New South Wales

Third Submission to the CGC 2015 Methodology Review

September 2014

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1. Executive Summary

This third NSW submission to the 2015 Review of State Revenue Sharing responds to the Commonwealth Grants Commission's (CGC) Draft Report released by the Commonwealth Government to the States on 1 August 2014.

This submission comprises two parts.

- Section 2 contains NSW responses to the CGC's views of general method issues contained in the CGC's Draft Report Chapters 1 to 4.
- Section 3 contains NSW responses to the CGC's proposed assessments contained in Attachments 1 to 29 of the Draft Report, including New South Wales comments on the Priority Issues identified by the CGC.

Main conclusions on general method issues

- New South Wales does not agree that an equal per capita GST distribution would not be consistent with Horizontal Fiscal Equalisation (HFE). New South Wales considers an EPC distribution would still involve equalisation and that this should be the long term equalisation objective.
- New South Wales believes that equalisation continues to be emphasised at the expense of other principles However, judgment continues to be used – inconsistently at times – to derive a 'best overall result' that can change over time. For example, the proposed phasing in treatment of iron ore fines in the mining assessment which is suggested on the basis of the "practical application" of equalisation.
- The proposed new approach to average policy appears to be difficult to implement consistently. New South Wales considers it is not applied consistently throughout the assessments with some 'average' policy decisions still based on what the majority of States do rather than what one State does.
- New South Wales agrees that materiality should not be an issue in relation to the correction of errors and misclassifications. This should be done regardless of materiality when it reliably can be done.
- New South Wales considers that discounting should not be used if HFE continues to be interpreted and implemented as currently. If assessments make conceptual sense and fit-for-purpose and reliable data are available, assessments should be made. If not, assessments should not be made. New South Wales' concern is that discounting involves considerable judgment, and that judgments about what 'uncertain' assessments to make and the extent to which such assessments should be discounted raise substantial issues of consistency.

- The proposed new approach to decisions on the treatment of Commonwealth payments raises issues on where one draws the line in the direct and indirect impacts of Commonwealth payments on State budgets.

Conclusions on significant assessment proposals

- New South Wales considers the threshold adjustment in the **Payroll Tax** assessment is inconsistent with the Commission's new approach to 'average policy' and influences State payroll tax policy.
- New South Wales does not support the inclusion of stamp duty on the transfer of motor vehicles in the **Stamp Duty on Conveyances** category rather than the **Motor Taxes** category. We consider the change reduces the transparency of the GST redistribution process by including revenue raised from very different tax bases, with a very different State distribution, in the one category.
- New South Wales considers revenue for which no tax base can be assessed should not be included in the **Insurance Tax** assessment. New South Wales is also concerned the inclusion of fire and emergency services levy revenue in this category, in addition to the inclusion of fire and emergency services revenue raised as levies on property in the Land Tax assessment, 'double assesses' revenue raised for fire and emergency services.
- New South Wales agrees with the CGC decision not to apply a discount to the **Mining Revenue** assessment. However, the proposed phasing in of iron ore fines is implicitly equivalent to a (temporary) discount of the mining revenue assessment.
- New South Wales considers treatment of NERA in the **Schools** assessment will need to be considered further in light of changes to Commonwealth policies.
- The lower use and higher cost of remote students in the **Post-secondary Education** assessment could cancel each other out. This issue should be re-examined prior to the final report to determine whether including the cost weight for remoteness is material.
- New South Wales considers that the economic environment factor should be removed from the **Health** assessment given the high degree of uncertainty on the appropriate level of substitutability in service provision.
- New South Wales believes that a cost of living adjustment should be included in the **Welfare** assessment. New South Wales contrasts the decision not to make an allowance for the (according to the CGC) conceptually-plausible impact of cost of living differences on demand for welfare services, due to absence of reliable data, with the decision to make allowances despite the absence of reliable data, in other instances, e.g., cross-border influences.
- New South Wales is concerned about the discrepancies between the Census and Australian Institute of Health and Welfare data on numbers of households using

social housing noted in the **Housing** assessment, however, we acknowledge that the Census data has fewer households with unknown Indigenous status.

- New South Wales considers that the provision of subsidies for uneconomic services in remote small communities is heavily influenced by policy choice and considers a differential assessment for this type of subsidy should not be included in the **Services to Communities** assessment.
- New South Wales considers the present **Roads** assessment overestimates traffic volume and heavy vehicle expense needs of States with relatively lengthy road networks. Road length – the maintenance costs of roads independent of the use made of roads stemming from climatic and environmental factors – is assessed in a separate component of the assessment. However, the current assessment effectively also assesses road length in the traffic volume and heavy vehicle road use components since it does not relate road use to the size of State road networks.
- New South Wales supports the **Transport** assessment approach which recognises that the cost of State provided urban passenger transport services increases with urban centre population size. New South Wales would have preferred the approach to include the presence of rail since this is consistent with the principle of 'what States do'. We contrast the CGC's exclusion of rail on grounds of simplicity and policy neutrality with the inclusion of policy-influenced subsidies to remote communities in the Services to Communities assessment.
- New South Wales notes that the direct assessment of capital needs will be retained in the **Infrastructure** assessments. New South Wales has outlined its position in favour of the holding cost approach in previous submissions to the Commission. New South Wales does not consider that uncertainty in the urban transport infrastructure component of the infrastructure assessment justifies a discount as high as 50 per cent, particularly when compared to the 12.5 per cent discount applied for uncertainty in the regional costs assessment.
- New South Wales notes that for the time being the CGC proposes to continue with a 12.5 per cent discount to the **Wages** assessment reflecting a low level of uncertainty around the reliability of the ABS data used in the assessment, the econometric model and whether private sector wages are a good proxy for the pressures on public sector wages. If this level of discount is considered appropriate for this assessment, New South Wales considers at least a similar level of discount should be applied in the administrative scale assessment.
- New South Wales considers the current **Administrative Scale** assessment is totally unsatisfactory: the current estimates of administrative scale expenses are far from robust; no State has been able to provide data from which new quantum amounts can be derived; and attempts to justify the current quantum using regressions of data that are significantly correlated to the scale of State service provision are far from convincing. New South Wales believes if the assessment goes ahead it should be discounted to the maximum extent, reflecting the high levels of data uncertainty.

- New South Wales considers the conceptual case and evidence supporting retention of a **Cultural and Linguistic Diversity** allowance to be at least as convincing as the conceptual case and evidence presented in support of cross-border services for community health, welfare services and library and information services and in support of the administrative scale assessment.

In some of the Draft Report assessments the CGC has used 'placeholders' where assessments are still being developed or up-to-date data is not available. New South Wales is not able to provide new data, evidence or analysis in all instances where placeholders have been used. New South Wales reserves the right to comment further on placeholder issues in future submissions should assessments change substantially when placeholders are replaced.

2. General Issues

This section of the NSW Third Submission to the Commonwealth Grants Commission's (CGC) 2015 Review of State Revenue Sharing Relativities contains our responses to the CGC's treatment of general issues in the CGC's Draft Report Chapters 1 to 4.

It provides NSW views on issues such as the definition and principles of Horizontal Fiscal Equalisation (HFE), the supporting principles and use of judgment, the definition of 'average' State policy, the use of discounting, materiality thresholds, and the treatment of Commonwealth payments.

New South Wales detailed comments on the CGC's proposals on the priority issues – the mining revenue assessment, mining expenditure, the treatments of the National Education Reform Agreement and the National Disability Insurance Scheme, the assessment of transport infrastructure and incorporating Indigeneity in the CGC's assessments – are provided in our comments on the proposed individual assessments contained in Section 3 of this submission.

In summary, New South Wales:

- does not agree with the Commission's conclusion that an equal per capita GST distribution would not be consistent with HFE
- considers that 'equalisation' should not be pursued to the extent of sacrificing all other principles
- continues to be concerned with the proposed new approach to determining average policy
- considers lack of consistency can become an issue in the CGC's decisions on whether or not to apply discounts to assessments where data is lacking or unreliable and whether or not to assess disabilities in cases where conceptual cases are established, but there is an absence of reliable data on which to make an assessment of the disability
- is concerned that the CGC's proposal to examine Commonwealth own-purpose expenses in the same way it examines Commonwealth payments to the States – where a Commonwealth expense funds a State service (or a substitute for that service) for which needs are assessed it should affect the GST distribution – may extend the scope of equalisation to an unreasonable extent.

The purpose and definition of HFE

New South Wales does not agree with the Commission's conclusion that 'an equal per capita GST distribution would not be consistent with HFE.'[1]

New South Wales is concerned with the CGC's emphasis on 'equalisation' in its interpretation and implementation of HFE.

We consider a broader and less detailed equalisation would have many advantages in providing a much simpler, more easily understood, more objective, less judgmental, more policy-neutral and more predictable distribution of GST revenue between the States. If, in the national interest further support for fiscally weaker States is thought appropriate, top-up funding should be provided to the fiscally weaker states by the national government as the Commonwealth has greater access to the financial bases and resources necessary to provide such assistance.

New South Wales is concerned that the CGC continues to broaden the scope of equalisation, potentially increasing revenue volatility and decreasing transparency.

The scope of equalisation has widened over successive reviews. Previously, HFE concentrated on equalising State fiscal capacities based on General Government sector operating statements, and then the 2010 Review expanded the scope of HFE into equalising the balance sheet concept of net financial worth. In the 2015 Review, equalisation is expanding further to include the operating revenues and spending and capital investment and capital stock of public non-financial corporations sector entities involved in transport and housing.

New South Wales remains of the view that, if HFE is to continue in its current form, the scope of equalisation should be restricted to a core range of State services.

Supporting principles and judgment

New South Wales considers that 'equalisation' should not be pursued to the extent of sacrificing all other principles.

- Policy-neutrality is important in ensuring that equalisation does not distort State revenue and spending policy decisions.
- Simplicity and transparency are important in ensuring that the process of HFE is easily understood and its outcomes more readily accepted.
- Efficiency is important in ensuring HFE does not provide disincentives to boosting productivity and reform. New South Wales is concerned by the CGC's view that in

[1] CGC, *2015 Review Draft Report,* p. 13.

deciding the inevitable trade-offs between principles the Commission 'has not set rules for how it would decide the appropriate approach … nor has it established a hierarchy among the principles. As required, judgment will be used to decide the best overall result.'[2]

We consider such an approach can accentuate the lack of transparency and lack of consistency that is the cause of many of the current misgivings some States have with HFE as currently implemented.

An example of the issues that can arise with the use of judgment is the Draft Report proposals for the Mining Revenue assessment.

Given the very unequal distribution of mineral resources across the States it is difficult to arrive at an assessment method that is policy-neutral. States dominating the production of some minerals can heavily influence the 'averages' against which royalty raising capacities are based, even when minerals are grouped to dilute the dominance of those States.

A grouping approach, with one group covering all minerals, would provide the most policy neutral outcome.

However, the CGC has proposed an assessment method that puts equalisation first – a mineral by mineral assessment which would assess the seven minerals that generate most royalty revenue separately and the remaining minerals together.

The CGC recognises that this has the potential to make the assessment less policy-neutral since changes in State policies may have a larger impact on their GST payments share than under alternative assessment methods that use groups of minerals or minerals as one group.

The CGC considers 'the goal of policy neutrality is subsidiary to the requirement to achieve HFE', and also considers 'that while it is theoretically possible for changes in State policies to affect GST shares, in practice we do not observe this to be an issue.' While there is room for debate on those issues, the CGC is merely exercising judgment in applying its principles.[3]

While the CGC puts equalisation first in its treatment of mining revenue, it appears to be considering an inconsistent approach in the treatment of iron ore fines. The CGC notes that a mineral by mineral assessment including iron ore fines in a separate iron ore

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[2] *CGC, 2015 Review Draft Report, p. 14.*

[3] CGC, *2015 Review Draft Report*, p. 63. An alternative view of the chances of GST-influencing policy behaviour in practice in respect of mineral royalties is that it has not been tested. The CGC was directed in terms of reference not to change the classification of iron ore fines in the 2011 Update. Though the terms of reference determined the outcome, the CGC advised in the 2011 Update that it believed the better equalisation outcome would be achieved if iron ore fines remained in the low royalty rate group. (See CGC, *2011 Update*, pp. 41-43.) Western Australia subsequently increased iron ore fines royalty rates in two steps to align with the higher lump iron ore rates. Since the 2011 Update, the CGC has been directed to ensure that iron ore fines remain in the low royalty rate group.

component 'raises significant high level questions going to the practical application of fiscal equalisation' and has 'formed a view that there should be a phased introduction of the impact of higher effective royalty rates on iron ore fines on the GST distribution.' The CGC says it will 'consider options for giving effect to phasing in consultation with States in preparing [the] final report.'[4]

This appears to give the 'practical application of fiscal equalisation' primacy over the achievement of fiscal equalisation in the mining revenue assessment.

The CGC recognises that this judgment is not one that has been proposed in past methodology reviews and not one that the CGC is proposing for more general application in the 2015 Review.

An EPC distribution of GST revenue supported by top-up payments from the Commonwealth to the fiscally weaker States, would have GST payments distributed by a simple, transparent rule that leaves no room for uncertainty.

New approach to determining average policy

New South Wales continues to be concerned with the proposed new approach to determining average policy.

The CGC proposes to change:

- from an approach which determined a policy to be average if a majority of States applied the policy and it affected a majority of the tax or service base
- to an approach where a policy will be regarded as average if even one State raises a revenue or provides a service and it has a material impact on State fiscal capacities (by redistributing, compared to an equal per capita distribution, at least $30 per capita for one State).

We consider the change:

- makes little conceptual sense for an important element of determining what is 'average'
- will not solve the perceived issue it is meant to address
- will not solve any disincentive to tax reform thought to be in the current arrangements and
- has practical uncertainties that will increase the need to use judgment in the current implementation of HFE.

[4] CGC, *2015 Review Draft Report*, p. 127.

Is one State 'average'?

The Commission's reason for the change is:

> Even if only one State raises a revenue or provides a service, this is collectively part of what States do and should contribute to what the average States does.
>
> … everything States do is part of what States do collectively and may affect their fiscal capacities…[5]

The CGC uses the concept of 'average' in two senses:

- to determine what expenses and revenues to assess and how to assess them – if the CGC decides a tax or service is 'average policy', i.e., part of what States do, it makes assessments of States' underlying capacities/needs to raise revenue/provide the service and these assessments affect the GST relativities. On the revenue side particularly, the CGC sometimes adjusts assessment methodologies to reflect 'what States do'. For example, the CGC adjusts the payroll tax base in all States by excluding that part of it estimated to be below an average tax-free threshold. The CGC argues this aspect of 'average' policy should be adjusted for since the differing proportions of employers above/below the 'average' threshold in different States affect States' capacities to raise payroll tax
- to determine the 'average standards' to which States are equalised – these are the Australian average per capita expenses incurred by States to provide services and the average revenues collected from their taxes and charges. The average for each expense and revenue category is derived by dividing the Australian total of State expenses or revenues by the Australian estimated resident population.

Use of the single state standard is effectively what currently happens in setting the average standards.

- On the expenses side, States may deliver similar services that are grouped in the one expenses category assessment, but have different policies on to whom the services will be provided and/or how the services are provided (and different levels of efficiency in providing the service). These differences are 'averaged' in the average per capita Australian expense; what each State does affects the average, to a greater or lesser degree depending on the proportionate share of the State's activity in the total Australian activity.
- On the revenue side, States apply similar taxes that are assessed in the revenue assessments, but may have different policies on whom to apply a tax to and the rate at which the tax is applied. Some of these differences – e.g., different tax rates, the applicability of exemptions and varying levels of exemption – are averaged out in the average per capita Australian revenue.

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[5] CGC, *2015 Review Draft Report*, pp. 24, 26.

New South Wales considers the CGC's average policy proposal is likely to increase uncertainty and lead to inconsistency when applied to determining what expenses and revenues to assess and how to assess them. For this determination of 'average' policy, New South Wales considers the more important test of 'average' is whether a policy is actually one that at least several States follow.

Risk of not assessing material revenue low

The Commission considers the outcome of the change will be better equalisation:

> This test … should lead to better HFE outcomes than the previous one…The previous test meant a unique tax or service had no impact on the GST distribution. It was regarded as above average policy and States retained all of the revenue or had to fund the unique service. It was based on a view that if only one State did something, it was not average policy. We ran the risk of not making an assessment of a material tax, even if only one State could levy it, or of a service only one State needed to provide.[6]

New South Wales considers it highly unlikely that there would be a tax that only one State could levy, or a service that only one State 'needs' to provide. We consider that in reality there is very little risk that assessments of material taxes/expenses would not occur.

If a tax that only one State could collect did exist, other States would be likely to introduce it also, even though they may gain no direct revenue from it. This is because other States would recognise that they could increase their GST payments shares by doing so. (It could be argued that the other States introducing the tax is somewhat artificial, but those States could equally argue they would levy the tax if they could, but they simply lack the tax base, so this is a case where equalisation is truly justified by unequal State circumstances.)

On the expenses side it would seem even less likely, since States always ultimately have some choice in whether to provide or not provide a service.

If only one State could levy a particular tax or needed to provide a particular service, State circumstances rather than policy would be the only determinant of differences in revenue or expenses per capita between the States. The tax/service base in other States would be zero, the average tax rate applied to the zero tax base would yield no revenue or the average expense per capita applied to the zero service base would yield no expense, and the assessment would be actual per capita (i.e. assessed revenue/spending would equal actual revenue/spending).

[6] CGC, *2015 Review Draft Report*, pp. 25-26.

The result would be that, through the GST distribution, each State would get its population share of the tax-levying State's revenue, and the tax-levying State would retain only its population share, or each State would bear its population share of the service-providing State's expenses, with the service-providing State spending (after netting of the GST distribution) its population share.

New South Wales considers it would be much more likely that there could be a tax that only one State *chooses* to levy or a service that only one State *chooses* to provide. This is the State's policy choice. In that case it is entirely appropriate that revenue from the tax and the costs of service provision are not equalised.

If one State chooses to levy a tax that other States choose not to levy, then this should be regarded as above average tax effort and the State should retain all of the revenue it raises from this above average effort. If a State chooses to provide a service that no other State provides, then the State providing the service should bear the total cost of that service provision.

Conversely, if other States *choose* not to introduce a tax or provide a service that only one State (or a minority of States) levies/provides, they should not be allowed to share (potentially) in the revenue that tax generates or fund (potentially) the provision of that service through the GST distribution.[7]

In this case, under the proposed policy, the assessment would not be actual per capita, and the resulting impact on the GST distribution would depend on the distribution of the tax base or service population across the States. Although the uniquely-taxing State may be allowed to retain a proportion of its above average tax effort, it would not be permitted to keep it all if it was assessed to have an above-average capacity to raise the revenue. (It could also gain increased GST payments if it is assessed to have a below-average capacity to raise revenue through a tax that only it chooses to levy.)

Implications for tax reform

It is not clear that the change in approach to determining average policy will have any systematic effect on the incentives for tax reform. In theory, the 'majority of States/majority of tax base' test to determine average policy could provide incentives for States to be early or late adopters of tax reform depending on the effect on their GST shares, and gave considerable leverage to States at the point where a change of their policy would determine whether a revenue was equalised or not. A change to a 'one

[7] The Northern Territory has no land tax, but receives a share of the revenue other States raise through land tax indirectly through the GST distribution. However, all other States do levy land tax. The Northern Territory not levying land tax is a case of below average tax effort. If the Northern Territory's capacity to levy land tax was assessed as above average it would lose GST revenue, compared to an equal per capita share, in the land tax assessment, and that would be a fair outcome. In fact, it gains revenue because it is assessed to have a below average capacity to raise land tax revenue. That is simply the outcome that follows from correct application of the principle.

State' test shifts the point of leverage and alters the time available for possible gains or losses for some States, since when one States moves all States are immediately affected.

It is unclear how this proposed policy would operate in an environment of one state abolishing a tax or discontinuing a service.

However, our major concern in relation to tax reform is that the HFE arrangements themselves provide incentives/disincentives for changes to State tax policy, regardless of the approach taken to determining 'average' policy. That is because, as the CGC notes, '…for all revenues there is a theoretical incentive for States to raise more revenue from taxes where they are assessed to have a lower revenue raising capacity to increase their GST shares.'[8] The potential is that tax reform will be viewed through the prism of these distorting incentives.

The CGC notes the GST Distribution Review found no evidence States currently act in such a manner. An alternative view is that the thesis has never been rigorously tested in all its various forms.

Some reviews of State tax policy have noted certain State tax policy behaviour that is consistent with the incentives provided by the CGC's methods of assessing some revenues. As noted in NSW Second Submission to the 2015 Review, the Henry Review of the Australian tax system noted the different experiences of States in adjusting payroll tax thresholds and rates. In New South Wales, Victoria and South Australia, thresholds have tended to remain fairly constant while tax rates have been reduced:

> Some other States have taken the opposite approach. Western Australia, Tasmania, Northern Territory and the Australian Capital Territory have narrowed their payroll tax base by increasing the threshold faster than the growth in wages. These States have generally been slower to reduce their payroll tax rates.[9]

This behaviour is broadly consistent with the incentives provided to smaller States through the CGC's payroll tax revenue assessment to maximise the 'average' tax-free threshold. This is because the CGC removes from the payroll tax base the 'non-taxable' part equivalent to payrolls below an 'average' tax free threshold. This non-taxable part tends to be much larger proportion of small States' payroll tax bases than large States'.

