



ACT
Government

Chief Minister, Treasury and
Economic Development

Mr Michael Willcock
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Michael
Dear Mr Willcock

ACT Response to New Issues for the 2019 Update

I am pleased to forward to you the attached submission to the Commonwealth Grants Commission (Commission) on Staff Discussion Paper CGC 2018-04-S, titled *New Issues for the 2019 Update*, as requested by the Commission by email dated 9 October 2018.

The submission provides the ACT's views on each of the Commission staff recommendations to the Commission captured in the discussion paper. The ACT notes that the unavailability of formal Terms of Reference (ToR) from the Commonwealth Treasurer has in various places forced the Commission staff's analysis to be based on assumptions about the content of the ToR. While the lack of formal ToR seems to be the new 'normal' for every Update and the Commission staff analysis indicates that advice has been given to the Commission on the ToR, the ACT considers that this approach is suboptimal for all participants in the Update process.

Broadly, the ACT supports the majority of the Commission staff recommendations to the Commission, though there are some differences in the ACT's perspective regarding the treatment of natural disaster relief expenses.

I trust that the commentary in the ACT's submission is informative and assists the Commission in framing the *Report on GST Sharing Relativities 2019 Update*.

Yours sincerely

David Nicol
Under Treasurer

29 November 2018

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COMMONWEALTH GRANTS COMMISSION 2019 UPDATE OF GST REVENUE SHARING RELATIVITIES

***NEW ISSUES FOR THE 2019
UPDATE***

ACT GOVERNMENT SUBMISSION

NOVEMBER 2018

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INTRODUCTION

Each year, the Commonwealth Grants Commission (Commission) updates the relativities which determine the distribution of the Goods and Services Tax (GST) between the States and Territories. As part of the update process, Commission staff consult with the States and Territories with any new issues which have arisen since the last update which could impact on the Commission's assessments of State and Territory fiscal capacities.

On 9 October 2018, the Commission circulated Staff Discussion Paper CGC 2018-04-S, New Issues for the 2019 Update to the States and Territories for comment. This Staff Discussion Paper identifies issues that have emerged over the course of the 2017-18 and 2018-19 financial years which may influence the Commission's 2019 Update of GST Revenue Sharing Relativities (2019 Update).

The ACT welcomes the opportunity of commenting on the range of issues that Commission staff have identified and presents its commentary on the Staff Discussion Paper below. We also note that the 2019 Update will be the final update prior to the release of the 2020 Methodology Review of GST Revenue Sharing Relativities (2020 Review). Consequently, the 2019 Update is also the last update that will be performed on the basis of the assessment methodology established in the 2015 Methodology Review of GST Revenue Sharing Relativities (2015 Review).

ISSUES FOR THE 2019 UPDATE

MINING REVENUE ASSESSMENT

Treatment of Lithium Royalties

Background

Under the assessment methodology established in the 2015 Review, the Commission maintains a mineral-by-mineral assessment across major minerals for mining revenue capacity. These major minerals are:

- Iron ore;
- Coal;
- Gold;
- Onshore oil and gas;
- Copper;
- Bauxite; and
- Nickel.

All other minerals are assessed under an aggregated category.

Over the last several years however, Australia's production of lithium has increased dramatically, with production increasing by 70 per cent from 1,610kT in 2015 to 2,730kT in 2016 alone as per the *Australia's Identified Mineral Resources 2017* report published by Geoscience Australia.

Consequently, mining royalty revenues for lithium have also increased, with Western Australia's (WA) lithium royalties increasing from \$24 million in 2016-17 to \$89 million in 2017-18. Further, Commission staff note that the WA 2018-19 Budget's lithium royalties forecasts exceed \$100 million from 2018-19; a quantum greater than the estimated royalties for nickel.

Commission Staff Position

As a consequence of the significant increase in lithium mining royalties, Commission staff have considered whether lithium royalties should be assessed separately in the mining revenue assessment. Commission staff have concluded that given the 2019 Update would only assess one year that includes significantly high lithium royalty revenues, a separate assessment of lithium royalties would likely not be material. Hence, Commission staff have proposed to retain the 2015 Review approach and not assess lithium royalties separately; retaining them in the other minerals component. Commission staff have noted that this issue will be addressed again as part of the 2020 Review as well as the broader issue of aggregating mineral revenue assessments.

