ACT Government

COMMONWEALTH GRANTS COMMISSION 2020 METHODOLOGY REVIEW OF GST REVENUE SHARING RELATIVITIES

DRAFT REPORT

ACT Government submission

ACT GOVERNMENT SUBMISSION

OCTOBER 2019

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CONTENT

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EXECUTIVE SUMMARY

- The Australian Capital Territory (ACT) commends the Commonwealth Grants Commission (CGC) on the overall clarity and transparency of the draft report and generally supports the conceptual basis for the proposed changes to the assessment methods. Our submission focuses on some refinements to several of the assessments and proposals for further elaboration or clarification in the final report. It also presents a possible alternative approach to future reviews of the CGC's methodology.

AREAS FOR FURTHER ELABORATION OR CLARIFICATION

- An appraisal of the change in the GST distribution outcome between the *2020 Methodology Review of GST Revenue Sharing Relativities* (Review) and the 2015 Review to changes in state and territory economic circumstances over the same time frame in the final report would be welcome.

- Additional explanatory information for Table 1-4 in chapter one of the main report linking to the arguments presented by states and territories would address possible perceptions that states and territories have limited impact on the 2020 Review.

- The inclusion of a discussion on state and territory proposals that were rejected due to unavailability of data or immateriality, including possible ways forward after the 2020 Review and potential new data sources would be welcomed.

- Further elaboration in the final report of the CGC's approach to maintaining two sets of relativities under the Commonwealth's *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018* and how it will use them to determine whether a state or territory has been made worse off would be welcome.

- The specification, variable types and units, detailed outputs and residual plots of the econometric models used in some expense assessments should be presented in either the main report or supplementary information.

- The current approach of reviewing the GST distribution methodology every five years is no longer suitable given the current administrative, political and economic environment. A rolling review program would be a more flexible approach suited to the current environment. The inclusion of a discussion chapter in the final report could be a catalyst for broader government discussions.

REFINEMENTS TO ASSESSMENT METHODS

- The ACT does not support the CGC's decision not to make an adjustment for tax elasticities that have a material impact on the GST distribution and considers that not doing so can create a disincentive for states and territories to reform their tax systems. The final report should explicitly address the findings of the consultants' report on tax elasticity.

- If 50 per cent of the National Network Road and Rail (NNR) payments from the Commonwealth to states and territories continues to be excluded from equalisation as proposed by the CGC, the ACT considers that 50 per cent of the associated expenditure should also be excluded from equalisation.

- The land value ranges used in the Land Tax and Stamp Duty on Conveyance assessments should be revised to reduce the concentration of the tax bases in single value ranges. Such revisions should take place as a normal part of Reviews.
- Fire and Emergency Service Levies (FESL) should not be removed from the Land Tax and Insurance Tax assessments and netted from emergency services expenditure in the Other Expenses assessment as they are not user charges.
- The discount applied to the Land Tax assessment should be reduced from 25 per cent to 12.5 per cent.
- Non-royalty mining-related revenues should be included in the adjusted budget.
- The ACT does not support moving more revenue and expenses to the Other Revenue and Other Expenses categories as this has contributed to reducing the transparency and credibility of the Horizontal Fiscal Equalisation (HFE) system and is incompatible with the Productivity Commission’s suggestions in its inquiry into HFE.
- Consideration should be given to discounting the proposed additional block funded hospital cost loadings for remoteness in the Health assessment due to concerns with data reliability. Further analysis by the CGC is required to determine the most appropriate proxy data for non-admitted patient (NAP) and community health (CH) remoteness loadings.
- The proposed approach for assessing service delivery scale (SDS) cost weights for NAP and CH may result in overestimates. The CGC should review the weightings applied to these services.
- The 25 per cent discount to the socio-demographic composition (SDC) loading for CH services should be retained because the data being used in the assessment are a proxy for actual usage data.
- The ACT considers it is appropriate for the CGC to assess a cross-border disability for homelessness services clients on the basis that the assumptions necessary to calculate cross-border usage of homelessness services are no different from the assumptions the CGC regularly makes in various assessments where some data is missing and must be imputed.
- We acknowledge that the use of our child protection and out of home care services by New South Wales (NSW) children, while remaining an issue of concern for the ACT, is not an issue to be addressed via equalisation.
- We do not support the inclusion of a variable for ferry in the Transport regression model as it results in a lower goodness of fit and poorer parsimony than the model proposed by consultants.
- The ACT does not support the squared populations model for assessing urban transport infrastructure needs, even with a weight of 25 per cent. The consultant’s regression model for Transport discounted by 25 per cent achieves a more appropriate outcome.
- We support the revised model for determining passenger numbers wherein use rates have been proposed for use instead of modelling based on remoteness areas.

- The Transport regression model should be re-executed with updated data from the 2021 Census once it becomes available.
- The use of the regional cost gradient for schools in the general gradient would lead to an overestimation of regional costs. As an alternative, the CGC could use regional cost gradients for admitted patients (based on hospital location) and prisons or discount the general gradient by 50 per cent.
- The CGC's proposals for the National Capital disability are accepted. HFE remains the key safeguard mechanism by which we can seek recognition for the unavoidable costs we face due to our status as the national capital. However, we recognise that it would be preferable for these costs to be dealt with through an intergovernmental agreement on national capital, which would allow removal of the allowance from equalisation.
- We generally accept the CGC's proposals on the Cross-Border disability, though as with National Capital, we acknowledge that equalisation is not the ideal mechanism for dealing with such costs, which should be addressed through an intergovernmental agreement with NSW. Further efforts have begun in this regard.
- The benefits of higher quality assets due to the higher costs of capital works imposed by the National Capital Plan should be captured through appropriate discounting.

INTRODUCTION

This submission provides the ACT's response to the CGC's 2020 Review draft report. This submission was coordinated by the ACT Government's Chief Minister, Treasury and Economic Development Directorate (CMTEDD), with input from other ACT Government directorates.

We commend the CGC and its staff on the overall clarity and transparency of the draft report. Broadly, we accept that most of our conceptual arguments seeking amendments to the 2015 Review framework have been adequately and fairly responded to. We also acknowledge the CGC report is a consultation draft only, premised on proposed data sources and methods the CGC intends to adopt in its final report due in February 2020. We note that the final report will incorporate feedback from the submissions of the states and territories on the draft report.

We are generally supportive of the conceptual basis for the changes to the assessment methods proposed in the draft report and do not consider any major modifications to the proposals are necessary. Rather, we consider that some refinements across a range of assessments may be appropriate.

The delay by the Commonwealth in releasing the draft report to the states and territories compromised our capacity to consider the draft report and created resourcing pressures. Hence, while we realise that the CGC could not influence the delay much, we do not share its view that the six-week delay in the release of the report has not substantively affected the indicative timetable for submissions that was circulated and agreed by all states and territories in April 2019.

In addition to responding to the proposed assessment methods in the draft report, we continue to argue for changes to the traditional five-yearly review cycle. Along with stronger governance and refined administrative arrangements to encourage a greater sense of shared responsibility in the application of the HFE framework, this would significantly enhance the framework. The section on *Issues in Horizontal Fiscal Equalisation* in this submission presents an alternative approach to reviewing the GST distribution methodology. Consideration of such a proposal by the CGC in the final report would be welcome and could serve as a catalyst for broader deliberations by governments on the practical operation of the HFE system in consultation with the CGC.

STRATEGIC CONSIDERATIONS

The CGC's draft report suggests that if the new methods had been applied in the *2019 Update of GST Revenue Sharing Relativities* (Update), the ACT's GST share would have reduced by approximately $142 million, or $340 per capita in the 2019-20 financial year. A change of this magnitude must necessarily create significant budgetary issues for the territory which will need to be addressed over the coming four-year period.

Broadly, this significant variation arises from reductions in the ACT's assessed expenses for providing services relative to other jurisdictions, particularly due to a greater recognition of costs associated with servicing remote and very remote areas. Conversely, the revenue assessment regime appears quite stable, indicating a level of maturity in the assessment methods.

Table 1 illustrates the indicative impact of the changes in the assessment methodologies on the ACT.

Table 1 – Indicative Impact of the 2020 Review on the ACT's GST Grant, 2017-18.

Assessment	Distribution from EPC, 2019 Update		Distribution from EPC – 2020 Review Draft Report		Difference	
	$m	$pc	$m	$pc	$m	$pc
Payroll Tax	-16	-37	-16	-38	0	-1
Land Tax	73	175	86	207	13	31
Stamp Duty on Conveyances	42	100	33	79	-9	-21
Insurance Tax	5	13	12	29	7	16
Motor Tax	23	56	24	58	1	2
Mining Revenue	214	514	201	483	-13	-31
Other Revenue	0	0	0	0	0	0
Total Revenue	**342**	**821**	**340**	**817**	**-2**	**-4**
Schools	-57	-137	-47	-113	10	24
Post-secondary Education	5	13	5	12	0	-1
Health	-91	-218	-152	-365	-61	-147
Housing	-17	-42	-16	-38	1	3
Welfare	-56	-134	-59	-142	-3	-8
Services to Communities	-18	-43	-15	-36	3	7
Justice Services	-41	-99	-58	-139	-17	-40
Roads	-53	-127	-65	-156	-12	-29
Transport	-62	-148	-78	-187	-16	-39
Services to Industry	-10	-24	-11	-26	-1	-2
Other Expenses	308	739	318	764	10	25
Total Expenses	**-91**	**-219**	**-178**	**-428**	**-87**	**-208**
Infrastructure	-48	-115	-112	-269	-64	-154
Net Lending	-7	-16	-8	-19	-1	-3
Commonwealth Payments	92	220	104	250	12	29
Grand Total	**288**	**691**	**146**	**351**	**-142**	**-340**

Source – 2019 Update, 2020 Review draft report and CMTEDD calculations.