Continued need for judgment and potential inconsistency

The CGC notes the new approach to determining average policy '…only provides a guide and we need to be practical in deciding what characterisation of average policy best

[8] CGC, *2015 Review Draft Report*, p. 27.

[9] Australia's Future Tax System, *Report to the Treasurer*, December 2009, Part 2, Detailed Analysis, p. 300.

meets the HFE objective in a particular case.'[10] New South Wales is concerned that the proposed approach provides a further need for what often could be contentious judgments.

New South Wales considers that it is not clear that the CGC is making consistent judgments of the average policy 'characterisation' in the Draft Report.

For example, in describing the derivation of average State policies on revenue raising the CGC notes:

> This average tax rate is applied to the bases States actually tax. Most often this is the legislative base, with adjustments for average exemptions and thresholds, because this is what States collectively tax. For this reason, we have not adopted global or broad indicators of State revenue raising capacity, although these may be simpler and more policy neutral.[11]

Notwithstanding the new approach, the CGC is still talking in terms of 'average' exemptions and thresholds, and what States 'collectively' tax, rather than what one State taxes.

This raises issues in relation to the consistent application of the new approach to average policy.

One issue is whether all elements of 'policy' are treated consistently. For example, some policy differences (e.g., differing tax rates) are averaged in the average tax rate; but other policy differences (e.g., differing tax thresholds) are not averaged in the average tax rate, but are 'adjusted'.

This is evident in the payroll tax assessment: different State tax rates are averaged in the average Australian tax rate; but different tax thresholds are not averaged in the average Australian tax rate. The CGC proposes to continue adjusting State tax bases for the 'non-taxed' part of State tax bases represented by an 'average' tax-free threshold, since all States apply a tax-free threshold.

There is another issue for consistent application of the new approach. States sometimes do things very differently, and it will be difficult to judge the materiality of the things States do differently.

Again in relation to payroll tax, it is true that in all States a firm whose total payroll is below the tax-free threshold does not pay payroll tax (though firms that operate in several States get access to only proportionate tax-free thresholds, rather than an entire tax-free threshold in every State).

[10] CGC, *2015 Review Draft Report,* p. 26.

[11] CGC, *2015 Review Draft Report,* p. 25.

However, two States apply a reducing tax-free threshold to firms whose payrolls exceed the tax-free threshold. In Queensland and the Northern Territory the tax-free threshold reduces by $1 for every $4 a firm's payroll exceeds the threshold. So in those States firms whose payrolls are above the threshold begin paying payroll tax on the tax-free threshold immediately and pay a flat rate of tax on their entire payrolls when payrolls exceed five times the tax-free threshold. Under the CGC's new approach this now could be regarded as 'average' policy, and its materiality assessed.

In the proposed conveyance duty assessment, it is also not clear that the CGC is adopting a consistent approach to adjusting the tax base for 'average' State policy.

- Five States levy stamp duty on transfers of non-real business assets, so the CGC says this is average policy and proposes to add revenue raised by the duty on transfers of non-real business assets to component revenue, and increase the revenue bases of those States that do not levy the duty.
- Seven States levy transfer duty on the transfer of property off-the-plan, so that also is be regarded as average State policy. The CGC proposes to include in component revenue the revenues States collect on off-the-plan purchases, and increase Victoria's revenue base by 2.75 per cent.
- Three States levy transfer duty on a wider range of unit trusts than other States. The CGC proposes in effect treating this wider application as non-average policy, by decreasing (by 3 per cent) the revenue bases of those States that apply duty to a wider range of unit trusts and, presumably, not including the revenue raised by application of the duty to the wider range of unit trusts in the component revenue.

As the CGC notes in relation to whether the new approach is an incentive or disincentive to tax reform, judgments can depend on the start point. This could also be an issue for the overall determination of average policy. If all States started out not levying a particular tax or allowing a particular exemption from a tax, then one State deciding to levy the tax or not allow the exemption might be determined to be average policy. If all States started out levying a particular tax or not allowing a particular exemption, could one State deciding not to levy the tax or allow a particular exemption be determined as average policy?

Only one State raised the approach to determining average policy in submissions to the CGC on the architecture of HFE and important issues for the 2015 Review. That was Tasmania in relation to the importance of the mechanism for determining average policy for treating the transition to the National Disability Insurance Scheme.

In response to the CGC's proposed new approach four States either opposed the new approach or preferred retention of the current approach: in addition to New South Wales, Victoria and the Northern Territory, Queensland also supported retention of the current approach;[12] one jurisdiction (ACT) agreed, with the remainder seeing merit or generally supportive but concerned about difficulties in implementation.

Discounting

In the absence of detailed explanation, New South Wales considers lack of consistency can become an issue in the CGC's decisions on:

- whether or not to apply discounts to assessments where data is lacking or unreliable and
- whether or not to assess disabilities in cases where conceptual cases are established but there is an absence of reliable data on which to make an assessment of the disability.

Consistency in discounting

The CGC considers discounting an appropriate means of dealing with uncertainty due to the indicator being used not being a good proxy of what the CGC is trying to measure or because data are of poor quality, either not fully comparable across all States or not representative of the situation in all States.

The CGC considers it inappropriate to discount:

- the best available estimates of national spending, such as those derived from ABS Government Finance Statistics
- a judgment-based estimate, say the proportion of expenses to which a disability should be applied, because it is the best available and already incorporates any necessary allowance for uncertainty or
- reliable assessments because of policy neutrality or other concerns, since this would be explicitly moving away from HFE.[13]

New South Wales considers discounting inappropriate. We consider that if there is sufficient uncertainty in an assessment to render its results less than fully acceptable the assessment should not be made. We accept that the CGC has different views.

However, if discounting is to be used it is important that it is consistently applied. Based on the reasoning provided by the CGC, New South Wales is not convinced that this is the case. A comparison of the data used and the application of discounting in the interstate wages and administrative scale assessments is a case in point.

[12] *Queensland Treasury Response to Staff Discussion Paper 2013-06S*, p. 4.

[13] CGC, *2015 Review Draft Report*, p. 33.

The interstate wages assessment assesses the relative effect on States costs of providing services of different public sector employee wage levels in different States due to differences in labour markets between States that are not influenced by State policy.[14]

The disability is assessed using a regression model of wages of private sector employees and controlling for differences in workforce attributes such as industry structure, education, experience, age and sex. Data used is from the 2009 ABS Survey of Education and Training (SET), with differences from the regression brought up to date using the relative change in the ABS private sector Wage Price Index. The assessment uses private sector wages as a non-policy affected proxy for public sector wages, assuming that the same factors that affect relative wages across States in the private sector act also on relative wages in the public sector.

In the 2010 Review, the CGC applied a 12.5 per cent discount to the private sector wage relativities derived from the SET regression to reflect a low level of uncertainty concerning:

- whether the SET data are sufficiently reliable
- whether the regression model controls for all relevant factors affecting private sector wage differentials between States and
- whether private sector wages are a good proxy for public sector wages.

The CGC proposes to continue the 12.5 per cent discount in the 2015 Review.

The administrative scale assessment is intended to capture the unavoidable initial service delivery set-up costs that are common to all States and incurred regardless of the size of the intended service population. These costs would be the same for all States, so would be higher per capita for smaller States.[15]

A major issue in the administrative scale assessment is establishing the quantum of administrative scale costs. In the 2015 Review, the CGC continues its view that 'work in the 1999 and 2004 Reviews suggested that the estimates [of the quantum of administrative scale costs] were robust' and that no discount to the existing quantum is warranted.

New South Wales considers the data on which the administrative scale costs assessment is based to be far less reliable than that underlying the interstate wage costs assessment, and the consequent uncertainty in the assessment to be far greater than the low, 12.5 per cent discount-worthy uncertainty in the interstate wages assessment.

- It may have been the case that the judgments relating to the quantum of administrative scale costs made in 1999 were the best that could be made at that

[14] This discussion is based on CGC, *2015 Review Draft Report,* pp. 400-405.

[15] CGC, *2015 Review Draft Report,* pp. 455-459.

time, and had already built into them a necessary allowance for uncertainty. However, since then the definition of administrative scale costs has changed twice. In 2004 the Commission recognised that 'scale-affected variable costs' were inappropriate for inclusion in the assessment, and a judgment-based proportion of those costs was excluded. In this Review it has been recognised that setting the quantum based on the minimum administrative costs that would be incurred for a State with the population the size of the smallest State is inappropriate, since properly-defined minimum administrative scale costs bear no relationship to any population size. However, there has been no adjustment to the quantum of administrative scale costs accompanying this change of definition in this Review.

- Administrative scale costs also have been adjusted over the period for changes in State functions and indexed to maintain their contemporaneity, most recently to a cost index that includes a small proportion of local government costs.
- The existing quantum of costs for schools education is said to be supported by the regression of Productivity Commission data that 'most closely aligns with our administrative scale concept'. However, the CGC recognises that the data it uses – the number of out-of-school staff – clearly grows with increasing numbers of students, so covers a broader range of fixed costs than 'administrative scale' costs. This means the resulting estimate of $14 million, though slightly lower than the estimate of $16 million currently being used, may be too high.
  - However, despite the obvious deficiencies in the data used to assess administrative scale and indications that the existing quantum estimates may be too high, the CGC does 'not consider that applying a discount to the existing quantum will result in an outcome closer to achieving HFE.'
  - New South Wales does not agree with this conclusion when compared to the reasons given for discounting the interstate wages assessment.
  - In another example, New South Wales considers the size of the discount inserted as a placeholder in the assessment of urban transport investment (50 per cent) appears inconsistent with the size of discounts applied in other assessments, such as the regional costs assessment (12.5 per cent).
  - The regional costs assessment assesses the higher costs of providing services in remote regions. These higher costs are unrelated to the potential need for more staff due to smaller service delivery scale – assessed in the service delivery scale assessment – but relate to higher costs for employing each staff member (due to the need to pay higher wages or allowances to attract staff to remote locations or provide housing in locations where accommodation options may be limited) or the higher cost of non-labour inputs (e.g., due to freight costs, use of four-wheel drive vehicles, higher fuel use due to greater distances travelled).
  - In the 2010 Review the Commission used State provided data on costs and number of staff allocated by region in providing schools and police to assess the disability, extrapolating the data to the provision of community and other health

services, welfare and housing services, rural roads, water, electricity and community development subsidies and about a quarter of the expenses in the Other Expenses category.

- In the 2010 Review the CGC considered there was some uncertainty in the regional costs assessment given that the data was not fully comprehensive, concerns about the reliability of the schools and police data, and the need to extrapolate that data to the provision of other services. The CGC judged the level of uncertainty to be relatively low, so applied a 12.5 per cent discount to the intrastate regional cost disability.
- The CGC intends to use much the same approach in the 2015 Review. However, the CGC considers individual school data from the Australian Curriculum, Assessment and Reporting Authority (ACARA) *My School* website sufficiently reliable that no discount is warranted to the assessment of regional costs in the Schools assessment. It also intends to use the more reliable ACARA data to extrapolate the regional costs disability to other relevant assessments. It intends to use the 2008-09 State-provided police data to assess regional costs throughout the Justice Expenses category.
- A 12.5 per cent discount will continue to apply to the police regional costs factor and the regional costs factors for all categories to which the schools regional cost factor is extrapolated reflecting:

▪ the more unreliable nature of the available police data compared to the ACARA data

▪ the degree of uncertainty attaching to the extrapolation of the ACARA derived regional costs factor to other categories.

- The infrastructure assessment allows for the impact on State fiscal capacities of the infrastructure (buildings, roads and equipment) States need to provide services. It has two parts, one covering investment in new infrastructure and the other covering depreciation to recognise the use of existing infrastructure. The new investment part has a separate component for urban transport investment.
- The CGC assesses investment in urban transport infrastructure based on average infrastructure stocks. One of the factors affecting urban transport infrastructure average stock per person is city size. Larger cities are assessed as needing much more stock per capita than smaller cities.
- The CGC assesses the transport infrastructure per capita needed by a city using a model based on the observed relationship between city population and per capita infrastructure asset values. The model uses State-provided data on infrastructure asset values by location.
- To reflect State concerns the CGC as a placeholder has discounted the relationship between assets per capita and city size by 50 per cent before applying it to the urban centre populations in each State. State concerns are that:

- the relationship between per capita asset values and city size may be driven by differences in State policies and timing of investments
- a quadratic function fits better than a linear function
- volatility may be an issue
- concerns about reliance on the raw statistical analysis of asset value to population centre size.
  - New South Wales considers that any discounting of this assessment should be done consistently with the CGC's judgments on the general use of discounting. These include that it is inappropriate to discount reliable assessments because of policy neutrality or other concerns. If this is accepted as a justification for discounting many other assessments should be discounted. It is also inappropriate to discount because a few observations may be affecting the results since this is inevitable in a regression where the sample size is rather small, and merely reflects what States do.
  - New South Wales considers that based on the CGC's other judgments the only reason to discount in this assessment could be the quality of the data. Given that transport systems often cross city boundaries it can be difficult to assign asset values to locations. This is an issue that New South Wales has noted often in CGC data requests.
  - New South Wales is not convinced that data quality issues in this assessment justify a discount of 50 per cent, while those in the regional costs assessment justify a discount of only 12.5 per cent.

Consistency in making assessments

In some cases where a conceptual case is considered to exist, the CGC goes to considerable effort in investigating a way to make an assessment, possibly using data that is not totally reliable and fit for purpose, and discounting if necessary the outcomes that result. In other cases where conceptual cases are established, comparatively little effort is made to investigate ways of making an assessment, and little explanation given of why it is judged an assessment cannot be done.

This impression simply may result from a less than full explanation of the reasons for making or not making the assessment. The absence of sufficient explanation risks States drawing incorrect conclusions.

An example of the considerable effort to which the CGC is prepared to go is assessing the effects of physical environment on the costs of building and maintaining infrastructure.

In the 2010 Review, the Commission concluded:

- '[s]ince each State would be able to point to unique features of its climate and geography, the Commission has not been convinced that there were material differences between the States in the overall effects of the physical environment on roads expenses'[16]
- while it accepted 'the conceptual case that it costs more to construct buildings in cyclone regions … the Commission also recognises that States incur other natural disaster mitigation expenses such as bushfire and flood mitigation costs.' Given the inability to develop a comprehensive assessment for all natural hazard mitigation costs, the Commission decided 'it cannot support an assessment of the impact of cyclone mitigation costs.'[17]

Despite these conclusions, at the request of the Northern Territory the Commission engaged consultants to advise on the issue in preparation for the 2015 Review.

The consultant looked at the impacts of topography, rainfall, temperature, wind, shrink/swell of soil and acid sulphate in soil, omitting flooding and soil salinity. Combining the geographical distribution of the environmental factors with the geographical distribution of State-provided assets and cost uplift factors suggested by experts employed by the consultant, the consultant concluded that soil shrink/swell and climate had significant impacts on construction costs for roads, public housing and public schools and maintenance costs for roads. The consultant provided estimates for each State of the increased costs.

CGC staff converted the consultant's average construction cost uplift factors into physical environment factors applicable to the construction and maintenance of roads, housing and schools. CGC staff then incorporated the construction cost factors into the investment and depreciation assessments. Staff did not investigate the impact of the physical environment maintenance factors.

CGC staff concluded that applying costs factors based on the consultant's advice to investment and depreciation costs would materially affect the GST distribution for one State.

In its October 2013 Staff Discussion Paper on proposed assessments, the CGC asked States whether the consultant's report provides a suitable basis for assessing the effects of the physical environment on road maintenance costs or infrastructure costs. Staff also:

- noted '[t]he consultant's report indicates that interstate differences in topography and soil type affect the maintenance costs of roads. Staff are investigating whether additional disabilities should be developed to capture these effects of the physical environment on road maintenance costs'

[16] CGC, *Report on GST Revenue Sharing Relativities – 2010 Review, Volume 2 – Assessment of State Fiscal Capacities,* p. 353.

[17] CGC, *2010 Review, Vol. 2,* p. 446.

- concluded '[t]he consultant's report provides a basis for assessing a physical environment factor' in the investment assessment. Staff noted the data and methods used to map State assets and environmental characteristics are reliable; the cost uplift factors were estimated by experts and are conservative; and the effects of omitted environmental factors could be expected to move in similar directions to those measured by the consultant. [18]

In response to the Staff Discussion Paper:

- six States did not support or had concerns with use of the consultant's report, noting it was partial in omitting flooding and soil salinity, contained high levels of subjective judgment, lacked good transparent data, and included estimates in some key areas for the geographical distribution of environmental characteristics and relevant State assets.
- two jurisdictions either strongly supported use of the consultant's report or supported further work on developing relevant factors, one noting that '[t]he physical environment consultancy report was specifically developed to support a Commission assessment of State government infrastructure investment.'[19]

In it Draft Report the CGC notes that in their submissions 'many States expressed concerns about basing a physical environment factor in the infrastructure assessment on the consultant's report' considering 'the report omits important environmental features such as flooding and fires and is heavily reliant on the consultant's judgment and internal data to derive the cost impacts.'

The CGC now does not propose to introduce a physical environment factor in the infrastructure assessment, '[u]nless we can devise a way of capturing the other environmental impacts without introducing double counting'. The capital construction cost factors based on the Rawlinsons indices that staff propose to use in the assessment already capture the impact of some environmental influences.[20]

In other cases the CGC's efforts are less extensive but the CGC is prepared to make assessments. For example, the CGC notes:

- in relation to cross border influences, 'despite the lack of actual data, there is a conceptual case that some welfare services provided by the ACT are used by New South Wales residents and that the reverse flow is significantly smaller…Taken together, the conceptual arguments and the available information suggest that, on a net basis, between 7-10% of community health, some welfare, and cultural and recreational services provided by the ACT are used by New South Wales residents.' So the CGC increases the ACT population for some assessments by an amount

[18] CGC, *2015 Review: Proposed Assessments,* Staff Discussion Paper CGC 2013-07S, pp. 132, 197-198.

[19] Queensland Treasury, *Queensland Treasury Response to Commonwealth Grants Commission 2015 Methodology Review: Response to Staff Discussion Paper CGC 2013-07S Proposed Assessments* ,January 2014, p.43.

[20] CGC, *2015 Review Draft Report,* p. 388.

which, given national average use rates, would be equivalent to use of 7-10 per cent of ACT services, with the population of New South Wales reduced by the same amount[21]

- in the justice assessment the CGC recognises police custody rates may not be a reliable indicator of relative police workloads, since custody rates do not adequately capture differences in the complexity of police work, but the Commission is prepared to use the data and discount it by 25 per cent.[22]

However, in other instances the effort the CGC has put into devising methods to make an assessment and obtaining data are not detailed. For example, the CGC notes:

- it has not recognised the impact of cost of living on the need for States to provide welfare services in the Welfare Services assessment: '…while the conceptual case is plausible, the absence of reliable data means we cannot reliably make an allowance for cost of living differentials'[23]
- in the Roads assessment, different drivers affect bridge and tunnel expenses than those affecting other rural and urban road expenses but '…because no reliable data can be found to support a differential assessment, the Commission has assessed bridge and tunnel maintenance expenses equal per capita.'[24]

Materiality thresholds

New South Wales notes the CGC's proposals in relation to materiality thresholds.

Our only comment is in relation to the $10 threshold for data adjustment and no threshold for correcting errors and misclassifications.

New South Wales agrees that there should be no materiality threshold for the correction of errors. Materiality simply should not be relevant to the correction of errors where the errors can be simply and reliably corrected.

However, judgment is sometimes required on what is regarded as a data adjustment and what is regarded as the correction of an error. An example of what the Commission regards as a data adjustment and what New South Wales regards as an error occurs in the Insurance Tax assessment.

In the Insurance Tax assessment, the CGC regards the removal of life insurance duty revenue from the assessment as the adjustment of data. Since the effect on the GST distribution is not greater than $10 per capita for any State it does not remove the revenue. New South Wales regards removal of life insurance duty revenue as the

[21] CGC, *2015 Review Draft Report,* p. 491.

[22] CGC, *2015 Review Draft Report,* p. 294.

[23] CGC, *2015 Review Draft Report,* p. 235.

[24] CGC, *2015 Review Draft Report,* p. 318.

correction of an error, since revenue should not be included if no corresponding tax base is available. Even though the effect is less than $10 per capita for any State we consider this irrelevant, since the correction of errors should have no materiality threshold.

Treatment of Commonwealth payments

The Draft Report notes that the simple new criterion for the treatment of Commonwealth payments will be that payments which support State services and for which expenditure needs are assessed will impact on the relativities, while leaving it to governments to specify those payments that should not affect the relativities in terms of reference.[25]

New South Wales notes also the CGC's decision not to adopt a materiality threshold for Commonwealth payments.

