) and capital subsidies to Public Non-Financial Corporations can achieve a similar outcome. They can both be used to fund the acquisition of infrastructure by the PNFC, increasing its value. As such, within the context of the 2010 Review capital assessment approach both would be reflected in a state's measure of its net financial worth.

[15] Page 94, GST Distribution Review Final Report

Following from this, because the Commission equalises state per capita net financial worth by recognising that states require more per capita net lending if their populations grow faster, the Commission does not assess a population growth disability in relation to capital subsidies in the Transport Services category. That is, to keep the methodology simple, capital subsidies are assessed EPC in the Transport Services category. The average subsidy still affects the net lending of states and their average net financial worth. The Net Lending assessment then ensures population change disabilities are recognised.

Tasmania continues to support the 2010 Review (continued) separation of Roads and Transport Services into two categories to reflect the different cost and use drivers. This split was also supported by Government Finance Statistics data.

However, Tasmania considers that the 2010 Review Roads and Transport Services assessments have both data quality, and some methodological issues.

The Commission's Data Working Party has been investigating ways of improving the Roads and Transport Services assessments in anticipation of the 2015 Review.

Given the problems with the Transport Services and Roads data and methods, Tasmania welcomes the Commission's examination of a new transport infrastructure assessment as part of the continuation of Data Working Party investigations.

A framework for the treatment of Commonwealth payments for transport infrastructure?

In the 2010 Review Final Report, the Commission reported that payments for National Network Roads have an impact on the relativities because they increase state infrastructure holdings. However, the Commission stated that Australian Government assessment of state road investment needs included broad national considerations, which the Commission were unable to assess. The Commission therefore treated 50 per cent of those payments as having no impact on state fiscal capacities.

The *GST Distribution Review Final Report* recommended that, in recognition of the inter-related nature of transport networks and the national benefits that accrue from increasing the efficiency of these integrated transport networks, the Commission should treat all Commonwealth payments relating to National Network Road infrastructure and

rail-based transport infrastructure on a consistent 50 per cent discount basis to recognise their dual national/state purpose.

Tasmania opposes both Recommendation 6.1 and the second part of ToR 2(c) (a framework for the discounted treatment of transport infrastructure payments) as inappropriate.

The underlying objective of the Panel in making Recommendation 6.1 was increased stability of GST grant shares – to be addressed, in part, through a discounted treatment of rail infrastructure payments.

The instability arising from the treatment of capital payments is caused by the "lumpiness" of the 2010 Review capital methodology which has resulted in material year-to-year volatility in states GST receipts.

Tasmania also considers this to be a real issue but believes that the appropriate means to address it is within the context of a re-evaluation of the 2010 Review Capital methodology.

There has been a longstanding general consensus as to the appropriateness of including Commonwealth payments to states.

This position has broken down in the face of the 2010 Review treatment of capital payments.

The Commission's 2010 Review decision in relation to roads seems to have opened the floodgates to arguments made on the basis of "national benefit".

National benefit arguments can be made in relation to a broad range of other Commonwealth payments, and is not limited to just rail infrastructure or transport infrastructure. Extending the existing roads treatment to rail is a "slippery slope" in this context.

Tasmania does not support addressing grant share instability via an arbitrary discounting of rail infrastructure payments or even transport infrastructure payments more broadly. Discounting of all rail infrastructure related payments in particular appears arbitrary and unprincipled, particularly if it extends to commuter rail.

As a purported response to grant instability it treats the effect rather than the cause (lumpiness of capital payments) and in this context it also risks damaging the long run integrity of HFE.

This is discussed further in Chapter Six: Treatment of Commonwealth Payments.

Tasmania did not support the Capital assessment in the 2010 Review. Tasmania's views on the Capital assessment framework are further set out in Chapter Five: Treatment of Capital.

Chapter Five: Treatment of Capital

Key points

- Tasmania supports the review of the Capital assessment framework and has favoured a holding cost approach, rather than the current assessment of capital needs. Tasmania supports investigation of a return to an operating statement assessment.
- However, if the Commission were to retain the current capital assessment framework, then there are a number of conceptual issues that were raised during the 2010 Review that remain a concern.
- These concerns include the:
    - direct approach to assessing states' capital needs;
    - differential population growth needs assessment; and
    - possible double count in the assessment of investment and depreciation as noted by the GST Distribution Review Panel.

The ToR item 2(e) requires the Commission to examine the merits of adopting a simplified and integrated assessment framework (Recommendation 6.3).

While the Panel considered the changes in the capital assessment framework introduced in the 2010 Review were a positive step forward, elements of the capital assessment framework introduced unnecessary complexity and volatility. The assessment comprises Investment, Depreciation and Net Lending which together assess the capital needs of states through both the net operating statement, and through net lending by equalising net financial worth.

The Panel recommended that the Commission consider a return to a net operating statement framework while retaining the population needs assessment, and to recognise the differential needs, other than for population growth, associated with state capital subsidies to Public Trading Enterprises (PTEs) (which are treated EPC in the Transport Services category).

It is noted that the Panel quite rightly did not provide details of how this should work, but rather left it to the Commission to examine in the 2015 Review.

The Commission, as well as some states have argued that the current direct approach to recognising the fiscal impacts of states' capital acquisition is already a simpler and more elegant method of assessing capital than the previous debt charges assessment. The previous debt charges approach was seen to be complex and data intensive.

However, some states, including Tasmania, have concerns with the current capital assessment in the direct approach to assessing states' capital needs and the differential population growth needs assessment.

The Net Lending assessment seems to complicate the capital assessment framework given that fiscal capacity to acquire capital infrastructure can be equalised through the net operating balance. By also equalising NFW it potentially conflates the objectives of HFE, which is to give states equal fiscal capacity on an annual basis to provide the average level of services, with that of funding capital acquisition. While Tasmania supports efforts to simplify the capital assessment framework, it also welcomes the opportunity for review of the current assessment on conceptual grounds.

The GST Distribution Panel's simplified and integrated (capital) assessment framework

The Panel's recommendation that the capital assessment be simplified could involve replacing the current Investment and Net Lending assessments with the following:

- a financial cost of capital use (holding cost) that scales up functional depreciation needs assessment. This composite rate (of capital investment and depreciation) is then applied to the stock of assets;
- a population growth needs assessment through equalising population dilution of net worth (total assets less total liabilities) instead of net financial worth (total financial assets less total liabilities); and

- the inclusion of net operating deficits of subsidised PTEs (including depreciation and before subsidies), such as public housing and public transport, as expenses in the net operating statement.

While Tasmania has not reached a final position regarding this approach, other than to support its investigation, a holding cost approach would overcome some of the issues that have been raised with the direct assessment of investment needs, that is, an apparent disconnect between the immediate acquisition of capital in a given year and service delivery needs in that year.

The holding cost rate (noting that an appropriate rate will need to be determined) would apply to the physical capital stock. A holding cost approach would represent the opportunity cost of holding capital represented as an annualised cost. That is, the annual return on financial assets used to invest in new capital that is foregone by that investment. This would give a better alignment with the cost of acquiring capital and its use in providing services.

The Panel's recommended approach also includes a population growth needs assessment through equalising population dilution of net worth. Tasmania still has concerns with this type of assessment.

