Department of Treasury and Finance

Victorian Response to Significant Changes Since the Draft Report

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State Government Victoria

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1. Mining Revenue Assessment

The Commission has sought the views of states and territories on the proposal by Western Australia that it would be inappropriate to use average royalties for 2011–12 to 2013 as the basis of the 2015–16 GST distribution. Western Australia suggests that a distribution based on prospective 2015–16 conditions would be preferable, given the recent fall in forecasted iron ore royalties.

Western Australia's proposal would result in three significant changes to the current methodology:

- assessment to be based on financial estimates for the application year;
- no averaging of assessment year per capita relativities; and
- subsequent corrections for actual financial data.

Victoria has previously outlined concerns with the merits of the Commission basing its assessments on forward estimates rather than historical data.

Victoria notes that there have been a number of booms over time, whether in mining, property or some other revenue base, that have resulted in relatively temporary boosts to revenue to one or a small number of states.

The proposal from Western Australia argues that it would improve the budgeting of states and territories by spreading revenue volatility of one state across all the states and territories. The current methodology does this, albeit with a lag. However, this lag is known and the state facing own-source revenue volatility would at least have some certainty about its share of GST revenue. It is unclear how introducing greater volatility in GST shares would improve budgeting.

As noted by the Commission, forecasts of revenues in an application year are not reliable and errors in forecasts are often very large. The use of forecasts would require a number of consequent revisions and GST adjustments in the future to address errors. These revisions and adjustments would undermine contemporaneity of future years, distributing large sums of money, impacting on future years fiscal capacity.

Victoria supports the current use of actual data and averaging to addresses fluctuation in revenue. In the Draft Report, the Commission notes:

> *"We consider the current approach of basing assessments on the average observed data for the last three years provides a balance between reflecting conditions likely in the year a recommended GST distribution could be implemented, and practicality concerns such as data reliability and stability."*

The use of actual data and averaging will result in a state that experiences a revenue boom receiving more GST relative to its fiscal capacities in the early years of the boom and relatively less GST in the immediate post-boom years. States should be aware of this and should take it into account in framing their fiscal strategies.

2. Mining Related Expenditure

The Commission has proposed to introduce two new assessments:

- expenditure related to the planning and regulation of investment projects; and
- capital grants to local governments relating to community development, amenities, culture and recreation.

These assessments relate not only to support for the mining industry but to where private investment and population growth requires differential spending by states.

2.1 Planning and regulation of investment projects

The Commission considers there is a conceptual case for including a disability reflecting the additional planning and regulation costs incurred by states to facilitate investment projects.

Victoria considers there are no grounds for this recognition of planning and regulation expenses without a broader examination of regulatory costs. Victoria notes that it is not only non-residential construction activity, but also residential construction that incurs project planning and approval expenses. The conversion of former industrial land to residential land in urban areas can also result in planning and approval expenses by government.

There is no conceptual basis for capturing only a portion of these expenses. The adoption of any such measure should be deferred until a more holistic assessment of investment and planning costs can be undertaken, that also includes residential construction.

The NSW Minerals Council has also stated that infrastructure spending for miners by state governments is usually provided on a commercial basis. The Commission needs to ensure that only net expenses are covered by the assessment.

Victoria considers that states should efficiently recover the costs of planning and investment regulation. If a state chooses to subsidise private businesses by failing to efficiently recover costs, it should not be able to pass these expenses onto other states and territories through HFE. Victoria considers that these expenses can, and should, be met through providing services efficiently, and there is no compelling case for their equalisation.

To the extent the figures provided are net of any cost recovery, Victoria is also concerned that the proposed measure may not fully capture the capacity of states to recoup this revenue. For the avoidance of doubt, the Commission should potentially apply a discount to this data to ensure states are not overcompensated for these expenses.

Finally, the Commission has not indicated the expense category under which these planning and regulation expenses are to assessed. Assuming services to industry expenses would be the appropriate category, the Commission would need to ensure that there is no double counting of expenses in regard to the support given to the agriculture industry.

2.2 Capital grants to local government

The Commission also considers that there is a conceptual case for including a disability reflecting the additional costs incurred by states to support local government infrastructure provision relating to community development, amenities, culture and recreation. The Commission notes that it considers local governments experiencing rapid population growth will undertake more investment, requiring a more than per capita share of capital grants from State governments to maintain their per capita levels of infrastructure.