ACT Position

The ACT supports the Commission staff position. While we welcome this issue being reinvestigated in the 2020 Review, we concur with Commission staff position that a separate assessment of lithium royalties would likely not be material for the 2019 Update. Moreover, we consider that assessing lithium royalties separately would represent a methodological change to the mining revenue assessment, which would be out of scope for the 2019 Update.

Transfer Pricing of Minerals

Background

As noted by Commission staff, in May 2018, the Queensland (QLD) Government settled a legal dispute with BHP on the underpayment of royalties on coal sales to BHP's Singapore based subsidiary; BHP Billiton Marketing. QLD had demanded payment in excess of \$300 million from BHP due to a reassessment of the value of coal exports produced by BHP and Mitsubishi from the Bowen Basin, with QLD arguing that the royalty rate should apply to the price that BHP Billiton Marketing sold the exported coal at to its end customers, rather than the transfer price between BHP and BHP Billiton Marketing. These transactions occurred from 2005 to 2015. The details of the settlement are confidential.

Commission Staff Position

Commission staff have considered whether the revenue from the settlement should be treated as coal royalties and thus assessed under the mining revenue assessment, or be treated equal per capita. Commission staff have commented that as the settlement is confidential, they are unlikely to be able to acquire the needed information of the settlement in order to differentially assess the revenue. Moreover, Commission staff also noted that BHP did pay royalties during the contested period and that the contested period falls outside of the 2019 Update's assessment years. On this basis, Commission staff have proposed to assess the revenue from the settlement on an equal per capita (EPC) basis.

ACT Position

The ACT supports the Commission staff position. We consider that the revenue from the assessment should be treated as revenue for the years in the contested period.

Given that the Commission does not provide retrospective adjustments in relation to years falling outside the current assessment period, we regard the revenue from the settlement to be not relevant to the 2019 Update.

USE OF 2016 CENSUS DATA

Background

In the 2015 Review, the Commission committed to the use of 2011 Census data across most assessments which required the use of Census data. However, in March 2018, more up-to-date data from the 2016 Census was released by the Australian Bureau of Statistics (ABS). The release of the 2016 Census, as noted by Commission staff, had further effects in updating numerous datasets which are dependent on it across a wide range of factors considered by the Commission in its assessments, including:

- Socio-economic status;
- Remoteness;
- Service delivery scale;
- Measures of local roads in unincorporated areas;
- Small isolated communities;
- Discrete indigenous communities;
- Social housing use; and
- Client bases for services to industry regional costs.

ABS has not however produced new estimates of indigenous population growth on the basis of 2016 Census data.

Commission Staff Position

Commission staff, noting the impact of the 2016 Census on other databases, have identified that the 2016 Census will be incorporated into its assessments automatically. Thus, Commission staff have proposed to use 2016 Census data across all assessments.

Noting that ABS has not produced new estimates of indigenous population growth based on the 2016 Census, Commission staff further propose to apply the growth rate in indigenous population from the 2011 Census to the indigenous estimated resident populations from the 2016 Census to estimate the indigenous population in 2016-17 and 2017-18. This is the same approach utilised in the 2018 Update of GST Revenue Sharing Relativities (2018 Update).

ACT Position

The ACT supports the Commission staff position. We consider that there is no conceptual basis for the ongoing use of old data when more up-to-date data is available for practical use.

NATURAL DISASTER RELIEF EXPENSES ASSESSMENT

Background

Under the Natural Disaster Relief and Recovery Arrangements (NDRRA), States and Territories are required to provide a share of funding for natural disaster relief (with a maximum 75 per cent coming from the Commonwealth Government).

Further, local governments are able to claim partial reimbursement for response and recovery actions taken under the NDRRA. As noted by Commission staff, some States and Territories report local government net expenditure on natural disaster relief in addition to net expenditure by the State/Territory government.

Under the Commission's principles of Horizontal Fiscal Equalisation (HFE), the Commission is required to only equalise the fiscal capacities of the State and Territory governments, not local governments. Hence, the inclusion of local government expenditure in the Commission's assessment of natural disaster relief expenses is not consistent with the Commission's approach to HFE. In order to ascertain the impact of local government expenses on the assessment, the Commission has requested for the 2019 Update that local government expenses be reported separately in the State and Territory data requests.

Commission Staff Position

Commission staff have proposed to continue to assess total reported NDRRA expenses (inclusive of local government net expenses) in the 2019 Update and to investigate the impact of local government net expenses on the assessment in the 2020 Review.