It is not disputed that population growth dilutes physical capital stocks and net assets and therefore net worth, and that the capital stock dilution will be greater where states are growing faster. The issue is whether this is a factor that requires full equalisation. It is not proven that there is a direct and one-to-one relationship between relative population growth and a state's greater need for capital assets to be acquired upfront.

It is noted that the Centre for International Economics (CIE) report, prepared for the NSW Treasury in September 2009 in its response to the 2010 Review, observed that, in relation to the Commission's approach to addressing population dilution of a state's physical capital stock:

> When capital costs are assessed using standard widely accepted economic and accounting concepts, the per capita cost of providing services does not change with population growth. Each state's fiscal capacity to provide those services has not

> changed. There are no grounds for an assessment of the physical capital stock dilution needs in the CGC's equalisation framework[16].

The CIE report goes on to note that in the case of net financial assets, there is some justification for recognising that population dilution reduces a state's capacity to raise equal per capita revenue from a given stock of accumulated financial assets. However, there may also be offsetting effects from higher population growth that have a positive correlation with NFW, rather than a negative one. These may include equity revaluations (as raised by Tasmania is its submission to the Commission in August 2009). Determining an appropriate measure to assess population dilution of net financial assets that appropriately addresses equalisation is difficult to achieve.

The CIE report goes on to conclude that a simple holding cost approach could be adopted with no account for dilution effects. The CIE argued:

> that population growth per se does not change the per capita cost of providing services in a holding cost model. There are no conceptual grounds to include physical capital stock dilution effects in the equalisation framework. While there is conceptually a case for a 'net interest' dilution effect related to the ability of states to earn revenue from accumulated financial assets, it is not straight forward to implement. And further, there may be offsetting advantages of higher population growth that have not been considered adequately in the equalisation framework. It is therefore not clear that including a dilution needs assessment would move us any closer to achieving the equalisation objective.[17]

The ToR for the 2015 Review is to have regard to the Panel's recommendation that it develop a new transport infrastructure assessment. If the Commission were to adopt a new integrated capital assessment methodology, then it would need to be in concordance with the proposed new transport capital infrastructure assessment as discussed in Chapter 4.

If the Commission, after considering the merits of an integrated capital assessment as recommended by the Panel, decides to retain the current capital assessment framework,

[16] Page 22 of CIE report, titled *The Commonwealth Grants Commission capital assessment methodology - A critique and proposed alternative*.

[17] Page 29 of CIE report, titled *The Commonwealth Grants Commission capital assessment methodology - A critique and proposed alternative*.

then Tasmania considers there are a number of conceptual issues with the current approach that require further consideration. These are set out below.

Does the direct assessment of capital really reflect what states do?

It is noted that the Commission prefers a direct approach that captures population dilution and that it considers that states with strong population growth must spend more contemporaneously on capital infrastructure and so it reflects "what States do".

However, during the 2010 Review there were divergent views from a number of states on the Commission's rationale that an upfront capital requirement reflects what states do. Tasmania supports an approach to the assessment of state infrastructure that focuses on when capital is used and not when it is acquired. Tasmania argues that this is in fact what states do. That is, the primary focus of Government is service delivery and this is reflected in accrual accounting practices such as depreciation expense.

Tasmania argued in its submission to the 2010 Review that year-to-year spending on capital is lumpy, volatile and decisions on when to invest in capital infrastructure spending are influenced by sheer coincidences of timing rather than reflecting any underlying need.

It is noted that the Commission's judgement is that an assessment of capital infrastructure needs upfront better reflects what states do collectively, and that the lumpiness of capital spending is smoothed out by the fact that the per capita investment is based on an average of all states. It is also understood that the Commission's methodology provides states with the fiscal capacity to acquire capital based on its assessed need, whether it is used for that purpose or not.

However, Tasmania would argue that while the funding decision may be upfront, funding and expenditure occurs over time as states generally do not have capital assets to meet the cost of significant capital investment upfront. Because money is fungible, it cannot be assumed to come from operating surpluses or GST revenue but a mixture of revenue sources, surpluses and debt depending on the economic cycle. That is, in some years there will be operating surpluses and in other years there will be deficits. Equalising over time, rather than up front, is therefore closer to what states actually do.

Does the current assessment of the population dilution of capital expenditure and net financial worth overstate the problem?

Tasmania does not support the Commission's assumption that population dilution requires full equalisation as it is not clear that this has a direct and linear effect on a state's fiscal capacity.

Both the Investment and Net Lending assessments are largely driven by population growth by comparing per capita needs to the national average, and as the population increases so does the assessed need.

In relation to capital investment, it is accepted that higher population growth leads to greater need for infrastructure. However, the approach taken in the assessment is that it is in direct proportion. That is, the relationship between capital investment and population growth is assumed to be linear. This raises the question as to whether this is a reasonable assumption, given the diverse nature of new investment requirements. Some infrastructure investment may be more directly and contemporaneously related to population growth than others. For example, at one extreme the demand for increased capacity for schools and roads (additional classrooms or additional lanes) are arguably more likely to be highly related to population growth. At the other extreme, the capital need for a new Parliament House, government offices, or even a library does not respond in direct proportion with population growth. There will be range of capital infrastructure that will lie somewhere in between in terms of responsiveness to population growth.

The increase in the assessed stock of infrastructure for a state over a year will include infrastructure that is strongly correlated to population growth as well as infrastructure that has a weaker correlation to population growth. The current assessment of GST will therefore include the population dilution effects of certain infrastructure when this impact may be insignificant.

Furthermore, while faster growing states incur population dilution of capital and NFW, they also enjoy economic benefits from that growth that may not be fully equalised through other Commission assessments.

There may also be other factors relating to population growth, such as equity revaluations, that negate the disadvantage from population dilution of NFW.

If equalisation of NFW per capita is to be retained as part of the capital assessments, then consideration should again be given to Tasmania's arguments that the impact of equity revaluations be taken into account. The part of the balance sheet made up by equity in PTEs is problematic because the value of PTEs (and their assets) is largely influenced by a state's population growth. In other words, Tasmania argues[18] that any disadvantages a state experiences due to the dilution of its NFW through population growth are more than offset by the increase in the value of its equity in PTEs.

Depreciation

As mentioned, Tasmania supports the examination of the GST Distribution Review Panel's recommendation to simplify the capital assessment framework. This includes treating depreciation as part of each General Government function expense rather than the current approach which is to assess it in aggregate as a separate category.

Tasmania has always supported the Commission's original approach to depreciation that applied prior to the 2010 Review – that is allocating depreciation expenses across categories and applying category disabilities to these expenses. This approach is consistent with GFS treatment of depreciation which allocates depreciation to its relevant GPC rather than reporting it as a separate category.

It is noted that the Panel concluded in its Final Report that one of the issues it had with the Investment assessment was that:

> The assessment of net investment and depreciation appears to involve a double count because "new" investment in one year gives rise to depreciation expenses that are then assessed over the life of the assets.[19]

If the current methodology is to be retained, then this concern should be addressed by the Commission in its consideration of the capital assessment methodology.

[18] Para 19 page 5 *Response to 2010 Review Draft Report Capital* Department of Treasury and Finance September 2009, and *Improving Net Lending Assessment Addendum* November 2009.