The CGC proposes examining Commonwealth own-purpose expenses (COPEs) in the same way it examines Commonwealth payments to the States. Where a COPE funds a State service (or a substitute for that service) for which needs are assessed – including through a deliberative equal per capita assessment – it should affect the GST distribution.

New South Wales is concerned that this may lead to a further significant expansion to the scope of equalisation. For example, it could be argued that Commonwealth welfare payments indirectly impact on State welfare spending, in that welfare payments relieve the need for States to provide welfare services in some States more than in others, particularly where Commonwealth welfare payments are uniform across Australia but costs of living and housing vary between States.

Likewise, as the CGC notes the Australian Capital Territory has pointed out, Commonwealth industry assistance spending could be argued to impact on State needs for spending on services to industry.

New South Wales notes the Commission's comment that:

> If governments want to ensure Commonwealth payments relating to projects of national significance are not subject to equalisation, it can direct the Commission in the terms of reference to ensure that those payments and the associated projects do not influence the GST distribution. Some States have said such quarantining dilutes HFE and could lead to States receiving financial recognition for the same project twice – once through the Commonwealth payment

[25] CGC, *2015 Review Draft Report,* pp. 49-57. A deliberative equal per capita (EPC) assessment – where expenditure needs are assessed but the CGC concludes there are no differences in State per capita service delivery costs so the assessment has no impact on the relativities – is regarded as the assessment of needs, and any associated Commonwealth payments would affect the relativities.

> and once through the GST. However, this is a matter for governments to resolve.[26]

New South Wales considers this approach to potentially lead to inconsistency in treatment and increase uncertainty.

[26] CGC, *2015Review Draft Report*, p. 77.

3. Proposed Assessments

This section of NSW Third Submission to the 2015 Review contains detailed responses to the CGC's proposed assessments contained in Attachments 1 to 29 of the Draft Report, including comments on the Priority Issues identified by the CGC.

Payroll Tax

> Summary of changes since the 2010 Review
>
> - There have been no changes to this assessment.

The CGC notes that it has:

> … retained the threshold adjustment and removed the remuneration below it. The threshold is a major feature of State tax policy and there are material differences in the proportion of total remuneration paid by small firms.[27]

New South Wales considers the threshold adjustment is inconsistent with the Commission's new approach to 'average policy' and influences State payroll tax policy.

The CGC states:

> In this review, the Commission has adopted a new approach to deciding what States do and how assessments will be made. It will consider any tax imposed or services provided by any State to be part of what States do collectively.[28]
>
> Even if only one State raises a revenue or provides a service, this is collectively part of what States do and should contribute to what the average State does.[29]

Maintaining the threshold adjustment in its current form does not reflect what States do under the new approach to deciding how assessments are made.

The threshold adjustment removes from the payroll tax revenue base remuneration paid to employees below the average tax free threshold, i.e. the total payroll of firms with total payrolls below the average tax free threshold, and that proportion of payroll that is below the average tax-free threshold for firms with total payrolls that exceed the average tax-free threshold.

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[27] CGC, *2015 Review Draft Report*, p. 88.

CGC, *2015 Review Draft Report*, p. 16.

[29] CGC, *2015 Review Draft Report*, p. 24.

Two jurisdictions apply a flat rate of tax to firms with payrolls above a certain threshold. Queensland and the Northern Territory use a deduction system under which the tax-free threshold is withdrawn by $1 for every $4 that payrolls exceed the tax-free threshold. That means that in those two jurisdictions there is no tax-free portion of payroll for firms with payrolls above $5.5 million and $7.5 million respectively.

Since two States raise revenue on the entire payroll of firms with payrolls above a certain amount, under the new approach to average policy this should be regarded as collectively part of what States do and should contribute to what the average State does.

The payroll tax threshold adjustment at least should not remove from the payroll tax revenue base that portion of payroll that is below the average tax-free threshold for firms with total payrolls that exceed the average tax-free threshold. New South Wales estimates that change would be material for four States at the $10 materiality threshold.

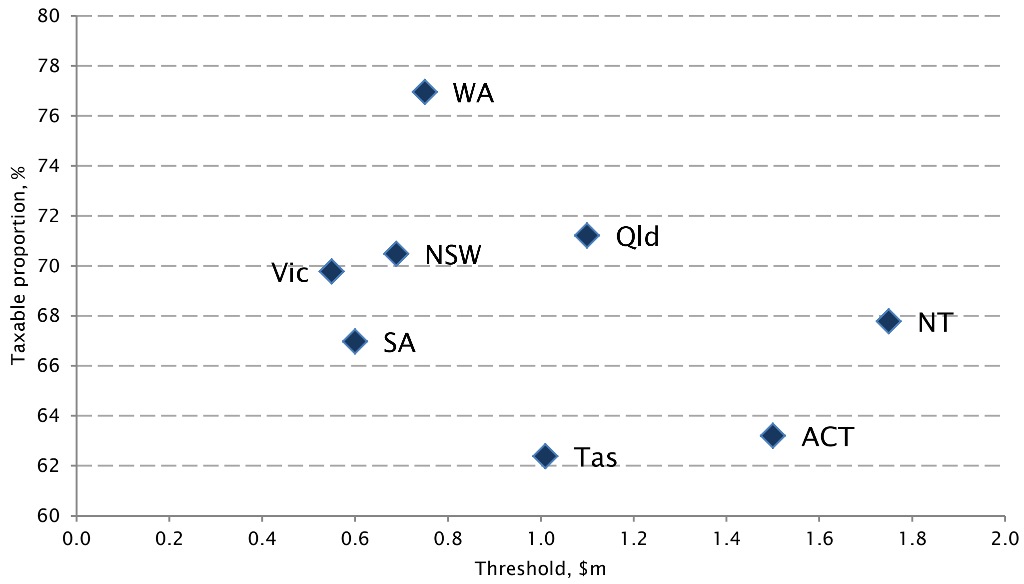
New South Wales notes the CGC's conclusion that there are material differences between the States in the proportion of total remuneration that is taxable using an average tax-free threshold.

The tax free threshold adjustment redistributed $243 million of GST revenue in the 2012-13 assessment year, mainly from Western Australia to the other States. This is a larger redistribution than some other categories.

This material difference reinforces New South Wales continuing concern that the CGC's assessment method for payroll tax influences State payroll tax policy.

- As shown in Chart 1, though taxable proportions of State payrolls are calculated using a policy-neutral 'average' threshold commonly applied to all States, the jurisdictions with the highest tax free thresholds generally have the lowest taxable proportions of payrolls. (The taxable proportions used in Chart 1 are those for the private sector, since the public sector taxable proportions mainly reflect the exclusion of general government employee payrolls).

Chart 1: Tax-free thresholds and taxable proportions of payroll, 2012-13



- As shown in Table 1, the jurisdictions with the lower taxable proportions of payrolls have tended since 2000-01 to make payroll policy changes more by increasing tax-free thresholds rather by reducing rates, while jurisdictions with the higher taxable proportions of payrolls have tended to reduce rates more often than increasing tax-free thresholds. Of the 24 rate/threshold changes in the larger States since 2000-01, 17 (71 per cent) have been rate reductions and 7 (29 per cent) have been threshold increases; for smaller States, 17 of the 32 changes (53 per cent) have been threshold reductions and 15 (47 per cent) have been rate reductions.

Table 1: Payroll tax rate and threshold changes since 2000-01

	Larger States				Smaller States			
	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Policy changes	8	9	5	2	9	7	6	10
Rate reductions	6	8	2	1	6	3	0	6
Applicable dates	1.1.01 1.7.02 1.1.09 1.1.10 1.7.10 1.1.11	1.7.01 1.7.02 1.7.03 1.7.06 1.1.07 1.7.08 1.7.10 1.7.14	1.7.01 1.7.02	1.1.02	1.7.01 1.7.02 1.7.04 1.7.07 1.7.08 1.7.09	1.7.00 1.7.01 1.7.02		1.7.00 1.7.01 1.7.02 1.7.03 1.7.08 1.7.11
Threshold increases	2	1	3	1	3	4	6	4
Applicable dates	1.7.08 1.7.13	1.7.02	1.7.06 1.7.12 1.7.15	1.1.14	1.7.02 1.7.08 1.7.09	1.7.00 1.7.01 1.7.02 1.7.13	1.1.01 1.7.01 1.7.02 1.7.08 1.7.12 1.7.14	1.7.04 1.7.05 1.7.06 1.7.11

Land Tax

Summary of changes since the 2010 Review

- Metropolitan improvement levies are combined with the property part of fire and emergency services levies and assessed using the value of properties.
- The assessment method for land taxes levied on a landholder basis is unchanged.

New South Wales does not support including metropolitan improvement levies and property levies to fund fire and emergency services in the Land Tax category.

Only two States (Victoria and Western Australia) have metropolitan improvement charges (though South Australia's Save the River Murray Levy also has similarities to these levies). Under the new approach to average policy the CGC proposes to assess the revenue in a component of the land tax assessment using a tax base – Valuer-General data on the value of properties – different from that used in the other component of the assessment – State revenue office data on taxable land values.

The CGC notes that in the other proposed component of the Land Tax assessment – the income-producing property component for land tax – it 'has attempted to capture the revenue base that best reflects what States collectively do.'[30] It is not clear what should be regarded as average policy in this category under the new approach to determining average policy based on what even one State does.

- The ACT has no tax-free threshold for land tax; under the new approach to average policy this could be regarded as the 'average' policy.
- The CGC requires New South Wales, Victoria and Queensland to provide State revenue office data on a basis different to the way land tax is levied in those States, and more consistent with the way land tax is levied in Western Australia, South Australia and Tasmania. The differences in policy relate to the way the value of land jointly owned by two or more entities is allocated between land owners, aggregated for individual land owners and taxed. None of these States tax jointly owned land in the same way as the Australian Capital Territory, where with no tax free threshold, each property can be taxed individually. Again, under the new approach to average policy, ACT policy could be regarded as 'average'.

If the CGC proposes to reflect the one state average policy in land tax, then a broad assessment may be more appropriate.

Such an assessment could:

[30] *CGC, 2015 Review Draft Report, p. 26.*

- have as its tax base the broad tax base available for taxation in all States, i.e., total land value, with no need for adjustments for what States 'collectively do'
- include all revenue that States choose to raise from the taxation of land, i.e., taxes applying to income-producing and non-income-producing land
- include all revenue that States raise from their different applications of the same form of tax, i.e., with and without tax-free thresholds, individual holdings or aggregated holdings, based on 'site values' or 'unimproved values'.

Additionally, under the current assessment system, New South Wales does not support the inclusion of fire and emergency services levies revenue in this assessment, as well as in the Insurance Tax assessment (for fire and emergency services funding levied on insurance taxes) and the Motor Taxes assessment (for fire and emergency services levies on motor vehicles).

New South Wales considers these are all different forms of the same tax. All States hypothecate fire and emergency services levy revenue for a specific purpose with the amount of revenue raised generally tied to the amount of funding needed to provide fire and emergency services. Assessing the revenue in three assessments means GST revenue is being redistributed in three instances essentially for the same tax.

Stamp Duty on Conveyances

Summary of changes since the 2010 Review

- Stamp duty on motor vehicles has been included in this category.
- Expenses and duty concessions relating to first home owners (such as First Home Owners Bonus Payments) have been moved from this category to Housing.
- The land rich adjustment for Tasmania has been discontinued because it is not material.

New South Wales does not support the inclusion of stamp duty on the transfer of motor vehicles in this category rather than the Motor Taxes revenue category. We consider the change reduces the transparency of the GST redistribution process by including revenue raised from very different tax bases in the one category. We realise that the change has no impact on the GST distribution, but it has a large impact on the presentation of the GST distribution.

New South Wales is concerned also that the adjustments to the tax base for 'average' State policy appear to be inconsistent within this assessment and with methods in other assessments. This is an example of the inconsistencies of treatment that the new approach to defining 'average' State policy may produce.

New South Wales agrees that levying transfer duty on transfers on non-real business assets is average State policy.

Re-categorising motor vehicle stamp duty

The CGC provides no reason for moving the assessment of stamp duty on the transfer of motor vehicles from the Motor Taxes revenue category to this category.

Stamp duty on the conveyance of property and stamp duty on motor vehicle transfers apply to quite separate tax bases.

- Stamp duty on the conveyance of property applies to transfers of real property (land and residential and commercial buildings) and non-real property (such as intellectual property like patents and copyrights, and intangible assets such as goodwill). However, the vast majority of revenue for most States comes from the transfer of residential and non-residential land and buildings. The number and values of these transactions in land and buildings are important drivers of the conveyance duty tax base.
- Stamp duty on the transfer of motor vehicles applies to transfer of the ownership of motor vehicles. The number and values of these transactions are the important

drivers of this tax base, as is the number of vehicles for other elements of the Motor Tax assessment such as annual weight tax and registration fees.

New South Wales realises that the re-categorisation of stamp duty on motor vehicle transfers will have no net impact on the outcome of the GST distribution. The assessment of stamp duty on motor vehicle transfers is effectively a self-contained assessment and will produce the same GST distribution whether included as a component in the Stamp Duty on Conveyances category or the Motor Taxes category.

The CGC notes in the Draft Report a tax will be differentially assessed 'in a broader category assessment if the distribution of the tax base is not materially different from the larger tax base [and] in a separate assessment if it is materially different.'[31] We see no need to assess motor vehicle transfer duty in a separate category, but consider that since its tax base is likely to be more closely related to that for other motor taxes it should continue to be included as a component of the Motor Taxes category rather than Stamp Duty on Conveyances.

New South Wales thinks it important for transparency that the impact of the assessment of particular tax bases is as clear as possible. We do not think it helpful that the redistribution of GST in respect of transfers of land and buildings – the generally understood meaning of conveyance duty – should be significantly affected by the redistribution for an entirely different tax base, transfers of motor vehicles. This impact would not be recognised by those without 'fine print' knowledge of the CGC's assessment methods.

New South Wales realises that motor vehicle transfer duty is proposed to be a separate component of the Conveyances Duty assessment – as it was in the Motor Taxes assessment. However, we note the CGC generally does not publish in its update reports the separate impacts of category components on the GST distribution.

The CGC generally publishes the impact on the GST distribution (compared to equal per capita) of the separate tax bases of 'property sales' and 'motor taxes' and the separate categories of Stamp Duty on Conveyances and Motor Vehicle Taxes. With motor vehicle transfers included in the Stamp Duty on Conveyances category the sets of figures for tax bases and revenue categories would not align, as they currently do. This is likely to lead to some confusion for readers of CGC publications that do not read the fine print.

Charts 2 and 3 show the impact of the re-categorisation for the assessments of Stamp Duty on Conveyances and Motor Taxes, in each case comparing the 2014 Update outcomes for 2012-13 with the potential outcomes following re-categorisation shown in Table 9 (p. 109) and Table 8 (p. 121) of the Draft Report.

[31] CGC, *2015 Review Draft Report*, p. 26.

Chart 2: Conveyances stamp duty assessment redistribution of GST, 2012-13

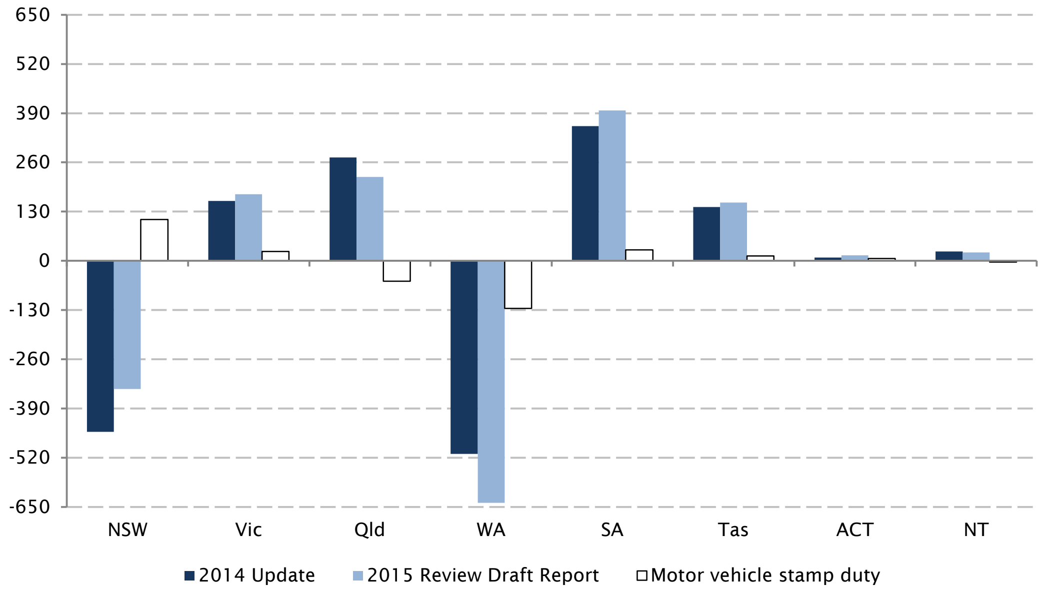
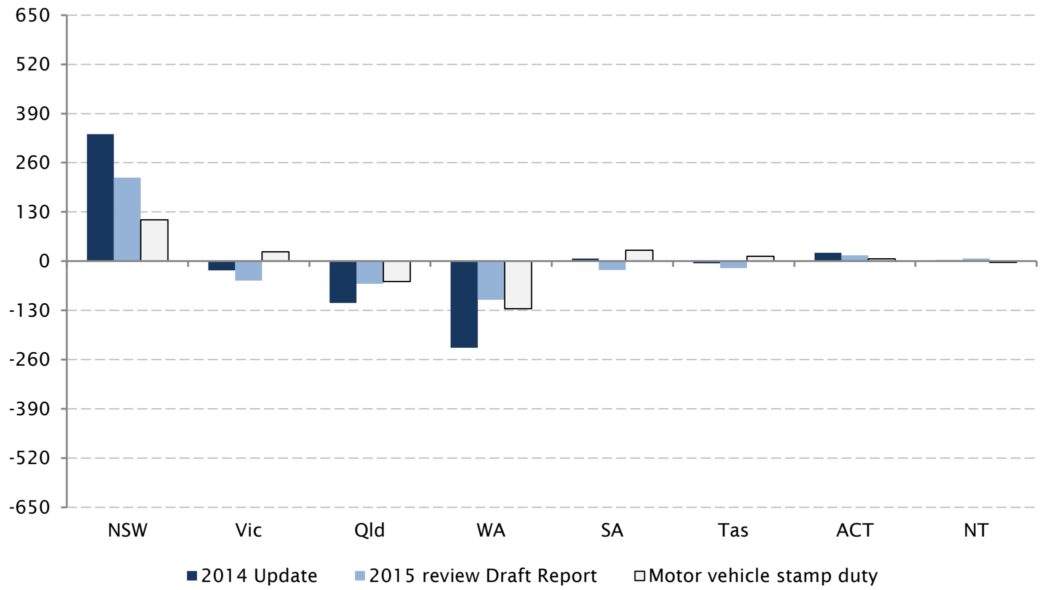


Chart 3: Motor taxes assessment redistribution of GST, 2012-13



The outcomes of the two assessments in the redistribution of GST revenue payments between the States, compared to an equal per capita (EPC) distribution, are significantly altered by the re-categorisation.

- For Western Australia, for example, a loss against EPC of $510 million assessed in 2012-13 for the Stamp Duty on Conveyances assessment becomes a loss of $639 million with the inclusion of motor vehicle transfer stamp duty revenue in the Conveyances assessment; for NSW, a loss of $452 million becomes a loss of $338 million.

- Similarly for the Motor Vehicle Taxes assessment, for Western Australia a loss of $228 million in the 2014 Update assessment becomes a loss of $102 million with motor vehicle stamp duty revenue taken out of the assessment, while a gain of $336 million for New South Wales becomes a gain of $221 million.

The redistributive effect of the stamp duty on motor vehicles component is clear in Charts 2 and 3 because it is separately identified. However, the CGC generally does not identify the redistributive effects of components of assessment categories in its Update reports.

Adjustments for 'average' policy

The CGC asked for State views on the appropriate treatment of transactions in non-real business assets.

New South Wales agrees that, since five States levy stamp duty on transfers of non-real business assets, the duty is average State policy under either approach to determining average State policy – the old approach of majority of States and majority of tax base, or the proposed new approach of one State.

New South Wales considers that other States' policies and/or other States' interpretations of policy options should not influence the CGC's assessment of average policy.

New South Wales is not convinced that, even if the interpretation that States that have abolished duty on non-real property transfers are precluded from reintroducing it is a correct interpretation, this should influence the CGC's assessment of what is average policy in this instance. Some States chose to abolish duty on non-real property. That policy was chosen knowing that taxes once abolished could be interpreted as not being capable of reintroduction.

More broadly on the issue of adjustments, New South Wales noted in Section 2 our concern about the consistent application of the proposed new average policy approach in the Stamp Duty on Conveyances assessment.

