SOUTH AUSTRALIAN SUBMISSION ON SIGNIFICANT CHANGES SINCE THE DRAFT REPORT – 2015 REVIEW

COMMISSION POSITION PAPER CGC 2014-04

SOUTH AUSTRALIAN DEPARTMENT OF TREASURY AND FINANCE

DECEMBER 2014

SOUTH AUSTRALIAN SUBMISSION
SIGNIFICANT CHANGES SINCE THE DRAFT REPORT
2015 REVIEW

Mining revenue assessment

Responding to economic “shocks’

In the *2015 Review – Significant Changes since the Draft Report* paper (Significant Changes Report), the Commission asked for views on the treatment of economic “shocks” or exceptional circumstances. Views have been sought in the context of the recent decline in the iron ore prices and the consequential impact on mining revenues.

Between 2004 and 2011,the average price received for iron ore grew by 23.4 per cent on average per annum. In the three years prior to this period, 2001 to 2004, average iron ore prices fell by 5.1 per cent. (BREE Resources and Energy quarterly, June 2012).

Cyclical volatility in commodity prices is a normal part of the mining industry. In this sense, a fall in global iron ore prices, that may either be prolonged or temporary, cannot be viewed as a shock.

Given the extraordinary growth in iron ore prices over the last decade, current price falls could be viewed more as a correction to what could be considered a period of unsustainable growth.

When considering the assessment of mining revenues, there also needs to be a degree of symmetry when examining any potential measures to improve contemporaneity. Throughout the period of exceptionally strong growth in iron ore prices, Western Australia significantly benefited from the five year averaging period up to 2010 and from the three year averaging period after 2010.

To the best of our understanding, Western Australia did not raise contemporaneity concerns during this growth phase.

Any contemporaneity measures should not only consider current circumstances but should also have regard to any recent past gains enjoyed as a result of less than contemporaneous assessments.

Further, should the Commission be inclined to make temporary contemporaneity changes for mining revenues targeting the next one or two application years, arrangements need to be established so that the beneficiary state(s) return this benefit in subsequent years. Any other approach would be inequitable.

In recent years, the only examples of what could be considered exceptional circumstances have been the natural disasters in Queensland. In these cases, the Commonwealth provided significant funding through Natural Disaster Relief arrangements which were treated as non-impacting for HFE purposes. Only the residual state expenditure on disaster recovery has had an impact on GST distributions and this has been assessed using the usual three year averaging arrangements.

The result of these arrangements is that measures to support the recovery effort in Queensland (as a result of a shock) have to a large degree been provided outside of HFE arrangements due to the provision of non-impacting Commonwealth assistance.

Specific contemporaneity measures

South Australia supports the Commission's view that the use of application year forecasts, whether they are provided by states or independently generated, are not sufficiently reliable to use as a basis for GST distribution.

The use of estimates for the application year with a subsequent correction reflecting actual outcomes introduces another layer of complexity and volatility.

The level of volatility could also be expected to be significant as there have been significant forecast errors for revenues, in particular, mining revenues, in recent years.

As noted by the Commission, correction adjustments in subsequent years also have the potential to undermine contemporaneity in future years.

Given the issues associated with using estimates, the only other alternative to improve contemporaneity is to reduce the current three year averaging period to two years or one year.

The sole use of the most recent completed financial year's data carries significant risk. The data would lack transparency as final GFS data compiled by the Australian Bureau of Statistics (ABS) would not be available in time for the annual Update. The CGC would have to rely on GFS data provided by the states which would never be subject to ABS review as ABS adjustments to data sets would never be reflected in assessments.

Assessments based on a single year could be extremely volatile and not just from revenue fluctuations. Expenditure items could also produce large variations. Recent natural disaster expenditure for flooding in Queensland is a recent example.

Other issues

Western Australia has suggested that contemporaneity changes could be quarantined to one or two categories.

South Australia questions selective application of contemporaneity changes as this immediately raises a consistency issue and potential "cherry-picking" of assessments to achieve particular outcomes. This would have the potential to compromise the equity objectives of current HFE arrangements.

South Australia also questions whether it is appropriate for significant contemporaneity changes to be incorporated at this stage of the 2015 Review. The issue should be examined at the next available opportunity for methodology review.

Mining related expenditure

Planning and regulation of investment projects

South Australia notes the proposed assessment of state spending on planning and regulation of investment projects that is based on each state's share of private non-dwelling construction expenditure.

Capital grants to local government

South Australia does not consider that population growth is the main determinant of state government provision of grants to support local government infrastructure investment relating to community development, amenities, culture and recreation.

Actual data on state government provision of community amenity infrastructure grants to local government show that Queensland is by far the largest provider of such grants. In 2012-13, Queensland actual expenditure on these grants amounted to $122 million or $26.50 per capita. In contrast, Western Australian expenditure on these grants in 2012-13 was $20.1 million or $8.10 per capita and Victoria's expenditure was only $3.63 per capita.