[19] Page 99, GST Distribution Review Final Report

Chapter Six: Treatment of Commonwealth Payments

Key points

- Tasmania is broadly supportive of the 2010 Review Commonwealth payments treatment framework, but considers explicit review is warranted in two specific areas.
- First, Tasmania does not consider that Commission exclusion guideline "programs implemented at the behest of the Australian Government and which lead to above average or unique state outcomes" is functioning effectively and needs review.
- This has resulted in a rise in quarantining through ToR as states do not have confidence that the Commission will properly recognise payments in accordance with this guideline.
- Second, the "lumpiness" of the 2010 Review capital payments treatment has resulted in material year-to-year volatility in states GST receipts, creating material budget flexibility issues.
- The Commission should consider, as part of its broader review of the treatment of capital, equalising capital payments over a longer timeframe, rather than as a lump sum in the year of receipt.

ToR 3 states that the Commission should prepare its assessments on the basis that:

a. National Specific Purpose Payments (NSPPs), National Health Reform (NHR) funding and National Partnership (NP) project payments should affect the relativities, recognising that these payments provide the States with budget support for providing standard State and Territory services;

    i. NHR funding and corresponding expenditure relating to the provision of cross-border services to the residents of other States should be allocated to States on the basis of residence.

b. NP facilitation and reward payments should not affect the relativities, so that any benefit to a State from achieving specified outputs sought by the Commonwealth, or through implementing reforms, will not be redistributed to other States through the horizontal fiscal equalisation process;

c. general revenue assistance, excluding GST payments, will affect the relativities, recognising that these payments are available to provide untied general budget support to a State or Territory;

d. those payments which the Commission has previously been directed to treat as having no direct influence on the relativities continue to be treated in that way. Where those payments are replaced, the treatment of the new payment should be guided by subparagraphs 3(a) – (c) and paragraph 4, unless otherwise directed; and

e. where responsibilities for funding and delivering aged care and disability services has not been transferred to the Commonwealth by a State under the NHR Agreement, these responsibilities will continue to be assessed as State services for that State.

ToR 4 states:

> Notwithstanding subparagraphs 3(a) – (c), with the exception of reward payments under NPs, the Commission may determine that it is appropriate for particular payments to be treated differently, reflecting the nature of the particular payment and the role of the State governments in providing particular services.

Together these ToR effectively replicate the equivalent ToR that have been applicable across the 2010 Review period. Augmented by the 2010 Review Commonwealth payments assessment guidelines, they broadly determine the current Commission framework for the treatment of Commonwealth payments.

That is, in the absence of an explicit ToR directing a particular Commonwealth payment treatment, the 2010 Review guidelines determine that Commonwealth payments should have a direct impact on the relativities unless:

1. they are a purchase by the Australian Government;

2. they are for programs implemented at the behest of the Australian Government and which lead to above average or unique State outcomes (such as a trial program which is not part of services delivered under average State policy);

3. they are a payment to a third party that has no impact on State fiscal capacities (States act as an intermediary and the payment does not reduce or increase State needs); and

4. needs have not been able to be assessed for the State expenditures to which the payment relates.

While Tasmania is broadly supportive of this treatment framework, there are certain specific areas where we consider explicit review is warranted for the 2015 Review as outlined below.

Quarantining of certain Commonwealth Government payments from equalisation

As previously flagged in our response to the *2013 Update New Issues Paper*, Tasmania does not consider that the Commission's second criterion is functioning effectively.

This criterion provides that it is legitimate grounds for a Commonwealth payment to be treated as not impacting the relativities where "it is for a program delivered at the behest of the Australian Government which leads to above average or unique state outcomes".

One reason for the relative non-use of this criterion may be definitional, as the intent of this exception remains ill-defined, particularly as it has barely been used to date. However, Tasmania believes that the more fundamental reason for the non-use relates to the implicit judgement that it requires the Commission to make and attendant difficulties this poses.

Notwithstanding these practical difficulties, this does not negate the fact that there is a legitimate case for excluding Commonwealth payments which fit this criterion.

One rationale for excluding relevant Commonwealth payments rests in the recognition that the HFE GST distribution does not provide the capacity for a state to overcome disadvantage; but rather, in giving the same fiscal capacity to a disadvantaged state, as to all other states, maintains any pre-existing differentials. This conclusion was independently supported by the GST Distribution Review Panel in both its First Interim Report[20] and its Final Report[21].

That is, there is a legitimate role for the Commonwealth Government to provide for economic equalisation, over and above fiscal equalisation, and that this funding should be

[20] Refer GST Distribution Review Panel discussion, pages 116-117 of the First Interim Report, under the heading 'The Indigenous "disability" should reduce over time'.

[21] Refer discussion in Chapter 10, pages 143-149, in context of Indigenous disadvantage and Finding 10.1

treated as outside the HFE system. This, in Tasmania's view, is the context in which the above exclusion criterion was intended to apply.

By way of example, this was the explicit objective of Commonwealth funding to the Northern Territory under the Northern Territory Emergency Response and subsequent (Northern Territory) Closing the Gap programs, which seek to actively reduce Indigenous disadvantage in the Northern Territory[22].

Further, using the above analysis of this criterion, other states could argue similar cases with respect to structural economic disadvantage. That is, there is a legitimate role for the Commonwealth Government to provide differential support to those regions experiencing severe negative impacts from the major structural transformation, which is now occurring across the national economy, to assist them to undertake the necessary structural adjustment.

It is Tasmania's strong view that the impact of the Commission treating such payments by inclusion would be not only to negate the intent of the Commonwealth Government funding, but to actively reduce the recurrent funding available to a state to meet its own budgetary priorities, in a period when the state is already under extreme pressure. This is effectively a "Catch 22" as it further reinforces the structural and budgetary difficulties already faced.

In the absence of this criterion functioning effectively, the only other recourse available is a Commonwealth Government direction through an explicit ToR exclusion, as was the case with the two NT Indigenous NPs referenced above. Tasmania contends that this has become the effective default option for the period since the 2010 Review.

That is, while such payments "quarantined" under a ToR may have also met the Commission's own exclusion criterion, there is sufficient doubt such that rather than take the risk, states generally prefer to request ToR quarantining rather than rely on the Commission's application of this guideline.

[22] Note that these payments were not excluded on the basis of this second criterion, but rather as the result of an explicit direction by the Commonwealth within the terms of reference.

Unless the Commission can overcome the problems with applying its second criterion, such as developing appropriate and clear guidelines, then the current approach will become the norm.

Volatility caused by the treatment of large capital payments

A further issue with the treatment of Commonwealth Government payments is that the current approach can create volatility in GST distribution when relatively large one-off Commonwealth Government payments are treated by inclusion in the Commission's assessments. The equalisation of capital payments to states generally even themselves out over the long term and hence have been argued not to be of significant concern to the long term realisation of HFE. However, under the current capital assessment framework, when a relatively large capital payment is received (particularly to a small state) the treatment of this creates material immediate recurrent budget flexibility constraints. This was particularly relevant for Tasmania with the Commonwealth Government payments for the Royal Hobart Hospital.

In the GST Distribution Review's first Interim Report the Panel saw merit in:

> equalising all capital payments over a longer period of time to recognise the lasting nature of the asset being funded and reduce the impact of the payment on GST shares in any one year[23].

While this proposition was not endorsed by all states, Tasmania remains open to the Commission considering an appropriate methodology that addresses this issue. Equalising capital payments over a longer timeframe, rather than as a lump sum in the year of receipt, provides an effective means to reduce single year impacts and also better reflects the useful life of the assets these payments fund. It is acknowledged that this would create methodological issues in terms of the timing and treatment of capital receipts and infrastructure needs, particularly the direct assessment of capital. But this approach is consistent with Tasmania's argument that capital funding of capital needs to occur over time.