As we have noted in the past, one of the positive aspects of the HFE arrangements is the fact the CGC can exercise judgement if its best endeavours to build a reliable assessment methodology do not lead to an outcome consistent with its observations of state and territory circumstances. Given that the significant overall impact of the proposed changes for the ACT does not appear to reflect commensurate changes in the economic circumstances of the ACT relative to other jurisdictions, we consider the CGC should step back from the individual assessments and consider whether the overall outcome is consistent with the ACT's actual position.

Within this context, we support the CGC approach in adopting the 2015 Review as the starting point for the 2020 Review premised on the robustness of the methodology. We see the 2020 Review as an evolution of the 2015 Review methodology, as opposed to a significant shift. We also support the underlying principle of HFE, its principles and associated guidelines, which we consider to now be broadly settled following the legislative changes passed by the Commonwealth Parliament in 2018.

That said, we note that a quote in Box 2-1 titled *Horizontal Fiscal Equalisation in the Australian Federation* - "Commonwealth funding policies generally apply on a common basis in all [states and territories], so that in these areas there is effective equalisation operating throughout the Commonwealth" - does not hold true in relation to the current distribution of federal infrastructure funding between jurisdictions, which is exacerbated by quarantining and discounting.

We do not support the movement of more revenue and expenditure items into the Other Revenue and Other Expenses categories. This approach has created a perception that the CGC has been unable to differentially assess a very large proportion of state and territory revenues rather than that the differences in capacity between states and territories are not significant. Moreover, we consider that such an approach reduces public accountability and transparency of the framework which are vital to the credibility and legitimacy of the equalisation system, which were key areas of concern identified in the Productivity Commission's Inquiry into HFE. We consider that this is illustrative of an ongoing issue with the CGC not taking the lead of presenting and defending its GST distribution methodology against a backdrop of poor awareness and perceptions of the public, media and political representatives towards the CGC and its work.

While we broadly accept the CGC's position on national capital allowances and cross border impacts, we had expected greater engagement with us on the issues by the CGC beyond the formal workplace discussions, given the detailed submission we provided on the issues. However, while acknowledging that the CGC, under its principles and guidelines, cannot compensate the ACT for the full costs of operating as the national capital, totalling approximately $30 million per annum, we emphasise that they are real costs faced by the territory. We consider that these costs should ideally be met by the Commonwealth, not the states and the NT through HFE and the GST distribution. A note to this effect in the CGC's final report would be most welcome.

Likewise, we consider that the equalisation process is not an optimal means of addressing cross-border service costs, again due to the GST distribution methodology not being able to compensate the ACT for the actual costs of providing these services. A recommendation that the cross-border arrangements between the ACT and NSW should ideally be met through intergovernmental agreements would also be welcome to assist our respective governments in negotiations. Equalisation in the case of both national capital and cross-border is being asked to do what governments should strive to address.

The ACT had also expected the draft report would present the overall impact of the proposed methods for each state and territory's relativity, in addition to the impact of the proposed methods in each assessment. As a result, the states and territories have had to individually calculate their effective relativity for 2017-18 to enable a comparison with the relativity determined for 2017-18 in the 2019 Update, rather than a consistent approach being applied by the CGC. Consequently, several different interpretations were developed by and exchanged between the states and territories. While the focus of the CGC was on providing a consultation draft on the data sources and methods it proposes to adopt in its final report, understanding the budget implications of the proposed changes is key for the states and territories and something that we consider the CGC should have foreseen and facilitated.

Finally, we encourage the CGC to audit the assessments after their finalisation to ensure that the principles and guidelines of HFE are being consistently applied across them. In doing so, we would expect the CGC to take into consideration the impact of the revised methodology on the states and territories and their respective budgets.

MAIN REPORT

CHAPTER ONE

In relation to Table 1-4, while we understand the rationale for including the table, the way it is presented could give readers the impression that the states and territories have had limited impact on the outcome of the 2020 Review. Additional explanatory information, including linking the arguments presented by the states and territories detailed in Table 1-4 to the changes in the assessment methodologies detailed in Table 1-3 would help to address this concern.

Similarly, several of the proposals presented by the states and territories were not accepted because data was not currently available, or they were not material. The ACT encourages the CGC in its final report to propose possible ways forward for these issues, particularly for some of the more significant issues such as gambling taxes. We consider that emphasis should be given to continuing to monitor developments in the availability of new data sources. In addition, we suggest that the CGC could consider engaging with the Australian Bureau of Statistics (ABS) and other agencies involved in the collection and publication of national datasets related to these areas to improve or augment available data. This would also feed into the work program after the release of the 2020 Review.

CHAPTER TWO

The ACT has no comments on Chapter Two of the 2020 Review draft main report.

CHAPTER THREE

Elasticity Adjustments

The ACT has been a strong advocate for the adjustment of assessed tax bases using tax elasticities. In our February 2019 submission on *State Tax Elasticities of Revenue Bases*, we supported the approach taken by consultants engaged by the CGC – the Tax and Transfer Policy institute (TTPI) – in calculating the elasticities of state and territory taxes. We considered that the regression models used by the TTPI for determining elasticities were sound and recommended that a value of -0.36 be adopted for the tax elasticity of conveyance stamp duty.

We recognise that, although four of the five elasticities estimated by the consultants were statistically significant, the impacts on the GST distribution, other than for conveyance duty, would not reach the materiality thresholds applied by the CGC. However, despite the conveyance duty elasticity being material, the draft report proposes that no adjustment be made in the 2020 Review.

The reason given by the CGC for not proceeding with an adjustment is that “it is not clear that equalisation is improved by applying single adjustments to often divergent tax rates, in some parts of assessments but not of others” (Main Report p.67). If this was a valid criticism of elasticity adjustments, then there would have been no reason to commission the work from the consultants in the first place. The CGC’s final report should address the consultants’ findings.

We consider that the methodology used by the consultants was thorough and comprehensive, not focused only on “some parts of assessments”. Because we accept that adjustments should only be made where there is a material impact on the GST distribution, it is appropriate for “single adjustments” to be made in such cases.

Moreover, material impacts are only likely to occur where there is significant divergence of tax rates between the states and territories – that is what elasticity adjustments are intended to do. Revision of tax rates at each annual Update would presumably occur if elasticity adjustments were incorporated in the assessments, thus allowing for variations in these differences between the states and territories over time. It is only the elasticity factors that would remain constant across Updates, with revision only occurring at each Review.

The CGC has also noted in relation to the ACT that a counteracting adjustment could not be made to recognise the elasticity effects of our higher municipal rates, as they are not differentially assessed. It is not clear whether this is seen as a further reason for not making an elasticity adjustment. The CGC will continue to assess the ACT's capacity to raise stamp duty revenue regardless of whether, or at what rate, the ACT is imposing such a tax, and the impact of the revenue collected or forgone by the ACT will have negligible effect on the national average rate.

Even if the CGC brought the municipal rates base, or part of it, into consideration for such an adjustment, it would be unlikely to be material, given the small size of the ACT land base and associated revenues on a national per capita basis. Given where the ACT sits in the current land tax assessment, if a differential assessment of this revenue were to be material, it would be likely to move GST towards the ACT, rather than away. Moreover, if no elasticity adjustment is incorporated in the conveyance stamp duty assessment, the overall effect of our reform program should be an increase in assessed capacity, as a result of the much higher elasticity of stamp duty compared with that of land tax. Therefore, the omission of a "counteracting adjustment" does not create any favourable treatment of the ACT's revenue raising capacity compared with that of the states or the NT.

Finally, the draft report indicates that the CGC may review the issue of elasticity adjustments should states and territories undertake major tax reforms in the future. In the scenario of all or most states and territories undertaking a common tax reform program it is likely that tax rates across jurisdictions will become more closely aligned, which will reduce the likelihood of a material impact from an elasticity adjustment. The greater the divergence between state and territory tax rates the stronger is the case for elasticity adjustments.

The ACT considers that the final report should explicitly address the findings of the consultants' report, particularly the implications for material impacts on the GST distribution, as well as the potential disincentive not making an adjustment may create for state and territory tax reform.

CHAPTER FOUR

The ACT supports the CGC's proposed approach to the Commonwealth's *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018*. However, we note that the CGC's proposed approach to the guarantee that no state or territory will be worse off during the transition period only addresses how the CGC will treat the additional boost payments to the GST pool. There is no discussion of the CGC's role in maintaining two sets of relativities – one based on the pre-legislation approach and one based on the post-legislation approach – and how it will use them to determine whether a state or territory has been made worse off. We consider that the final report should detail the CGC's approach to this issue.