Western Australia has higher population growth than Queensland but its per capita investment is only a fraction of Queensland's investment.

This indicates that population growth alone is not an appropriate indicator of needs.

The provision of such grants to local government would also be influenced by population dispersion, the socio-economic status and age profile of residents in a local government area and possibly the proportion of Indigenous residents.

Local government areas that have relatively high levels of unemployment or a high proportion of older residents may be provided with additional state government infrastructure funding in order to facilitate the provision of additional services by local government.

If the Commission's proposed assessment approach is to be retained, the maximum level of discount should be applied.

Health assessment

South Australia supports the inclusion of socio-economic status and age in the calculation of the economic environment factors for the Emergency Department, Non admitted patients and Community Health components of the new Health assessment.

South Australia supports the proposed reduction in the substitutability assumption for Emergency Departments. The 10 to 20% range is a more appropriate level of substitutability between Emergency Department services and GP services.

South Australia holds significant reservations about the Commission introducing a level of substitutability within the range of 10-20% of admitted patients and an associated environment factor to the admitted patient component of the new health assessment.

South Australia is not convinced that there is a conceptual rationale for introducing a level of substitution for non-fee paying admitted patients and considers the treatment of non-fee paying public hospital patients should be analogous to the treatment of non-international government school students.

Further, South Australia is of the view that the overwhelming majority of patients receiving treatment as non-fee paying admitted patients in public hospitals represent those people that do not have private health insurance or where there is no viable private alternative (eg. in country areas) and hence there is very little or no substitutability for these patients.

People with private health insurance would normally be admitted to a private hospital or be admitted to a public hospital as a private patient. In South Australia, when patients with private health cover are treated in the public system, public hospitals recover costs from insurers and bear only small costs in respect of a patient's insurance 'excess'. Therefore, the level of service provision for privately insured public patients, net of costs recovered in a public hospital, is minor, and service levels for public patients are relatively untainted.

Where there is only a small private hospital sector in a state, patients with private health insurance could be admitted to a public hospital as a private patient so the observed level of service provision for public patients in a public hospital would still be untainted.

In terms of Downie's substitutability argument, the substitutability of public and private services seems to be made with limited reference to patient complexity – it assumes that all patients are identical with the same health issues. As such, it makes no adjustment to recognise the types of complex cases that are generally treated at a higher rate in a public hospital.

South Australia notes that there is a significant variance in the level of private health insurance coverage between jurisdictions (a low of 38.9% in the NT and a high of 57.7% in ACT), and that the level of private service provision in each jurisdiction will also vary for a variety of reasons, including historical patterns of service delivery and deliberate policy decisions of government.

Further, South Australia considers it is premature to introduce a level of substitutability and an environment factor to the admitted patient component of the new combined health assessment without States being able to scrutinise the quantification of the proposed admitted patient adjustment. CGC officers have advised that they will not be able to calculate the quantification until late January when final data from the AIHW (Australian hospital statistics) and PHIAC are available.

It is only by analysing the relative impacts that States are able to assess if there is likely to be an anomaly with the proposed methodology. We raised concerns with the proposed environment factor for Emergency Departments in the Draft Report after analysing the relative impacts associated with the proposed methodology.

Welfare assessment

South Australia accepts the assessment of other general welfare expenses using the relative proportions of state populations in the bottom quintile of the 2006 Census SEIFI.

Although not raised in the Significant Issues Report, South Australia reiterates its view on the proposed transition arrangements for the National Disability Insurance Scheme (NDIS).

South Australia believes that that the current methodology and population base used for assessing disability services needs should be retained until the time of full implementation of Disability Care Australia (DCA).

South Australia continues to support the 'switch' approach with the switch point being fixed at the year in which most jurisdictions fully transition to the NDIS. We believe this position is appropriate given the unreliability of current NDIS eligibility projections.

The existing methodology should be retained until at least the 2019 Update using disability support pensioners as the relevant population base.

South Australia previously brought to your attention the National Disability Insurance Agency *Report on the sustainability of the scheme – 1 July 2013 to 31 March 2014,* prepared by the Scheme Actuary.

The Scheme Actuary noted that "*it is possible that the number of Tier 3 participants will be lower than expected under the current eligibility rules – say by 100,000*". This would reduce the number of expected participants from 419,516 to 319,516. This is a potential 24% adjustment to ultimate participation in the scheme.

South Australia believes that these estimates will continue to vary until full implementation.

These estimates should not be used as a basis for assessing the provision of state-funded disability services in the period leading up to full implementation and should not be used as the basis for backcasting the introduction of the NDIS.

If the Commission does decide to proceed with its "dual" assessment approach and backcast the introduction of the NDIS, the provision of state-funded disability services should continue to be based on the number of Disability Support Pensioners in each jurisdiction as a way of mitigating the risk of unreliable NDIS eligibility.

Regional cost gradients

South Australia notes the proposed application of a general regional cost gradient.