[23] The Review Panel made this recommendation in the context of grant stability effects – Page 90 GST Distribution Review

This proposal might require some changes to the way the Commission currently assesses capital expenditure to ensure that there is consistency in its treatment of capital revenue and capital expenditure. For example, if the capital assessment was assessed over time through a holding cost approach, rather than upfront, then the equalisation of Commonwealth Government payments over a longer period may enable a better alignment of a state's capital receipts from the Commonwealth Government and its capital needs. That is, both are treated over time rather than contemporaneously.

As discussed in Chapter Four: Treatment of Roads and Transport Services, Tasmania considers that ToR 2(c) requiring (if deemed appropriate) the development of a framework to discount nationally significant transport infrastructure projects reflects a misplaced response to this capital grant volatility issue.

Furthermore, to ask the Commission to make this judgement in relation to nationally significant transport infrastructure projects is outside of the current Commonwealth Payments guidelines and risks to place the Commission in an untenable position.

In Tasmania's view there is no principled basis for nationally significant transport infrastructure project payments to be singled out for "special" treatment relative to any other nationally significant infrastructure in which state governments have played a significant role in attracting the infrastructure for the benefits of their residents.

At a practical level, it is also likely to be difficult for the Commission to consistently and transparently identify payments for projects of "national significance."

If the Commonwealth Government is of the view that it is in the national interest for an infrastructure project payment to be fully or partially quarantined from equalisation, then a better solution would be for this to be clearly stated in the funding agreements rather than left to the Commission to determine.

That is, the Commonwealth Government, not the Commission, is best placed to make this determination with respect to the national significance of the capital infrastructure being funded and therefore is also best placed to make the determination about the Commission treatment of such payments and the criteria which should apply.

Chapter Seven: Treatment of Mining Revenue

Key points

- Tasmania interprets the overarching clause 2(g) as an instruction to the Commission to consider recommendations 7.1 and 7.2 within the normal context of a methodology review with no *a priori* presumption as to the outcome.
- Tasmania is not, at this point, advocating a specific mining revenue approach – all have their issues reflecting the ongoing problematic nature of the mining revenue assessment.
- Of concern to Tasmania would be approaches that further diminished the capacity of the Mining Revenue method to reflect differences in relative revenue raising capacities.
- In this context Tasmania opposes single rate, or effective single rate, and APC models proposed by some states within the GST Distribution Review context.
- Tasmania is still considering its response to the recently circulated paper, titled *Staff Discussion Paper CGC 2013-02-S New Issues for the 2014 Update – Treatment of Iron Ore Fines* and will respond in due course in line with the requested response timeframe of 13 September 2013.

In the GST Distribution Review, Western Australia and Queensland argued that mining revenue should be treated differently from other sources of state revenue and therefore either excluded or discounted from equalisation through HFE.

Other states, including Tasmania, opposed these arguments countering that mining revenue is an important source of revenue to state governments in the same sense as other sources such as conveyance duty or payroll tax.

The GST Distribution Review Panel's Final Report endorsed the arguments of Tasmania and other states with respect to mining revenue.

The 2015 Review starting point for the Mining Revenue assessment is therefore understood to be the ongoing equalisation of mining revenue consistent with that for any other state revenue tax base.

With respect to the treatment of Mining Revenue, ToR 2(g) provides that:

> In undertaking its assessments, the Commission should also have regard to the recommendations of the final report of the GST Distribution Review (October 2012) to develop a new mining revenue assessment (Recommendations 7.1 and 7.2);

ToR 8 further provides that this new mining revenue assessment will be 'progressed as a priority and subject to early consultation (including multilateral discussions) with the Commonwealth and States'.

In relation to clause 2(g), Recommendation 7.1 recommends:

> That, in the ToR for the 2013 Update, the Commonwealth Treasurer direct the CGC to:
>
> - continue to ensure that Western Australia's removal of iron ore fines royalty rate concessions in 2010 does not cause iron ore fines to move into the high royalty rate group in the 2010–11 or 2011–12 assessment years;
> - consider the appropriate treatment of iron ore fines for the 2012–13 assessment year and future years, in light of Western Australia's decision to bring the iron ore fines royalty rate to the same level as that for iron ore lump.[24]

Recommendation 7.2 recommends:

> That the CGC and other stakeholders develop a new mining revenue assessment at the earliest opportunity. The new assessment should:
>
> - avoid excessively large GST effects such as when a commodity moves between groups under the current assessment; and
> - treat iron ore, coal and petroleum differently to minerals that are not subject to the Commonwealth resource rent taxes.[25]

There is scope for disagreement as to the precise interpretation of recommendations 7.1 and 7.2.

However, Tasmania interprets the overarching clause 2(g) as an instruction to the Commission to consider recommendations 7.1 and 7.2 within the normal context of a

[24] Page 112, *GST Distribution Review Final Report*

[25] Page 113, *GST Distribution Review Final Report*

methodology review with no *a priori* presumption as to the outcome. That is, the Commission should evaluate potential methodologies for the 2015 Review assessment of Mining Revenue from a first principles perspective consistent with its consideration of any other revenue category.

The assessment of Mining Revenue will always be both problematic and contentious. The tax base is both highly skewed towards a couple of states, giving rise to policy neutrality issues, and is highly redistributive even in more "normal" periods. The GST Distribution Review, the peaking of the mining boom, rapid rises in state royalty rates, and the introduction of the Commonwealth MRRT, have meant the inherent HFE assessment tensions and GST redistributive consequences have been greatly amplified and politicised in recent years and the spotlight placed on the current two tiered high/low royalty assessment method.

The more disaggregated the treatment of differing minerals the better the method will capture the relative revenue raising capacities of different states based on their individual mineral bases but the more prone it becomes to policy neutrality issues given certain mineral bases (notably iron ore and export coal in the current environment) are dominated by one or two states.

The GST Distribution Panel considered a profit based approach ideal but acknowledged the difficulties that have existed in obtaining the necessary data to support this assessment basis.

Prior to the 2004 Review, Mining Revenue assessments were based on "estimated profitability" (value added less recognised costs with varying degrees of cost disaggregation and other amendments through time) rather than value of production. This was replaced with a value of production approach from the 2004 Review because it had fewer data issues and was considered simpler and to better reflect what states do.

While value of production tends to reflect what states do currently in imposing royalties (exceptions are Northern Territory and Tasmania to a more limited extent) it does not recognise interstate differences in underlying extraction cost structures relative to a profitability-based measure (this remains a specific issue for Tasmania with the 2010 Review method).

The 2004 Review adopted a value of production approach based on four tiers (onshore oil and gas; open cut coal; underground coal and other minerals).

The 2010 Review “clean slate” approach adopted the current two tiered approach based on “high royalty” and “low royalty” minerals within a value of production base. This decision sought to balance the 2010 Review “clean slate” disaggregation criteria (which would have seen iron ore and coal assessable as categories in their own right), revenue neutrality (fewer tiers to dilute the dominance of certain states in determining the national average royalty rate applicable to a given tier, relative to the previous 2004 Review assessment method), with the need to continue to capture the relative revenue raising capacities between those states with strong mineral bases in the high value minerals and those with weaker capacities oriented more towards the lower valued bases (a single tier assessment would average the royalty rate to all minerals, materially overstating the revenue raising capacities of states such as Tasmania – a two tier approach that groups high value minerals versus low value better captures relative revenue raising relativities).

