Commonwealth Grants Commission 2015 Methodology Review

Tasmanian Government Submission in Response to the Draft Report on State Revenue Sharing Relativities 2015 Review

September 2014

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Contents

Chapter 1 Policy and Principles Issues

Tasmania's previous submissions have responded to the broad suite of principle and policy-related issues raised. The commission is referred to those submissions for detailed substantiation of Tasmania's position, but in summary, Tasmania:

- endorses the commission's re-statement of its approach to equalisation – that is, equalisation is the paramount determinant of the distribution of GST, and is not influenced by other objectives such as stability, predictability, or efficiency;

- endorses the continued use of internal standards consistent with the supporting principle "what states do", and the other supporting principles of policy neutrality, practicality and contemporaneity, to assist in guiding the development of assessment methods;

- acknowledges inadequacies of data and other key information gaps or complexities across the commission's assessments. In this context, Tasmania considers the commission's exercise of informed judgment to be an integral component of its role in implementing its fiscal equalisation objective;

- while supporting the commission's right to make judgments about materiality thresholds, notes Tasmania's disappointment with its decision to raise the materiality threshold to $30 (a three-fold increase relative to the 2010 Review). We do, however, welcome that the commission does not consider the proposed increase in the materiality threshold for this Review establishes a precedent for future reviews (refer paragraphs 54-57, page 31 of the Draft Report);

- stands by our previous position with respect to the new approach to defining average policy – that is, while conceptually we agree that HFE will be better realised through this new approach, we remain cautious about implementation issues;

- endorses the commission's clarification of its policy in relation to the application of discounts (refer paragraphs 67-72, page 33 of the draft report) and its rejection of a general discount as a response to a concern about policy neutrality;

- consistent with our previous position, agrees that the commission should continue to backcast major changes in Commonwealth–State financial relations for contemporaneity but only if this can be done reliably and the effects are material;

- supports the decision to continue to report relativities to five decimal places;

- supports the continued use of data which best reflect States' likely circumstances in the application year;

- supports the decision not to adopt a spend gradient approach;
- endorses the commission decision that a framework to identify payments for nationally significant infrastructure projects is neither appropriate nor possible to do in a consistent, comparable and defendable way; and
- has responded to the individual priority issues in our individual chapter responses.

While Tasmania notes the changing environment within which Commonwealth-State financial relations is now operating (and is likely to continue to operate) over the life of the 2015 Review, we do not agree that this justifies a departure from the established historical pattern of five yearly reviews.

Five yearly reviews allow for a systematic, rigourous review of the equalisation process and methods, at regularly defined intervals. Changes arising from the Commonwealth-State financial reforms cannot be anticipated in advance. While these may well impose the need for method changes, the method changes required can only be properly considered once the reform detail is agreed and understood.

A program of rolling reviews of specific assessments would not address the current uncertain policy environment and in all likelihood would accentuate the uncertainty and detract from the principles of HFE.

There are past precedents where the commission has responded to major Commonwealth–State financial reforms within the course of a review period. Examples include in the course of the 1999 Review in response to the introduction of the GST in 2000, and, more recently, in the course of the 2004 Review, in response to the removal of the 2006 IGA taxes. Tasmania does not accept that there is anything intrinsically different in the current reform environment to warrant a new review approach.

In terms of the treatment of Commonwealth payments, Tasmania agrees that in exercising its discretion the commission "be guided only by the objective of the GST distribution which is the principle of HFE". It then follows that "the appropriate treatment of a particular payment where [the commission has] discretion is that which improves HFE".

Consistent with this, Tasmania has previously argued against the commission becoming involved in judgments as to the "national significance" of particular projects. Tasmania has also previously argued that if the Australian Government considers a particular payment should not be subject to equalisation, it should provide explicit instructions to the commission to that effect.

Against this contextual background, Tasmania supports the proposed adoption of the single guideline "payments which support state services, and for which expenditure needs are assessed, will impact the relativities" to decide the treatment of all (non-quarantined) payments.

This streamlined guideline is proposed to replace the 2010 Review guidelines which included a series of explicit circumstances where a payment would be treated as "no impact". However, Tasmania understands that payments which were excluded from impacting the assessments under the previous guidelines, will, in many cases continue to be excluded under this guideline – for example, in cases where needs are not assessed or where a needs assessment has not been found material.

While this places a greater weight on commission judgment, Tasmania considers this also improves the potential internal consistency of payment treatment and should, in principle, improve HFE. Tasmania also agrees that the development of additional criteria to deal with more complex payments would proliferate boundary and interpretative issues. Tasmania considers that payments for which the decision treatment is complex, either in the presence or absence of additional criteria and guidelines, ultimately will rely on commission judgment. The annual New Issues paper provides a forum for each state to present its position prior to the commission making a judgment in relation to the treatment of any particular Commonwealth payment.

Consistent with arguments in its January 2014 submission, Tasmania supports the commission decision not to apply a materiality threshold to Commonwealth payments.