Insurance Tax

Summary of changes since the 2010 Review ▪ Fire and emergency levies imposed on insurance premiums are included in the category. In the 2010 Review they were included in the Other revenue category, and assessed EPC.

The design of this assessment exposes problems with implementing the principle of 'what States do' and the new application of 'average policy'.

To apply its new definition of 'average policy', the Commission will consider any tax imposed by any State as part of what States do collectively. New South Wales previously raised concerns with this approach, and the Draft Report now highlights particular difficulties implementing this for fire and emergency services levies.

Funding for fire and emergency services is raised in various ways by different jurisdictions.

In New South Wales, the total amount of funding for fire and emergency services is determined through the Budget process each year. These expenses are met through funding from insurance companies, local government and the NSW Government. The amount to be funded by insurance companies is allocated between individual companies in proportion to their market shares for certain types of insurance. In turn, the insurance companies pass on their shares of the levy to their customers in the form of higher premiums. The Commission has determined this to be akin to an insurance tax, even though it is collected and imposed differently.

Other States raise revenue through a property based levy on land or motor vehicles. The result is that revenue raised to fund fire and emergency services will be assessed in three different categories: insurance tax, land tax and motor taxes.

The Commission generally measures a tax base as 'the legislative base, with adjustments for average exemptions and thresholds because this is what States collectively tax'.[32] However, for insurance taxes, 'a range of revenue is included in the category but not in the revenue base (for example life insurance revenue and revenue from fire and emergency levies)'.[33]

Insurance premium data from the Australian Prudential Regulation Authority (APRA) is used to measure the insurance tax base. This data however, does not accurately capture the revenue base that reflects what States do.

[32] CGC, *2015 Review Draft Report*, p 25.

[33] CGC, *2015 Review Draft Report*, p 113.

APRA cannot provide data on the total premiums paid for life insurance by State. Where possible, revenue included in an assessment should similarly be included with the taxable base for it to properly reflect what States do.

The Draft Report states:

> We considered removing revenue on life insurance premiums from the category, and assessing it equal per capita (EPC). Four States provided data to suggest duties on life insurance are a small proportion (less than 5%) of all insurance taxes. A data adjustment to exclude life insurance duties from the category is not material. We have, therefore, left life insurance duties in the category and assessed them using the general insurance revenue base.[34]

In the case of fire and emergency services levies, these levies are included in the total premiums data provided by APRA. However, the CGC has removed these levies from the general insurance base. The Draft Report states that this has been done to avoid overstating the revenue base of the States that impose levies on insurance.

The result of asymmetrically including some insurance-related revenues, but excluding their corresponding taxable base, is that the assessment calculates the national average effective tax rate for insurance taxes at 15.9 per cent for 2012-13. This is 45 per cent higher than the legislated rate on general insurance in any jurisdiction. In 2012-13 general insurance stamp duty rates ranged from 7.5 per cent in Queensland to 11 per cent in South Australia, with 5 per cent concessional rates covering some of the tax base in some States. It is much higher than the average rate calculated under the 2010 Review method (11.9 per cent in 2012-13).

New South Wales considers that revenues from life insurance and fire and emergency service levies should be removed from the insurance category and assessed equal per capita under Other Expenses.

New South Wales views the inclusion of revenue in an assessment for which no associated tax base can be assessed, and where the revenue could be removed relatively easily, as an error. We do not view the proper alignment of revenue with the revenue base as a data adjustment, since the revenue should never have been included in the data in the first place.

[34] CGC, *2015 Review Draft Report,* p 114.

Motor Tax

Summary of changes since the 2010 Review

- The assessment method is unchanged, but the stamp duties on the transfer of motor vehicles assessment have been moved to the conveyances category.
- Revenue from fire and emergency levies on motor vehicles have been moved from Other revenue to this category.

New South Wales does not support the removal of stamp duties on motor vehicles from the motor taxes category. Stamp duties on the transfer of motor vehicle registration are closer to the revenue base of motor vehicle taxes, i.e., light and heavy vehicle stock, than stamp duties on conveyances. For transparency, it should remain in the motor tax category.

Only one State raises fire and emergency levies on motor vehicles and for that State, revenue has been added to Motor Tax revenue. Other States raise revenue to fund fire and emergency services through a levy on property value or obtain funding through insurance companies. New South Wales is not convinced that revenue related to fire and emergency levies should be assessed differentially across three separate categories.

The Other Revenue category includes revenues for which a conceptual case for a differential assessment does not exist, and this is where all fire and emergency levies should continue to be assessed.

New South Wales notes that apart from the changes discussed above, the assessment method is unchanged.

Mining Revenue

Summary of changes since the 2010 Review

- There is now a mineral by mineral assessment with separate assessments of iron ore, coal, gold, onshore oil and gas, copper, bauxite, nickel and 'all other mineral'. Grants in lieu of royalties are assessed APC in a separate component as in the 2010 Review.
- Subject to the results of further consultation, the impact of higher royalty rates on iron ore fines will be phased over three years commencing from 2015-16.

Policy neutrality has been given lesser importance in the Mining Revenue assessment proposal of a mineral by mineral assessment at the expense of the equalisation objective.

The Commission's 2010 Methodology Review concluded that the grouping approach of high and low royalty rate categories ensures policy neutrality and 'what states do':

> we favoured two groupings because it provided a balance between the competing issues of accurately capturing States relative revenue raising capacities and policy neutrality (determining an average policy that is representative of the policies adopted across the States, because higher levels of disaggregation could result in the average policy being dominated by one State because it has the vast bulk of the tax base.[35]

New South Wales continues to favour a single group approach. By aggregating all mineral commodities into one group and calculating the average royalty overall there will be no discontinuities in the assessment. This will remove the grant design effects inherent in the current assessment.

The average royalty rate will, of course, continue to reflect the average policy of the large mining states, but there should be some degree of moderation in the movement imposed by the spread of commodities attracting different royalty rates in the total group. A single group would also increase transparency and reduce complexity compared to the current assessment.

The Draft Report notes that the 'Commission has decided to take a mineral by mineral approach giving primacy to HFE considerations.'[36] New South Wales believes that this approach gives rise to significant potential grant design effects.

[35] CGC, *2010 Review, Vol.2,* p.133.

[36] *CGC, 2015 Review Draft Report,* p. 135.

However, this approach seems inconsistent with the proposed approach to the treatment of iron ore fines where the ‘practical application’ objective of phasing seems to be based on a judgment of what WA would have lost had iron ore fines been reclassified from the low royalty group to the high royalty group under the 2010 Review methodology.

The 2015 Review presents an opportunity for the Commission to prevent any repetition of the uncertainty and issues about the appropriate treatment of iron ore fines previously canvassed by States and the Staff Discussion Paper on the New Issues for the 2014 Update (CGC 2013-02-S).

In New South Wales’ opinion the phasing is equivalent to a discount of the mining revenue assessment which the Draft Report notes should only be applied to cases where there are issues of data quality.

New South Wales strongly supports the staff proposal not to apply a general discount to the mining revenue assessment.

New South Wales does not support the view expressed by some States that perceived weaknesses in one assessment should be offset by discounts in other assessments. That is, that the Mining Revenue assessment should be discounted because of perceived weaknesses in the treatment of mining expenses.

New South Wales is not convinced that other assessments do not adequately capture State spending to support mining. State expenditure on infrastructure to support the mining sector is directly or indirectly captured across various assessments (services to industry, roads, infrastructure, net lending and school education).

In addition, the private sector makes a significant contribution to the provision of infrastructure that supports mining activity and mining communities in rural and remote areas of Australia.

New South Wales agrees with the Commission’s recommendation not to have a separate assessment of mining expenses given that it considers there are no other material mining related expenses or previous expenses that are unassessed.

The report notes that staff will closely monitor the impact of mining policy effort between the States. New South Wales does not believe that it is possible to determine below or above State average effort based on the potential revenue from a State’s mining resources. Any indicator along those lines would be highly subjective and rely heavily on judgment about the potential size of mineral reserves and its possibility of extraction, which is heavily dependent on economic factors, Commonwealth Government policies and environmental laws.

Other Revenue

Summary of changes since the 2010 Review

- The assessment method is unchanged. Revenue from fire and emergency services levies has been moved from this category to the Land tax, Insurance tax and Motor taxes categories.

As noted in our comments on the Land Tax, Insurance Tax and Motor Taxes assessments, New South Wales does not agree with moving revenue from fire and emergency services levies from Other revenue to Land Tax (for revenue raised by property levies), Insurance Tax (for revenue raised by levies on insurance companies) and Motor Taxes (for revenue raised by levies on motor vehicles).

New South Wales considers these are all different forms of the same tax. Notwithstanding the fungibility of money, all States hypothecate fire and emergency services levy revenue for a specific purpose with the amount of revenue raised generally tied to the amount of funding needed to provide fire and emergency services. Assessing the revenue in three assessments means GST revenue is being redistributed in three instances essentially for the same tax.

New South Wales agrees that it is not possible to develop a differential assessment of gambling revenue. Gambling revenue is raised in a number of ways (through taxes on gaming machines, lotteries, casinos, Keno, racing totalisators, fixed odds racing betting and other fixed odds sports betting), is heavily influenced by State policies, and is driven by factors that are difficult to determine.

We support the continued assessment of gambling revenue equal per capita in the Other Revenue category.

Schools Education

Summary of changes since the 2010 Review

- The assessments now use actual enrolments as the broad measure of use for all age groups with an adjustment to the distribution of students in pre-Year 1.
- ACARA data is used to directly estimate cost weights for Indigeneity, socio-economic status (SES), service delivery scale (SDS) and remoteness contained in State Government funding of government and non-government students.
- Following new policy, State funding of non-government students reflects their socio-demographic characteristics rather than being set as a proportion of funding for the average government student.
- The assessment of expenditure of Commonwealth NERA funding for government schools is based on the average SRS amount for government students in each State to avoid unwinding the recognition of educational disadvantage embedded in the NERA funding arrangements.

The Draft Report proposes that the assessment of Schools education expenses is undertaken separately for each of the following components:

- State funded schools expenses
- Commonwealth funded government schools expenses
- Commonwealth funded non-government schools expenses
- Student transport expenses.

Changes arising from the Commonwealth's 2014-15 Budget

New South Wales notes that the Draft Report was prepared on the basis of funding arrangements prior to the Commonwealth's 2014-15 Budget which announced significant changes to school education funding. These changes now need to be taken into consideration for the 2015 Review.

On 23 April 2013, New South Wales signed a new National Education Reform Agreement (NERA) with the Commonwealth. Under the NERA, Commonwealth, and signatory State and Territory Governments agreed to significantly reform and increase funding from 2014 to 2019. For States that did not sign the NERA, additional Commonwealth funding was subsequently announced through 'Students First'. However, in its 2014-15 Budget the Commonwealth stated:

> From the 2018 school year onwards, total recurrent funding will be indexed by the Consumer Price Index, with an allowance for changes in enrolments.

> Further, from 2018, the Commonwealth will provide equal per student base funding, as well as an even proportion of existing loadings to address disadvantage, noting that final State allocations for the 2018 school year are subject to formal negotiations between the Commonwealth and the States and Territories and the non-government sector.[37]

This unilateral decision by the Commonwealth Government represents a reduction to New South Wales of $1.3 billion over the two years 2018 and 2019 and means the full implementation of the needs-based Student Resource Standard (SRS) framework may not be achieved as originally intended.

The Schools education category must now address how to incorporate these significant shifts in Commonwealth-State arrangements where Commonwealth funding is provided to all States but only some are subject NERA conditions on State funding of government and non-government schools. Further, this change only applies for four years (2014 to 2017) and the detail on funding arrangements from 2018 is still to be determined.

For the assessment to reflect the application year, the Schools education assessment will require significant change part way through the 2015 Review period to recognise the removal of Students First funding.

State funded school expenses

New South Wales notes the Commission proposes to use of actual enrolment for all age groups (with an adjustment to the distribution for student in pre-Year 1) to measure State needs to fund school expenses.

To account for high cost students, the Commission have estimated additional expenses using regression modelling based on ACARA data. The CGC has since revised this regression analysis in Staff Discussion Paper CGC 2014-03-S, *Update and Supplementary Issues for the 2015 Review*. New South Wales will comment on student loadings in its submission on the *Update and Supplementary Issues for 2015 Review* at a later date.

New South Wales notes that the Commission will not backcast changes in State resourcing models:

> Changes to States' own funding of schools are expected to result from the NERA funding arrangements, at least for some States. These changes are part of a major change in Commonwealth State relations. And we usually backcast such changes to make the GST distribution more contemporaneous. However, we have not backcast changes to State resourcing models. While we expect the pattern of national spending for schools to change under NERA, we

[37] *Commonwealth Budget Paper No 3: Federal Financial Relations, pp 36-37*

> do not have reliable information on the details of each State's new resourcing model, or the rate at which they are evolving. We have decided that what we observe historically is the only reliable measure of State spending patterns, although we intend to use the latest available ACARA data to recalculate student loadings for each update.[38]

New South Wales is unclear on what the Commission has determined to be 'average policy' and how this informs its assessment of States funded school expenses. Some States are signatory to NERA, and have therefore implemented a needs-based funding model, aligned to the SRS. In this case, all funding, both State and Commonwealth funding is based on NERA loadings, and the terms of reference require these loadings not to be unwound.

For those States that have not signed the NERA, previous State policies appear to remain for State funded expenses.

Commonwealth funded government school expenses

To meet the terms of reference of not unwinding the educational disadvantage embedded in the NERA funding arrangements the Commission proposes to assess the difference between what States actually receive and what they would have received had the Commonwealth funds been distributed among States only on the basis of the SRS amounts for different students and the numbers of such students in each State. The difference reflects factors such as different base funding, which the Commission believes should be the subject of equalisation.

The Commission proposes to backcast the assessment by modifying the relevant historical data to reflect changed funding arrangements in the application year. The Commonwealth Budget announcement to cease NERA/Students First funding in 2017 however, means that the 'average policy' of all States receiving additional funding will change part way through the 2015 Review methodology period, most likely for the 2018 Update.

The Commission says that it will continue to assess Commonwealth funding of government students based on the SRS amount until otherwise instructed by terms of reference.

New South Wales supports the terms of reference that the educational disadvantage embedded in the NERA should not be unwound. Additionally, New South Wales generally supports the standard approach for the Commission to backcast significant changes in Commonwealth-State relations.

[38] CGC, *2015 Review Draft Report*, p. 157

But given this unusual situation where backcasting to recognise a change will need to be subsequently backcast again to remove it from as assessment, it could be simpler if these changes were not backcast and relevant data flowed through the assessment naturally in the three year average. This would also be consistent with the treatment of State funded school expenses which the Commission is not proposing to backcast.

Post-secondary Education

Summary of changes since the 2010 Review

- Vocational education and training expenses previously recorded in Services to industry have been moved to this category.
- The assessment now recognises non-remote Indigenous and non-Indigenous people from low socio-economic backgrounds use post-secondary education services more.
- The differential use and cost of people who do not speak English at home is no longer assessed.

To account for State differences in socio-demographic composition, the Draft Report includes a number of placeholders that will be updated with State supplied data for 2010 to 2012 prior to the final report.

As a placeholder, the Commission have applied the same Indigenous cost weight of 30 per cent used in the 2010 Review.

The assessment also recognises that it is more costly to deliver services to students that attend remote institutions. As a placeholder, the same cost weight of 35 per cent used in the 2010 Review has been applied.

However, the Draft Report notes that the use rates for remote and non-remote people have changed. CGC analysis shows that from 2008 to 2010, people living in remote areas used post-secondary education services more than those in non-remote areas. This however, has changed and in 2011 and 2012, non-remote students used post-secondary education more intensely than remote students.

The assessment recognises that it is more costly to deliver services to students attending remote institutions. However, given the use patterns have changed, it is possible that the lower use and higher cost of remote students cancel each other out, similar to the 'healthy migrant effect' used to support the Commission's decision not to include a cost weight for people from non-English speaking backgrounds for the Health category. This issue should be re-examined prior to the final report to determine whether including the cost weight for remoteness is material.

New South Wales notes that the Commission does not consider that disaggregating remote areas by socio-economic status is warranted as analysis does not reveal a discernable pattern of usage for people from different socio-economic status regions who live in remote areas. New South Wales supports this approach.

The Draft Report proposed to assess all revenues generated from user charges equal per capita within the Other Revenue category. Subsequently, Staff Discussion Paper CGC

2014-03-S, *Update and Supplementary Issues for the 2015 Review*, has been released where staff propose to recommend the Commission net all post-secondary user charges off the post-secondary education expenses rather than assessing them in Other Revenue.

New South Wales will respond to this proposal in its submission on the *Update and Supplementary Issues for 2015 Review* at a later date.

Health

Summary of changes since the 2010 Review

- There is a single Health category and a direct method of assessment is used for all components, instead of the previous subtraction method. The impact of the private sector is assessed using economic environment factors.
- Category expenses are assessed net of user charges, because we have data on the net expenditure on different socio-demographic groups.
- Data on the use and cost of health service are source from IHPA instead of the AIHW.

New South Wales supports a single Health assessment category and a direct method for all components.

New South Wales considers that the economic environment factor should be removed from the assessment given the high degree of uncertainty on the appropriate level of substitutability.

This is illustrated in the large differences in the economic environment factor that has been proposed by Commission staff over the course of the 2015 Review (see Table 2).

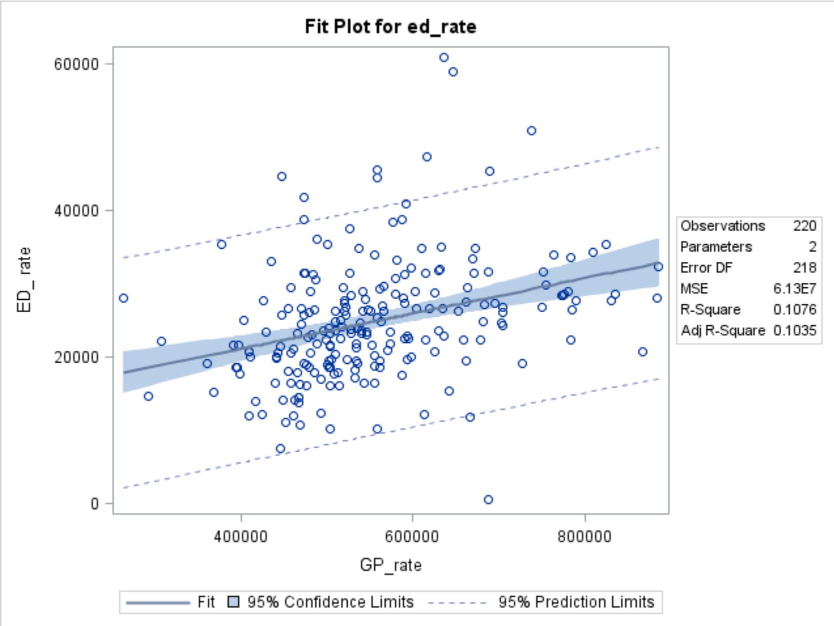
Table 2: Economic environment factor, staff proposals

Report on State Revenue Sharing Relativities, 2015 Review, Draft August 2014	Emergency Departments – 40 per cent Outpatients – 40 per cent Community health – 75 per cent
CGC Staff Telepresence Papers 3 April 2014	Emergency Departments – 25 per cent Outpatients – 25 per cent Community health – 50 per cent
Staff Discussion Paper CGC 2013-07S, Proposed Assessments, 2015 Review October 2013	Emergency Departments – 60 per cent Outpatients – 60 per cent

New South Wales has highlighted in previous submissions that the conceptual case for substitutability between Emergency Department and GP services does not hold given the above-average level of ED presentations and GP attendances in New South Wales.

Chart 4 based on national ED presentations and GP attendances in 2013-14 shows a positive correlation between both services in major cities. New South Wales considers that an inverse relationship would exist if the concept of substitutability held.

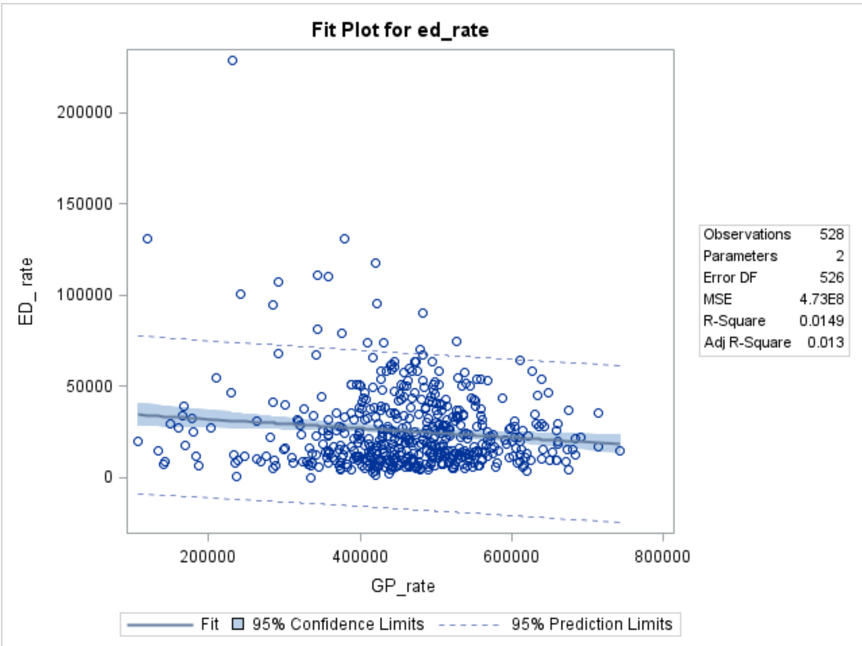
Chart 4: Substitutability of GP and ED services in major cities, 2013-14



Source: NSW Health

However, it appears that there may be some level of substitutability between GP and ED services in rural areas across Australia based on the inverse relationship in Chart 5.