Past Reviews have considered, but rejected, alternative approaches based on a broader indicator of revenue capacity. Consistent with any new Review period, Tasmania notes these remain valid alternatives for reconsideration within the context of the 2015 Review.

At this point in time, Tasmania is not advocating a specific approach – all have their issues reflecting the ongoing problematic nature of the mining revenue assessment. However, of concern to Tasmania would be approaches that further diminished the capacity of the Mining Revenue method to reflect differences in relative revenue raising capacities.

In this context, Tasmania notes that several states made quite specific recommendations to the GST Distribution Review as to possible alternative Mining Revenue assessment bases.

Queensland argued for a single rate model. Tasmania would oppose such an approach. This effectively dispenses with any recognition of the higher or lower revenue raising capacities associated with different mineral groups. In doing so, it would inflate the revenue raising capacities of a state such as Tasmania while understating that of the large mining states such as Queensland and WA. Tasmania would not consider this outcome consistent with HFE.

Victoria argued possible approaches would include assessing mining revenue on an APC basis; using value of mining production as a broad based indicator of mining revenue capacity; or using gross value added as a broad based indicator of mining revenue capacity.

Assessing mining on an APC basis has some initial superficial appeal. However, it would leave policy contamination embedded and is problematic to justify on an assessment principles basis. In a redistributive sense, Tasmania understands this would treat all state-specific increases in mining revenue as a change in the underlying state mining production base even where this may only reflect a change in royalty rate. Tasmania would argue this is demonstrably inferior to the current approach.

Tasmania understands Victoria's second and third options to be effectively equivalent to that of Queensland's single rate approach. That is, the Victorian method would derive the average royalty rate (a single rate) as total royalty revenue (all states) divided by total value of production (all states) or, alternatively, the gross value of production (all states). Tasmania would oppose these on principle on the same basis that it would oppose Queensland's single rate model.

In terms of the specifics of recommendation 7.1, Tasmania notes the recently circulated *Staff Discussion Paper CGC 2013-02-S New Issues for the 2014 Update – Treatment of Iron Ore Fines* clearly separates the issue of the 2014 Update treatment of iron ore fines from that in the 2015 Review. Tasmania is still considering its response to that paper and will respond in due course in line with the requested response timeframe of 13 September 2013.

Chapter Eight: Mining expenditure

Key points

- Tasmania supports the 2015 Review consideration of the appropriate treatment of mining expenditure on a first principles basis and consistent with HFE.

The 2015 Review ToR 2(h) requires that:

> In undertaking its assessments, the Commission should also have regard to the recommendations of the Final Report of the GST Distribution Review to consider the appropriate treatment of mining related expenditure (Recommendation 7.3).

Recommendation 7.3 in the *GST Distribution Review Final Report* states:

> The Panel recommends that, in the Terms of Reference for the 2013 Update, the Commonwealth Treasurer direct the CGC to add an amount to its expenditure assessments equivalent to a 3 per cent discount of the mining revenue assessment in order to compensate for the fact that some mining related needs of the resource States are not fully recognised. This interim assessment should remain in place until the next methodology review is completed.[26]

Recommendation 7.3 reflects the Panel's evaluation of the specific claims by Western Australia and Queensland of costs identified as unrecognised or insufficiently recognised within the 2010 Review methodology.

Overall the Panel concluded that most expenditure was accounted for, where appropriate from an HFE perspective, but some small gaps did exist. Specifically, the Panel noted that:

- in the Services to Industry category, an assessment of mining regulatory costs should be developed similar to that currently assessed for the agricultural sector.

- the existing "residential population" assessment base was unlikely to recognise the pressures on services in mining communities arising from fly-in-fly-out and drive-in-drive-out mining workers and suggested an adjustment could be applied.

[26] Page 120, *GST Distribution Review Final Report*

- some government employee costs in remote locations may not be fully recognised due to the discount applied to the Regional Location assessment and that this should be reviewed; and

- within the Capital assessments, the Commission could re-examine the feasibility of replacing the proxy recurrent disabilities measures with capital cost measures.

In line with the first principles approach applicable to any methodology review, Tasmania considers that if “gaps” are substantiated within specific expenditure assessments within the 2015 Review process, these should be addressed within those expenditure assessments where appropriate and consistent with HFE. We also note that ARIA, if adopted, is based on enumerated population rather than resident population and that this may also act to address the fly-in-fly-out and drive-in-drive-out pressures.

Chapter Nine: Location

Key Points

- Tasmania does not have a formed view, at this point in time, on the interstate cost assessments as they relate to Australia's population settlement patterns and therefore macroeconomic efficiency.
- Tasmania welcomes discussion on this issue but is more concerned with on-going issues with the Location cost assessment methods, from both conceptual and data points of view, as opposed to a macroeconomic efficiency point of view.

A spend gradient approach?

The 2015 Review ToR 2(f) directs the Commission to investigate whether it is appropriate and feasible to equalise interstate costs on a 'spend gradient' basis (Recommendation 6.4).

The GST Distribution Review Panel's Final Report argued that intrastate costs reflect differences in the number of high cost locations within states primarily due to population dispersion. These costs (that is, cost differences within states) are recognised to allow high cost locations to be treated the same way regardless of what state they are in. The Panel made the important point that this does not give everyone the same service standard – it just allows the similar high cost locations to have the same services in different states. Within a state, high cost locations have lower standards of service but are more expensive on a per capita basis. States do not provide the same level of service in a Remote location as compared to a Highly Accessible location.

The Panel went on to state that interstate costs are recognised to allow different states to deliver the same services regardless of state level cost differences. In other words, some states are, as a whole, more expensive. The Panel concluded that this allows Western Australia (to have the capacity) to provide the same (national average) education service as Victoria even though WA may have to pay its teachers more to compete with higher private sector wages.

The Panel questioned whether this was appropriate and whether expenditure on services with high cost inputs should be rationalised in a similar way as service standards are reduced for high cost intrastate locations.

Tasmania notes that GST Distribution Review Recommendation 6.4 stems from concerns that some parts of HFE are potentially distorting efficient settlement patterns. Some HFE literature compares federations to unitary states and concludes that HFE can enhance equity and efficiency at the same time. However, efficiency would call for partial equalisation for interstate costs, not full equalisation.

Tasmania notes that the impact of HFE on Australia's macroeconomic efficiency is subject to academic debate both in terms of theory and quantification of the impact. Some econometric studies show a relatively small efficiency loss from HFE as compared to EPC, while others find a small positive impact.

This is a complex and controversial issue. Tasmania has previously stated that it supports full equalisation. Macroeconomic efficiency impacts are subject to debate and, when quantified, are usually small (be it positive or negative). Tasmania therefore welcomes the discussion on this issue but is more concerned with on-going issues with the interstate cost assessment methods, especially interstate wages, from a conceptual case and data point of view, as opposed to a macroeconomic efficiency point of view.