REVENUE ASSESSMENTS

COMMONWEALTH PAYMENTS

The draft report (Attachment 2, p.4) notes that in 2017-18 quarantined payments were 4.4 per cent of total payments for specific purposes, while no impact payments were a further 30.4 per cent of payments. Such a high proportion of excluded payments made by the CGC and not at the direction of the Commonwealth Treasurer requires careful consideration of the assessment approach in this category. In that regard, we welcome the CGC's intention not to apply a materiality threshold to Commonwealth Payments.

A large part of the no impact payments consists of infrastructure payments for NNR projects. The CGC intends continuing to treat 50 per cent of these payments as having no impact on state and territory fiscal capacities because these payments are influenced by Commonwealth considerations that are not captured in the disability measures used by the CGC in the Roads assessment. No evidence for assigning a high, rather than medium or low discount, has been provided, nor as to why a single discount factor should be applied to all projects. The draft report states only that spill-over effects would be difficult to quantify reliably.

The discussion of this issue in the draft report contrasts with the treatment in the Draft Assessment Paper (DAP) on Roads. In the DAP, CGC staff indicated that discussions with the Department of Infrastructure and Regional Development revealed that “the concept of a ‘National Network’ is fading as an influence on investment funding allocation.” It went on to say that investment funding for new projects “is more focused on achieving objectives, such as improving productivity/access, freight transport, connectivity (to ports etc), improving commuter times, reducing congestion, improving safety etc, rather than building a national network. That is, similar objectives apply to both NNR and non-NNR project funding”.

However, in the draft report the CGC considers that transport infrastructure projects “can have national objectives related to the efficient movement of people and goods that the [CGC's] assessments do not capture”. Accordingly, it has decided, “in the absence of a reliable method for quantifying the national benefits”, to maintain the current 50 per cent discount.

Further to this, the Roads attachment of the draft report sets out the basis for Commonwealth funding of NNR projects, which include improved infrastructure to support economic growth and activity; improved connectivity for communities, regions and industry; improved transport safety and integrated network-wide planning. The implication of the CGC's position is that these objectives include Commonwealth considerations that are not captured in the Roads assessment disability measures, thus warranting exclusion of 50 per cent of the payments from being equalised as revenue. However, the Roads chapter contains no discussion of the implications of this approach for the expenditure related to the Commonwealth payments. If those payments relate in part to needs which are not (and should not be) assessed by the CGC, then the associated expenditure should also be excluded from equalisation.

The ACT has consistently advocated for comprehensive equalisation of NNR payments. We will not repeat the arguments here, other than to note that Table 13 of the Roads DAP provides support for the ACT's concerns about the current assessment approach.

It shows an average allocation of $1 per capita in NNR funding to the ACT over the period 2013-14 to 2016-17, compared with a national average of $139 per capita. This allocation clearly does not reflect the ACT's real needs.

However, if the CGC maintains the position that 50 per cent of the NNR payments from the Commonwealth to states and territories should be excluded from equalisation, then the ACT considers that 50 per cent of the associated expenditure should also be excluded from equalisation. This amount would average in excess of $1.6 billion per year over the four years from 2013-14 to 2016-17. We ask the CGC to consider this proposal in the final report.

PAYROLL TAX

The ACT has no major concerns with the CGC's proposed assessment methodology for Payroll Tax.

Common Exemptions

We note that the CGC has not supported the ACT's proposal for an adjustment for common payroll tax exemptions provided by states and territories due to the lack of available data. The CGC does not appear to have any conceptual issues with such an adjustment.

While we acknowledge the CGC's position that the ACT's proposed data source – the Australian Charities Report – is not suitable for the purpose of making a common exemptions adjustment for charitable and non-profit organisations, we consider that the Business Longitudinal Analysis Data Environment (BLADE) could potentially provide the necessary data for such an adjustment in the future. As such, we consider that when the BLADE data set is finalised, the CGC should investigate whether it could be used to adjust state and territory payroll tax capacities to account for common exemptions.

In our response to the DAP on Payroll Tax, we noted that all states and territories other than Victoria (VIC) exempt charities and non-profit organisations from payroll tax. This was reiterated in the CGC's draft report. However, we now understand that under the *Payroll Tax Act 2007* VIC does exempt charities from payroll tax, so all states and territories provide payroll tax exemptions to charities and non-profit organisations.

LAND TAX

The ACT is generally content with the CGC's proposed methodology for Land Tax, however we do raise some issues with the approach.

Value Ranges Used in the Land Tax Assessment

Under the proposed methodology (as well as the methodology set in the 2015 Review), the CGC uses Revenue Office data on the value of properties and revenue generated from them, split across a variety of different value ranges.

The splitting of the revenue base into numerous value ranges is done to capture the effect of progressive land tax regimes, wherein properties of greater value are taxed at a higher marginal rate than properties with a lower value.

As shown in Table 2, when comparing the distribution of the tax base across the value categories, there is a clear concentration of the tax base into the *above $3 million* value range. From 2015-16 to 2017-18, 22.7 per cent of the tax base for the Land Tax assessment was captured under the *above $3 million* category. The next highest concentration, for comparison, was $0.2 to $0.3 million at 10.5 per cent.

Table 2 – Distribution of Land Tax base by value range – 2015-16 to 2017-18.

Value range ($ million)	Concentration (per cent)
0 to 0.1	3.7
0.1 to 0.2	10.3
0.2 to 0.3	10.5
0.3 to 0.4	7.4
0.4 to 0.5	6.0
0.5 to 0.6	4.9
0.6 to 0.7	4.3
0.7 to 0.8	3.7
0.8 to 0.9	3.2
0.9 to 1	2.8
1 to 1.5	9.3
1.5 to 2	5.3
2 to 2.5	3.4
2.5 to 3	2.4
Above 3	22.7

Source - CGC 2019 Update Simulator – 220 Land Tax – State Provided Data Simulator.

Furthermore, the above value ranges contrast considerably with the value ranges used by the states and territories in their land tax regimes. While the CGC's value ranges peak at $3 million, NSW, Queensland (QLD) and Western Australia (WA) all have value ranges for their land taxes which exceed the $3 million threshold:

- NSW's value ranges peak at $3.8 million;
- QLD's value ranges peak at $5 million; and
- WA's value ranges peak at $11 million.

Based on the high concentration of the land tax base in the *above $3 million* value range and the existence of higher value ranges in the land tax regimes of some states and territories, a case can be made for expanding the number of value ranges in the land tax assessment. The exact number of additional value ranges is difficult to determine without access to individual unit data, but in principle, they should be expanded such that the highest concentration of the base in any given value range is no greater than approximately 10 per cent.

We note that the CGC originally proposed not to change the composition of the value ranges used for the Land Tax assessment. However, the CGC has since indicated that they are receptive to doing so, noting in correspondence to the states and territories that they are considering expanding the number of value ranges to include *$3 million to $5 million*, *$5 million to $10 million* and a*bove $10 million* value ranges. This came after the ACT proposed an increase in the number of value ranges in the assessment in response to a draft data request on land and transaction values. The CGC's draft report does not reflect this possible expansion.

Accordingly, we do not support the CGC's position in the draft report that the value ranges used for the Land Tax assessment should remain unchanged from the 2015 Review.

We encourage the CGC to revise the assessment to include the *$3 million to $5 million*, *$5 million to $10 million* and a*bove $10 million* value ranges, noting that analysis of these value ranges should provide further insight into whether further value range additions would be required, depending on the concentration of the tax base. More generally, we consider that reviewing the value ranges used in the assessment should take place as a normal part of Reviews.

Fire and Emergency Service Levies

As we noted in our response to the DAP on Other Revenue, user charges relate to the provision of a specific service in order to offset the cost of that service. That is, user charges are revenues resulting from the sale of goods and services. As such, they discriminate between users and non-users of the good or service such that only those who use the good or service are expected to offset its cost. While we are generally support netting off user charges from their related expenses, reflecting that user charges reduce the financial burden to state and territory governments of providing services for which user charges apply, we do not agree with this treatment for FESLs.

FESLs are generally applied to all properties, either as a fixed charge, a variable charge determined by the value of the property or some combination of the two. As such, FESLs are applied as a relatively broad-based tax – they do not discriminate between properties for which fire and emergency services have been required to attend and those that have not. Consequently, the revenue generated from FESLs cannot be said to be from the direct provision of a service to a user.

Moreover, while the underlying drivers of emergency services usage and FESL revenue capacity share similarities – they are both influenced by the number of properties, for example, the drivers of the two have noticeable differences. Fire and emergency services use are influenced by drivers such as environmental factors as well as a variety of socioeconomic and sociodemographic indicators. These factors are generally not drivers of FESL revenue capacity.

Given this, we do not consider FESLs to be user charges and therefore do not support the CGC's proposal to remove them from the Land Tax assessment and netting them from emergency services expenditure in the Other Expenses assessment.

We acknowledge the CGC's position not to accept our proposal to assess other land-based revenue, including FESLs, using the same tax base as land tax and support the CGC continuing to assess them separately.