Tasmania also supports the commission using judgment on a case-by-case basis, and guided by policy neutrality considerations, when considering the treatment of payments where States exercise discretion as to whether to accept or reject a particular payment.

Tasmania notes the in-principle treatment of COPEs, as to whether they impact State fiscal capacities under the same guideline proposed for direct Commonwealth payments to States, but also the practical limitations on being able to identify such payments.

Chapter 2 Land Tax

In its January 2014 submission in response to the Proposed Assessments Staff Discussion Paper (CGC 2013-07S), Tasmania noted the commission's concerns about comparability of SRO data. Tasmania suggested that with four years of additional data since the 2010 Review commenced using SRO data instead of Valuers-General data, the commission should review the current comparability of SRO data with a view to discontinuing the 25 per cent discount.

The Northern Territory also supported the discontinuation of a 25 per cent discount to the Land tax category, on the basis that there is no evidence which indicates that the error arising from the proposed assessment is biased towards an equal per capita distribution rather than a differential outcome.

In the Draft Report, the commission has again highlighted some specific concerns about the reliability and comparability of data and has elected to retain the 25 per cent discount, noting that:

> We have found inconsistencies between the total value of land holdings and the distribution of those holdings across values. We are concerned these apparent inconsistencies reflect data quality problems. We are also concerned States deal with aggregations of land parcels very differently. We consider a 25% discount appropriate.

It appears that the commission has not been able to address its concerns about land tax data quality and comparability during the four years since the 2010 Review.

Tasmania accepts that it is unlikely to sway the commission's position at this late stage of the 2015 Review. However, Tasmania urges the commission to attempt, in conjunction with the States, to address SRO data quality and comparability issues during the period between the 2015 Review and the next five-yearly review.

Chapter 3 **Mining Revenue**

Tasmania accepts most aspects of the commission's proposed Mining revenue assessment for the 2015 Review, including:

- implementation of a mineral-by-mineral assessment with separate assessments of iron ore, coal, gold, onshore oil and gas, copper, bauxite, nickel and "all other minerals";
- the continued assessment of grants in lieu of royalties on an APC basis; and
- the use of value of production data as the measure of mining revenue capacity.

This submission addresses two outstanding areas of concern for Tasmania:

1. the phase-in of impacts of iron ore fines; and
2. the need for an adjustment for profitability for Tasmania.

Phase-in of impacts of iron ore fines

Tasmania notes the commission's proposal for smoothing the impact of WA's increases in iron ore revenues brought about by its increases in the royalty rates of iron ore fines.

Tasmania has always supported the role of commission judgement in the commission's decision making processes and continues to do so for the 2015 Review. As such, Tasmania does not oppose the commission's use of judgement on this issue.

Adjustment for profitability for Tasmania

Tasmania reiterates its previously stated concerns that the use of value of production data to calculate the mining revenue base ignores a fundamental issue in that it does not account for differences across States in the cost of production and the profitability of mining activity.

A mine's value of production is not an accurate reflection of its capacity to pay royalties. Value of production is determined by commodity prices in the (usually international) market which do not alone necessarily reflect relative differences in the cost of extraction between mineral types, nor relative differences in the profitability of any particular region or for any particular mining operation.

As such, while an assessment based on value of production data tends to reflect what most States do currently in imposing royalties (with the exceptions of the Northern Territory and Tasmania to a more limited extent), it does not adequately recognise interstate differences in underlying extraction cost structures relative to a profitability based measure.

Tasmania is currently compiling data in support of the application of a jurisdiction-specific adjustment in recognition of Tasmania's relatively higher costs and lower profitability of mining activity. A further submission will be provided by 26 September 2014.

Chapter 4 Schools Education

Government schools regression

The following section addresses some issues that arise from the commission's response to the econometric consultant's report, which are detailed in the Update and Supplementary Issues for the 2015 Review staff discussion paper. Tasmania may make further representations with regard to the Schools Education assessment in its response to that paper.

Tasmania raised two concerns about the proposed Government schools regression in its January 2014 submission:

1. the large unexplained State variations in per student funding; and

2. the reliability of ACARA data.

Tasmania was concerned that the large State-specific unexplained component was attributed to differences in State policy, without investigation of whether the unexplained element related to non-comparable ACARA data, policy differences, or unidentified policy differences.

The commission staff acknowledged the concerns of some States about the large differences in spending per student between States which are not explained by the regression model in its discussions with the econometric consultant engaged by the commission to review the regression model.

In the consultant's report, he advised that: "if the state dummies were excluded, some of the funding differences across the states would be attributed to other attributes that are correlated with the dummies, especially those related to state specific policies". He concluded that the State dummy variables could be replaced with variables describing specific State policies. However, in the Update and Supplementary Issues for the 2015 Review staff discussion paper, the commission staff advise that "State dummies were removed so the model better reflects what States do".

In that discussion paper, the commission staff have not discussed the inclusion of additional new variables describing State-specific policies or further investigation of the source of the unexplained element, which leads to a conclusion that the staff have removed state dummies and allowed funding differences across the States to be attributed to other variables or as unexplained variation, without further investigation.