Tasmania's concerns with the existing approach to interstate costs

Tasmania has, for many years, not supported the interstate wages assessment. Tasmania has argued in past Reviews that state governments are moving towards wage parity with each other (nexus wage agreements etc) and that the Commission's use of private sector wage differentials as a policy-neutral indicator of state government wage differentials is flawed. Despite Tasmania putting many arguments to the Commission including engaging consultants and providing in-depth analysis the Commission has proceeded with an interstate wages assessment.

The ABS Survey of Education and Training has been discontinued by the ABS. The SET has been used by the Commission for some time to quantify non-policy differences in interstate wage levels. Previous work by the Commission has indicated that the ABS

EEBTUM (Employee Earnings, Benefits and Trade Union membership) dataset is the best alternative dataset.

In the 2010 Review a low discount of 12.5 per cent was applied as the Commission acknowledged that there is uncertainty in:

- how accurately the wages data used measure wage costs;
- how accurately the econometric model controls for differences in productivity; and
- how well private sector wages proxy wage pressures in the public sector.

Tasmania considers that this discount was conservative and has argued for a larger discount (25 per cent), which is equivalent to the amount of variation not explained by the Commission's SET based model.

The use of the SET by the Commission has been examined on numerous occasions over the past decade. In the 2010 Review, all states expressed a preference for the use of SET data.

Given that the Commission must now use an alternative data source, which has been deemed as an inferior data source by states and the Commission over a significant period of time, it is logical that a larger general discount should be considered in the quantification of non-policy differences in interstate wage levels.

The Commission did apply a discount to Tasmania of 25 per cent (Tasmania argued for a 50 per cent discount). The discount was made because the Commission considered that there are constraints on the variation in public sector wages and that there are likely to be bounds within which public sector wages lie.

Labour market differentiation between the public and private sector is more pronounced in Tasmania than on mainland Australia. Public sector workers are largely homogenous with those in other states in terms of education, skills and productivity, while private sector workers are not (reflecting significant differences in average educational attainment, industry and occupational distributions). An isolation premium is necessary to retain or attract many public sector workers to Tasmania. The Commission's model does not recognise this. A significant body of work has been undertaken by Tasmania in pursuit of this issue over the last decade, including a consultancy for Tasmania by the Centre for

Labour and Market Research within Curtin University, which provided the case for the isolation premium.

Interstate non-wages

Tasmania supports the recognition of freight and airfare disabilities. However, Tasmania supports the re-categorisation of Hobart and Darwin to more remote towns in the remoteness classification to be used and understands that this may have implications for the interstate non-wages assessment.

Regional location

Tasmania was concerned, throughout the 2010 Review, that the use of SARIA did not adequately address the service delivery disability the state faces due its small decentralised communities. Despite numerous submissions containing analysis of cost and population data, the Commission proceeded with an approach that did not explicitly recognise Tasmania's location related service delivery challenges.

However, Tasmania did acknowledge that state population distributions by SARIA are somewhat diverse by state and finding an average policy was not straightforward for the Commission. Also, the available cost data by SARIA region, showing an upward sloping gradient nationally, together with the approach to Service Delivery Scale, appeared to partially capture Tasmania's issues, albeit inadvertently. Tasmania, therefore, did not oppose the general approach during the 2010 Review.

Tasmania does not oppose the continuation of the general approach, but considers that a more appropriate remoteness classification needs to be used other than SARIA+(2006) or SARIA+(2011).

Chapter Ten: Administrative Scale

Key points

- The ultimate objective of the Data Working Party Administrative Scale work project is a new data collection for 2015 Review Administrative Scale assessment.
- This project appears to have stalled since August 2012 and the planned 2013 data collection did not proceed.
- Tasmania considers this a priority issue for the 2015 Review and urges the Commission to relaunch the data collection project as soon as possible.

There is no direct ToR instruction in relation to Administrative Scale. However, a significant area of Data Working Party activity since 2011 has been the Administrative Scale project where Commission staff have aimed to:

- develop a common understanding across states of the definition of Administrative Scale for the purposes of the Commission; and
- identify and specify data that could be used to measure the quantum of state spending related to Administrative Scale and establish data collection processes.

These data would then form the basis for determining the Administrative Scale costs in the 2015 Review.

Develop a common understanding across states of the definition of Administrative Scale for the purposes of the Commission

The Commission has long assessed states with small populations to have higher per capita administrative costs because the costs of the minimum functions of government have to be spread over a smaller number of residents. The Commission refers to the costs of these minimum functions of government as “administrative scale” costs.[27]

The current assessment captures the minimum administrative cost that would be incurred

[27] The CGC’s concept of administrative scale costs differs from that found in economic literature or elsewhere and should not be confused with these external concepts.

for a State with a population size of the smallest State. It includes costs associated with:

- core head office functions of departments (for example, corporate services, policy and planning functions, but not all staffing and other resources delivering these functions); and

- services that are provided for the whole of the State (for example, the legislature, the judiciary, the Treasury, the revenue office, and a State museum but not all staffing and other resources delivering these functions).

As this assessment is intended to capture the costs of providing the minimum level of administration required, each State is assessed as having the same requirement. That is, the same absolute assessment for all States with the exception of ACT (it receives a little less as it does not need to provide some services) and NT (receives a little more as it requires a dual service delivery model). The end result of this process is that the smaller (in terms of population) states are assessed to have a greater per capita cost (and hence disability factor above 1.00).

In line with its objective of developing a common understanding of the definition of Administrative Scale for Commission purposes, Commission staff proposed, and the Data Working Party accepted, the following definition:

> Administrative Scale costs are the costs incurred by a State in delivering services (whilst acting with average efficiency and following average policy), where the costs are independent of the size of its service population.[28]

Tasmania strongly endorsed this definition as simple and clear. It is consistent with the assessment principles "what states do" and "policy neutrality". It also makes clear that there is a consistency of approach between this and other disability factor assessment approaches in that the range of scale-affected functions assessed is defined on the basis of what states do on average, and costed on the basis of average state expenditure.

[28] Paragraph 5, page 4, *Data Working Party Report on Progress and Proposals – April 2012*, *Data Working Party Discussion Paper, CGC 2012-01*

Identify and specify data that could be used to measure the quantum of state spending related to Administrative Scale and establish data collection processes

Regarding the approach or process for collecting data, Commission staff suggested two approaches – one involving ABS/GFS data and regression analysis and the other based on the average ministerial portfolio and data collection at the departmental level (as had been done previously for the 1999 and 2004 Reviews).

Tasmania supported the total expenses ABS GFS approach being used only as a potential validation tool for the outcome of the average ministerial portfolio approach. The average ministerial portfolio approach is the preferred option on the basis that it would lead to a more robust, defensible and sustainable 'Administrative Scale' data measure.

Following on from discussions at the July 2011 Data Working Party meeting, Commission staff forwarded States a draft data request for administrative wages and staffing information in March 2012, based on the second option, and proposing a range of agencies/parts of agencies from which data could be collected.

In response, Tasmania nominated a single central agency (Treasury) and a single service delivery agency (Education) for data collection. In regards to the type of data to be captured, Tasmania suggested that this required further clarification as the proposed work program was not sufficiently clear. Tasmania stressed the need for a tight specification to avoid differing interpretations, lack of data comparability and wasted effort. Other states also queried most aspects of the draft collection proposal.