Chart 5: Substitutability of GP and ED services in rural areas, 2013-14



Source: NSW Health

Standardised GP service data from the Public Health Information Development Unit, University of Adelaide, show that rural areas are less likely to have GP services than capital cities which may explain the difference between rural areas in the previous chart (see Table 3).

Table 3: GP services in capital cities and rural areas, 2013-14

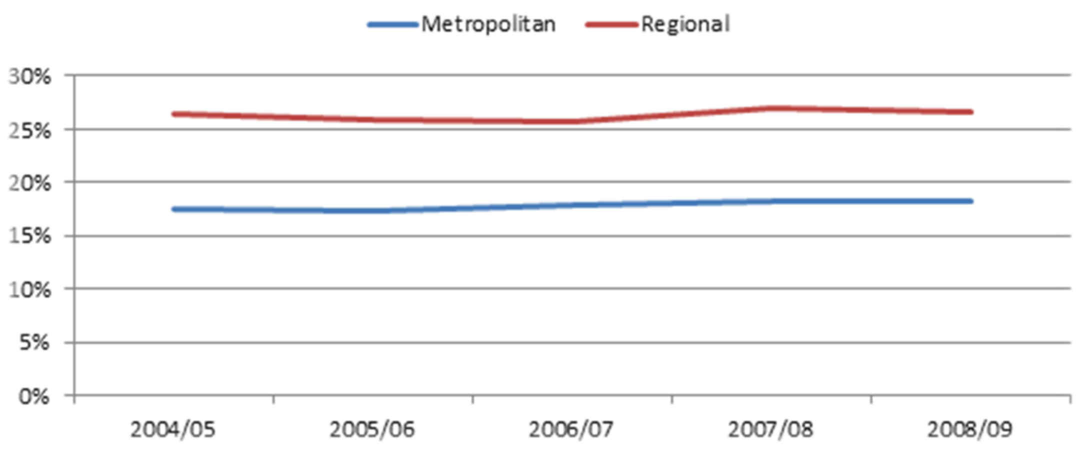
	Total GP services (Number)	Age standardized rate per 100,000	Standardised Ratio
Australia			
capital cities	79,245,594	569,028.8	104
rural areas	39,978,993	500,169.0	92
New South Wales			
capital cities	28,308,346	635,502.6	107
rural areas	13,601,464	499,494.0	92

Source: http://www.adelaide.edu.au/phidu/maps-data/data/

On the basis of the above, New South Wales considers that Commission should limit the economic factor for ED and GP to rural areas given that substitutability does not hold for major metropolitan areas.

NSW Health analysis of ED presentations in eight metropolitan and seven regional hospitals from 2004-05 to 2008-09 shows that the level of avoidable presentations is 18 per cent for metropolitan hospitals and 27 per cent in the case of regional hospitals (see Chart 6).

Chart 6: Avoidable presentations in NSW Emergency Departments



Source: NSW Health

The 40 per cent suggested in the Draft Report based on the ABS Patient Experiences Survey is considerably higher than the figures shown in Chart 6. The ABS survey found that 23 per cent of people that presented at an ED thought care could have been provided by a GP and 15 per cent of people cited that the time or day was the main reason for not seeing a GP.

New South Wales queries the addition of this 15 per cent which is most likely due to the lack of GP availability after hours. Its addition results in a larger economic environment factor and assumed level of substitutability despite the lack of available GP services. New South Wales suggests it should be excluded from the economic environment factor.

Notwithstanding New South Wales' objection to an economic environment factor, if the Commission were to include the non-State sector it should also include the impact of private hospitals which features prominently in Victoria and Queensland.

The report does not indicate the basis for the 75 per cent of substitutability assumed in community health, previously suggested to be around 50 per cent in the April 2014 Staff telepresence papers. New South Wales would like to understand the basis for this figure.

NSW Health indicates that the level of substitutability for community health is significantly lower for most services as indicated in Table 4 following consultation with senior health service managers from one of the largest Local Health Districts in NSW.

Table 4: Substitutability of services in community health

	NSW Public Health Provision	Private Provision
Community Health Centre Services		
Domiciliary nursing services	50%	50%
Well baby clinics		
12 months and under	90%	10%
12 months - 2 years	75%	25%
2 - 5 years	50%	50%
Dental health	10%	90%
Home nursing services	90%	10%
Community Health Centre programs	95%	5%
Family planning	5%	95%
Alcohol and drug rehabilitation	75%	25%
Public Health Services		
Organised immunisation	10%	90%
Health promotion	50%	50%
Screening programs		
StEPS - Statewide Eyesight Preschooler Program	70%	30%
SWISH - Statewide Infant Screening Hearing Program	98%	2%
OOHC - Out of Home Care Program	90%	10%
Well Baby Screening	see well baby clinics	
Communicable disease control		
Sexual Health STI's	80%	20%
Prevention of hazardous and harmful drug use	25%	75%
Mental Health Services		
Mental health services (community setting)	95%	5%

Source: NSW Health

NSW Health has indicated that the substitution between State-based mental health and private services within the community health component is minimal because of the vastly different patient groups and types of conditions that each sector predominantly provides care to.

The private sector (including GPs, psychologists and allied health providers) overwhelmingly focus on less severe disorders such as anxiety and affective disorders, and provide planned, non-emergency treatment for those disorders. State services provide outpatient care for more severe disorders (e.g. psychoses, severe mood disorders, personality disorders), as well as providing emergency outpatient (and inpatient) care for people with mood and anxiety disorders who are having acute crises.

In the specialist outpatient services, there is a small amount of substitutability with private psychiatrists, who provide some treatment of people with severe mood disorders and psychosis in that private psychiatry group, but only to a limited extent.

Overall, NSW Health has estimated that the substitutability factors to be negligible for state-based community mental health services and 10 per cent for specialist outpatient services.

In their 2014-15 Budget, the Commonwealth announced it will cease activity based funding in 2017-18 and index its hospital funding contribution by the CPI and population growth. The Commission may need to rely on the AIHW dataset in the absence of IHPA data from 2017-18.

The report proposes that the proxy for community health will be based on admitted triage ED levels 4 and 5. New South Wales considers that the non-admitted ED levels 4 and 5 are more reflective of the types of costs incurred by States in the provision of community health.

Welfare

Summary of changes since the 2010 Review

- New child protection unit record data are used which improves the reliability of the family and child welfare services assessment.
- As the Commonwealth has taken over State responsibilities in the areas of aged care services and disability services for older people, needs relating to welfare-related aged care services, including for Western Australia, are assessed EPC.
- During the National Disability Insurance Scheme (NDIS) transition period, the Commission will be adopting dual disability services assessments – one for NDIS services and one for existing disability services delivered under the National Disability Agreement. Both NDIS and existing disability services will be assessed using the population eligible for NDIS.
- All concessions other than transport concessions are included in the general welfare component and assessed using the number of concession card holders.
- The Staff Discussion paper (CGC 2014-03-S) notes that ABS's SEIFI will not be updated for the latest Census data and will not be used to assess the remainder of general welfare services as suggested in the report. The paper proposes that the proportion of families with dependants be used a broad indicator of disadvantage.
- The changes in Commonwealth–State arrangements affecting this category and associated Commonwealth payments are, or will be, backcast as required.

New South Wales supports the use of new child protection unit record data for family and community services expenses, noting that Indigenous client data is still being developed for New South Wales, Queensland and Western Australia.

The proposal for an EPC assessment of Western Australia's expenditure on aged care services and its receipt of Commonwealth aged care payments is supported given the change in Commonwealth-State responsibilities.

The dual assessment of NDIS and existing State disability services is a reasonable approach. New South Wales notes that the impact of this approach is not clear given that the illustrative impacts in the report are based only on existing disability services.

The report indicates that all concessions other than transport concessions are to be included in the general welfare component. New South Wales considers that concession expenses are partly driven by cost of living pressures and should be incorporated in the welfare assessment.

The report suggests that 'there is some evidence that higher cost of living may increase demand for State services…we conclude that, while the conceptual case is plausible, the absence of reliable data means we cannot reliably make an allowance for cost of living differentials.'[39]

However, in some cases the Draft Report makes an allowance, sometimes discounted in the absence of reliable data, for a number of assessments. These include cross border influences for welfare services, the application of the Rawlinsons Index to road construction costs and the use of police custody rates as an indicator of relative police workloads.

In the 2010 Review methodology, the CGC noted for interstate freight costs that although it could find 'no comprehensive, comparable data that would allow us to make a reliable policy neutral measure of the disabilities … we are convinced that a better equalisation outcome would be delivered by making an assessment than not.'[40]

New South Wales considers if the CGC consistently applied its criteria it should include a cost of living adjustment in the Welfare category.

The Draft Report indicates that the remainder of general welfare services will be assessed using relative State proportions of people in the bottom quintile of the ABS's Socio-Economic Index for Individuals (SEIFI). Staff have now learned that the ABS is not intending to update the SEIFI using 2011 Census data.

The Staff Discussion paper (CGC 2014-03-S) proposes that the proportion of families with dependants be used a broad indicator of disadvantage. New South Wales suggests that applying IRSEO/NISEIFA to the remainder of general welfare services as is the case for other categories such as admitted patients would be a more consistent approach.

The backcasting of Commonwealth–State arrangements affecting this category is supported.

[39] CGC*, 2015 review Draft Report,* p. 235.

[40] CGC*, 2010 Review, Volume 2,* p. 509.

Housing

Summary of changes since the 2010 Review

- The category now covers public non-financial corporation (PNFC) expenses and revenue as well as general government expenses and revenues.
- Gross expenses and revenue are assessed separately instead of net expenses.
- Census data on households in social housing cross-classified by income, Indigeneity and location are used to estimate assessed users instead of Commonwealth pensioner numbers classified by Indigenous status.
- Assessed rents are calculated by applying average rents paid by the different household groups to assessed users.
- First home buyer grants, bonuses and stamp duty concessions are consolidated in the Housing category and are assessed equal per capita (EPC).

New South Wales acknowledges the CGC's approach to include PNFCs in the assessment.

The separate assessment of gross expenses and revenue is reasonable given the Commission's decision to include housing PNFCs in the Housing category.

New South Wales acknowledges that a benefit of Census data is that it has fewer households with unknown Indigenous status than reported in the AIHW dataset.

New South Wales holds concerns about the discrepancies between both datasets which is not consistent between each State and the effect this will have on the proposed assessment (see Table 5).

Table 5: Census and AIHW data on social housing household numbers, June 2011

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
Census households (No.)	127,022	64,340	64,140	37,455	45,145	11,892	10,084	9,426	369,504
AIHW households (No.)	142,562	74,710	68,521	40,631	47,104	12,159	11,464	7,198	404,349
% difference	12.2	16.1	6.8	8.5	4.3	2.2	13.7	-23.6	9.4

Source: CGC, *Staff Discussion Paper CGC 2013-07S*, Table 15-6.

New South Wales supports the proposal to assess housing rents based on average rents paid by various household groups to assessed users, noting that this adjustment will address differences in rent collections between the states.

New South Wales considers that State policies on assistance to first home buyers now differ significantly between States and supports the report's suggested approach to assess these expenses on an EPC basis.

New South Wales considers that the low income sufficiently covers the SDC factor for the proposed housing category. The inclusion of location and Indigeneity increases the risk of double counting SDC cost components, particularly if the cost weight for Indigenous dwellings increases by 15 per cent to 40 per cent.

Services to Communities

Summary of changes since the 2010 Review

- A utilities subsidies assessment has been introduced, distinguishing between water and electricity subsidies for uneconomic services in remote small communities and for uniform tariffs and special projects. The former is assessed using the proportion of population living in small remote communities. The latter is assessed equal per capita (EPC)
- Small communities now cover those with populations between 50 and 1000 instead of 200 to 1000.
- Needs associated with water availability and quality are no longer assessed.
- A new definition of discrete Indigenous communities has been adopted.

New South Wales supports the merging of waste water and electricity subsidies in a single utilities subsidies assessment and supports an equal per capita (EPC) assessment of remote tariffs and special projects.

New South Wales agrees that the Commission no longer recognise that water availability and quality have an impact on water subsidies.

New South Wales considers that subsidies for uneconomic services in remote small communities, is a policy choice and should not be assessed. We do not support a differential assessment for this type of subsidy which is heavily influenced by State policy. The use of isolated population to determine the level of the general subsidy for electricity fails to consider the role of policy in determining the costs of electricity to more isolated communities.

Justice

> Summary of changes since the 2010 Review
>
> - The assessment method is unchanged.
> - There may be changes due to the new approach to measuring Indigenous and non-Indigenous socio-economic status and if new police offender data become available.

New South Wales notes there are no changes in methods proposed for the assessment of justice services expenses in the 2015 Review.

- The assessment will continue to be divided into police, courts and prisons components.
- Some sub-components – police services provided on a community-wide basis (50 per cent of total police expenses) as distinct from specialist police services principally devoted to the investigation of crime, and civil court expenses (40 per cent of total court expenses) as distinct from criminal court expenses – will continue to be assessed on an equal per capita basis.
- For differentially assessed components, age, sex, Indigeneity and socio-economic status will be used since males aged 15-34, Indigenous people and people in low socio-economic quintiles have above average rates for 'use' of police, court and prison services.
- Interstate wage and regional cost disabilities (using regional cost weights derived from police services for all components) will be assessed for all components; service delivery scale disabilities will be applied to police services and local courts; and national capital disabilities will be applied to police services for the Australian Capital Territory.

New South Wales notes the GST redistribution in this category may change considerably as a result of the new approach to measuring Indigenous and non-Indigenous socio-economic status (SES).

The illustrative GST impact contained in Table 17 (page 306) of the Draft Report is based on placeholder SES weights used in the 2010 Review calculated using the Socio-Economic Index for Areas (SEIFA).These weights were 1.5 for people in the most disadvantaged SES quintile, 1.0 for people in the middle three quintiles and 0.7 for people in the least disadvantaged quintile.

The CGC intends to calculate separate Indigenous and non-Indigenous SES weights using the Indigenous Relative Socio-Economic Outcomes Index (IRSEO) for

Indigenous people and the non-Indigenous Socio-Economic Index for Areas (NISEIFA).

Given the large redistributive impact on some States indicated in the illustrative GST redistribution – Victoria loses close to $600 million compared to an equal per capita distribution of GST payments – New South Wales recommends the CGC provide an updated indication of the redistributive effect of this change in method prior to final release of the 2015 Review report.

New South Wales questions the continued allowance for the Australian Capital Territory for the higher costs of using the Australian Federal Police (AFP) – which pays above average salaries – for its policing services. The CGC argues the Australian Capital Territory has 'no practical alternative but to use the AFP…'41 New South Wales considers that 25 years after self-government and with the example of the Northern Territory, which has its own police force, the Australian Capital Territory's continued use of the AFP is as much about policy as necessity. The AFP and State police forces operate independently in other jurisdictions.

New South Wales also questions whether civil court expenses should continue to be assessed equal per capita while criminal court expenses are assessed differentially. Just as there are factors that are identified as driving criminal court expenses – age, sex, Indigeneity and low SES – there may be factors – such as industry composition if certain industries are more litigious than others, or SES – that impact on relative costs of civil court cases. Table 6 suggests civil court expenses and activity are above national average per capita levels in New South Wales, Victoria, Western Australia and the Northern Territory. This issue could be explored in subsequent reviews.

Table 6: Civil courts, 2012-13: Expenses, lodgments and finalisations

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
Recurrent expenditure ($m)	186.6	127.5	57.4	59.7	29.6	7	12.2	10.9	490.9
% of total	38.0	26.0	11.7	12.2	6.0	1.4	2.5	2.2	100.0
Lodgments ('000)	172.5	118.9	68.6	60.8	34.5	9.3	4.7	7.3	476.6
% of total	36.2	24.9	14.4	12.8	7.2	2.0	1.0	1.5	100.0
Finalisations ('000)	175.2	126.3	68	60.8	31.9	10	4.7	7.7	484.6
% of total	36.2	26.1	14.0	12.5	6.6	2.1	1.0	1.6	100.0
Population ('000)	7,356	5,684	4,613	2,478	1,662	512	378	238	22,922
Per capita									
Recurrent expenditure, $	25.37	22.43	12.44	24.09	17.81	13.66	32.27	45.78	21.42
Lodgments per 1,000 people	23.5	20.9	14.9	24.5	20.8	18.1	12.4	30.7	20.8

41 *CGC, 2015 Review Draft Report, p. 296.*

Finalisations per 1,000 people	23.8	22.2	14.7	24.5	19.2	19.5	12.4	32.3	21.1

Sources: Productivity Commission, *Report on Government Services 2014*, Tables 7.1, 7.3 and 7.6, pp. 7.14-7.21.

Finally, the Commission notes it has not incorporated a disability to reflect costs associated with deploying personnel to patrol urban transport networks, since '[w]hile Victoria is in the process of establishing a sizeable security force for this purpose, other States' operations are on a significantly smaller scale.'[42]

New South Wales notes that under the new approach to average policy – where policy is deemed average if only one State provides a service, subject to the assessment having a material effect on the GST distribution – the test for inclusion of such a disability would be materiality rather than the number of States undertaking a service. Though the number of States undertaking a service may provide a rough indication of likely materiality, under the new approach materiality would need to be tested more rigorously.

[42] *CGC, 2015 Review Draft Report, p. 306.*

Roads

Summary of changes since the 2010 Review

- The assessment method is unchanged but ABS Urban Centres and Localities are used instead of Significant Urban Areas to distinguish between areas served by urban and rural roads.

New South Wales considers the present assessment method overestimates traffic volume and heavy vehicle expense needs of States with relatively lengthy road networks. Adjusting the assessment to relate traffic volumes and heavy vehicle use to States' road networks would in our view provide a more appropriate assessment outcome.

The current assessment redistributes substantial GST revenue from the smaller land area States to the larger States. Some redistribution may be justified given the larger per capita road lengths (particularly rural roads) of the larger States. However, this is accounted for in the road length component. The current assessment effectively assesses road length in the traffic volume and heavy vehicle road use components as well.

Traffic volume and heavy vehicle use

In both the rural and urban road components the CGC assesses factors for traffic volume and heavy vehicle road use. High traffic volumes increase the cost of providing and maintaining traffic control and safety equipment on roads; heavy vehicle use increases maintenance costs due to wear and tear on roads caused by heavy vehicles.

- Traffic volume measures the total distance travelled by all vehicles on a State's roads; it is measured as the number of vehicles using a State's roads multiplied by the distance travelled. The result is vehicle kilometres travelled (VKT) measured in kilometres.
- Heavy vehicle use measures the total tonnage hauled over the total distance on a State's roads; it is measured by applying Australian average gross mass (AGM) for various classes of heavy vehicle to the kilometres travelled by each class of heavy vehicle in each State. The result is average gross mass kilometres (AGM-km) measured in tonne kilometres (one tonne kilometre is equivalent to one tonne moved one kilometre).

The CGC does not relate the traffic volumes or heavy vehicle use occurring in each State to the length of roads in each State. Traffic volumes and heavy vehicle use are essentially assessed on a per capita basis. New South Wales considers that it is not traffic volumes and heavy vehicle use themselves that should be assessed since they place no direct costs on a State's population. It is the pressure that traffic volumes and heavy vehicle use put on a State's roads through the need for traffic control and safety and road maintenance that produces the cost to a State's population. That pressure cannot be assessed without reference to the size of the State's road network

For traffic volume, for example:

- 12 billion vehicle kilometres – 29.1 per cent of Australia's total – are travelled on NSW rural roads, and 5 billion vehicle kilometres – 11.6 per cent of Australia's total – are travelled on WA roads.[43]
- The CGC assesses New South Wales will have 29.1 per cent of the total traffic control and safety expenses on Australia's roads and Western Australia will have 11.6 per cent. (Those percentages are then adjusted for location, reflecting higher wages in some States adding to relative costs.)
- Those traffic volumes expenses are then related to population: New South Wales, with 32 per cent of Australia's population, is assessed to have a less than average per capita need to spend on rural traffic volume; Western Australia – with 11 per cent of Australia's population is assessed to have a higher than average per capita need to spend on rural traffic volume.