Discounting

The ACT supports the CGC's proposal to reduce the discount applied to the Land Tax assessment from 25 per cent to 12.5 per cent. We agree with the CGC's position that improvements in the quality of state and territory Revenue Office data and the general acceptance of that data being the most appropriate source for the assessment suggest that a 25 per cent discount is now too high.

ACT Replacement Revenue

In relation to the assessment of replacement revenue for the ACT, we support the CGC's position to no longer include replacement revenue for stamp duty in the Land Tax assessment. However, we consider the draft report does not accurately capture our position on the issue.

The draft report suggests our view is that as the CGC does not assess replacement land tax revenue for the Northern Territory (NT), it should not capture replacement conveyance duty revenue for the ACT. While this was part of our argument for the discontinuation of the replacement revenue assessment, our main point was that assessment of replacement revenue is not necessary, given how the CGC assesses revenue capacities.

As stated in our response to the DAP on Land Revenue, the CGC's assessment of the ACT's capacity to raise stamp duty revenue is unaffected by the ACT Government's tax reform program – once stamp duty is fully abolished in the ACT, the CGC will still assess the ACT's capacity to raise stamp duty revenue, just as is the case with NT and land tax. It was on this basis that we supported the CGC no longer assessing replacement revenue for the ACT in the Land Revenue assessment. We would appreciate if the final report more clearly outlined our position on this issue.

STAMP DUTY ON CONVEYANCES

The ACT is generally satisfied with the CGC's proposed methodology for Stamp Duty on Conveyances, however we do raise some issues.

Value Ranges Used in the Stamp Duty on Conveyances Assessment

Like the Land Revenue assessment, the CGC uses Revenue Office data on the value of property transactions and the revenue generated from them, split across a variety of different value ranges in calculating its assessed revenues from stamp duty for the states and territories.

As shown in Table 3, when comparing the distribution of the tax base across the value ranges, there is a clear concentration of the tax base into the *above $1.5 million* range. From 2015-16 to 2017-18, 31.4 per cent of the tax base for the stamp duty assessment was captured under the *above $1.5 million* range. The range with the next highest concentration, for comparison, was $0.4 to $0.5 million at 10.4 per cent.

Table 3 – Distribution of Stamp Duty on Conveyances (Property Component) base by value range – 2015-16 to 2017-18.

Value range ($ million)	Concentration (per cent)
0 to 0.1	0.4
0.1 to 0.2	2.5
0.2 to 0.3	5.8
0.3 to 0.4	9.4
0.4 to 0.5	10.4
0.5 to 0.6	9.2
0.6 to 0.7	7.5
0.7 to 0.8	5.7
0.8 to 0.9	4.5
0.9 to 1	3.4
1 to 1.1	2.3
1.1 to 1.2	2.1
1.2 to 1.3	2.1
1.3 to 1.4	1.8
1.4 to 1.5	1.5
Above 1.5	31.4

Source - CGC 2019 Update Simulator – 230 Stamp Duty – Property Component – State Provided Data Simulator.

Unlike the Land Revenue assessment however, the value ranges used by the CGC are generally in line with those used by the states and territories for their stamp duty regimes. Most jurisdictions have progressive stamp duty regimes with peak values around $1 million. Only one large jurisdiction, NSW, has a peak value above $1 million ($3 million). The other jurisdictions with peak values above $1 million are the NT ($5 million) and the ACT ($1.5 million).

That said, the significant concentration of the tax base in the *above $1.5 million* range suggests that an expansion of the number of tiers could be warranted. As with the land revenue assessment, the exact number of additional ranges is difficult to determine without access to individual unit data, but in principle, the number of ranges should be expanded such that the highest concentration of the base is no greater than approximately 10 per cent.

We note that the CGC has not proposed a change in the composition of the value ranges used for the Stamp Duty on Conveyances assessment. However, the CGC has indicated that they are receptive to doing so, noting in correspondence to the states and territories that they are considering expanding the number of value ranges to include *$1.5 million to $3 million*, *$3 million to $5 million* and a*bove $5 million* value ranges.

As with land tax, we encourage the CGC to revise the assessment to include the *$1.5 million to $3 million* and a*bove $5 million* value ranges, noting that analysis of these value ranges should provide further insight into whether further value range additions would be required, depending on the concentration of the tax base. More generally, we consider that reviewing the value ranges used in the assessment should take place as a normal part of Reviews.

Treatment of Concessional Rates

The ACT notes that the CGC intends to treat concessional rates of duty as a reduction in states' and territories' effective rates of tax, reversing the 2015 Review approach of converting concessional rates of duty into an expense assessed as a component of the Housing category.

Our view is that the 2015 Review treatment was more transparent, aligned with the concepts underlying tax expenditure statements and better reflected states' and territories' fiscal capacity.

The CGC has noted that six states and territories provide both concessional rates of duty and grants, suggesting that they are different forms of assistance. The introduction of first home owner grants was mandated by the Commonwealth government at the time of introduction of the GST, and maintained for some time afterwards at their insistence, rather than being a deliberate policy decision of state governments.

From 1 July 2019 the ACT abolished First Home Owner Grants and expanded conveyance duty concessions for eligible first home buyers to cover both new and established properties. The basis of this policy change was that reductions in duty are a more effective form of assistance than direct grants, indicating that they were regarded as alternative means of achieving the same objective.

INSURANCE TAX

Generally, the ACT has no concerns with the CGC's proposed assessment methodology for Insurance Tax, though we do not support the movement of insurance based FESLs from the assessment and netting them against the emergency services component of the Other Expenses assessment. As insurance based FESLs are levied on insurance premiums as the taxable base, they should continue to be assessed in the Insurance Tax category. Further details on our reasons for this position are in our response to the Land Tax assessment.

MOTOR TAXES

The ACT raises no issues with the CGC's proposed assessment methodology for Motor Taxes.

MINING REVENUE

The ACT raises no issues with the CGC's proposed assessment methodology for Mining Revenue.

Non-Royalty Mining Related Revenues

We support including non-royalty mining-related revenues as mining revenue in the adjusted budget. While noting that the letter from the Commonwealth Treasurer to the CGC requests no changes to the Mining Revenue assessment and that several of these revenues, such as WA's lease rentals, were not in existence at the time of the 2015 Review, we support the CGC's position that there is precedent from the 2015 Review and 2003 Update for non-royalty mining-related revenues being included in the Mining Revenue assessment. We consider there is no conceptual basis for their exclusion from the Mining Revenue assessment.

OTHER REVENUE

The ACT has consistently opposed the continuing trend for the CGC to move more revenue from specific revenue categories into the Other Revenue category.

In the case of revenue, such movements create a perception that the CGC has been unable to differentially assess a very large proportion of state and territory revenues rather than because the differences in capacity between states and territories are not significant.

Only about 13 per cent of Other Revenue is assessed EPC because either a sound assessment method or sufficiently reliable data are not available to support an assessment. The remaining 87 per cent of Other Revenue, comprising around $38 billion over the assessment years of the 2018 Update, is assessed EPC either because states and territories are considered to have the same fiscal capacity in the relevant categories or because a differential assessment would not be material.

The ACT considers that moving more revenue and expenses to the Other Revenue and Other Expenses categories reduces the transparency and understandability of the equalisation system, with consequent adverse impact on its credibility and legitimacy.

Gambling Revenue

The ACT considers that the CGC has incorrectly attributed taxation of online gambling as taxation in one state or territory relating to the activities of residents from another jurisdiction or overseas. We note that in Australia, taxes on online gambling are now based on point of consumption, pioneered by South Australia. Many other states and territories have followed that approach. Hence, using socio-demographics of a state or territory to determine the propensity of gambling, including online gambling, as a measure of gambling taxes collected is still feasible due to the nature of the tax imposed on gamblers.

EXPENSE ASSESSMENTS

GENERAL COMMENTS

The ACT welcomes the increasing use of regression models by the CGC in determining the assessed expenses in various categories. We note that in addition to Schools, in the 2020 Review assessed expenses in the Police and Prisons components of the Justice category have also been proposed to be determined using regression models. We also note a much-improved regression model has been proposed for use in the Transport category in comparison to those used in the 2015 Review. We consider these to be steps in the right direction, especially in cases where both regional costs and SDS disabilities apply, wherein the use of an inverse-size variable in the regression model (such as that used for Schools) enables a clear delineation of the two. In such cases, if the regression models used are robust, clear delineation of regional and SDS costs enhances the transparency of the assessment.

That said, there are some opportunities to improve the quality of information shared when regression models are used in assessments. At a minimum, the model specification, the type of variables used (categorical, a proportion etc) along with their units (dollars, million dollars, no units etc) and detailed results of the model (e.g. F-statistics, for each independent variable - value of the coefficient, standard error, t-value, p-value) should be presented in the reports. It would also be helpful to show the plot of residuals against each of the independent variables as they can reveal the presence of heteroscedasticity, omitted variable bias and so on. If such information is considered too complex for inclusion in the main report or the attachments, then such information should be provided in the supplementary information (in the same way as a subset of the requested information has been provided there in the draft report). Making this information available would assist the states and territories in their analysis and improve transparency of the assessment process.

SCHOOLS

The ACT raises no issues with the CGC's proposed assessment methodology for Schools.