In the light of state comments, Commission staff noted in the agenda paper for the August 2012 Data Working Party meeting that further discussions were needed on:

- the agencies/departments that should be the targeted by the data collection (the Commission proposed this should be Schools Education and Treasuries);
- the range of functions and costs that should be captured (the Commission proposed this should be data for each staff member carrying out head office functions for primary and secondary school education (i.e. not teachers, teacher's

aides etc), and for all Treasury staff – to cover wages and on-costs, classification level and section/unit name and responsibilities); and

- the timing of data collection (proposed to be February – April 2013).

However, since that time, progression of the Administrative Scale project appears to have stalled and the proposed 2013 data collection has not been progressed.

We note that this stalling may relate, in part, to ToR 2(f) which requires the Commission to investigate whether it is appropriate and feasible to equalise interstate costs on a "spend gradient" basis.

While it is not immediately evident that the Administrative Scale assessment is caught within this "spend gradient" evaluation, the context of the underlying *GST Distribution Review Final Report* Recommendation 6.4 suggests it could be. This has yet to be determined. Tasmania's initial response to ToR 2(f) and Recommendation 6.4 is addressed in the previous chapter (Chapter Nine: Location).

Independently of ToR 2(f), Tasmania considers that the Commission will require new administrative scale data for the 2015 Review in order to continue to assess Administrative Scale, whatever its future assessment basis.

In this context, Tasmania considers that notwithstanding the compressed Review timeframe, Administrative Scale is a priority project for the 2015 Review and we urge the Commission to re-launch the stalled work program as soon as possible.

Chapter Eleven: Indigeneity

Key points

- Given that there is no viable alternative to the Census data to measure the Indigenous population, nor a reliable way of measuring the propensity for self-identification by which to modify the Census dataset, Tasmania considers the Commission's decision to use unmodified 2011 Census data to be appropriate.
- Tasmania does not consider that changes in the propensity for self-identification as Indigenous invalidates the current assessment approach, nor that the changing characteristics of the population is, in itself, a reason to assume that the current methodology is inadequate.
- The paper, titled *Staff Discussion Paper 2012-04 Relative Indigenous Disadvantage* undertakes a preliminary analysis of potential alternative approaches to assessing Indigenous disadvantage.
- In response, Tasmania is yet to be convinced that any material differences that are not captured under the current methodology either should be measured or could be measured in a reliable manner.

The ToR clause 1(d) requires that 'In preparing its assessments the Commission should develop methods which appropriately capture the changing characteristic of the Indigenous population'.

Tasmania considers there to be two key issues for deliberation in the context of ToR 1(d) for the 2015 Review:

1. the changes occurring within the Indigenous population base, as evidenced in the 2011 Census; and
2. the issue, as canvassed through the *CGC Staff Discussion Paper 2012-04 Relative Indigenous Disadvantage* of whether further disaggregation is needed within the current methodology to better recognise differences between the Indigenous populations across States.

Changing population

The 2011 Census Indigenous estimates for June 2011 differ significantly from the June 2011 projection that had been produced from the 2006 Census. The estimates, which are updated for assumptions about births, deaths and migration, were around 18 per cent higher overall than the projected estimates and the pattern of difference varies significantly among the states.

Tasmania agrees with the conclusion of the Commission in the 2013 Update that the changes in the Indigenous population shown in the 2011 Census came not only from births, deaths and net migration, but also from changes in the propensity of people to identify as Indigenous.

Tasmania notes that the ABS considered the 2011 Census estimates to be the best available estimate of the distribution of Indigenous people in 2011 (the midpoint of the 3 years used in the assessment) despite this rise in self-identification.

Tasmania recognises that the propensity to self-identify as Indigenous changes over time and in response to different circumstances, and that this has a clear impact on the Indigenous populations of states and subsequently the distribution of GST. However, Tasmania considers that population data should only be modified if it can be done so reliably and in a way that would improve HFE outcomes. Tasmania observes that it is not possible to judge how Indigenous self-identification has changed over time and across datasets, and therefore it is not possible to modify the Census data reliably.

Tasmania considers it difficult to see how an outdated data source, such as the 2006 Census data, could be considered more appropriate for use than the more recent 2011 Census data. Whilst it is difficult to know how comparable the 2011 Census data set is with the administrative data sets in use, this could also be said of the comparability of previous datasets. Tasmania considers the use of data with some limitations to be, in some cases, inherent to the process of equalisation and unavoidable in the absence of viable alternative sources.

Given that there is no viable alternative to the Census data as the count of the Indigenous population, nor a reliable way of measuring the propensity for self-identification by which to

modify the Census dataset, Tasmania considers the Commission's decision to use unmodified 2011 Census data appropriate.

On this basis, the changing nature of the Indigenous population then becomes part of the broader discussion on whether the current methodology accurately and appropriately recognises the expenses associated with addressing relative Indigenous disadvantage across states.

Further disaggregation to better recognise differences in indigenous populations?

Under the current methodological approach, the Commission deems states' circumstances to differ in relation to Indigenous residents because of differences in:

- the proportion of Indigenous people in state populations and their age-gender profile;
- where Indigenous residents live within different states; and
- the socio-economic status of Indigenous residents.

However, some states have argued that the assessments of the effects of Indigeneity should recognise that there are extra expenses associated with some sub-groups of Indigenous people within their state. That is, while the current Commission treatment captures some of those effects, it omits others.

Within the context of the 2012 Data Working Party program, Commission staff issued the *Staff Discussion Paper 2012-04 Relative Indigenous Disadvantage,* to consider this issue.

The Paper noted that Indigenous populations are not homogenous across states, and that various current assessments allow for this heterogeneity by disaggregating the Indigenous population by remoteness (SARIA), socio-economic status (SEIFA), age and sex. However, it suggested that this disaggregation may not account for all material differences between the profiles of Indigenous people in different states.

The Paper sought to initiate a discussion around whether further disaggregation of the Indigenous population could reliably be undertaken if it was established that different

identifiable groups of Indigenous people placed materially different demands on state services.

In this context it noted the very different profiles of remoteness-attributed expenditures between Indigenous residents and non-Indigenous residents. It then suggested that "remoteness" as an assessed driver of expenses on Indigenous service provision is acting as a proxy for some other underlying driver(s), referred to as the "Indigenous X factor".

The Paper then undertook analysis of various approaches that could be considered to potentially more precisely recognise Indigenous disadvantage within different Indigenous population groups.
Options considered within the Paper were:

1. Potential individual-based disaggregation measures:

    - those who speak an Indigenous language from those who speak only English;
    - Aboriginals from Torres Strait Islanders;
    - stolen generation from others; and
    - the level of assimilation into mainstream society

The Paper concluded that these individual-based disaggregation options failed due to one or more of the following problems:

- they only captured a small proportion of the heterogeneity of the Indigenous population;
- data do not exist on the population in the groups; and/or
- data do not exist on the use and costs of services by these groups.

2. Potential area-based disaggregation measures:

    - SARIA;
    - SEIFA;
    - Indigenous concentration; and

- Index of Relative Indigenous Socioeconomic outcomes (IRISO).

The Paper made the following observations in relation to these area-based disaggregation options:

- disaggregating by SARIA and SEIFA captures a significant amount of the variation between Indigenous people in different States in their disadvantage, as measured by Census indicators. However, significant variation remains that is not being captured. Whilst this may be reduced by applying additional geographic variables, in all cases, considerable and material differences would still remain;

- IRISO best addressed the issue of differences in the “Indigenous X factor”, but is potentially policy contaminated. In particular, the Northern Territory’s policies on expenditure on Indigenous people would have a major influence on GST allocation; and

- it would be possible to better capture more of the “Indigenous X factor” by disaggregating further using SARIA and SEIFA, such as by using deciles instead of quintiles. However, it could not be done reliably as it would mean disaggregating an already small population group into very small components.