ACT Position

The ACT has numerous concerns with the proposed approach. We note that inconsistencies in State and Territory data are of particular concern in the natural disaster relief assessment due to it being an actual per capita assessment. As such, discrepancies and anomalies in reported data are not smoothed out by averaging across States. Pending the results from the 2019 Update data requests, if these discrepancies are significant, the data that is used for the assessment may not be fit for purpose.

The ACT acknowledges that the Commission has identified the problem and, through the 2019 Update data request, has taken steps to determine its significance. However, we consider that the Commission has not made clear what its intended course of action will be in the event that the returned data from the States and Territories indicates that local government net expenditure is significant relative to State and Territory net expenditure. Moreover, we note that Commission staff's latest concerns with the reported data are at odds with advice given in the draft assessment paper for the 2020 Review which states, on the basis of an Australian National Audit Office report, that the Commission is confident that reported claims under the NDRRA are comparable and eligible (i.e. there is little to no inappropriate reporting by the States and Territories of NDRRA expenses).

In light of the above concerns, we consider that the Commission should not commit to assessing total reported NDRRA expenses in the 2019 Update until it has received and reviewed State and Territory data to ensure that the impact of local government net expenditure is not significant. If local government net expenditure is significant, the Commission should remove it from the assessment.

WELFARE ASSESSMENT – TREATMENT OF NATIONAL DISABILITY INSURANCE SCHEME RELATED PAYMENTS

Background

Seven States and Territories are currently scheduled to reach full implementation of the National Disability Insurance Scheme (NDIS) by the beginning of the 2019-20 financial year; the application year of the 2019 Update. However, several of these States and Territories are currently lagging in their implementation of full scheme NDIS and are not expected to have actualised full scheme by the scheduled date.

Due to the ongoing difficulties experienced by some States and Territories in reaching full scheme by 2019-20, some States and Territories will be permitted to discount their funding of NDIS on the basis of the number of disability service programs that are yet to transition to NDIS. This means that the full scheme level of participation will not have been achieved in all States by July 2019, with actual levels affected by policy choices of States and Territories.

Further, States and Territories currently assign disability funding to different areas of service delivery (i.e. health, education, transport, etc.), in particular funding related to in-kind services. These in-kind services are counted as contributions to the NDIS up to an agreed maximum value, though there is currently no uniform framework for what services are eligible to be counted as NDIS contributions. It is expected that both the discounts and in-kind contributions will be phased out over time after implementation of full scheme.

In the 2015 Review, the Commission committed to differentially assess NDIS expenses during the transition period on the basis of estimated participant numbers by State at the start of full scheme, while implementing an actual per capita (APC) assessment upon the commencement of full scheme. This approach was deemed feasible by the Commission on account of all States and Territories operating under the same disability policy upon implementation of full scheme NDIS.

Commission Staff Position

As indicated above, the preferred approach of Commission staff for assessing NDIS expenditure upon implementation of full scheme would be an APC assessment based on NDIS expenditure in 2019-20, backcast to the assessment years. However, as NDIS funding for States and Territories which are experiencing difficulty in implementing full scheme NDIS by 2019-20 has been permitted to be discounted on the basis of a policy influenced measure, Commission staff consider a backcast APC assessment to be incompatible with the principle of policy neutrality. Thus, Commission staff propose to assess NDIS expenses on an EPC basis. The EPC assessment would however be based on population data from the 2011 Census; the same data source used to determine State and Territory contributions to the NDIS.

Commission staff also propose to continue to differentially assess non-NDIS disability expenses on the basis of the number of NDIS eligible people upon the implementation of full scheme, adjusted for regional and wage costs and cross-border influences.

ACT Position

The ACT supports the Commission staff position.

We concur with the observation made by Commission staff that the discounting of NDIS contributions and provision of in-kind services introduces policy influence into State and Territory NDIS expenditure and thereby makes a backcast APC assessment untenable for this Update.

We further consider that using the same census data that is used for determining Commonwealth Government funding under the NDIS for each State and Territory is also conceptually sound and would result in the EPC assessment more closely approximating an APC assessment without introducing policy influences.

Furthermore, we consider that using an APC based assessment could be problematic given the ongoing recognition of in-kind services under NDIS. An APC assessment is only viable if there is a uniform framework for determining which services can and cannot be counted as NDIS contributions. Without that, the provision of in-kind services introduces further policy neutrality concerns and decreases the comparability of each State and Territory's expenditure on NDIS. This concern should be taken into account by the Commission in the 2020 Review and further Updates.