New South Wales considers the pressure that traffic volumes place on roads and the need for traffic control and safety equipment should be related to the size of the State road networks that bear the traffic volume load. The traffic volume in New South Wales occurs on a relatively smaller rural road network than in Western Australia. New South Wales considers that traffic volume per kilometre of road drives the relative need for spending on traffic control and safety.

- The 12 billion vehicle kilometres travelled on NSW rural roads takes place on a road network – measured by the consultants – of 25,238 km (summing major and minor mapped rural roads, or sealed and unsealed roads as assumed by the CGC and using the weighted road length), or 0.466 million vehicle kilometres travelled per kilometre of rural road.
- The 5 billion vehicle kilometres travelled on WA rural roads takes place on 18,940 kilometres of rural roads, or 0.247 million vehicle kilometres travelled per kilometre of rural road.

Tables 7 and 8 indicate the effect of relating rural traffic volumes to the size of rural road networks.

Table 7 shows the CGC's illustrative assessed expenses for rural traffic volumes from page 314 of the Draft Report, breaking down the steps in the assessment. State shares of rural traffic volumes are multiplied by the location factor to give adjusted State shares.

[43] CGC, *2015 Review Draft Report,* Table 8, p. 314.

The adjusted State shares of rural traffic volumes are then applied to total Australian rural traffic volume expenses. The resulting assessed expenses are rescaled to ensure that assessed expenses equal actual expenses to produce States' assessed rural traffic volume expenses. Assessed expenses are then divided by populations to produce assessed expenses per capita. (Numbers are slightly different from the CGC's due to the use of rounded/unrounded numbers.)

Table 7: Illustrative assessed expenses, rural traffic volumes, 2012-13[(a)]

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
Rural VKT (billion km)	12	10	9	5	4	1	0	1	40
State shares of rural VKT (%)	29.1	24.1	21.5	11.6	9.6	2.7	0.0	1.5	100.0
Location factor	1.005	0.988	0.989	1.036	0.988	0.977	1.028	1.041	1.000
Adjusted State shares of rural VKT (%)	29.2	23.8	21.3	12.0	9.4	2.6	0.0	1.6	99.9
Expense ($m)									970
Assessed expenses ($m)	283.5	230.8	206.7	116.2	91.6	25.2	0.0	15.2	969
Rescaled assessed expenses ($m)	283.7	231.0	206.8	116.3	91.7	25.3	0.0	15.2	970
Populations, 2012-13 ('000)	7,356	5,684	4,613	2,478	1,662	512	378	238	22,922
Assessed expenses per capita ($)	38.57	40.64	44.84	46.93	55.17	49.30	0.00	63.83	42.32

(a) Based on CGC, *2015 Review Draft Report*, Table 8, p. 314. Slight differences from Draft Report numbers due to use of rounded/unrounded numbers.
(b) State share of rural VKT multiplied by location factor.
(c) Rescaled to ensure that total assessed expenses equal actual expenses estimated by CGC using GFS and National Transport Commission data.

Table 8 shows the difference in the outcome when State rural traffic volumes are related to the size of State rural road networks.

In Table 8 a rural traffic volume factor is derived from the ratio of a State's average rural traffic volume per kilometre of rural road to the national average rural traffic volume per kilometre of rural road. Relatively higher average traffic volumes per kilometre of rural road could be expected to produce relatively higher traffic control and safety costs. State shares of rural traffic volumes are multiplied by the (rebased) traffic volume factor and the location factor to give adjusted State shares of national rural traffic volume. The remaining steps are the same as in Table 7.

Table 8: Illustrative assessed expenses, rural traffic volumes, 2012-13, adjusted for road network size

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
Mapped rural road length (km)[(a)]	25,238	14,614	25,774	18,940	10,426	2,534	6	9,133	106,663
Rural VKT (billion km)	12	10	9	5	4	1	0	1	40
State shares of rural VKT (%)	29.1	24.1	21.5	11.6	9.6	2.7	0.0	1.5	100.0
Rural VKT per km of mapped rural road (million km)	0.466	0.667	0.338	0.247	0.371	0.425	0.000	0.067	0.379
Traffic volume per kilometre factor	1.229	1.758	0.892	0.651	0.978	1.121	0.000	0.176	1.178
Rebased volume factor[(b)]	1.043	1.492	0.757	0.553	0.830	0.952	0.000	0.149	1.000
Location factor	1.005	0.988	0.989	1.036	0.988	0.977	1.028	1.041	1.000
Adjusted State shares of rural VKT (%)[(c)]	30.5	35.5	16.1	6.6	7.8	2.5	0.0	0.2	99.3
Expense ($m)									970.0
Assessed expenses ($m)	296	344	156	64	76	24	0	2	963
Rescaled assessed expenses ($m)[(c)]	298	347	158	65	77	24	0	2	970
Assessed expenses per capita ($)	40.50	61.01	34.15	26.11	46.09	47.22	0.00	9.58	42.32
Change from Table 1 assessed expenses per capita($)	1.93	20.37	-10.69	-20.82	-9.07	-2.07	0.00	-54.26	0.00

(a) Sum of mapped sealed (major) and unsealed (minor) roads from CGC, 2015 Review Draft Report, Table 6, p. 131. Weighted length is used, but the result is much the same if unweighted road lengths are used.
(b) The factor is rebased so that the Australian average equals 1.000.
(c) State shares of rural VKT multiplied by rebased volume factor and location factor.
(d) Rescaled to ensure that total assessed expenses equal actual expenses estimated by CGC using GFS and National Transport Commission data.

Table 8 shows that accounting for the pressure of traffic volumes on a State's road network produces a materially different result at a $10 per capita materiality threshold for four States. Even with a 50 per cent discount of the volume factor, the result would be materially different for three States at the $10 threshold.

The same applies for rural heavy vehicle use. New South Wales considers the costs of heavy vehicle use for a State depend on the weight/distance travelled by heavy vehicles on the State's roads rather than simply in relation to the State's population.

- Heavy vehicles travel 47 billion tonne-km – 28.2 per cent of the Australian total – on NSW rural roads, and 23 billion tonne-km – 13.7 per cent of Australia's total – on WA rural roads.

- Again disregarding the location adjustment, New South Wales is assessed to have 28.2 per cent of Australia's rural road maintenance cost due to heavy vehicle use – lower than its population share – and Western Australia is assessed to have 13.7 per cent – higher than its population share.

- However, related to rural road length, heavy vehicle use per kilometre of rural road is 54 per cent higher in New South Wales (1.867 million tonne-km per kilometre) than in Western Australia (1.214 million tonne-km per kilometre).

Tables 9 and 10 illustrate the variation in assessed rural heavy vehicle use expenses when account is taken of rural heavy vehicle use per kilometre of State rural roads.

Table 9 shows the CGC's illustrative assessed expenses for rural heavy vehicle use from page 315 of the Draft Report, breaking down the steps in the assessment. State shares of rural heavy vehicle use are multiplied by the location factor to give adjusted State shares. The adjusted State shares of rural heavy vehicle use are then applied to total Australian rural heavy vehicle expenses. The resulting assessed expenses are rescaled to ensure that assessed expenses equal actual expenses, to produce States' assessed rural heavy vehicle use expenses. Assessed expenses are divided by populations to produce assessed expenses per capita. (Numbers are slightly different from the CGC's due to the use of rounded/unrounded numbers.)

Table 9: Illustrative assessed rural heavy vehicle use expenses, 2012-13[(a)]

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
Populations, 2012-13 ('000)	7,356	5,684	4,613	2,478	1,662	512	378	238	22,922
Rural AGM-km (billion tonne-km)	47	35	37	23	18	4	0	3	167
State shares of rural AGM-km (%)	28.2	21.1	21.9	13.7	11.0	2.4	0.0	1.6	100.0
Location factor	1.005	0.988	0.989	1.036	0.988	0.977	1.028	1.041	1.000
Adjusted State shares of rural AGM-km (%)[(b)]	28.3	20.8	21.7	14.2	10.9	2.3	0.0	1.7	100.0
Expense ($m)									998
Assessed expenses ($m)	282.7	208.0	216.3	142.2	108.8	23.0	0.0	17.1	998
Rescaled assessed expenses ($m)[(c)]	282.6	208.0	216.3	142.1	108.8	23.0	0.0	17.1	998
Assessed expenses per capita ($)	38.42	36.60	46.89	57.35	65.47	44.96	0.00	71.82	43.54

(a) Based on CGC, *2015 Review Draft Report*, Table 9, p. 315. Slight differences due to use of rounded/unrounded numbers.
(b) State share of rural AGM-km multiplied by location factor.
(c) Rescaled to ensure that total assessed expenses equal actual expenses estimated by CGC using GFS and National Transport Commission data.

Table 10 shows the difference in the outcome when State rural heavy vehicle use is related to the size of State rural road networks.

In Table 10 a rural heavy vehicle use factor is derived from the ratio of a State's rural heavy vehicle use per kilometre of rural road to the national average rural heavy vehicle use per kilometre of rural road. Relatively higher heavy vehicle use per kilometre of rural road could be expected to produce relatively higher rural road maintenance and rehabilitation expenses. State shares of rural heavy vehicle use are multiplied by the (rebased) heavy vehicle use factor and the location factor to give adjusted State shares of national rural traffic volume. The remaining steps are the same as in Table 9.

Table 10: Illustrative assessed rural heavy vehicle use expenses, 2012-13, adjusted for rural road network size

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
Mapped rural road length (km)[a]	25,238	14,614	25,774	18,940	10,426	2,534	6	9,133	106,663
Rural AGM-km (billion tonne-km)	47	35	37	23	18	4	0	3	167
State shares of rural AGM-km (%)	28.2	21.1	21.9	13.7	11.0	2.4	0.0	1.6	100.0
Rural AGM-km per km of mapped rural road (million km)	1.867	2.414	1.422	1.214	1.770	1.560	0.000	0.301	1.567
Heavy vehicle use per kilometre factor	1.191	1.540	0.907	0.774	1.129	0.995	0.000	0.192	1.137
Rebased heavy vehicle use factor[b]	1.048	1.355	0.798	0.681	0.994	0.875	0.000	0.169	1.000
Discounted heavy vehicle use factor	1.048	1.355	0.798	0.681	0.994	0.875	0.000	0.169	1.000
Location factor	1.005	0.988	0.989	1.036	0.988	0.977	1.028	1.041	1.000
Adjusted State shares of rural AGM-km (%)[c]	29.7	28.2	17.3	9.7	10.8	2.0	0.0	0.3	98.1
Expense ($m)									998.0
Assessed expenses ($m)	296	282	173	97	108	20	0	3	979
Rescaled assessed expenses ($m)[c]	302	287	176	99	110	21	0	3	998
Assessed expenses per capita ($)	41.06	50.57	38.16	39.84	66.34	40.14	0.00	12.39	43.54
Change from Table 3 assessed expenses per capita($)	2.64	13.97	-8.73	-17.51	0.87	-4.82	0.00	-59.43	0.00

(a) Sum of mapped sealed (major) and unsealed (minor) roads from CGC, 2015 Review Draft Report, Table 6, p. 131. Weighted length is used though results would be broadly similar if unweighted lengths were used.
(b) The factor is rebased so that the Australian average equals 1.000.
(c) State shares of rural AGM-km multiplied by rebased heavy vehicle use and location factors.
(d) Rescaled to ensure that total assessed expenses equal actual expenses for rural heavy vehicle use estimated by CGC using GFS and National Transport Commission data.

Table 10 shows that accounting for the pressure of heavy vehicle use on a State's road network produces a materially different result at a $10 per capita materiality threshold for three States. Even with a 50 per cent discount of the heavy vehicle use factor, the result would be materially different for one State at the $10 threshold.

For urban traffic volumes and heavy vehicle use the outcomes adjusted for urban road networks sizes are not as marked, though undiscounted an adjustment for urban road length in relation to urban traffic volumes would be material for one State at the $10 materiality threshold.

This is because State shares of urban traffic volumes and heavy vehicle road use are not as different to State shares of urban road length as State shares of rural traffic volumes and heavy vehicle road use are to State shares of mapped rural road lengths (see Table 11). State shares of urban road length also are not as different to State shares of total population as are State shares of rural road length.

Table 11: State shares of rural and urban road lengths, traffic volumes and heavy vehicle road use

	NSW %	Vic %	Qld %	WA %	SA %	Tas %	ACT %	NT %	Total %
Rural traffic volumes	29.1	24.1	21.5	11.6	9.6	2.7	0.0	1.5	100.0
Rural heavy vehicle use	28.2	21.1	21.9	13.7	11.0	2.4	0.0	1.6	100.0
Rural road (weighted) length	23.7	13.7	24.2	17.8	9.8	2.4	0.0	8.6	100.0
Urban traffic volumes	30.5	26.3	21.3	11.1	5.9	2.0	2.1	0.7	100.0
Urban heavy vehicle use	32.7	23.5	23.8	10.8	5.6	2.0	0.8	0.8	100.0
Urban road length (proxied by urban populations)	31.6	25.9	20.5	10.7	7.0	1.6	2.1	0.7	100.0
Total population	32.1	24.8	20.1	10.8	7.3	2.2	1.6	1.0	100.0

Sources: CGC, *2015 Review Draft Report*, Tables 6, 8, 9, 11, 12 and 13, pp. 313-317, and Table 1, p. 507.

We have no data for urban road lengths considered by the CGC to be non-policy influenced. As a proxy for urban road lengths the CGC uses urban populations in locations with populations of 40,000 or above.

The CGC has noted in the past that, conceptually, measuring the effect of heavy vehicle road use on road maintenance costs using the frequency of application of loads over a length of road has merit.[44] New South Wales considers the same applies to traffic volumes. However, the CGC concluded that States cannot provide data on road lengths classified by traffic volume and that data would be critical to developing an assessment recognising the impact of traffic volumes and heavy vehicle road use over lengths of road.

New South Wales considers that using averaged data in this assessment to relate rural traffic volumes and heavy vehicle road use to the size of State rural road networks would provide a better equalisation outcome.

[44] CGC, *2010 Review, Volume 2,* p. 350.

Unrecognised road maintenance expenses

The draft report notes some States' claims that there are unrecognised road maintenance costs resulting from road networks between mines, associated infrastructure and mining communities that connect localities to less than 400 people and are not therefore captured in the rural road length algorithm. The CGC has requested information from states to enable it to develop an adjustment to the roads assessment.

New South Wales recommends the CGC not assess perceived unrecognised road maintenance costs unless the CGC is able to use a reasonable and consistent approach.

The CGC is seeking data from states relating to rural roads used for economic purposes. This data will supplement the CGC's synthetic road lengths data in assessing the rural roads component. However state policies may differ on the classification of roads, where they are built and allocation of responsibility for such roads between State and local governments. State policies may also differ on whether roads dedicated to particular mines or economic centres are funded by the state or mining companies/other economic beneficiaries. For such reasons the CGC does not use State-provided road length data. It should be careful in using State-provided road length data for some road types and not others.

New South Wales considers all roads should be treated consistently in the CGC's assessment. All States probably would be able to nominate many roads with useful economic and social purposes that are currently not picked up in the consultant's mapping algorithm because they do not connect localities with more than 400 people. Such roads may service other forms of economic activity, such as tourism, creative industries, agriculture or mineral exploration, in addition to established mines. There should be no discrimination between roads based on the 'value' of economic activity (such as mining) that the road supports.

Geography

The CGC will use the ABS's Urban Centres and Localities (UCLs) to define urban areas and populations in the Roads category rather than the ABS's Significant Urban Areas (SUAs) it currently uses. UCLs capture less of the surrounding hinterland of urban areas, which the CGC considers more appropriate for determining urban boundaries for the urban and rural road length factors.

New South Wales notes that the change will impact:

- **Urban road lengths:** In the 2010 Review, urban road lengths were calculated using the proxy of urban population, i.e., population within localities of 40,000 people or more. The change to UCLs may result in a material difference in the size of the urban population and urban road lengths.

- **Rural road lengths:** The length of rural roads could alter due to the change in boundaries between urban and rural areas and the need to recalculate the rural road length algorithm based on the new urban/rural boundaries.

In effect, all other things being equal, one would expect the 'length' of urban roads to decline and the length of rural roads to increase as the urban/rural divide contracts toward the centre of urban areas.

The CGC will need to ensure that the change occurs in an integrated and consistent way. If this is not the case a potentially material change may alter the GST revenue distribution for no reason other than a definitional change.

New South Wales notes also that using UCLs will not be possible in calculating the urban and rural road use factors, since those calculations use data not available on a UCL basis. The road use factors will be inconsistent with the road length factors.

The CGC believes the effect on the assessment will be 'minor'. New South Wales would be interested in further information concerning the impact of this inconsistency and the impact of the definitional change before the final report is released.

Transport

Summary of changes since the 2010 Review

- The category now covers public non-financial corporation (PNFC) expenses and revenues as well as general government expenses and revenues, resulting in an increase in total expenses.
- The CGC refined the regression model underpinning the urban net expenses assessment and used new data in the regression.
- A regional cost assessment has been added to the non-urban expenses assessment, which is otherwise unchanged.

The Commission has decided to treat the provision of transport services, including those provided through PNFCs, as a general government function. The Commission's thinking is that transport services have few commercial features. They depend on government funds to meet operating costs and pay for major investments; the services stem from social policy objectives; and government departments make the policy on service delivery charges.

New South Wales has expressed general concern with the expansion of HFE beyond the general government operating balance. Specific to the Transport assessment, expanding the coverage of HFE to include PNFC expenses and revenue introduces complexity. As the Draft Report notes, States differ considerably in the way they provide transport services. There is a mix of direct general government provision, local government operation and service delivery through PNFCs or contracting with private providers. Possibly, the differences between transport service delivery models of States are a policy decision.

Net urban operating expenses

The Commission has used a regression analysis to estimate a relationship between per capita spending in cities with population over 20,000 and the logarithm of those cities' populations. The Commission has included all cities with population over 20,000 regardless of whether States were funding transport services or not.

New South Wales notes that urban centres may not represent populations serviced by urban transport networks, but this is a policy neutral measure.

New South Wales supports the assessment approach which recognises that the cost of State provided urban passenger transport services increases with urban centre population size. Evidence shows that the transport task increases with population, and the Draft

Report notes that consultants engaged by the CGC confirm that this is the right approach.

To account for the diverse ways in which urban transport services are provided, urban centres that do not have State provided or subsidised urban transport services were given a net operating expenses value of zero. The CGC states that this better reflects what States do.

New South Wales would have preferred that the approach recognised the much higher costs associated with heavy rail consistent with the principle of 'what States do'. Some cities need to provide rail to transport large populations in urban areas. However, even though the presence of rail was found to be a significant variable, the Commission has excluded it from the assessment on grounds of simplicity and policy neutrality, asserting that State policy on when rail is introduced has an influence.

We would argue that large cities cannot function efficiently without rail transport. The existence of rail transport in turn supports higher urban densities which in turn results in higher land valuations. For consistency, the Commission should assess the cost along with the higher revenue raising capacity it results in, for example, transfer duty and land tax.

Overall however, New South Wales supports the assessment method and agrees that no recognition of regional costs is required as they are already captured in the regression model.

Non-urban subsidies

New South Wales notes that the CGC proposes to assess non-urban operating subsidies based on the proportion of State populations that live outside capital cities.

Differences in wage costs between States are taken into account along with a new regional cost disability has been included to recognise that distance between population centres increases costs.

Services to Industry

Summary of changes since the 2010 Review

- No discount is applied in this category.
- The assessment now includes a separate assessment of regulatory expenses for the mining industry.
- Vocational education and training expenses previously included in this category are now in Post-secondary education.

The overall method of assessing services to industry expenses is unchanged from the 2010 Review methods, though two important changes in the detail are proposed. New South Wales does not support:

- the removal of the 12.5 per cent discount to the expenses weights currently used in the assessment, since the expense weights themselves are rendered uncertain at two points and it is not clear that this uncertainty has been otherwise allowed for
- the separate assessment of mining regulation expenses unless the sub-component properly meets the required materiality test.

Expenses on services to industry are assessed in two main components.

- Regulatory expenses account for about 40 per cent of total category expenses. Examples of expenses included are business registration, trade licensing, building codes, food and health standards, consumer protection, occupational health and safety, and retail trading. These expenses are assessed differentially.
- Business development expenses cover the remaining 60 per cent of expenses in the category. Expenses in this component can take many forms including marketing, tourism promotion, and industry research and development. This component of expenses is assessed equal per capita – with no impact on the GST distribution – since State policies vary greatly and there are no clear drivers of spending.

The regulatory expenses component is disaggregated into three sub-components:

- agriculture regulation
- mining regulation
- other industries regulation.

The regulatory expenses for each sub-component are then split into two or three sub-sub-components based on the extent to which the expenses are affected by:

- the level of activity for the industry
- the number of businesses for the industry or

- the size of the population.

Overall expenses for the category are based on ABS Government Financial Statistics, which also provides a broad breakdown into the industry sub-components. From that point on State provided data from a survey conducted for the 2010 Review becomes important.