This approach appears to reduce the focus on large State-specific funding differences, without actually attempting to explore or explain the variance. Tasmania assumes that removing the State dummy variables has resulted in a greater unexplained component, reducing the R-squared of the regression from the previously high 0.96 to the significantly lower 0.36 displayed in the regression results circulated on 10 September 2014.

ACARA data deficiencies is an area of significant concern and Tasmania again suggests that the commission will need to complete a comprehensive data checking and cleaning exercise in order to undertake a reliable and defensible regression analysis and resulting cost weightings if the ACARA data are to be used. Further work should also be undertaken to identify non-policy drivers of the unexplained State component so that the commission can reliably attribute this unexplained component to policy choices.

In the context of the current flux in funding arrangements, and a maturing ACARA dataset, annual improvements to the model appear necessary, and may improve States' confidence in the model over time.

Commonwealth funding for Government schools

Tasmania advocated a subtraction approach in its January 2014 submission. However, Tasmania considers the commission's proposal to equalise differences in Commonwealth funding to the States that arise from differences in base funding, while assessing on an actual per capita basis funding attributable to the SRS loadings, is a reasonable compromise in the context of the Terms of Reference requirement not to unwind the recognition of educational disadvantage embedded in the NERA funding arrangements.

Commonwealth funding for non-Government schools

Tasmania agrees with the proposal to assess Commonwealth funding for non-Government schools on an actual per capita basis.

Student transport

Tasmania supported the proposal to update the student transport assessment with 2011 Census data, and agrees with the proposal to discontinue the assessment of urban student transport assessment if it is not material.

Chapter 5 **Health**

In our January 2014 submission and related discussions, Tasmania detailed its concerns with the proposal to adopt a direct assessment approach based on the Independent Hospital Pricing Authority's National Weighted Activity Units across all the health components. Tasmania noted its concerns with the maturity of the IHPA NWAU measures, most specifically in relation to emergency department and outpatients data, and the paucity of community health data on which to base a direct assessment of the community health component. While acknowledging that the 2010 Review subtraction method also had issues, we argued that it remained a viable alternative assessment approach for the 2015 Review and suggested deferring consideration of an IHPA based direct assessment approach until the 2020 Review.

With the release of the Draft Report, the detail of the commission's direct assessment method is now clearer. Tasmania is better able to see where and how the commission would use the IHPA data under the direct assessment method and has more confidence in the robustness of a direct assessment approach for the individual health components. Conversely, we now also have a better appreciation of the concerns the commission would have with a continuation of the subtraction method (as outlined in paragraphs 126-131 of Attachment 12 to the draft report).

In Tasmania's view, the core issue for resolution within the Health assessment remains this choice between:

- a direct assessment of emergency departments, outpatients and community health components, based on national weighted activity units and requiring the direct attribution of substitutability; or

- a return to the alternative subtraction model concept to assess these component elements and related socio-demographic composition and economic environment-equivalent needs as an aggregate.

At this point in the review process, Tasmania is inclined to defer to the commission's judgment as to the better of these two second-best alternative methods as we do not have new evidence to assist with the determination of current placeholders, or the detailed comparative information base to make an informed evaluation. However, we do not believe that this method choice will be critically dependent on, or even significantly impacted by, the Commonwealth unilateral decision, flagged in its 2014–15 Budget, to cease activity based funding under the National Health Reform Agreement with effect from 2017–18.

That is, activity-based costing and a "national weighted activity unit" measurement system for admitted patients (in the form of the National Hospital Cost Data Collection) pre-dated the NHRA and the explicit creation of the IHPA as the national body with the role of coordinating and reporting on the NHCDC collection under the NHRA. The advent of national activity based funding under the NHRA significantly accelerated the development of the scope of NHCDC collection, including in relation to unit-based records and the non-admitted patients data collections. It is anticipated that the pace of the NHCDC development will slow with the movement away from a formal Commonwealth activity-based funding regime and that the "IHPA", as an identified body, may cease to exist. However, there will continue to be an equivalent national body which will undertake the coordinating and reporting role currently performed by the IHPA, the NHCDC data will continue to be available, and the scope of the data series will continue to be at least the equivalent of that now available through the IHPA (ie. the progress that has been made in the NHCDC will not be undone). This data series is a foundation data set for all States and is too important to States to allow it to lapse. Under the NHCDC arrangements which pre-dated the IHPA, the States and the Commonwealth shared the NHCDC coordination and reporting costs.

With respect to the direct assessment approach, the Draft Report:

- acknowledges that the IHPA outpatients data are not mature enough for use in the outpatients component assessment. It instead proposes the use of admitted patient separations as a proxy SDC indicator, based on evidence from the National Health Survey as to the similarity of inpatient and outpatients age, SES and remoteness profiles;

- suggests the emergency department NWAU data, while less comprehensive and less mature than the admitted patients data, are sufficiently robust for use, and provide a more accurate measure of the use and cost of particular population groups (SDC profile) than if the commission were only to assess the number of ED presentations;

- in the absence of reliable and comprehensive national data proposes the use of ED NWAUs for triage categories four and five as a proxy measure of the community health services SDC profile but that this be discounted by 25 percent due to concerns about how closely this measure approximates the actual community health SDC profile; and

- details the measurement of the impact of the non-State sector (service substitutability) in each of the ED, outpatients and community health components, based on component-specific economic environment indicators derived from Medicare bulk-billing rates weighted for the percentage of component expenses judged to be directly substitutable.