The ACT has raised concerns with the Commission's proposed treatment of non-NDIS expenses in future years in our response to the draft assessment papers for the 2020 Review. We reserve the right to continue to pursue these concerns over the course of the 2020 Review.

SALE OF SNOWY HYDRO LIMITED TO THE COMMONWEALTH

Background

Snowy Hydro Limited is a government owned corporation that provides electricity generation services, principally through the operation of the Snowy Mountains Hydroelectric Scheme. Snowy Hydro Limited also provides electricity retail services through its subsidiaries Red Energy and Lumo Energy.

Snowy Hydro Limited was, for most of its history, owned jointly by the Commonwealth Government (13 per cent) and the New South Wales (NSW) (58 per cent) and Victorian (29 per cent) governments. However, in March 2018, the Commonwealth Government announced that it would purchase NSW's and Victoria's equity in Snowy Hydro Limited for \$4.154 billion and \$2.077 billion respectively. This transaction was completed over the course of the 2017-18 financial year. The Commonwealth Government's purchase was made with the condition that the proceeds of the sale be used for the development of productive infrastructure.

Commission Staff Position

Commission staff have indicated that they expect to receive Terms of Reference (ToR) for the 2019 Update to quarantine the proceeds of the sale of Snowy Hydro Limited, such that they will have no impact on the relativities. Moreover, Commission staff consider that the sale is an exchange of different financial assets (equity for cash) and thus would have no impact on States' and Territories' net financial worth or fiscal capacities.

Commission staff have also indicated that the sale condition that the proceeds be spent on productive infrastructure may have second order effects on State and Territory fiscal capacities, though notes that the impact is ambiguous and dependent on what exact infrastructure is developed though the expenditure as well as impractical to remove.

On this basis, Commission staff propose to not assess the impact of the sale of Snowy Hydro Limited and to not make any adjustments to State and Territory budgets to account for any second order effects from the consequent infrastructure expenditure.

ACT Position

The ACT supports the Commission staff positions, though we do note that any increase in infrastructure funding resulting from the proceeds of the sale would not likely result in any changes to the underlying drivers of infrastructure investment needs. However, there may be some effect from the increase in total expenditure in this category, which would work against States and Territories with below average assessed needs. This impact would also depend on the timeframe over which the funds are expended. The ACT agrees that attempting to adjust for such effects would be impractical.

CHANGES IN THE ADJUSTED BUDGET

Use of New Government Finance Statistics Classification Data

Background

The Commission compiles actual State and Territory revenues and expenses on the basis of Government Finance Statistics (GFS) data across the assessment years, with the first two assessment years using GFS data sourced from ABS and the final assessment year using GFS data sourced from the States and Territories. All GFS data is generated in compliance with ABS's GFS framework.

In July 2017, ABS implemented a new GFS framework, AGFS15, replacing the AGFS05 framework that was originally implemented in July 2005. For the 2019 Update, the most recent assessment year's (2017-18) GFS data was prepared under the AGFS15 framework, while the GFS data for the other two assessment years (2015-16 and 2016-17) were prepared under the AGFS05 framework. ABS is currently in the process of remapping GFS data from financial years prior to 2017-18 to the AGFS15 framework, though this remapped data is not expected to be available until April 2019.

Commission Staff Position

Advice given to the Commission from ABS is that the Commission should continue to use AGFS05 based data for 2015-16 and 2016-17, as preliminary remapped data is not likely to be reliable. On this basis, Commission staff have proposed to use AGFS05 based data for 2015-16 and 2016-17, while using AGFS15 based data for 2017-18.

ACT Position

Given the advice provided by ABS, the ACT supports the proposed approach for the 2019 Update. We do consider however that for the 2020 Review, remapped GFS data under the AGFS15 framework should be utilised to maximise consistency in the data used for the assessments, provided that the remapped data is demonstrated to be reliable.

Cease Sending the Preliminary Adjusted Budget to the States and Territories for Comment

Background

Each year, the Commission sends a preliminary adjusted budget for the upcoming Update for comments.

The circulation of the preliminary adjusted budget typically occurs in December of each year and, in some cases, results in adjustments for the final adjusted budget used by the Commission for its assessments. These revisions are usually small.