The need for discount

New South Wales considers the survey undertaken by the CGC for the 2010 Review does not provide an unequivocally reliable basis for disaggregating total expenses. Services to industry expenses are spread across a large number of agencies in all States. It is not clear that the 'survey' conducted by States covered all relevant agencies in all States or that agencies/States attributed comparable and consistent meanings to terms used in the survey.

Consequently, the weightings States attributed to services that are regulatory or industry development varied considerably, such that spending some States considered was regulatory other States considered industry development. There were substantial differences across the States in nominating the main drivers – 'sector size/activity', 'number of businesses' or 'other factors' – to different items of regulatory spending.

The CGC applied a 12.5 per cent discount to the average proportion of expenses affected by the level of business activity and the number of businesses, with the proportion of expenses affected by population correspondingly increased.

New South Wales does not consider 'the Commission's decision not to discount estimates of total national expenditure' provides a justification to remove the discount.[45] The CGC considers:

> … we should not discount the best available estimates of national spending, such as those derived from ABS Government Finance Statistics. Nor should we discount a judgment based estimate, say the proportion of expenses to which a disability should be applied, because it is the best available and already incorporates any necessary allowance for uncertainty.[46]

While, the estimate of total national expenditure in this assessment comes from GFS, the estimates of proportions of that expenditure allocated to regulatory expenses comes from the survey data, and the further estimate of the proportions of regulatory expenditure allocated to activity, number of businesses or population also is based on unreliable survey data.

[45] CGC, *2015 Review Draft Report,* p. 352.

[46] CGC, *2015 Review Draft Report,* p. 33.

New South Wales considers the 12.5 per cent discount should remain in place. The assessment contains two levels of uncertainty for which no evidence is presented that there is any 'necessary allowance'.

Mining sub-component not material

The CGC proposes a separate mining industry sub-component for regulation expenses, in addition to sub-components for agriculture and other industries.

This is despite the mining industry sub-component not moving $30 per capita for any State, the CGC's proposed materiality threshold for the assessment of disabilities (though this can be aggregated across categories). The CGC says inclusion of the separate assessment is justified 'on the assumption that in aggregate, mining related expenditure assessments across all categories may be material. We will review the materiality of all mining related expenditure assessments for the final report.'[47]

New South Wales disagrees with the interpretation the CGC gives to the aggregation of a disability across categories. We consider that if the 'mining regulation' sub-component does not redistribute more than $30 per capita or more of itself it cannot be aggregated with 'mining related expenditure assessments' across other categories to reach the materiality threshold.

Aggregating GST redistribution effects across categories is usually applied to 'generic' disabilities that are perceived as affecting a number of spending areas.

- The interstate wages disability – differing wage levels for similar employees across States for reasons other than State policy – impacts on wages paid to employees across a broad range of expense categories.
- The regional costs disability – perceived higher costs of providing services in regional and remote areas due to the need to pay higher wages, use more non-labour inputs, or freight in non-labour inputs – is thought to increase costs across a broad range of expense categories.
- The service delivery scale disability – perceived higher costs due to relatively higher staffing levels in providing services in small isolated communities – is thought to increase costs across a broad range of services.

The economic regulation of the mining industry – with expenses driven by the size of the mining industry, the number of mining businesses, or population – is not a 'generic' disability. Expenses associated with regulation of the mining industry are classified by States according to Government Finance Statistics definitions to the particular GFS categories included in this CGC expense category. 'Mining related' expenditure classified by States to other GFS categories, and included in other CGC expense categories, is not

[47] *CGC, 2015 Review Draft Report, p. 344.*

likely to include spending the primary purpose of which is to regulate the mining industry.

New South Wales doubts that 'other mining related expenditure' would be affected by disabilities related to the extent of mining activity or the number of mining businesses being considered in this assessment.

If related to social infrastructure – the provision of schools, police stations, health services and so on – in mining communities, expenses will have been classified in other categories because they are primarily related to the provision of those broader services rather than any particular industry.

If related more specifically to a mine – the provision of economic infrastructure such as a road or railway – it is more related to economic or business development than to mining regulation. Business development expenses are assessed equal per capita and have no impact on the GST distribution.

Other Expenses

Summary of changes since the 2010 Review

- The impact of cultural and linguistic diversity (CALD) on State expenses is no longer assessed.
- Administrative scale, native title and land rights and some National capital assessments have been relocated from other categories.

New South Wales does not agree with the CGC's decision to no longer assess the impact of cultural and linguistic diversity on State expenses. We contrast the CGC's decision in this instance to no longer assess a disability, though the conceptual case is accepted, given the lack of data on which to base a definitive assessment, with its decisions in other instances – administrative scale, cross-border effects, regional costs – to make assessments based on judgment in the absence of data on which to makes definitive assessments.

New South Wales notes the inclusion of assessments for administrative scale, native title and land rights and some national capital effects have been relocated to Other Expenses from other assessments.

We note this relocation has no effect on the overall distribution of GST revenue payments between the States.

New South Wales continues to have concerns with the conceptual cases and reliability of the assessments for administrative scale and National Capital influences. These concerns are discussed in the section on Administrative Scale and Other Disabilities respectively.

New South Wales notes also that the cross border effects included in this category relate to expenses on the ACT library, sportsgrounds and other cultural and recreational services that are argued to be increased because of cross-border use by New South Wales residents. The CGC notes cross-border disabilities have been applied in this category to 'expenses related to culture and recreation, which include expenses on libraries, swimming pools, public halls, civic centres, museums and art galleries.'[48]

New South Wales notes that in New South Wales and other States many of these facilities are provided by local government. We question the need to include in this assessment an adjustment for expenses that are undertaken by the Australian Capital Territory in its capacity as local rather than State government.

[48] *CGC, 2015 Review Draft Report, p. 357.*

We note that the ABS Government Financial Statistics includes ACT municipal transactions with State transactions, and that the CGC does not remove ACT municipal transactions because the effect of including them on the relativities is immaterial.[49]

However, most revenue and expenses related to ACT municipal-type transactions (such as ACT rate revenue on the revenue side and expenses on municipal services on the spending side) is included in Other Revenue, which is assessed equal per capita, and Other Expenses, which also is assessed mostly equal per capita in the service expenses component.

Explicitly assessing a cross-border effect for the provision of ACT municipal-type services to New South Wales residents means this aspect of ACT expenses is, in NSW view inappropriately, no longer assessed equal per capita. While the effect is small, it is, according to Table 11 (page 362) of the Draft Report, material for the Australian Capital Territory at the $10 per capita materiality threshold.

[49] *CGC, 2010 Review, Volume 2, p. 4.*

Infrastructure Assessments

Summary of changes since the 2010 Review

- Infrastructure used in providing urban transport and housing services is included in the general government infrastructure stocks.
- The quantity of infrastructure stock disabilities are calculated by combining the factors affecting the use of each service using the average proportion of infrastructure devoted to the service.
- Factors affecting recurrent service use but which do not affect infrastructure requirements are explicitly excluded from the infrastructure calculations and the 12.5% discount has been deleted.
- Capital cost disabilities are measured by reference to construction cost indices, discounted by 50% for roads and urban transport and 25% for other services.

New South Wales notes that the direct assessment of capital needs will be retained. New South Wales has outlined its position in favour of the holding cost approach in previous submissions to the Commission.

New South Wales acknowledges the proposal to include urban transport and social housing in the assessment of general government infrastructure stocks. New South Wales outlined concerns in its second submission about the broadening of HFE with the inclusion of PNFCs.

New South Wales supports the exclusion of recurrent disability factors that have minimal or no effect on the quantity of infrastructure. However, a discount should apply to the recurrent disabilities because they are not an accurate measure of capital needs and form part of a very large assessment.

The use of a construction cost index is not a significant improvement on the current approach and is not supported. The construction cost indices do not adequately capture the key cost drivers relevant to government infrastructure. The Rawlinsons Capital City Index does not include the cost of roads, bridges, hospitals and school buildings.

In addition, building regulation and design features stipulated by State Government authorities may contribute to interstate differences in construction costs despite the Building Code of Australia (BCA).

New South Wales considers that applying a regional loading to a capital city index may not be sufficiently accurate. For example, the construction of cottage style social housing in regional areas is much cheaper compared to the more costly forms of construction such as townhouses in densely populated parts of inner-Sydney.

Wages Costs

Summary of changes since the 2010 Review

- There have been no method changes in this assessment.
- The assessment will be reviewed when new ABS Characteristics of Employees data become available (expected prior to the 2016 Update).

New South Wales agrees that private sector wage differentials between States are an appropriate proxy for measuring differences in public sector wages. We consider there is a relationship between public sector and private sector wages which holds in the long term. The analysis of trends in ABS Average Weekly Earnings (AWE) and Survey of Education and Training (SET) data provided in the Draft Report support this view.

New South Wales notes that the CGC has deferred a number of decisions on this assessment until data from the new ABS Characteristics of Employees survey is available. These decisions include simplification of the assessment through possibly reducing the number of variables in the regression model, use of private sector capital city rather than whole of State wages and the need for discounting. At present 2009 SET data is used and updated using ABS's Labour Price Index (LPI).

In principle, New South Wales supports simplification of the current regression model, noting that there are currently 219 variables, and consideration of the question of whether all the variables currently standardised *should* be standardised.

In principle, New South Wales also supports assessing interstate wage differences using private sector capital city wages as a proxy for public sector wages. New South Wales considers that, provided data of sufficient quality is available, using private sector wage differentials in wages paid in capital cities as the proxy for public sector wage differentials between States make sense since capital city wages exert a strong influence on public sector wages across States.

Use of capital city wages also would solve a potential double counting issue if the need to pay higher wages in regional areas is reflected in both this assessment and the regional costs assessment.

Unless the regression model controls for the geographic dispersion of private sector employment, the whole of State wage data presumably reflects any regional wage pressures that may exist. Whole of State wages levels would be more affected in States where regional employment is a higher proportion of total employment than average. However, any adjustments for regional wages are also assessed in the regional costs assessment. Controlling for workforce differences such as industry structure and occupation may remove some of this influence from the interstate wage costs assessment to the extent that industries/occupations are regionally biased, but some potential double counting might remain.

New South Wales notes that for the time being the CGC proposes to continue with a 12.5 per cent discount to this assessment reflecting 'a low level of uncertainty around whether the SET data are sufficiently reliable, the econometric model controls for all relevant factors and that private sector wages are a good proxy for the pressures on public sector wages.'[50]

If this level of discount is considered appropriate for this assessment, New South Wales considers at least a similar level of discount should be applied in the administrative scale assessment. In our view the uncertainties around whether the currently used data in that assessment are sufficiently reliable, are a good proxy for administrative scale costs, and whether the econometric model used to support the current quantum of costs is based on appropriate data are much higher than the uncertainties in the interstate wages assessment.

New South Wales notes that data is not currently available on the wages paid by State owned public non-financial corporations as part of bringing the activities of transport and housing public non-financial corporations within the scope of equalisation. New South Wales would be interested in an analysis of the outcomes of incorporating this data prior to the release of the final report.

[50] CGC, *2015 Review Draft Report*, p. 413.

Regional Costs

Summary of changes since the 2010 Review

- Remoteness is now assessed on the basis of ABS remoteness areas rather than SARIA.
- For categories, other than Justice, where a regional cost disability is assessed, the gradient has been based on the output from the regression analysis of ACARA data.

The Regional costs disability recognises that differences in the costs of delivering services can vary between regions. Conceptually, the Commission believes the cost of delivering services increases with remoteness.

The Commission have captured these Regional costs directly for Schools education and Justice. But for other categories, a cost factor is applied using the output from the regression analysis of ACARA (school) data. A low level discount (of 12.5 per cent) will be applied.

Econometric model

Since the release of the draft report, the Commission has received the report from the consultant engaged to examine econometric modelling used to estimate differences in spending of students with difference characteristics using ACARA data. 2012 ACARA data has also been received.

New South Wales is concerned by changes to the model resulting in largely offsetting changes to the loadings for Indigenous and remote students. NSW will address this issue in its response to the *Update and Supplementary Issues for 2015 Review* at a later date. However, we note the CGC explains that:

> We understand that whether the high costs for remote Indigenous students are allocated to Indigeneity or remoteness is sensitive to the exact specification of the model. We would be interested in any information on whether that way the current model allocates these costs is consistent with State experience.[51]

This identification of remote costs compared to Indigenous costs is important to identify so that the model properly reflects school service costs. However, this could differ for other services.

[51] CGC, *Update and Supplementary Issues for the 2015 Review*, Staff Discussion Paper CGC 2014-03-S, page 2.

Extrapolation to other categories

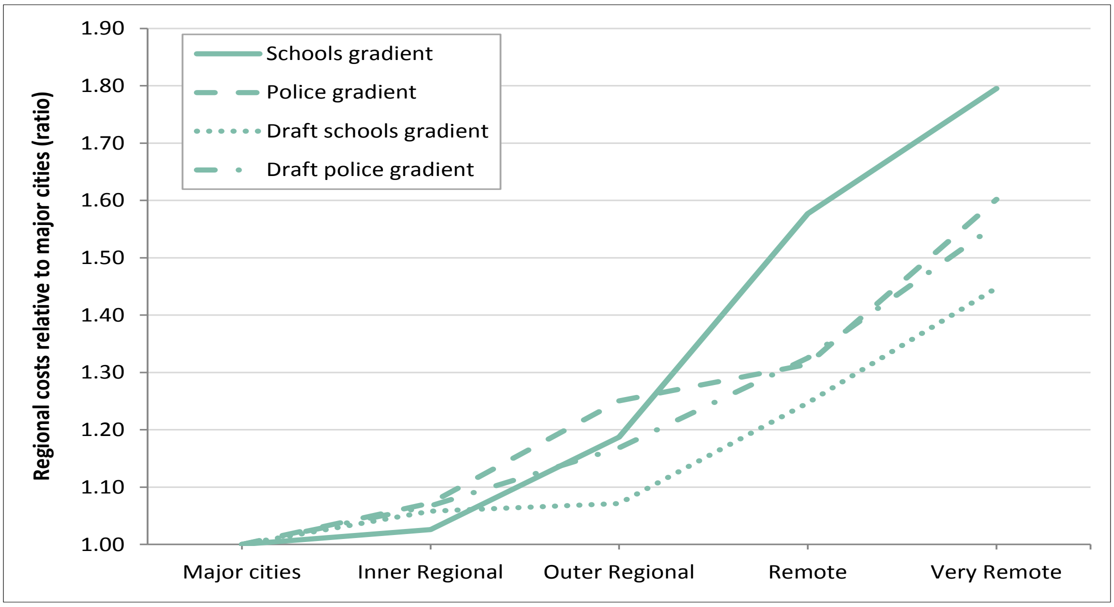
The extrapolation of the Schools regional cost gradient to other expenses continues to cause concern. As previously submitted, even if the schools cost gradient calculated from the regression was totally reliable, its extrapolation to other services assumes that:

- the regional cost differential applicable to labour and other inputs in the delivery of school education and equally applicable to other services and
- the delivery of other services requires the same combination of inputs of labour and non-labour inputs as does the delivery of school services.

These assumptions have not been supported by evidence. As a consequence, New South Wales believes that, if this cost gradient is to be extrapolated to other assessment at all, at least a medium level discount of 25 per cent should be applied to the regional cost factor applied to other expense categories.

Since the release of the draft report, CGC staff have undertaken further analysis of the extent of the impact of moving to an ABS remoteness area geography and have also updated both the police and schools regional cost gradients, as shown in Chart 7 below.

Chart 7: Schools and police regional cost gradients for the 2015 Review[52]



[52] CGC, *The GST Impact of Using ABS Remoteness Areas in Place of SARIA for the Regional Costs Assessment*, Figure 1, p2.

Service Delivery Scale

Summary of changes since the 2010 Review

- Output from the regression analysis of the ACARA data has been used to assess Service delivery scale disabilities in Schools education.
- The assessment of Service delivery scale for housing and community health expenses, as well as for welfare services, with the exception of family and child expenses, has ceased.

The service delivery scale (SDS) assessment is meant to assess diseconomies in the provision of certain services to small isolated communities due to relatively higher staffing levels in those communities. The higher staffing levels reflect the indivisibility of labour (for example, higher staffing levels are needed in smaller schools since class sizes will be smaller) or unproductive travel time (for example, police must travel larger distances between incidents in isolated areas).

The CGC proposes to assess service delivery scale disabilities in a number of assessments:

- Schools, using data from the Australian Curriculum, Assessment and Reporting Authority (ACARA) *My School* website to calculate a school SDS weight which will be applied to SDS influenced students defined as students attending government schools in areas located more than 50 kilometres from an urban centre of 5,000 people or more
- the police and magistrates courts components of Justice, using police staffing by location data available from some States in the 2010 Review to calculate an SDS scale influenced police staffing to client ratio to clients in SDS influenced areas (defined as in the Schools assessment)
- the family and child services component of Welfare, using the SDS factor calculated in the Justice assessment for police services.

The CGC proposes to continue the 12.5 per cent discount for the SDS factors applied for police and magistrates courts and family and child services, reflecting the lack of comprehensive and up-to-date data available, and uncertainties regarding the comparability of police staffing data from different States, whether it was representative of a national average and the appropriateness of extrapolating factors from one category to another.

However, it proposes to remove the 12.5 per cent discount applied in the 2010 Review to the SDS factor for schools.

New South Wales continues to have concerns with the use of the ACARA data.

The CGC says that while controlling for a range of variables – State, FTE enrolments, Indigenous students, remoteness area and socio-economic status – it investigated funding variations per school based on distance from towns of a certain size. The CGC found SDS most affected schools a certain distance from a town of 5,000 people.[53]

However, the CGC notes also that the regressions, at least when using different combinations of distances from urban centres to predict funding per student (rather than funding per school), returned a positive coefficient for all distance and urban centre combinations except when measuring distance from a capital city. The CGC concludes this provides strong evidence for the conceptual case for SDS.[54]

New South Wales concludes that this result adds to uncertainty. It appears to suggest that the 'same' small school could have a 10 per cent higher funding level compared to a school located 50 km away in a town with 5,000 people, but a not noticeably different funding level compared to a school located (say) 200 kms away in a capital city; and the school in the town of 5,000 people also would have a not noticeably different funding level from the school located in the capital city.

Combined with the ACARA data suggesting that the level of the SDS effect for schools is around a quarter of that applied in the 2010 Review, but that the regional cost calculated from the ACARA data should be higher in this Review than for the 2010 Review, New South Wales is not convinced that the impacts of SDS are being totally isolated from the effects measured by the regional costs assessment (which is designed to measure the impact of higher expenses stemming from greater use or higher costs of non-labour inputs, or higher costs of labour inputs).

Given these uncertainties New South Wales again notes its opposition to the removal of the 12.5 per cent discount for the SDS factor calculated for schools. We agree that at least a 12.5 per cent discount should continue to be applied for police and magistrates courts and family and child services expenses.

[53] CGC, *2015 Review Draft Report,* pp. 443-444.

[54] CGC, *2015 Review Draft Report,* pp. 442.

Administrative Scale

Summary of changes since the 2010 Review ▪ The assessment method is unchanged.

The CGC has revised the definition the administrative scale disability as recognising 'those costs incurred by a State in delivering services, whilst acting with average efficiency and following average policy, which are independent of the size of the service population.'[55]

New South Wales agrees that omitting reference to costs incurred 'for a State with the population size of the smallest State' more properly recognises that the assessment of these costs should be totally independent of the size of the service population to which services will ultimately be delivered.

The CGC notes that conceptually the administrative scale disability is intended to capture 'unavoidable initial service delivery set-up costs, incurred prior to the 'first' service user.'[56] In other words, New South Wales understands administrative scale costs to mean the minimum costs that any State would face in establishing the capability to deliver average State-provided services. In the past the CGC has noted that these costs relate mainly to labour costs.[57]

Viewed in those terms, States with small populations will face higher per capita minimum service delivery set-up costs than States with large populations. The quantum of costs is exactly the same, the populations are different sizes, so the costs per head of population will vary.

However, in making this assessment it is critical that only the minimum costs that States face in establishing the capability to deliver the average range of State-provided services are included in the assessment.[58]

If any of the costs included in the assessment are related to the scale of service delivery in particular States, the equal per State assessment underestimates the needs of States

[55] CGC, *2015 Review Draft Report,* p. 453.

[56] CGC, *2015 Review Draft Report,* p. 453.

[57] 'The Administrative scale assessment captures mainly salary costs. It does not include the costs associated with providing floor space or capital equipment. They are picked up indirectly. The Administrative scale assessment feeds into the Depreciation assessment and both assessments feed into the expense disabilities that will be [and subsequently are] applied to capital stocks in the Capital [Infrastructure] assessment.' CGC, 2010 Review, *Administrative Scale – Including Functionalising Superannuation and Depreciation Expenses,* Commission Position Paper, CGC 2008/12, September 2008, p. 2.