Tasmania strongly endorses the commission conclusion that the outpatients data are not mature enough for use in the commission's assessments. In its April 2014 submission, Tasmania supported the then-proposal to use admitted patient SDC profiles as a proxy for outpatient SDC profiles, noting internal analysis of the Tasmanian public hospital data indicated this would be a better proxy than either emergency department or simple population profiles. Tasmania supports the proposal, as further refined in the Draft Report, to use admitted patients separations, in preference to admitted patient expenditure, as the outpatients proxy measure. We agree that the large variation in cost per separation in admitted patients is less likely to be reflected in outpatient services.

With respect to the emergency departments NWAU data, we documented our concerns with the developmental status of the data in our January 2014 submission. In that submission we also acknowledged that the 2010 Review alternative measure of emergency department usage itself relies on a series of bold assumptions.

While we consider that the emergency departments NWAU data are still under development, we agree that the emergency department NWAU data provide a more accurate measure of the use and cost of particular population groups (SDC profile) than if the commission were only to assess the number of ED presentations.

With respect to the proposed emergency department adjustment, while the SDC profile data for remote areas in particular is based on a small sample, we support the proposed approach of adjusting for limitations in the national SDC profile coverage within IHPA's national emergency department NWAU data.

Tasmania considers attribution of the community health SDC profile is the most problematic of all the health components SDC profiles.

The draft report makes specific reference to the SDC uncertainty which became evident during the life of the 2010 Review and ascribes this to revealed shortcomings in the subtraction model use of the National Health Survey to infer patterns of usage of community based services by different population groups.

Under the alternative direct assessment approach, as now proposed emergency department data rather than National Health Survey data will be used to proxy community health profiles. However, these NWAU-based emergency department data measure hospital use and cost relationships, not community health use and cost relationships.

The core underlying problem is the paucity of reliable and comprehensive community health data and this is an issue whether a direct assessment approach or a subtraction method is adopted.

Against this background context, Tasmania supports the proposed use of ED NWAUs for triage categories four and five as a proxy for a community health services SDC profiles as reasonable in the absence of a more compelling case for an (available) alternative proxy measure. Tasmania also supports the proposed 25 per cent (medium) discount to account for uncertainty as to how closely the SDC profile of people using EDs reflects the profile of people using community health service.

However, a caveat, raised in our April 2014 submission, is that while we agree emergency department data may provide the best (available) proxy for community health usage, it could be expected to understate the community health usage of residents in remote areas due to the comparative absence of EDs in these areas. This is evident in the Tasmanian data. Whether the 25 per cent EPC community health expense adjustment would sufficiently compensate for this is not clear as this has not been directly addressed in the Draft Report proposal with respect to the community health SDC profile.

Consistent with our April 2014 submission, Tasmania also supports the proposals to measure economic environment factors:

- for emergency departments and community health components based on GP bulk benefits paid from Medicare, standardised by indigeneity and remoteness;

- for outpatients based on the value of bulk billed specialist, pathology and imaging benefits paid by Medicare, standardised by indigeneity and remoteness; and

- for Indigenous community health organisations based on the differential between a State's share of their indigenous population and the State's share of Indigenous and Rural Health Division grants provided in that State.

However, Tasmania notes that the ACT economic environment factors in the Draft Report derived from the bulk billing data (refer table 9, page 197; table 11, page 201; and table 14, page 206) stand out as anomalies. A priori, Tasmania suspects that the ACT outcomes are measuring high SES effects (resulting in low bulk billing rates) in addition to the intended economic environment driver. We acknowledge that the Draft Report notes the commission would standardise for age and SES, but has been unable to source the data required.

In our January 2014 submission Tasmania put forward an argument for an ED substitution percentage based on a clinical study of three Perth-based metropolitan emergency departments presentations. Across the course of the 2015 Review the commission/commission staff have considered, to date, emergency department expenses substitutability percentages ranging from 60 per cent initially, to 25 per cent and now a placeholder of 40 per cent, after consideration of a range of studies/surveys and conflicting arguments advanced by different States. Tasmania has no further constructive suggestions to make, or evidence to present, as to the emergency department substitution percentage. In the absence of compelling evidence in other States' submissions, we are supportive of the commission consulting with health experts to get an independent indication of likely substitutability.