The Paper then considered the option of using a proxy to produce a state adjustment factor of relative Indigenous disadvantage. The following possible proxy data sets were considered based on criteria of reliability, relevance, policy neutrality and possible data issues:

1. Health – Admitted patient expenditure per capita
2. Health – Mortality*
3. Health –Low birth-weight babies*
4. Health – Indigenous type hospitalisations*
5. Education – NAPLAN
6. Education – Year 12 retention rates*
7. Law and order – Prisons

8. Welfare – Pension use*

9. Census measures*

10. ABS National Aboriginal and Torres Strait Islander Social Survey*

*Indicator considered potentially viable

Of these possible proxies, the Paper suggested indicators 2, 3, 4, 6, 8, 9 and 10 were potentially viable for the Commission's use.

Depending on the proxy measure used to calculate the state factor, the Paper noted the risk of double-counting occurring if the state factor were to be combined with the current disaggregation by SEIFA, SARIA, age and gender. To avoid this, the Paper proposed the Commission could either:

- stop the current disaggregation by age, sex, SARIA and/or SEIFA for Indigenous populations and simply use the state specific disadvantage measure(s); or

- use some administrative datasets to calculate the relative interstate disadvantage based on small groups of comparable people and use these to augment the existing approach.

This Paper was discussed at the Data Working Party meeting in August 2012 and states were invited to provide written comments and/or follow up directly with Commission staff. Consistent with this, Tasmania makes the following points in relation to the further disaggregation of Indigeneity.

Tasmania does not consider that changes in the propensity for self-identification as Indigenous invalidates the current assessment approach, nor that the changing characteristics of the population is, in itself, a reason to assume that the current methodology is inadequate.

Tasmania believes that the current application of up to four indicators (SARIA, SEIFA, age and gender) to assessments on a case-by-case basis ensures that the measures of disadvantage are broadly correlated with states service use and the costs of service provision.

For the purposes of ensuring the reliability of the Indigeneity assessment, Tasmania considers that alternate treatment methods or data sources should only be pursued in cases where:

- the presence of significant, material differences can be demonstrated across states;
- these differences can be clearly attributable to the impact of Indigeneity on service use and the costs of service provision, rather than other mitigating factors (such as policy differences); and
- that appropriate, comparable data are available to support the assessment of these differences.

Tasmania is yet to be convinced that any material differences that are not captured under the current methodology could be measured in a reliable manner.

Tasmania suggests it would be very difficult to ensure that any state differences found when measuring relative excess disadvantage were the result of an innate difference in Indigenous populations rather than of policy or other state differences.

Tasmania is also concerned that further disaggregation of the Indigenous population will lead to less data reliability given the relatively small size of the Indigenous community as a proportion of the overall population.

Given the significant data quality issues experienced at an Indigenous population sub-group level, Tasmania believes it would be particularly difficult to incorporate criteria into the assessment which would accurately recognise sub-groups within states Indigenous populations.

Tasmania notes that the Paper concludes that further individual-based disaggregation measures are unfeasible as viable data on population, service use and costs of services is not available at the level of disaggregation that would be required.

We also note that it indicates that use of any of the area-based measures is unrealistic in attempting to recognise the “Indigenous X factor”, as it would be difficult to ensure that any state differences were specifically related to an innate difference in Indigenous populations, rather than the result of policy differences.

In all, the Paper indicates the lack of an alternative or complementary measure (individual or area-based) that would capture more than a small proportion of the unaccounted heterogeneity of the Indigenous population in a policy neutral context, a conclusion with which Tasmania concurs.

As to whether the differences across states could be measured using a state adjustment factor, Tasmania believes that, in the absence of an indicator related to state government services, the use of a state adjustment factor would be less reliable at recognising differences across states than the current method used by the Commission.

Tasmania particularly notes that it would be difficult to ensure that differences in relative excess disadvantage measured by a proxy indicator were the result of an innate difference in Indigenous populations rather than of policy or other state differences.

In relation to specific *Potential Indicators of Relative Excess Disadvantage* discussed, within Attachment C of the Discussion Paper:

- Tasmania experiences a known Indigenous under-identification issue, specifically in relation to health-related datasets. For this reason, Tasmania is strongly against the use of any health-based indicator as a proxy for Indigenous disadvantage, including Hospital expenditure per capita; Relative excess Indigenous mortality; Low birth-weight babies; and Indigenous type hospitalisations;

- leaving aside identification issues, while “low birth weight babies” may be a viable “neo-natal” proxy, justifying its extrapolation as a “health” proxy, let alone broader indicator, seems highly problematic;

- we endorse the other drawbacks identified within the paper in relation to both hospital expenditure data and mortality data as possible indicators;

- between the NAPLAN and the Year 12 retention rates, and in contrast to the Paper, we would argue the NAPLAN is a more policy neutral indicator than the year 12 retention rates, though neither can be considered policy neutral;

- we endorse the Paper’s conclusions as to the strong policy contamination in the Prisons data, and conversely, the potential viability of the Pensions measure within specific contexts (consistent with the Welfare and Housing assessment);

- we challenge all of the selected Census measures as problematic:
    - in Tasmania's context, low "car free households" is directly attributable to the nature of Tasmania's transport systems and the lack of alternative public transport options, not a lack of disadvantage among households;
    - "unemployment" is too narrow - the disadvantage base measure would need to be more broadly based (e.g. also capturing single parents);
    - "household income less than $400", while a potentially broad measure of disadvantage, should be queried in the Indigenous disadvantage context – Indigenous household structures can be extended (i.e. include a number of incomes);
    - "households without internet access" is an unproven indicator – potential explanatory variables include age; geographical access; and the dynamic internet environment where smart phones and free public wi-fi is increasingly the norm – the presumption that this is a viable indicator of disadvantage seems "a bridge too far"; and
- Tasmania has yet to assess the NATSISS data and withholds comment at this point.

Further, Tasmania considers it difficult to see how a state adjustment factor that is based on one or a few indicators could be applied across all assessments in a manner that accurately correlates with service use or cost of service provision patterns across states in all applicable expenditure assessments.

Tasmania notes that the Paper's analysis demonstrates that results varied widely for states depending on the proxy indicator tested. Strong judgements would need to be applied in deciding which indicator is the best proxy for the drivers of state expenditure. Tasmania suggests this option would not be an improvement upon current methodology.

For these reasons, Tasmania would reject the replacement of the current approach with state specific measures of Indigenous disadvantage[29].

[29] Refer discussion paragraphs 35-39 of the Paper

Tasmania notes that the Paper concluded that the current application of SARIA and SEIFA enables recognition of a significant part of the disadvantage recognisable by area-based measures. We also note that there is a statistically significant correlation between the SEIFA rank in low and high SES areas and Indigenous-specific SES in those same areas, despite the relatively little contribution the proportionately low Indigenous population would have on the SEIFA scores in most areas.

Tasmania concludes that while the Paper found that the current assessment may not capture all material differences, it is unclear as to how these additional perceived differences could be captured reliably and accurately or even whether they should be captured.