[58] This is another instance where the new approach to defining 'average' State-provided services is problematic. If one State has a policy to provide a service not provided by any other State, would not that State have different initial service delivery set-up costs?

with larger populations in relation to those costs and overestimates the redistribution of GST revenue required to compensate smaller States for the disability.

This overestimation could be significant given the size of the redistribution due to the Administrative Scale assessment.

The 2014 Update estimated that in 2014-15 administrative scale would redistribute $845 million in GST payments from the three largest-population States (or $46 per person) to the five lower-population States (or $154 per person).[59] For the assessment year 2012-13, the Draft Report estimates the redistribution needed is $773 million from the largest three States (or $44 per person) to the five smaller States (or $147 per person).[60]

Even small changes to the quantum of assessed administrative scale costs can have material effects on the redistribution. A change of only $21 million (1.1 per cent) in total assessed administrative scale expenses is sufficient to make a material change in the GST distribution for one State (at the $10 per capita level).

New South Wales considers the current assessment is totally unsatisfactory.

- The current estimates of administrative scale expenses are far from robust. They were originally estimated 15 years ago when the definition of administrative scale was very different.
- In the lead-up to the 2015 Review no State was able to provide data from which new quantum amounts could be derived.
- Attempts to justify the current quantum using regressions of data that are significantly correlated to the scale of State service provision are far from convincing.

New South Wales notes that in the current circumstances of a very truncated review it is not possible to estimate a realistic quantum of administrative scale expenses. We appreciate the Commission's view that development of an updated assessment should be a priority for the next review.

However, New South Wales considers that the current assessment is so flawed that it seriously undermines attempts to achieve equalisation. We agree that given the shortcomings of the current assessment there should be no 'step' increase in the quantum of administrative scale expenses in this Review. We doubt that even the indexation of the current quantum is justified.

[59] CGC, *Report on GST Revenue Sharing Relativities – 2014 Update*, p.72. This is based on 2014-15 GST pool size and State populations expected at the time of the 2014 Update.

[60] CGC, *2015 Review Draft Report*, p. 463.

New South Wales considers the current uncertainties are sufficient to warrant a 50 per cent discount of the assessment.

The uncertainty of the current quantum

Since the 2010 Review New South Wales has been pointing out that the current estimate of administrative scale costs cannot be regarded as 'robust'.

New South Wales considers 'robust' suggests an estimate has been constructed from independently-provided, fit-for-purpose data with the use of little or no judgment. The administrative scale estimates have been constructed from data provided predominantly by the smaller States based on a definition of administrative scale no longer considered appropriate and with the use of extensive judgment.

We will not go through the detailed history of those estimates again. However, we note that:

- the estimates were originally prepared for the 1999 Review when administrative scale was defined as including 'minimum fixed costs' and 'scale-affected variable costs'
- in the 1999 Review the Commission used judgment to estimate both elements of what were then regarded as administrative scale costs
- in the 2004 Review scale-affected variable costs were dropped, but, again using judgment, the Commission rolled about 10 per cent of previously defined scale-affected variable costs into 'minimum fixed costs'
- in the 2004 Review, again using judgment, the Commission added $10 million to total minimum fixed costs across all categories to allow for changes in government functions since the 1999 Review
- in the 2004 Review the Commission used a composite index of public sector wage movements (80 per cent) and CPI (20 per cent) to inflate the 1999 Review minimum fixed costs, as amended by the addition of some scale-affected variable costs and an allowance for changes in government functions, to 2004 levels
- in the 2010 Review the Commission switched to using the chain price index for State and local government final consumption expenditure from the National Accounts to index the quantum of administrative scale expenses.

New South Wales also notes:

- the Data Working Party's work in 2011 'was not able to achieve a way of re-estimating the quantum of administrative scale costs'
- 'no State was able to provide (due in part to privacy issues) sufficiently detailed workforce data from which new quantum amounts could be derived'

- 'as a result [Commission staff] have not been able to develop a State data collection that would provide the detailed data allowing [it] to undertake analysis similar to that undertaken in the 1999 and 2004 Reviews.'[61]

Uncertainty in the education regression analysis

New South Wales does not agree that the regression analysis of Productivity Commission data on out-of-school staff and student numbers provides 'a reasonable indication of school education administrative scale costs.'[62]

New South Wales notes, as does the CGC, that that the Productivity Commission data are likely to contain expenses that should not be considered to be administrative scale type expenses.[63] New South Wales considers those non-administrative scale type expenses are significant.

The CGC notes 'the minimum cost for out-of-school staff expenses across States is $18 million (for the ACT).'[64]

The ACT's data might not contain regional office staff expenses, but it would contain head office staff commensurate with providing policy and administrative services to a teaching service containing 84 schools and 4,100 school leaders and teachers.[65]

As for all States, the Productivity Commission data contains no information on the unavoidable initial service delivery set-up costs, incurred prior to the 'first' service provision, for the ACT. For example, the data would include all staff providing payroll services for paying teachers; that number of staff would be influenced by the size of the payroll payment task, i.e., the number of in-school teachers and other staff . It would not include only those staff involved in the establishment of a system to provide the capacity to pay in-school staff.

The Productivity Commission data is clearly influenced by the scale on which States provide education services, i.e., it includes scale variable costs. The correlation co-efficient between out-of-school staff and full time equivalent (FTE) students in the Productivity Commission data is 0.829.

So the regression equation does not provide in its constant term an indication of the number of staff needed to provide 'minimum' administrative services in States when the number of students is zero. The constant term provides an indication of the scale

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[61] CGC, *2015 Review Draft Report,* pp. 455-456.

[62] CGC, *2015 Review Draft Report,* p. 457.

[63] CGC, *2015 Review Draft Report,* p. 456.

[64] CGC, *2015 Review Draft Report,* pp. 456.

[65] ACT Government, Education and Training Directorate, *Annual Report 2011-12,* pp. 9 and 117, accessed at http://www.det.act.gov.au.

variable costs derived from two sets of data when one set of data (FTE students) is set to zero. That is not what administrative scale costs are intended to measure.

Even if that was the case, the CGC notes that the Northern Territory is a special case, needing to provide an above average level of service in education (as well as health, welfare and housing) to operate its dual service delivery model for its Indigenous and non-Indigenous residents.[66]

This suggests the Northern Territory should be omitted from any regression analysis aimed at establishing the 'average' administrative scale costs for States. That regression is shown in Chart 8.

Chart 8: Regression using Productivity Commission data on out-of-school staff and students, data for 2008-09 to 2010-11 excluding NT

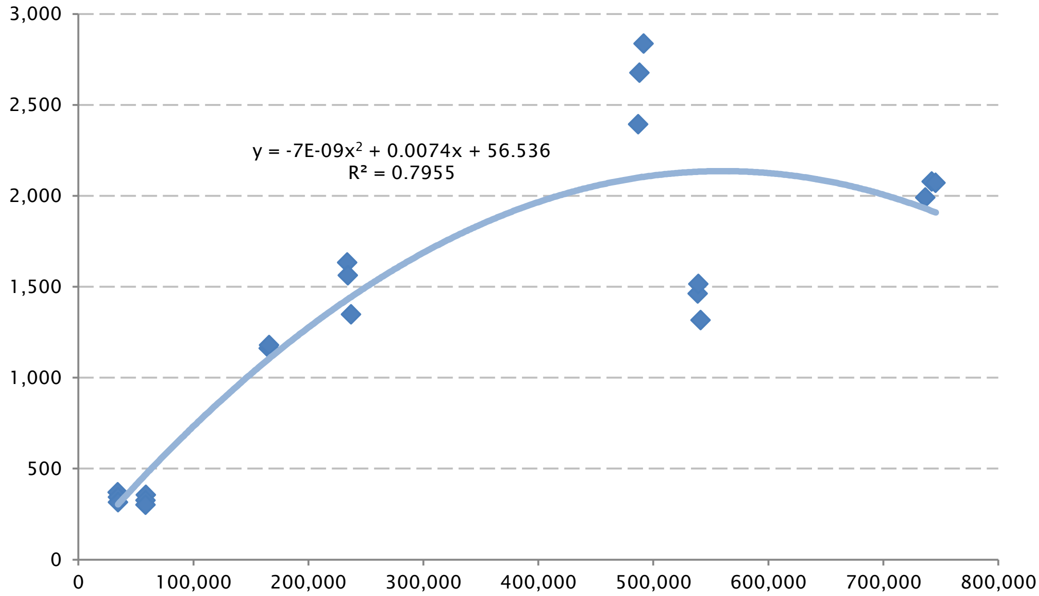

Chart 8 shows that if the Northern Territory is omitted from the regression, the number of out-of-school staff when FTE students are set to zero reduces to 57 (with only a slight reduction in R-squared).

Using the national average out-of-school staff yearly wage of about $101,561, the 'minimum scale variable cost' estimate for education reduces to $5.8 million, or less than half that suggested by the CGC.

Discount required

The Commission considers:

[66] CGC, *2015 Review Draft Report*, p. 460.

> … discounting is an appropriate means of dealing with uncertainty in assessments. Assessments might have a level of uncertainty attached to them because the indicator we are using may not be a good proxy of what we are trying to measure or because data are of poor quality, either not fully comparable across States or not representative of the situation in all States.[67]

The Commission has three levels of discount, based on whether uncertainty is of a low, medium or high level.

New South Wales does not agree with discounting for uncertainty. We consider that if assessments are sufficiently uncertain as to require discounts the assessments should not be made.

However, if discounts are made New South Wales considers the uncertainties in the administrative scale assessment – in exactly what is intended to be measured, the lack of data to measure it, and the age, provenance and judgments associated with the currently-used data – are among the highest in any of the CGC's assessments.

The uncertainties are at least the equal of the uncertainty in the assessment of urban transport asset stocks concerning the measured relationship between per capita urban transport asset values and city size. Pending the consultant's report on the urban transport asset stock regression, the Commission has judged a 50 per cent discount is warranted as a placeholder for that assessment.[68]

[67] CGC, *2015 Review Draft Report,* p. 33.

[68] CGC, *2015 Review Draft Report,* pp. 34-35.

Indigeneity (including Low Socio-Economic Status)

Summary of changes since the 2010 Review

- Where we use a geographic measure of socio-economic status, we will use the Indigenous specific IRSEO, and non-indigenous specific NISEIFA measures. In the 2010 Review we used a generic SEIFA to measure relative disadvantage for both indigenous and non-Indigenous.

New South Wales supports the Indigenous Relative Socio-Economic Outcomes (IRSEO) Index and the Non-Indigenous Socio-Economic Indexes for Areas (NSEIFA).

However, the Commission should explain some of the large discrepancies between the IRSEO values provided in the 2015 Review Draft Report and the CGC paper, *Appropriately assessing the Indigenous population,* as shown in Table 12.

Table 12: State shares of Indigenous population by IRSEO quintile, 2011

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
	%	%	%	%	%	%	%	%	%
CGC Staff paper[(a)]									
Least disadvantaged	23	16	39	1	4	10	5	3	100
2nd least disadvantaged	46	6	25	7	6	7	0	3	100
Middle quintile	35	6	30	16	5	2	0	5	100
2nd most disadvantaged	35	5	29	19	6	1	0	4	100
Most disadvantaged	16	0	18	17	7	0	0	42	100
Total	31	7	28	12	6	4	1	12	100
2015 Review Draft Report[(b)]									
Least disadvantaged	34	18	30	3	2	7	5	3	100
2nd least disadvantaged	42	5	27	6	6	10	0	5	100
Middle quintile	24	9	40	17	3	1	0	5	100
2nd most disadvantaged	39	4	28	18	9	1	0	1	100
Most disadvantaged	17	0	17	22	7	0	0	38	100
Total	31	7	28	13	6	4	1	10	100

(a) https://cgc.gov.au/index.php?option=com_content&view=article&id=173:socio-economic-status-and-characteristics-of-indigenous-populations&catid=50:2015-review&Itemid=142
(b) CGC, *2015 Review Draft Report*, Attachment 26, Table 1, p. 467.

Some of the quintiles, particularly the least disadvantaged and middle quintile, are considerably different to the data in the most recent Draft Report which warrants further investigation.

New South Wales notes that there are several major placeholders relating to the assessment of Indigenous costs and use for the Justice, Housing and Post-Secondary Education categories.

Other Disabilities

Summary of changes since the 2010 Review

- For presentational purposes only, and with no impact on the GST, we have moved:
    - the National capital allowance for roads to the Other expenses category
    - all Native title and land rights expenses into the Other expenses category.
- There has been a small change to the geography used in the cross-border assessment, reflecting changes made by the ABS.
- No assessment is made for Cultural and linguistic diversity in any assessment. This means that we no longer:
    - assess a CALD allowance in Other expenses
    - use language spoken at home in the Post-secondary category.

National capital allowances

The CGC considers national capital allowances are justified by the unavoidable extra costs the Australian Capital Territory incurs because of Canberra's status as the national capital or because of legacies inherited from the Commonwealth at self-government.

- The additional 'status' costs (estimated at $16 million in 2012-13) are the planning decision restrictions placed on the Australian Capital Territory by the Commonwealth's continuing interest in the strategic planning and development of Canberra as the national capital.
- The additional 'legacy' costs are the ACT use of the above-average-paid Australian Federal Police (AFP) to provide policing services, for which there is said to be no practical alternative, with a cost estimated at $9 million in 2012-13; and wider-than-average arterial roads inherited from the Commonwealth, with additional maintenance costs estimated at $4 million.

The additional costs for the use of the AFP are estimated using Productivity Commission data on State police services. The additional costs for planning and roads are estimated using indexed ACT Treasury provided data from past reviews, which are believed to provide robust and reliable estimates.

New South Wales considers that any additional costs placed on the ACT Government owing to Canberra's status as the national capital should be met by the Commonwealth

Government rather than subsidised by the other States through the GST payments distribution. However, we note that the CGC has little control in this area.

New South Wales considers that 25 years after self-government the legacy issues should be receding in importance. We note that the allowance for wider roads will continue to be assessed until 2017-18 by which time roads existing at the time of self-government will have reached the end of their useful life.

We do not agree that the Australian Capital Territory has no practical alternative but to use the AFP to provide its policing services. Smaller jurisdictions, e.g., the Northern Territory, have established their own police service, and the AFP operates in other Australian jurisdictions independently of the State police. We question whether the continued use of the AFP is a 'necessity' or an ACT policy decision taken as an alternative to establishing its own police service.

New South Wales considers the allowance for the use of the AFP should be discontinued or a sunset provision applied.

Cross-border effects

Cross-border costs are thought to occur where residents of one State use services provided in another. This is thought only to be a material issue for New South Wales-Australian Capital Territory cross-border flows, where the use of ACT services by NSW residents is thought to be much larger than the use of NSW services by ACT residents.

For services for which this cross-border use of services is likely to be the largest – school education, vocational and trade education, hospital admitted and non-admitted patients and roads – either:

- reimbursement arrangements already exist (for hospital services)
- cross-border usage is captured in the assessments (for roads, where road usage data comes from surveys of motor vehicle use, and school education, where assessments are based on actual school enrolments) or
- data on cross-border use is available (post-secondary education, where National Centre for Vocational Education Research data includes the number of hours of training supplied by New South Wales and the Australian Capital Territory to other jurisdiction residents.

This leaves a number of services for which the CGC accepts a strong conceptual case exists but for which records of service are either not reliable or not feasible. These services include community health, welfare and library and information services.

In these instances the CGC used illustrative or indicative information provided by the Australian Capital Territory suggesting:

- around 10-12 per cent of community health services in the ACT were provided to non-ACT residents
- cross-border flow for some welfare services (excluding child protection and aged care services expenses) having a material impact on ACT costs
- data provided by the ACT Library and Information Services indicated interstate members of ACT libraries represented 4 per cent of all ACT library memberships.

The CGC concludes that '[t]aken together the conceptual arguments and the available information suggests that, on a net basis, between 7-10 per cent of community health, some welfare, and cultural and recreational services provided by the ACT are used by New South Wales residents.'[69]

The CGC therefore assesses a cross-border factor for these services by applying a 7-10 per cent cross border use ratio to the population of the Australian Capital Territory (380,000) to arrive at an estimate of 36,000 NSW residents using ACT services. In the assessment of these services, the ACT population is increased by this amount and the NSW population in surrounding areas within around an hour's drive of Canberra is reduced by this amount.

Cross-border allowances are calculated to reduce NSW GST payments and increase ACT payments by $25 million in the 2012-13 assessment year.

New South Wales notes that this assessment is based on a conceptual case and 'available', 'illustrative' and 'indicative' information.

We do not consider the conceptual case to be as strong as suggested by the CGC.

- As the national capital, Canberra attracts visitors from all over Australia. It is not clear that the 10-12 per cent of ACT community health services provided to non-ACT residents is provided solely to NSW residents. Some element could be provided to other-State residents visiting Canberra for a period of days. Similarly, New South Wales would provide services to residents of other States visiting New South Wales as tourists (including ACT residents holidaying on the NSW South Coast).
- The cross border flow for welfare services is unquantified.
- The cross border flow for library and information services uses services that in most States are provided by local government. New South Wales considers that local government type services provided by the Australian Capital Territory, though not removed from ACT expenses in the CGC's adjusted budget for reasons of materiality and simplicity, at least should not affect the GST distribution.

New South Wales considers that, if the CGC is to make assessments on the basis of arguable conceptual cases and illustrative data, it should be consistent and do so in other

[69] CGC, *2015 Review Draft Report*, p. 491.

areas where conceptual cases exist but only illustrative or indicative information is available.

Cultural and linguistic diversity (CALD)

The CGC notes there is a strong conceptual case that people with poor English skills impose a higher cost in using State services than those with English as a first language. It notes that New South Wales and Victoria have both provided significant evidence supporting the conceptual case.

In the 2010 Review the CGC made allowance for cultural and linguistic diversity in:

- the Post-secondary Education category based on National Centre for Vocational Education Research data suggesting that people who do not speak English at home use post-secondary education services slightly more intensively than those who speak English at home, though this was said to be primarily driven by Indigenous people rather than migrants to Australia
- the Other Expenses category, where an allowance reflected the additional expenses incurred by States in providing services to migrants with low English fluency in Schools Education, Admitted Patients and Community and Other Health services. The allowance was based on the number of people in each State who were born overseas and spoke a language other than English at home, and the CGC's judgment that set the Australian average expenses on culturally and linguistically diverse people as $15 per head of State population in 2006-07 (indexed for later years).[70]

However, in the 2015 Review, the CGC proposes to make no allowance for cultural and linguistic diversity in any assessment.

Despite the strong conceptual case and significant evidence that people with poor English skills impose a higher cost in using State services than those with English as a first language, the CGC notes:

- a strong conceptual case that people with poor English skills use service less than people with English as a first language, due to a 'healthy migrant effect' meaning migrants may have less demand for Australia's health services and people with poor English may receive some services from within their own community rather than as part of a State government service
- evidence from the Australian Institute of Health and Welfare that people born in Australia have higher use of hospitals than overseas born after controlling for socio-economic status and age and evidence from the Census that people born in Australia have higher use than overseas born in public housing, after controlling for household income

[70] CGC, *2010 Review, Volume 2,* pp. 182 and 423.

- there is evidence that while some birthplace groups have higher than average use and/or cost for at least some services, other birthplace groups have lower use and/or costs, and there is no strong evidence about which State's mix of birthplace groups would lead to a higher than average cost profile

- the regression of Australian Curriculum and Reporting Authority (ACARA) *My School* website data undertaken for the Schools assessment showed students from a language background other than English had lower costs per student than those from an English speaking background and

- the 2014 Update Post-secondary Education assessment showed that enrolment in post-secondary education was 3 per cent higher for non-Indigenous non-remote people who spoke English at home than for similar people who did not speak English at home.[71]

New South Wales is not convinced that these arguments invalidate the case for CALD effects. Data based on place of birth (Australian and overseas born) could be heavily influenced by Indigeneity. The heavier use of Australian-born people of hospital and housing services could be influenced by heavier use by Indigenous people of these services. The CGC makes no mention of usage rates adjusted for Indigeneity.

The ACARA regression result is counter intuitive. New South Wales notes that the National Education Reform Agreement involves changes to how funding levels for schools will be determined, with the use of a Schooling Resource Standard providing a base amount per student and extra loadings for disadvantage, including for lack of English proficiency. We are not convinced States would accept this new arrangement if it was thought lack of English proficiency had no effect on the costs of school education. It will have been necessary in the ACARA data regressions to adjust for many other factors, including location and school size, since low English proficiency as a result of migration is more likely to affect non-remote and larger schools than remote and smaller schools where costs are assessed to be higher due to remoteness and service delivery scale.

New South Wales considers that the CGC's conclusion that it is not clear whether having a large CALD population increases or decreases the overall cost of delivering State services is not supported by the evidence the CGC uses to change its conclusions since the 2010 Review.

We consider the conceptual case and evidence in this instance to be at least as convincing as the conceptual case and evidence presented in support of cross-border services for community health, welfare services and library and information services and in support of the administrative scale assessment.

[71] CGC, *2015 Review Draft Report*, pp. 497-499.