The Draft Report has an outpatient substitutability placeholder "consistent with the ED placeholder of 40 per cent". In earlier submissions, Tasmania argued that there is no obvious link between the degree of substitutability applicable to emergency departments and that applicable to outpatients services, but that on a first principles basis we would expect the outpatient percentage to be higher. Tasmania does not have any further constructive arguments to make, or evidence to present, as to the appropriate outpatients substitutability percentage. As for the ED percentage, in the absence of compelling evidence through other State submissions, Tasmania is supportive of the commission consulting with health experts to get an independent indication of likely outpatient substitutability. In the absence of this Tasmania believes this must be a matter for commission judgment.

With respect to community health services Tasmania agrees with the commission that there would be a reasonably high degree of substitutability with non-State government providers expected across the range of services covered by community health services, but also limitations. In our April 2014 submission, Tasmania supported, as not unreasonable, the then-proposed 50 per cent substitutability assumption for community health. The Draft Report has a 75 per cent placeholder. In the absence of further information, Tasmania is supportive of the placeholder of 75 per cent as a reasonable estimate of the likely substitutability of community health services, subject to independent health expert confirmation if possible.

Tasmania considers the assumption of full substitutability of Indigenous community health organisations and mainstream community health organisations to be reasonable, based on Tasmania's own experience.

Chapter 6 **Welfare**

Tasmania is broadly supportive of the commission proposals as outlined in the Draft Report regarding the treatment of the Welfare category. In general, these reflect already flagged method changes to which Tasmania has responded in earlier submissions.

Tasmania is disappointed by the decision to cease Service Delivery Scale assessments within the general welfare and disability services components but is unable, at this time, to provide direct substantiating data to support their continuation.

Tasmania notes the new Family and child services data and method for assessing socio-demographic composition, and the finding that differences between usage rates by remoteness has not been found to be material.

We also note the commission decision with respect to the method it will adopt to assess Western Australia aged care services.

As indicated in detail in previous submissions, Tasmania supports the proposed approach to assessing disability needs through the transition period and into full scheme.

As a general caveat, we note that the actual NDIS transition and full-scheme implementation arrangements may differ significantly from those on which the commission has predicated its proposed 2015 Review assessment method, but consider it unlikely that the commission will have further clarity on the future arrangements prior to the finalisation of the 2015–16 financial year relativities at least (the first year of the 2015 Review method). The current "Heads of Agreements" as signed by States reflect the previous Australian Government's commitment to, and high level implementation framework for, a national disability insurance scheme. The current Australian Government, while committed to a NDIS may prove to have a different vision as to how this should be realised in practice. The NDIS "launches" are also a testing ground for all governments to inform full scheme implementation and may in themselves give rise to substantive changes to the full scheme arrangements outlined in the Heads of Agreement. Further, we note that the NDIA has recently published a report advocating its preferred approach to transition.

Tasmania accepts the proposed changes to the scope of the Welfare assessment to reflect the changes in State roles and responsibilities in relation to residential and community care services.

Tasmania acknowledges the assessment advantages of the proposed use of NDIS eligible population across both assessment streams (NDIS and non-NDIS).

With regard to the Concessions sub-component, Tasmania considers that notwithstanding the Australian Government's unilateral withdrawal of the Certain Concessions NP, current indications are that a number of states will continue to provide these concessions to their eligible resident populations. In an expenditure assessment context, Tasmania therefore considers the proposal to continue to assess this sub-component based on pension concession card and health care card holders remains appropriate. In terms of the treatment of the associated Certain Concessions NP cessation, Tasmania does not support backcasting the cessation as this is not a "major change in Commonwealth-State relations".

With respect to the Other General Welfare sub-component assessment, Tasmania has previously indicated its support for a SEIFI measure of low SES.

Chapter 7 Housing

Tasmania generally supports the commission's approach to assessing housing services needs.

However, a consequence of the commission's decision to treat the provision of social housing as a General Government activity, rather than it being provided through the PNFC sector, is that it increases the quantum of infrastructure stocks in the Investment assessment. Tasmania and a number other States have consistently raised concerns with the Investment assessment methodology and its upfront infrastructure need based on population growth. The inclusion of Housing infrastructure exacerbates this issue.

In terms of the proposed Housing services assessment, Tasmania makes the following comments.

Indigenous housing expense cost weight

The commission has compared recurrent expenses per dwelling for non–Indigenous public housing and State-Owned and Managed Indigenous Housing and arrived at an average cost difference of 43 per cent higher for SOMIH expenses.

The data are derived from the Productivity Commission's report, titled, *Report on Government Services 2014* and is only available for the four States that have SOMIH (New South Wales, Queensland, South Australia and Tasmania).

Tasmania has concerns that the data do not appear to be reliable. For example, the data for Queensland show a 41 per cent increase in SOMIH recurrent expenses over three years to 2012–13 whereas for all the other States, the average cost is relatively stable. There is also a wide divergence in the average cost differential between SOMIH and non-indigenous public housing ranging from 0.89 for Tasmania to 1.74 for Queensland.

It is noted that the Commission has sought specific data directly from the States on SOMIH and public housing service expenses and this may provide better data than contained in the ROGs.