Urban transport infrastructure assessment

South Australia still holds concerns about the conceptual reasoning underpinning the Commission's proposed assessment approach and the policy neutrality of the underlying data for the urban public transport infrastructure assessment.

South Australia does not accept the rationale for:

- the adoption of a linear upward sloping curve passing through the origin to describe the relationship between city size and urban transport asset values per capita, and
- any reduction in the 50% placeholder discount included in the Draft Report.

Concerns raised by several states in responses to the Draft Report regarding the quality, policy neutrality and nature of the regression model used to capture the relationship between city size and asset values per capita, are not addressed in the Significant Changes Report.

The Commission's assumption that there is a simple linear relationship is a result of the specification of the regression analysis. Conceptually, the relationship between the two variables in question is more likely to be S-shaped (sigmoidal) over a complete range of town and city sizes.

There are too few data points to determine the relationship for the Australian range of city sizes, especially since data points are affected by privatisation. It could well be a line without a constant slope.

The reliability of a regression analysis of rail-based large cities is not improved by including small cities without rail networks.

In considering the level of discounting, the reliability of the assessment is not improved by assuming a constrained version of the linear relationship.

There is a strong case for retaining the 50% discount should the CGC consider that retention of the proposed linear relationship forced through a constant (zero) intercept has advantages, such as reduced volatility.

In relation to the conceptual base of the assessment, to have confidence in the "depreciation plus investment" approach requires that it apply over a very long period and that there is stability in the extent of on and off balance sheet financing of activities (and stability in financial reporting). The validity of the CGC approach is also assisted by stability in the time path of annual investment relative to depreciation.

South Australia has particular concerns about these requirements for urban transport infrastructure. Further, the internal consistency of the "depreciation plus Investment" approach comes into question, or at least is less transparent, with the application of disability factors which are different (potentially larger) for the investment assessment than the depreciation assessment. This is not the case for any other expenditure category.

If urban transport capital expenditure fluctuates, then the proportion which gets assessed with any one year's depreciation disability and the proportion which gets assessed with that year's capital stock disability will vary significantly. This is not the case for all other categories where each portion is assessed the same because depreciation and capital stock disabilities are equal.

It is highly unlikely that annual investment levels will bear a steady relationship to depreciation levels. If the disability factors are different this introduces the potential for semi- permanent effects on outcomes which is not the case for other expenditure categories.

The following table sets out disability factors for population squared disability factors, the latter discounted by 50%, and net operating expense (including depreciation).

The implicit depreciation assessment imbedded in the combined net operating expense assessment (albeit divergent from current expense and revenue assessments for the same combined outcome), is more likely to be consistent with the 50% discounted investment assessment than a lower discount.

There is a strong case for the retention of the 50% discount because of:

- the lack of explanation about why stock disability factors may be different to depreciation factors;
- the calculation of the stock disability factors; and
- the early stage of development and introduction of this assessment.

Urban Public Transport – net operating cost and infrastructure assessment factors (2012-13)

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Urban public transport capital factor (population squared)	1.25	1.49	0.52	0.75	0.52	0.28	0.13	0.03
Urban public transport capital factor – 50% discount	1.12	1.24	0.76	0.87	0.76	0.64	0.56	0.52
Net Urban transport operating cost factor	1.078	1.189	0.803	1.038	0.897	0.241	0.799	0.178

Source: CGC Report on State Sharing Relativities – 2015 Review – Draft Report, and SA DTF estimates backwards calculated from Assessed Investment figures in Table 5.

Treatment of nationally significant infrastructure projects

South Australia supports consistent treatment of Commonwealth payments for national road and rail network projects.

In relation to rail infrastructure funding for the national network, the Commonwealth will be providing South Australia with $231.1 million in 2015-16 for the Goodwood Junction Rail Grade Separation project. This project will see a grade separation of the Australian Rail Track Corporation's (ARTC) interstate rail line and the metropolitan rail line at the Goodwood and Torrens rail junctions.

This will be an improvement to the national rail network as it removes the need for the ARTC line to give way to the Noarlunga line allowing an increase in the speed in which ARTC trains can approach the Goodwood intersection. It will also enable the use of 1.8 km freight trains, increased from 1.5 km. This also increases the maximum length of trains travelling between the eastern states and Perth.

Commonwealth funding for this project should be treatment as funding for improvements to the national rail network.

Other issues

Interstate wages

In the Draft Report, the Commission decided not to change its assessment of interstate wages in the 2015 Review as the current data source (ABS Survey of Education and Training) will not be collected in the future and the replacement data source (ABS Characteristics of Employment Survey) is currently unavailable.

Commission staff believe that the new data source will be available for the 2016 Update and it is proposed that this data will be applied to a revised method.

South Australia believes that there is sufficient evidence to question the assessment's conceptual base, a position supported by several other jurisdictions.

South Australia believes that a substantial discount (50%) should be applied to the current assessment in the 2015 Review process. The Commission does not have to wait until the release of the new data source.

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