Commission Staff Position

Due to the small impact of revisions resulting from comments provided by the States and Territories on the preliminary adjusted budget, the Commission has proposed to cease circulating the preliminary adjusted budget to the States and Territories from the 2019 Update. Commission staff have reserved the right to query the States and Territories directly if required.

ACT Position

The ACT is supportive of the Commission staff position, with qualifications.

While we acknowledge that the circulation of the preliminary adjusted budget typically yields limited or no changes to the final adjusted budget, the proposal would remove the opportunity for States and Territories to carry out a quality assurance check of the final data being used to generate the GST distribution recommended in the Update Report.

We consider that the Commission staff proposal is acceptable provided an adequate timeframe is allowed for the States and Territories to review the draft 2019 Update report. We recognise that this depends critically on the cooperation of the Commonwealth Treasurer and Treasury.

We maintain our strong position that consultation with the States and Territories is an essential component of the Commission's work under its ToR and the Quality Assurance Strategic Plan. The Commission should not cease the practice of circulating the preliminary adjusted budget unless a robust assurance can be given to States and Territories of an adequate period of time to review the draft report before it is approved by the Commonwealth Treasurer.

TREATMENT OF NEW COMMONWEALTH PAYMENTS

New Commonwealth Payments Commenced in 2017-18

Background

A total of 16 Commonwealth Government payments were identified by Commission staff to have started in 2017-18 as per the Commonwealth Government's 2017-18 Final Budget Outcome.

Commission Staff Position

The Commission has received advice from the Commonwealth Government that the Western Australian Hospital Infrastructure Package is likely to be quarantined from equalisation by the 2019 Update's ToR. Further, Commission staff have noted that funding to Victoria under the Regional Rail Revival Program and re-allocated Perth Freight Link funding to WA were quarantined in the 2018 Update ToR. As such, Commission staff have proposed to treat these payments in the 2019 Update as not having an impact on the relativities.

Commission staff also propose that the following Commonwealth Government payments be treated as having no impact on the relativities:

- Payment from the DisabilityCare Australia Fund;
- Transition to NDIS in Western Australia;
- Hydrogen Energy Supply Chain Pilot Program;
- National Fire Danger Rating System; and
- Commonwealth Assistance to the Northern Territory.

All other Commonwealth Government payments that commenced in 2017-18 are proposed by Commission staff to be assessed.

ACT Position

The ACT is broadly supportive of Commission staff position. However, we consider that the Commission should not commit to quarantining Commonwealth Government payments on the basis of likely being required to under the ToR for the 2019 Update. It is our view that the Commission should wait until it has received the ToR before deciding to quarantine Commonwealth Government payments, in the absence of any other compelling reason to do so.

New Commonwealth Payments Commencing in 2018-19 or 2019-20

Background

A total of six Commonwealth Government payments were identified by Commission staff to start in either 2018-19 or 2019-20 as per the Commonwealth Government's 2018-19 Budget.

Commission Staff Position

As none of the new Commonwealth Government payments represent significant changes to the operation of federal financial relations, Commission staff have proposed to not backcast any of the new payments to the assessment years of the 2019 Update.

The Commission has received advice from the Commonwealth Government that four of the six new Commonwealth Government payments are likely to be quarantined under the 2019 Update Terms of Reference:

- Proton Beam Therapy Facility;
- Biosecurity Emergency Response and Research Fund;
- Health Innovation Fund; and
- Comprehensive Palliative Care across the Life Course.

ACT Position

The ACT supports the Commission staff position. We agree with Commission staff analysis that the new Commonwealth payments due to begin in 2018-19 or 2019-20 do not represent significant changes to the operation of federal financial relations.

For future consideration, we reiterate our position expressed in our response to the 2020 Review draft assessment papers that the quarantining of Commonwealth Government

payments exaggerates inequities in the distribution of Commonwealth Government infrastructure funding.

We consider that the Commission should, to the fullest extent possible, use its powers in assessing State and Territory fiscal needs to correct such inequities and commit to avoid the non-assessment of such payments in other than exceptional circumstances. This includes the removal of the 50 per cent discount applied to national network road and rail funding.

Within the context of Commonwealth Government payments commencing in 2018-19 or 2019-20, we consider that the Major Projects Business Case Fund and Roads of Strategic Importance payments due to start in 2018-19 should both be equalised upon their commencement.

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Chief Minister, Treasury and Economic
Development Directorate

November 2019