Treatment of the Remote Indigenous Housing NPP

In the commission staff discussion paper, staff were of the view that that the Remote Indigenous Housing NPP should treated as having no impact as ownership of Indigenous Community Housing Organisations' houses funded by the NPP were held by ICHOs not the State Governments.

The commission now proposes to change the treatment of the NPP to ICHOs to impact State relativities as there has been a trend towards jurisdictions taking control over ICHOs and therefore the funding having an impact on the provision of State public housing.

The Commission has sought State views on this change in responsibility.

The two Tasmanian ICHOs (Flinders Island Aboriginal Association and Cape Barren Aboriginal Association) own 63 dwellings in their own names. While there are now 10 dwellings (soon to be 12) that are owned by Housing Tasmania that have been constructed under the NPARIH, they are managed by the ICHOs.

It was originally a requirement of the NPARIH that the State Government hold title to these dwellings. However, as the NPARIH is being paid out early in Tasmania's case as part of a one-off arrangement with the Commonwealth Government, the Tasmanian Government may no longer need to continue to hold the title to these properties and it may be more appropriate to transfer title to the ICHOs.

In Tasmania's case, since the assets are predominantly within the ownership of the ICHOs, it will be the ICHOs rather than the State Government that will primarily be responsible for the management of public housing for the indigenous population on the two islands.

Whilst Tasmania is expected to provide funding for operational purposes to each ICHO from the former NPARIH funding that is being paid to the State, this will be controlled by the respective ICHOs for the purposes of managing and maintaining their portfolio.

Chapter 8 **Roads**

Tasmania provided a list of State Government rural roads, not on the synthetic network, that link to sites of economic activity with quantification of the economic benefit from the economic activity (where possible).

This included rural roads not on the synthetic network that provide access to working power stations where the economic benefit was the spot price revenue generated by the power station.

Some of the economic activity's "benefits" could not be quantified despite being significant. This means there is a risk that only roads where economic benefit can be quantified are added to the synthetic network, which would be biased towards mines.

It is also not clear whether a mine, or any other site of economic activity, that is in care and maintenance is significant or not. Certainly the maintenance of the road cannot be abandoned as there are other vehicles using the road (not just suppliers and employees at the site) and the site may resume production/activity at a later date.

The commission requested:

- the two localities connected by the road (latitude and longitude if available);
- length of the road; and
- type of road surface e.g. whether the road is sealed or unsealed.

However, the site of economic activity may not connect to a locality but to a highway (already on the synthetic network). Or, the site may connect to a highway that is not on the synthetic network but is parallel to the synthetic network where both roads connect to the same town. It is not clear how many kilometres of rural road to include in this case as the synthetic network was derived as existing roads connecting localities larger than 400 people by the fastest route. In this case a government policy decision to have competing roads (sub-optimal network) is rewarded.

It is also the case that the site may connect to a highway which connects to two localities in different directions. It is not clear how many kilometres are relevant.

The synthetic network was derived in the first place to overcome policy neutrality concerns. Tasmania is concerned that the manual adding of roads may jeopardise its neutrality.

Chapter 9 Transport

The commission states that while the definition of urban centres may not perfectly capture the population serviced by the urban transport networks, the commission has adopted it because it is policy neutral. While UCL may be considered policy neutral, there is the potential for inconsistent treatment of the disaggregation of transport service region costs into costs by UCL.

For Tasmania, the expenditure has to be notionally split into Hobart, Launceston and Burnie using boardings data as the General Government subsidy to the PNFC is a lump sum not tagged to any particular city. It appears that data from the NT was split between Darwin and Alice Springs using 2010 Review expense proportions.

The commission has correctly treated Newcastle, Wollongong and the Central Coast, the Sunshine Coats and the Gold Coast as separate cities, rather than amalgamating them with their principal city since the demand for travel by public transport between these satellite areas and the principal city is low relative to public transport travel within each satellite area. This approach was supported by the consultants in the 2010 Review. However, the consultants stated that the inter-urban costs should not be included with the costs of the individual urban areas but be considered like other regional interconnection services, i.e. non-urban. Costs relating to links between UCLs need to be separately identified and included in non-urban. However, it is unlikely that States that are affected by this aspect of the methodology will be able to provide the disaggregated data or that the commission can take account of this issue. This will have the effect of inflating the pool of urban expenses.

Tasmania notes that Western Australia's concerns were not addressed in the Draft Report. Western Australia's submission showed that the US data do not justify the fitting of a log curve as there is no visual relationship to a log curve and the R-squared value for the assumed log curve is very low (0.22). Removing the most significant outlier reduces the R-squared to just 0.19 (and a linear fit is not significantly better with an R-squared of just 0.22). Removing just four outliers reduces the R-squared down to just 0.15 providing no evidence to support the relationship. There is significant clumping along the vertical axis indicating that costs for small cities can vary significantly (many of the small cities have high per capita subsidies).

Western Australia has shown that the US data are not convincing supporting evidence of the Staff's hypothesis regarding city population and net expenditure.