POST-SECONDARY EDUCATION

The ACT raises no issues with the CGC's proposed assessment methodology for Post-Secondary Education.

HEALTH

Regional and Service Delivery Scale Costs

The ACT found the presentation of the CGC's proposals in this area difficult to follow and we needed to seek clarification on a significant number of matters. In particular, the relationship between Table 7 (p.14, Attachment 12) and Table 12 (p.18, Attachment 12) required substantial further explanation. We ask the CGC to provide a clearer presentation of the regional and service delivery scale costs for Health in its final report.

The draft report proposes to introduce loadings for block funded hospitals based on the ratio of costs between the Independent Hospital Pricing Authority (IHPA)'s National Efficient Cost and National Efficient Price models. This ratio is regarded as reflecting the higher remoteness and service delivery scale costs for low-volume, remote hospitals, which are not captured by National Weighted Activity Units (NWAU) data.

We note that the CGC DAP identified the possibility of change in this area, but also commented on the need for caution in interpreting the cost difference between very remote and less remote hospitals, stating that this difference "is heavily influenced by NWAU data from very small block funded hospitals where the NWAU data are less reliable". While the ACT recognises the conceptual validity of the CGC's approach, the concerns over data reliability indicate that consideration should be given to discounting the proposed additional loadings.

A further key area of concern is the use of proxy data in the NAP and CH components of the assessment. We acknowledge that the quality of the IHPA data in these two sectors may not yet be adequate for assessment purposes and that the use of proxies is appropriate. However, discussions with CGC staff have indicated some uncertainty about the best proxies to use, particularly between Emergency Department (ED) NWAU data and Admitted Patient (AP) separations data. Further analysis may be required for the final report.

The draft report appropriately recognises that the cost structures for NAP and CH services are different, and less expensive, than those for AP and ED services. In our view, the fixed costs of CH services are particularly likely to be considerably lower than for hospitals – maintenance of an ED being a major contributor to scale costs for small hospitals. The ACT is concerned that the proposed approach may overstate the SDS costs for NAP and CH and asks that the CGC review the weightings applied to these services for SDS costs.

Socio-Demographic Composition

The SDC assessment for CH is also currently subject to a 25 per cent discount, reflecting, as the CGC's has noted, "concerns about how closely the socio-demographic profile of people using EDs reflects the profile of people using [CH] services". However, the draft report now proposes to remove this discount, with no justification other than "it is unclear that a discount improves the assessment". This position contrasts with the views of the principles underpinning discounting expressed by the CGC in its Position Paper on *The Principle of HFE and its Implementation* (CGC 2017-21, September 2017). In this paper, the CGC stated:

> *"Discounting allows the [CGC] to partially recognise the influence of a disability when the presumptive case for the disability has been established but there are concerns with the measurement of that disability. In other words, discounting allows the [CGC] to achieve the HFE objective while taking into account practical issues which affect the measurement of [state and territory] fiscal capacities."*

The ACT considers that application of a discount to this element of the Health assessment is appropriate because the data being used are a proxy for actual usage data, an approach which is consistent with the CGC's approach in other assessments. We therefore consider the current discount of 25 per cent should be maintained.

WELFARE

The ACT broadly accepts the changes that have been suggested to the assessments in the Welfare category except for:

- the assessment of the cross-border disability in the homelessness sub-component of the other general welfare component; and
- the use of the regional cost gradient for schools in the general gradient for regional costs.

The CGC did not agree with the ACT's arguments in relation to the cross-border disability for homelessness expressing concern about the number of assumptions required to determine the cost impact and that the ACT did not provide data on ACT residents' use of NSW provided homelessness services. We consider that the assumptions we used are consistent with those the CGC regularly makes in various assessments where some data is missing and must be imputed.

The Australian Institute of Housing and Welfare (AIHW) data does not capture information on the number of homelessness services clients using services when they decline to report their address from the past week. This is likely because they are concerned that they would not be able to use the ACT's services for the homeless if they do not live in the ACT, therefore it is reasonable to assume that people withholding their address are likely to be from interstate. AIHW data from 2014-15 to 2017-18 shows that among the cross-border residents using the ACT's services, NSW residents account for a stable proportion of 75 per cent to 80 per cent. We consider a similar proportion can be applied to the number of homelessness services clients who refuse to declare their past address and therefore are very likely to be from interstate, in order to determine the total number of NSW residents using the ACT's services for the homeless. We consider these assumptions are reasonable and that the CGC should assess a cross-border disability for homelessness services clients.

Table 4 estimates NSW residents' use of the ACT's homelessness services. We have not included the ACT's actual costs since the cross-border assessment would be based on national average costs.

Table 4 - Estimated number of NSW homelessness services clients using the ACT's homelessness services

	Number of clients	Identified interstate clients	Identified interstate clients (per cent)	Identified NSW clients	Identified NSW clients as proportion of all clients (per cent)	Unidentified clients	Unidentified clients (per cent)	Unidentified clients likely from NSW	Total clients likely from NSW
2014-15	4510	322	7.1	241	5.3	934	20.7	699	940
2015-16	4298	343	8.0	258	6.0	963	22.4	724	982
2016-17	4162	361	8.7	279	6.7	864	20.8	668	947
2017-18	4026	292	7.3	232	5.8	803	19.9	638	870

Source: AIHW Geography Confidentialised Unit Record File (CURF) July 2019 and CSD calculations

We request the CGC to source similar data from AIHW and NSW and apply a similar approach to determine the use of NSW homelessness services by ACT residents. We consider that this would enable the CGC to determine whether a material cross-border disability applies in the case of homelessness services.

While it remains a significant issue for the ACT, we now accept that it is not appropriate to assess a cross border claim in relation to child protection and out of home care services provided to children in NSW.

Our driver for the claim was that the administration of the Protocol has significant cost impost on the ACT arising from the lagged reimbursement process. We acknowledge that this is a matter to be further pursued between the ACT and the NSW Governments.

Finally, while we agree with the conceptual case for the existence of regional costs in the Welfare category, we consider the use of the regional cost gradient for schools in the general gradient is an inferior approach since it potentially overestimates the impact of regional costs. Please refer to our response to *Attachment 25 – Geography* presented later in this submission for our supporting arguments and analysis.

HOUSING

The ACT raises no issues with the CGC's proposed assessment methodology for Housing.

SERVICES TO COMMUNITIES

The ACT raises no issues with the CGC's proposed assessment methodology for Services to Communities.

JUSTICE

The ACT raises no issues with the CGC's proposed assessment methodology for Justice.

ROADS

The ACT raises no issues with the CGC's proposed assessment methodology for Roads.

We note that the CGC has requested feedback on the bridge and tunnel data and calculations used for the Roads assessment. We will provide our feedback separately from this submission.

TRANSPORT

While we broadly support the introduction of the models for determining assessed urban transport recurrent expenses and urban transport infrastructure investment, we do not support all the changes the CGC has made to the model originally recommended by the consultants, Jacobs and Synergies Economic Consulting. We also do not support the blended assessments the CGC has proposed for both urban transport recurrent expenses and urban transport infrastructure investment, which attempt to avoid the application of a discount on these assessments. Our view is that application of a 25 per cent discount on these assessments is a better approach than the blended assessments that have been proposed.

Changes to the Regression Model in the Consultants' Stage Two Report

In our response to the consultants' report on Stage Two of the urban transport consultancy, the ACT expressed our support for the work the consultants have done in modelling the recurrent expenses for urban transport and their proposal to use the same model for the urban transport infrastructure investments assessment. The consultants' structured approach to development of the model along with the goodness of fit of the model they produced were clear indications of the soundness of their method.

We note, however, that the CGC has made certain adjustments to the model the consultants recommended. The CGC has:

- Considered bus services and light rail to be highly substitutable and to have similar cost structures. Hence, they have added the number of passengers travelling by light rail to the consultants' model which previously had only the number of passengers travelling by bus (along with heavy rail); and

- Added a dummy variable for the existence of ferry services to the model to ensure that all major modes of transport are covered.

The ACT supports adding the number of passengers travelling by light rail to the consultants' model. Advice from our Transport Canberra and City Services directorate confirmed that bus services and light rail can be considered as substitutable. The ACT does not, however, support the addition of the dummy variable for ferry to the model.

Detailed results of the new model sourced from the CGC indicate that the standard error of the dummy variable for ferry services (42.03) is much higher than the standard error for the other independent variables (the highest standard error among which is 6.96), which is a strong indicator of the presence of multicollinearity in the model. Regression coefficients can be unreliable in the presence of multicollinearity. The correlation matrix of independent variables the consultants prepared (Jacobs, *Urban Transport Consultancy Stage 2*, Figure D.1, p. 90) clearly shows that a dummy variable for ferry would be highly correlated with variables capturing the number of passengers commuting by heavy rail and bus and moderately correlated with the variables for population density and the number of light rail passengers. Hence it is not surprising that the addition of this variable has introduced multicollinearity to the model.

We also note that the adjusted R^2 and standard error of the CGC's proposed model are worse than those for the model that the consultants had proposed, albeit marginally, noting that the CGC's model has more variables. The adjusted R^2 for the CGC proposed model is 0.7585 while it is 0.77 for the consultants' proposed model, and the standard error for the CGC proposed model is 72 while it is 69 for the consultants' proposed model. Thus, the CGC's proposed model has a **lower goodness of fit and poorer parsimony** in comparison to the consultants' proposed model.