Western Australia went on to note that, like the US data, the Australian data show considerable clumping for lower population sizes. Among these lower population sizes, there is some basis for increasing per capita subsidy for increasing population size, but the relationship is very weak. However, there is no reason to fit a smoothly increasing curve through both the smaller population centres and the larger capital cities.

Western Australia noted, for larger population sizes, there is only one city in each state. Without the Sydney data point it would be quite valid to fit a horizontal line through the larger capital city data points (i.e. populations above one million).

While the commission have mentioned that they have no basis to state that Sydney is an outlier (it could be that Melbourne is an outlier or that neither city is an outlier) the key issue is that there are not enough data points at the large city end of the curve to have confidence in the regression results.

In conclusion, Tasmania is of the view that the lack of data overall and especially at the high end of the curve (i.e. a lack of information on how States with very large cities respond to passenger transport demand) and the data manipulation that has occurred all point to the need for a discount due to uncertainty.

For non-urban, the commission proposes to use a regional cost disability to recognise distance between population centres increases costs not just the non-urban population. While Tasmania welcomes the recognition of this issue, in Tasmania's view, the rural road length factor (representing the existing rural roads connecting localities of more than 400 people) appeared to be a more direct indicator of the disability.

Chapter 10 **Urban Transport Infrastructure**

Tasmania understands that the commission's general conceptual case is that assets per capita by city size are upward sloping. This is because greater use is made of public transport in bigger cities with rail investment occurring, at some point, as city size becomes increasingly large (with rail being expensive to build and maintain).

Tasmania's main concern is with the uncertainty surrounding how much stock is needed per person. The independent econometric consultant engaged by the commission to review the 2015 Review econometric use considers that the sample size is small. Furthermore, there are only two very large cities in Australia. By comparison, there are many more observations for remote costs in the Regional location costs assessment compared to the high cost end in public transport. The consultant stated that "given the small number of cities, the regression results will always be sensitive to some observations" and "observations with big values influence the results quite much".

The commission has shown that the assumptions that assets per capita are determined by a linear relationship to city populations, and that the line passes through the origin, lead to a result that State shares of assessed assets, and assessed investment, are independent of the slope of the linear relationship (and therefore insensitive to the data from any one city or set of cities). The commission state that the data points available from States are consistent with an upward sloping linear relationship that passes closely to the origin.

However, the consultant has highlighted that the functional form is dependent on a couple of data points given that the sample size is small. A tapering off at the high end, i.e. some form of quadratic equation, is conceptually appealing as the share of trips on public transport cannot increase ad infinitum, and should a data point move year-to-year, such an equation maybe more appropriate.

In the Transport services assessment and in the urban transport infrastructure component of the Investment assessment, many States have argued that Sydney is a clear outlier. In response, the commission has stated that it has no basis to determine that Sydney is an outlier and that, in fact, Melbourne may be the outlier. While it may be the case that Melbourne is the outlier, not Sydney, (or that neither are outliers) there are not enough data points in the scatter diagram to provide confidence in the results.

Tasmania considers that the small sample size and the econometric uncertainty justifies retaining the 50 per cent discount that was used as a placeholder in the Draft Report.

Chapter 11 Services to Industry

In its discussion paper the commission proposed to include a separate assessment of mining regulatory expenses within the Services to industry assessment. This was in response to the commission's Terms of Reference to consider the appropriate treatment of mining related expenditure.

The creation of a separate mining regulation expense, similar to agriculture, forestry and fishing regulation, results in mining regulation accounting for only 10 per cent of total regulatory expenses and moves $20 per capita to Western Australia. By the commission's own definition this is not material.

However, the commission argues in its Draft Report that a separate assessment of mining regulation should be included, if when considered with other mining related expenditure assessments across all categories in aggregate the assessment is material.

Tasmania notes that this approach of grouping related expenditures across categories into an aggregated mining related expenditure assessment would appear to be a precedent. That is, no other component expenditures are treated this way. This assessment across categories has only been used in respect of general disability factors such as Administrative scale, Interstate wages and Regional costs.

If mining regulation is to be treated this way then a similar approach could be adopted in assessing the impact of other expenditure that has impacts across a range of expenditure categories, such as tourism related expenditure, and if it is also material in aggregate then should be included in the commission's assessments.

In principle, Tasmania does not oppose this approach if it is material and it is consistently applied. However, it increases the complexity of HFE by expanding the assessment of expenditure components not only within existing expenditure categories but across categories.

Furthermore, the CGC uses a variety of disability factors and techniques to assess expenditure within each category. For example, the assessment of Housing expenditure uses SDC, Location, Administrative Scale, FHOS, Native Title and land rights, and Remote Indigenous Housing NPP to assess relative expenditure need. Whereas the Roads assessment uses road length, maintenance costs, Location, Administrative scale, National capital and Native Title and land rights to determine need.

Aggregating such expenditure across categories to determine whether in total it is material, as proposed with the mining related expenditure, is potentially trying to add "apples with oranges" and could therefore lack consistency.

Chapter 12 **Mining Related Expenditure**

As stated in our January 2014 submission, Tasmania supported the commission's examination of the impact of mining related expenditure on State fiscal capacities provided that the expenditure identified was not already captured in other assessments, is material, and is not within the policy control of State governments.

It is noted in the Draft Report that after seeking mining related expenditure data from the States, the total amount of direct mining related expenditures is small (less than 0.5 per cent of total State expenditure). The commission has concluded that in most areas, States with significant mining sectors face no higher expenses per capita than States with a different industrial composition. Tasmania supports the commission's conclusion to not assess these costs.

It is also noted that the commission is still considering the impact on road maintenance and road construction outside of the commission's synthetic roads network that is related to economic activity such as mining. The commission is also considering separately assessing State mining regulation expenses and to use Rawlinsons construction cost index as a basis for capital cost disabilities

As discussed in the previous chapter (Services to industry), while Tasmania supports in principle the commission introducing new individual assessments if it is proven to be material and in accordance with other commission assessment criteria. However, we have concerns if the commission is considering the inclusion of mining related expenditures that in isolation are immaterial, but when considered in aggregate, are found to be material.

Chapter 13 Infrastructure

Tasmania continues to have concerns with the commission's up-front, population growth dilution treatment of infrastructure investment expenditure. The commission has clearly not been persuaded by Tasmania's and other States' arguments against its approach.

In regard to the other areas within the infrastructure assessment, our comments relating to the proposed inclusion of public transport and housing are dealt with in the relevant sections of this submission.

It is noted that the commission has decided to use Rawlinsons Construction Cost Index as the basis for determining capital cost disabilities. Tasmania supported this approach provided that discounts were applied, as the index may not fully capture State differences due to data gaps or limited data for smaller States, and its adequacy in capturing road construction costs. It is noted that the commission has decided to apply a 50 per cent discount for roads and urban transport, and 25 per cent discount for other services. Tasmania also agrees with the commission's decision not to include a separate physical environment factor as it is already captured to some degree in the Rawlinsons cost index.

Chapter 14 **Indigeneity**

Tasmania accepts the commission's replacement of SEIFA with IRSEO and NISEIFA for the Indigenous and non-Indigenous populations respectively in the 2015 review within the Education, Post-Secondary education, Health, Welfare (Family and child services component), and Justice (Police component) as proposed in the Draft Report. However, Tasmania remains concerned about the robustness and fitness-for-purpose of IRSEO for the commission's needs.

As discussed in detail in our January 2014 Submission, Tasmania considers that IRSEO has been constructed to measure the positive aspects of socio-economic status, as opposed to measuring relative disadvantage across Indigenous populations. Tasmania considers this to be disconnected from the aim of recognising the socio-economic differences the commission is attempting to measure, and therefore at odds with the commission's needs.

Tasmania considers it important that robust and "fit-for-purpose" data sets are key drivers for all changes to the commission's methodology, to continue to ensure the integrity of the HFE process. Accordingly, Tasmania urges the commission to investigate development of a tailor-made Indigenous disadvantage index prior to the next Review.

Chapter 15 Interstate Wages

Paragraph 19 in Attachment 22 of the Draft Report states that Tasmania, among other states, said "private sector wages are an appropriate proxy for public sector wages". However, Tasmania has, for many years, not supported the Interstate wages assessment. Tasmania continues to hold this view. In our last submission we considered that, between the private sector whole-of-state wages approach and the private sector capital city wages approach, the latter was conceptually superior, notwithstanding our on-going concerns with the initial hypothesis that private sector wages are a good proxy for public sector wages.

The Draft Report states that the 2009 SET showed a weakening link between public and private sector wages. Queensland's Statisticians Office showed that the relationship between public and private sector wages was not statistically different from zero in 2009 (implying no difference in public sector wages). These results from the 2009 SET post-date the Interstate wages 12.5 per cent discount decision.

Also, following on from South Australia's consultant's report, the Draft Report states that, conceptually, the optimum approach would be to measure wage differences of private sector employees with characteristics similar to public sector employees. However, the commission is reluctant to use this optimum approach as there are data reliability and policy neutrality issues in pursuing an approach of identifying private sector workers comparable to public sector workers.

Given these concerns, which compound the issues that led to the 12.5 per cent discount, Tasmania is of the view that the discount should be increased in the period before a new assessment is possible with the release of the Compensation of Employees data.

Chapter 16 Population

Consistent with previous submissions, Tasmania broadly endorses the commission's proposed population treatments/adjustments as outlined in the Draft Report but notes the following.

For capital assessments the CGC require population growth across financial years 30 June to 30 June. In the 2010 Review, the CGC used calendar year growth as a proxy for financial year growth. In the 2015 Review, the CGC considered changing to financial year growth and Tasmania supported this proposal in principle. The commission has stated in the Draft Report that, given the GST Distribution is based on a three-year average, the commission is not convinced, at this stage, that a change to financial year population growth would materially improve the equalisation outcome. Nevertheless, Tasmania considers that if there are no transition costs it is still worth using financial year growth since it is conceptually more appropriate for the capital assessments.