Further, Figure 4 in *Attachment 18 – Transport* (p. 21) shows that the percentage of commuters using ferry services is minuscule in comparison to the other modes of transport, with usage by 2 per cent of commuters in NSW being the maximum figure across the five largest states. Given such relatively low usage, when the adverse effects of the addition of this variable to the model are considered, we consider that the dummy variable for ferry should be removed.

Discounting rather than the Blended Assessments Approach

The ACT notes that the CGC has traditionally applied discounts to address shortfalls in data quality or in recognition that the data used to calculate a given factor or factors is not necessarily fully reflective of the factor(s). The use of proxies in the regression model, as acknowledged by the CGC, reflects the latter situation and warrants the application of discounting. However, the CGC has taken the view that the blended assessments approach is better than discounting. We do not agree with this view.

One of the reasons for our strong support for the consultants' proposed model for the urban transport assessments is our view that the two models used in the 2015 Review for assessments of urban transport recurrent expenditure and urban transport infrastructure investment were too simplistic and lacked strong conceptual bases.

While we support discontinuing the model used in the 2015 Review for recurrent expenses assessment, we consider it an anomaly that the arbitrary model currently used in the urban transport infrastructure investment assessment is still recommended for use, although with a lower weight of 25 per cent in comparison to the 50 per cent weight it had in the 2015 Review.

We consider the conceptual basis is weak for treating the quantum of infrastructure assets required per capita as directly proportional to urban population – in other words, the quantity of urban transport infrastructure assets a state or territory needs is dependent on the square of urban population. We note that Jacobs and Synergies Economic Consulting found very strong correlation between urban transport infrastructure investment and operating costs (Jacobs, *Urban Transport Consultancy Stage 2*, pp. 40-41) since the factors underpinning such expenditures are common to both. Further, studies undertaken by consultants in previous Reviews (e.g. the 2010 Review) with large American cities have shown that per capita operating costs tend to show a lower rate of growth for larger cities. This suggests that evidence for the proposition that cities of the size of Sydney and Melbourne (they both would have been among the ten largest American cities in 2018, even when the populations of the Greater Metropolitan Areas of American cities are considered) would need infrastructure investments depending on the square of their populations is quite weak.

The CGC's proposed blended assessment for urban transport infrastructure investment appears to combine two contradictory positions. The CGC accepts the consultants' argument that urban transport operating costs and urban transport infrastructure investments are strongly correlated with each other with similar underlying drivers. However, the CGC still proposes to use the squared populations model (which is linear at the per capita infrastructure investment level) for determining urban transport asset stocks. That model has a very different interpretation from the well-established diminishing returns shape of per capita urban transport operating costs, implying the two cannot considered to be highly correlated if the squared populations model is appropriate for urban transport infrastructure investments.

Hence, we do not support the use of the squared populations model for assessing state and territory urban transport infrastructure needs, even with a weight of 25 per cent. Instead, we consider the CGC should use the regression model (after dropping the dummy variable for ferry) to determine assessed urban transport recurrent expenses and assessed urban transport infrastructure investments in the first instance and then discount the results by 25 per cent to determine state and territory assessed expenses for both the assessments.

Determination of Modelled Passenger Numbers Using Use Rates

We support the revised model for determining passenger numbers wherein use rates have been proposed for use instead of modelling based on remoteness areas. Firstly, the sole focus on remoteness assumes that variation in public transport passenger numbers across Significant Urban Areas (SUA) can be significantly explained by the location of a SUA within a remoteness classification, which does not seem to be very accurate. Modelling passenger numbers using use rates considers all the myriad factors and avoids unnecessary assumptions, which is a better approach. Secondly, we note that the results produced using the model with use rates has a stronger correlation with the actual use of heavy rail and all modes of transport (i.e. heavy rail, bus and light rail combined) than the model based on remoteness areas (0.975 and 0.972 respectively vs 0.938 and 0.955 respectively), though we acknowledge the latter does show a stronger correlation with the actual use of bus and light rail (0.971 vs 0.957).

Updating the Assessment

Finally, we do not agree with one of the proposals on the updating of the assessment. We note the sensible proposal to update the population density, assessed number of passengers using public transport and distance to work after the release of the 2021 Census.

However, at the same time, the coefficients for the regression model have been proposed to be held constant during the review period and not be updated post the 2021 Census. This difference in updating approach appears illogical. Since the population density, assessed passenger numbers and distance to work are critical independent variables which assist in determining the regression coefficients themselves, it is appropriate that the regression model is re-executed, and the coefficients are updated once the data for these variables are updated post the 2021 Census.

SERVICES TO INDUSTRY

The ACT raises no issues with the CGC's proposed assessment methodology for Services to Industry.

We note the CGC's did not support our proposal for an adjustment to state and territory business development needs to account for Commonwealth assistance. The CGC rejected this proposal based on a lack of available data on Commonwealth business development expenditure by jurisdiction. While we acknowledge the lack of available data at present, we consider that this issue should remain open to reinvestigation in the future, should appropriate datasets become available.

OTHER EXPENSES

The ACT raises no issues with the CGC's proposed assessment methodology for Other Expenses.

In the DAP on Community Services CGC staff proposed that Protection of the Environment expenses be assessed in the Other Expenses category, on the grounds that most other state and territory expenses assessed on population are classified in the service expenses component of Other Expenses. However, the draft report takes the view that these expenses should be retained in the Services to Communities category "in order to maintain continuity with the 2015 Review category definitions and to simplify time series analysis". The ACT supports this position and asks that the CGC consider applying such criteria to other components of expense categories which are assessed equal per capita.

INVESTMENT

The ACT does not support the CGC's proposed blended assessment approach for the urban transport component of the Investment assessment. For details, please refer to the Transport chapter of this submission.

The ACT raises no other issues with the CGC's proposed assessment methodology for Investment.

NET BORROWING

The ACT raises no issues with the CGC's proposed assessment methodology for Net Borrowing.

DISABILITY ASSESSMENTS

ADMINISTRATIVE SCALE

The ACT raises no issues with the CGC's proposed assessment methodology for Administrative Scale.

WAGE COSTS

The ACT raises no issues with the CGC's proposed assessment methodology for Wage Costs.

GEOGRAPHY

The ACT broadly agrees with the CGC's proposed approaches for measuring regional costs and SDS, except for the proposed use of regional costs for schools in the general gradient and the use of proxies for measuring regional costs and SDS in the CH component of the Health assessment.

Regional Costs and Service Delivery Scale

The ACT agrees that regional costs and SDS are different concepts. As far as the cost gradients for the two are concerned, to understand the remoteness classification contributing the most to the slope, we sought to determine the relative increase in the cost gradient for a given remoteness classification in comparison to the immediately preceding remoteness classification. The results of our analysis are presented in Table 5 below. The orange shaded cells denote the highest ratio in a row.

Table 5 – Analysis of remoteness and SDS cost gradients by service delivery area.

Cost gradients according to Remoteness Areas (Source: Table 1, p.4, Attachment 25 - Geography)						Ratio of Cost Gradients		
	Major cities	Inner regional	Outer regional	Remote	Very remote	Outer Regional/Inner Regional	Remote/Outer Regional	Very Remote/Remote
Schools								
Regional costs	1	1	1.13	1.55	1.55	1.13	1.37	1.00
SDS	1.05	1.09	1.11	1.14	1.22	1.02	1.03	1.07
Combined effects	1.05	1.09	1.24	1.7	1.78	1.14	1.37	1.05
Post-secondary education								
Combined effects	1	1.1	1.16	1.62	1.87	1.05	1.40	1.15
Admitted Patients (by location of hospital)								
Regional costs	1	1	1	1.08	1.12	1.00	1.08	1.04
SDS	1	1.03	1.07	1.09	1.73	1.04	1.02	1.59
Combined effects	1	1.03	1.07	1.18	1.94	1.04	1.10	1.64
Emergency departments (by residence of patient)								
Regional costs	1	1	1	1.22	1.22	1.00	1.22	1.00
SDS	1	1.03	1.11	1.15	1.47	1.08	1.04	1.28
Combined effects	1	1.03	1.11	1.4	1.79	1.08	1.26	1.28
Prisons (Prison location basis)								
Regional costs	1	1	1	1.07	1.07	1.00	1.07	1.00
SDS	1	1	1	1.02	1.02	1.00	1.02	1.00
Combined effects	1	1	1	1.09	1.09	1.00	1.09	1.00
Courts								
Combined effects	1	1	1	1.1	1.1	1.00	1.10	1.00
Police								
Combined effects	1	1.5	1.6	3.2	9.5	1.07	2.00	2.97
Housing								
Regional costs			NYA				NYA	
Electricity subsidies								
Regional costs	-	-	-	1	3.45		-	3.45
Water subsidies								
Regional costs	-	1	1.26	2.62	2.62	1.26	2.08	1.00
Construction costs								
Regional costs	1	1.04	1.09	1.32	1.54	1.05	1.21	1.17

Source – CGC 2020 Review draft report and CMTEDD calculations.

Table 5 shows that the regional costs for water subsidies and schools have the highest gradient when one considers changes in input costs in a remote area vis-à-vis an outer regional area. We do not consider the ratios where the combined effects have been presented (as in the case of police) since in such cases the impact of regional costs solely is not discernible. We note the results for water subsidies and school education make intuitive sense.

However, we consider that the use of the regional cost gradient for schools in the general gradient, even though it is averaged with the regional cost gradient for admitted patients, would lead to an overestimation of the regional costs in the areas where the general gradient is applied.

The proportion of state and territory government employees working in schools in remote areas, as per Figure 2 p. 13 of *Attachment 25 – Geography* is approximately 1.6 times the proportion of the population living there (3.2 per cent vs. 2 per cent). Hence some of the premium paid in schools may be demand-driven which is possibly not the case for Social Services (for example) since the proportion of employees working in that field is approximately 50 per cent of the population (1 per cent vs 2 per cent). In other words, incentives are likely to be needed to attract qualified people residing in non-remote areas to move to remote areas in the case of schools, whereas in the case of social services the need for such incentives is lower since at least some of the positions can be staffed from the local population.

By contrast, if we look at the services where the general gradient is applied – child protection and family services, rural roads, services to communities other than water and electricity subsidies, regulation components of services to industry and other expenses – none of them need higher qualifications for providing the services (or have a specific need for higher input costs, apart from rural roads possibly), unlike schools. Hence, we consider the use of the regional cost gradient for schools potentially overestimates regional costs for the applicable services.

We understand one of the reasons the CGC uses the regional cost gradients for schools and police as measures of the general gradient is the state and territory-wide presence of those services. In the context of the 2020 Review, the CGC has indicated why it is not appropriate to use the regional cost gradient for police in the general gradient in Attachment 16 - Justice. We support this and consider that using the regional cost gradient for schools in the general gradient is also likely to be an inferior approach.

A possible alternative approach would be to use an average of the regional cost gradients for admitted patients (based on location of hospital) and prisons, given the proliferation of prison services across states and territories (as shown in Figure 2 p. 13 of Attachment 25 – Geography) and the apparent non-requirement of staffing people with higher qualifications (with associated premia) in prison services, similar to the services where the general gradient is applied. Further, the regional cost gradient for prisons has been determined reliably through a regression model.

If the CGC considers that the regional cost gradient for schools is the only viable option, a high discount (50 per cent) should be applied wherever the regional cost gradient is calculated using an average of schools and admitted patients, as currently done in the case of Other Expenses.

Our comments on the use of proxies for measuring regional costs and SDS in the CH component of the Health category are outlined in the relevant section of this submission.

OTHER DISABILITIES

National Capital

We generally accept the CGC's draft proposals for the National Capital disability. That said, this disability presents ongoing difficulty for the ACT and the CGC.

Both the ACT and the CGC have expressed the view that National Capital issues should be addressed through intergovernmental agreements and that HFE should not be expected to address their financial consequences in the absence of such agreements. We note that the Commonwealth continues to require the states and the NT to indirectly fund our status as the national capital through the GST distribution. We consider that this should be the responsibility of the Commonwealth.

In the absence of such an agreement however, HFE is the only remaining safeguard mechanism by which we can seek recognition for the unavoidable costs we face due to our status as the national capital. We note that due to the principles and guidelines of HFE, we will not be able to be compensated in full for these costs – we will only ever be able to be compensated in line with the national average cost of service provision related to national capital. We also acknowledge that benchmarking these costs is difficult for the CGC, on account of no other state or territory being subject to similar costs. Similarly, it has been a challenging task for us to collect the appropriate data to demonstrate the additional costs we face.

As a result of these inadequacies, residents of the ACT are thus required to bear the remaining costs of Canberra's status as the national capital. As indicated by Table 6, this remaining cost is equal to approximately $24 million per annum.

Table 6 – Difference between actual national capital costs and indicative 2020 Review disability.

Allowance	**Identified Cost**	**Implied 2020 Review Disability**	**Difference**
	$ million	**$ million**	**$ million**
National Capital			
Impact of the National Capital Plan on planning and development	1.8	1.8	0
Impact of the National Capital Plan on the ACT's Light Rail project	7	0	7
Impact of the National Capital Plan on the ACT's capital works program (excluding Light Rail)	10	2.2	7.8
Costs incurred by the ACT in operating a leasehold land management system	2.5	2.5	0
Additional costs incurred by the ACT in managing and maintaining above average urban open space and land	5.1	0	5.1
Protective services provided to the Commonwealth – suspicious packages response	1.5	0	1.5
Wider arterial roads and main avenues	2.8	0	2.8
Use of Australian Federal Police	8.5	8.5	0
Total	**39.2**	**15**	**24.2**

Source – CGC 2020 Review draft report, ACT Rejoinder Submission to the 2020 Review Workplace Discussions and CMTEDD calculations.

In the section on national capital planning allowances in the Other Disabilities attachment of the draft report (paragraph 21), the CGC has commented:

"While the Commission considers there to be a case for the extra administrative costs of the dual planning system, the case is less clear for the costs associated with higher quality assets and materials required in capital works projects, particularly since these have some offsetting benefits to the ACT which are difficult to quantify.

The [CGC] notes that, in relation to both the light rail project and other capital works, the majority of the additional costs cited by the ACT reflect acquisition of higher quality assets, rather than the administrative costs of interacting with the [National Capital Authority]. These higher asset costs, especially in the cost of transport, also appear to be informed by the choice of transport mode. This makes it difficult to determine the ACT's unavoidable capital costs."

The ACT considers that the argument about offsetting benefits of higher quality assets is unclear and of questionable relevance. To attempt to measure and then equalise differences in asset or service quality would be virtually impossible, both conceptually and practically, and beyond the normal scope of the CGC's methodologies. As we understand it, the CGC assesses averages purely in terms of expenditure on services or infrastructure and does not attempt to assess the quality of the services or assets provided. The assumption is that equalising expenses gives states and territories the capacity to provide services or assets of equivalent quality. Therefore, if the expenditure in question is a normal state and territory government function and needs can be assessed, then unavoidable cost differences between jurisdictions should be considered in the assessment.

Further confusion has been added by the comment that "higher asset costs, especially in the cost of transport, also appear to be informed by the choice of transport mode". The implication is that transport mode is a policy choice. However, the model proposed for the Transport assessment does not support that proposition, because mode is treated as one of the key drivers of cost without any discounting or adjustment of its influence.

If the CGC accepts the conceptual case for the higher costs of capital works imposed by the National Capital Plan but considers that some of the benefits of higher quality assets accrue to functions which are outside normal state and territory responsibilities, then the CGC should apply an appropriate discount to the additional costs to allow for these benefits.

Cross-Border

As with the National Capital disability, we broadly accept the CGC's proposals on the Cross-Border disability.

Similarly, it would be our preference, as well as the general preference of the CGC, that Cross-Border issues be addressed through intergovernmental agreements. We continue to pursue the development of such agreements, such as the intergovernmental agreement on the provision of healthcare services between the ACT and NSW. However, there are constraints in this regard due to our limited bargaining power in negotiations. To date, the HFE framework has remained the only feasible mechanism for the cost of significant elements of Cross-Border service usage to be recognised. We acknowledge that the development of an intergovernmental agreement with NSW will require a stronger whole-of-government approach, as opposed to the portfolio-by-portfolio approach that has been previously adopted.

An approximate estimate of the subsidy that the ACT taxpayers provide to NSW is shown in Table 7 below. The figure is about $55 million. When combined with the $24 million excess cost of Canberra's status as the national capital, ACT taxpayers effectively provide a combined subsidy of $79 million per annum to the Commonwealth and NSW, for which they are not reimbursed through the HFE framework.

Table 7: Calculation of an approximate estimated subsidy that the ACT provides to NSW

Serial	**Status of Cross-border Services Payment (on a net basis)**	**Amount**
A	Scheduled payment/awarded at present/claims accepted (approx.) ($ millions)	175
B	Restricted by CGC methodology/bilateral agreement with NSW (approx.) ($ millions)	40.5
C	Claims rejected fully/partially (approx.) ($ millions)	14.1
D	Total estimated value of cross-border services provided ($ millions) (A + B + C)	229.6
E	Total estimated value of subsidy to NSW residents ($ millions) (B + C)	54.6
F	Estimated subsidy (per cent) (E/D*100)	23.8

Source: CMTEDD calculations

Further, as noted in our response to the proposed assessment methodology for the Welfare assessment, we do not accept the CGC's rejection of our argument for a cross-border allowance for homelessness services. Please refer to the Welfare chapter of this submission for further information on this issue.

Land Rights and Native Title

The ACT raises no issues with the CGC's proposed assessment methodology for Land Rights and Native Title.

ISSUES IN HORIZONTAL FISCAL EQUALISATION

While the principle of HFE, guidelines and the assessments themselves have been comprehensively dealt with during the 2020 Review, there has been limited discussion of the approach taken to reviewing the methodology and other aspects of the administration and governance of the HFE framework.

ROLLING REVIEW

As we have indicated in the past, the ACT considers the cycle of five-yearly Reviews is no longer appropriate for deciding the methods used to determine the distribution of the GST. Political and economic settings have changed significantly since the five-yearly Review cycle was introduced in 1993, and the demands on public services and the way they meet them have also responded to the different context in which we are operating

The ACT considers that an alternative, more flexible approach would be more appropriate for the current environment in which we are operating. One such alternative would be a rolling review – reviewing a select number of assessments mutually agreed upon by the CGC and the states and territories on an annual basis. A rolling review would allow changes in the GST distribution methodology to be introduced gradually in response to changing economic and policy environments, as well as making the HFE framework more transparent to the Australian public and more accessible to governments and their public services.

At the time of the 2015 Review draft report, the CGC had indicated the possibility of more frequent reviews of the GST distribution methodology rather than through the five-yearly cycle, given the dynamics of federal financial relations, then driven by the White Papers on Federation and National Taxation Reform. The CGC did not, however, take the issue further in the 2015 Review final report, instead suggesting that annual Update guidelines provide it with the capacity to respond to changes in state, territory and national policy if required. Although it was again raised by the ACT in correspondence with the CGC, this issue has not been canvassed in the 2020 Review draft report. We would welcome the CGC including a discussion of the proposal in the final report which could serve as a catalyst for a broader discussion by governments.

The 2020 Review draft report builds upon the 2015 Review, with the CGC noting in paragraph 1.6 that the bulk of the 2015 Review methodology was sound. Given the relative stability of the GST distribution methodology, particularly going forward given the reforms arising from the Commonwealth's *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018*, a comprehensive 2025 Review may not be necessary. We consider that a rolling review program would be a more practical alternative to updating the GST distribution methodology.

Conceptually, a rolling review would entail the CGC investigating possible changes to the GST distribution methodology on an annual basis, as opposed to on a five-yearly basis as is currently done. These annual reviews would not require all assessment categories to be examined simultaneously but would rather involve a targeted approach where there is consensus among the CGC, the states and the territories that a given category or disability should be scrutinised.

A rolling review would represent a significant shift in how the GST distribution methodology is determined. Assessment categories would be analysed on a needs basis and the process of reviewing the GST distribution methodology would be broken down into smaller projects which are conducted on a more frequent basis. This approach would significantly smooth the workload of reviewing the GST distribution methodology, while making the process more responsive to changes in state, territory and national policy.

History of the Five-Yearly Review Cycle

The five-yearly review cycle was first introduced in 1989-90, when the CGC introduced new arrangements for updating the GST relativities. Triennial Updates were to be replaced with annual Updates based on the average of the last three financial years using the existing assessment methodology, while the methodology itself was to be reviewed in five-yearly intervals.

Expectations at the time were that the new arrangement would reduce work demands on the states and territories and provide more flexibility for addressing major policy changes, while still accommodating medium-term trends in state and territory fiscal capacities. Further, by extending the length of time between Reviews, the CGC would have more time to analyse and report on the assessment methods. Commencing in 1989, the CGC produced annual Updates under the GST distribution methodology set in the 1988 Review until the 1993 Review. This process continues to this day.

In practice, however, the GST distribution system has not been genuinely settled by five-yearly review since the 1999 Review. From the 2004 Review onwards, every analysis of the GST distribution methodology has been followed shortly thereafter by an independent evaluation of Australia’s HFE system:

- The 2004 Review was followed by a Heads of Treasuries’ Strategic Task Force on HFE;
- The 2010 Review was followed by the 2012 GST Distribution Review; and
- The 2015 Review was followed by the Productivity Commission Inquiry into HFE.

The 2012 GST Distribution Review and the Productivity Commission Inquiry into HFE were both responses to the perception that Australia’s HFE system was failing to cope with the consequences of the mining boom.

The 2020 Review draft report suggests that the GST distribution methodology will be next reviewed in five years – the 2025 Review. However, under new Commonwealth legislation the Treasurer is required under Section 4 of the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018* to refer the recently introduced GST distribution arrangements to the Productivity Commission for review, with a reporting date no later than 31 December 2026. This means that the 2025 Review would also be followed immediately by an independent evaluation of Australia’s HFE framework. A rolling review program would avoid the complexities and resourcing associated with potentially overlapping review processes.

Administration of Horizontal Fiscal Equalisation

As mentioned earlier, Australia’s HFE system is highly complex and difficult to understand. Reflecting this, recent CGC reviews, as well as independent evaluations of the HFE system have advocated for greater simplicity, particularly in how the GST is distributed.

However, the difficulty of achieving such reform has been exacerbated by the zero-sum nature of the GST distribution.

Due to its complexity, the successful administration of Australia’s HFE system (and federal financial relations framework more broadly) is dependent on the maintenance of capacity in the public services of the states and territories, as well as the Commonwealth and the CGC. This has generally been achieved by highly specialised teams in each jurisdiction’s public service.

One of the key disadvantages of the five-yearly review cycle is the large variations in workload during the inter-review period. This is compounded by the current arrangements for reporting, wherein each review is required under Terms of Reference to be finalised by February of the first application year’s calendar year, while including data from the previous financial year (e.g. the 2020 Review is required to be completed by February 2020 and include data from financial year 2018-19, ending 30 June 2019). This arrangement leads to significant increases in work intensity in the last two years between each review.

Further, the resources required for the two final years of each inter-review period significantly exceed those for the Updates for the first three years of the inter-review period. However, due to the complexity of the work, it is impractical for federal financial relations units to adjust resourcing levels in accordance with their workloads. As a result, the five-yearly review cycle creates inefficiencies in departmental resourcing.

Additionally, today’s public sector is significantly different to that which existed in 1993, with a focus on staff agility, flexibility and multi-tasking. This approach has resulted in staff, particularly at the management and executive levels, getting broader experience across a range of issues, rather than necessarily developing deep expertise in individual areas. While beneficial for encouraging holistic approaches to policy and service delivery, it can make it more challenging to get across complex issues. In some cases, states and territories have relied on contractors with background on HFE issues to provide the detailed technical expertise.

The major peaks and troughs created by the five-year review cycle make it more difficult to maintain the detailed technical expertise necessary to participate in the reviews, and this could be improved by a better distribution of the workload over that period. While any review of the GST distribution methodology requires significant analytical and research work, opportunities to smooth the workload over time should be investigated. We consider that a rolling review program would be of significant benefit in this regard, while also being more suitable for the current operation of agile public services across the nation.

Implementation of a Rolling Review

A rolling review from 2021 could be built on the GST distribution methodology set by the 2020 Review. The principles and guidelines of HFE set by the 2020 Review and the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018* would provide the broader conceptual basis of the program and generally would not need to be reviewed.

In practice, the CGC could be given ongoing Terms of Reference to provide the Commonwealth Treasurer recommended GST relativities on an annual basis in accordance with the principle of HFE. These Terms of Reference would permit the CGC to investigate changes to its assessment methodology at its discretion in consultation with the states and territories.

The Commonwealth Treasurer would no longer be required to provide annual Terms of Reference for Updates or Reviews but would be able to provide to the CGC details of payments to the states and territories that are to be quarantined from equalisation at their discretion. An ongoing Terms of Reference could be provided through an amendment to the Intergovernmental Agreement on Federal Financial Relations and/or to the *Commonwealth Grants Commission Act 1973* and *Federal Financial Relations Act 2009*.

The Commonwealth Treasurer could also provide instruction to the CGC to investigate the use of emerging research or data in the assessments, such as those identified in the 2020 Review as requiring further analysis, including differential assessments of gambling revenue, cultural and linguistic diversity disabilities, allowances for disabled school students, the impact of Commonwealth assistance to industry on state and territory business development expenses and the differing capacities of jurisdictions to attract Public-Private Partnerships. In addition, the CGC could lead the development of a work program with the states and territories for investigating emerging issues and their possible ramifications on the assessments.

ADMINISTRATION AND GOVERNANCE OF HORIZONTAL FISCAL EQUALISATION

In addition to changing the current cycle of five-yearly reviews, the ACT considers greater emphasis needs to be given to the administrative and governance arrangements of Australia’s HFE framework. The recommendations of the Productivity Commission inquiry, as well as the 2012 GST Distribution Review, have called for a more proactive role from the CGC and the Commonwealth in ensuring a stronger HFE framework and the general understanding of that framework. Australia’s HFE system is not well understood by not only the public, but also by members of Australia’s governments and public services, which led to confusion as to who is accountable for outcomes in the GST distribution and created misunderstandings about how the framework operates.

A change to the five-yearly review cycle would work hand in hand with a stronger administrative and governance framework. The implementation of a revised review cycle would facilitate reform of the administrative and governance framework of HFE. This would include the potential for creating a greater role for the Council on Federal Financial Relations in the governance of HFE and the development of the HFE work program.

We acknowledge that reform of HFE’s administrative and governance arrangements, as well as changes to the review cycle, are issues that the CGC is not expected to address under the 2020 Review Terms of Reference. Thus, these suggestions would ultimately need to be considered by governments outside of the 2020 Review. Nevertheless, we would welcome discussion on these issues by the CGC in the 2020 Review final report.

Chief Minister, Treasury and Economic Development Directorate

October 2019