The assessment methodology needs to be explained in more detail before Victoria is able to provide detailed commentary. Whether or not the methodology is based on an assumption of certain local governments having above state average population growth will be one of several relevant considerations. It is also not clear how the differing sizes of local governments between the states have an impact on the assessment.

Victoria considers that the Commission needs to more substantially explain why a per capita assessment would not be a more suitable indicator of need, and the extent to which states fund this need on a local, rather than state-wide basis. Victoria notes that the proposed assessment on its own would have an immaterial impact on the distribution of GST.

3. Health Assessment

The Commission has noted that the structure of the health assessment has not changed from that proposed in the Draft Report, but has sought state views in relation to changes to the standardisation of economic environment factors, and on the findings of consultants engaged to review elements of the health assessment.

Victoria supports the structure for the health assessment proposed by the Commission. Victoria also supports the proposal to standardise bulk billed services by Indigeneity, remoteness, SES and age.

Victoria has separately provided a response to the Commission on the issue of substitutability and the relevant consultants' reports. Subsequently the Commission has released a discussion paper on health substitutability in which a range of substitutability is proposed for the various components of the health assessment.

Victoria appreciates the effort that the Commission has undertaken to develop substitutability factors that are soundly evidence based.

The discussion paper presents the substitutability factors as ranges. Obviously a single figure will have to be chosen in order for the Commission to make an assessment. The ED example provided in the discussion paper suggests that the mid-point of the ranges will be used. If this is the case then the Commission should state this up front.

Victoria supports the substitutability factors proposed for ED and non-admitted patients. However, Victoria considers that the 60 per cent lower limit for community health should be 50 per cent given Professor Savage's view that the level is likely closer to 50 per cent than 75 per cent.

It is noted that the Commission is proposing to use a substitutability factor of 10–20 per cent for admitted patients instead of the 0 per cent proposed in the draft report. Victoria would appreciate the Commission providing data that would illustrate the difference in outcomes between the two methods. On the basis of the evidence provided by the Commission Victoria would support a substitutability factor of 10 per cent.

4. Welfare Assessment

The Commission proposes to assess other general welfare expenses using the relative proportions of state populations in the bottom quintile of the 2006 Census Socio-Economic Index for Individuals (SEIFI) and adjust by the change in the relative proportions of state Health Care Cards between 2006 and 2011.

Victoria appreciates the difficulties faced by the Commission in determining an appropriate indicator for other general welfare expenses in the absence of SEIFI being updated for the 2011 Census. The proposal by the Commission to index the values of the 2006 SEIFI appears reasonable.

5. Regional Cost Gradient

The Commission proposes to apply a general regional cost gradient derived from ACARA data where a regional cost disability is applied to categories other than schools education or Justice.

Victoria has not changed its views in regard to the general regional cost gradient. Victoria has previously argued that schools are provided in more population centres than most other government services and have a lower client to provider ratio than health, housing or welfare services. Victoria remains of the view that rather than simply extrapolating this data to other service delivery areas, the Commission should investigate use of more tailored data in these areas (for example, the use of Independent Hospital Pricing Authority data for the health category).

If the Commission is to apply this gradient in its current form then Victoria considers that a discount higher than the minimum discount is warranted due to the lack of evidence of regional costs for expenses other than schools education and police services.

6. Urban Transport Infrastructure Assessment

The Commission has noted state concerns over the quality and policy neutrality of the data on urban transport infrastructure by city, and nature of the regression model used to capture the relationship in the Draft Report. Given these concerns, the Commission has proposed it will adopt a population based model for the urban transport infrastructure assessment.

Victoria notes the strength of the conceptual case and the reduction in concerns regarding the sensitivity and non-policy neutrality of asset data. In this case the Commission should reduce the placeholder discount of 50 per cent adopted in the draft report.

Victoria considers that no discount should be applied, however if the Commission determines a discount should be applied then it should be the minimum discount of 12.5 per cent.

7. Nationally Significant Infrastructure Projects

The Commission proposes to treat all Commonwealth payments for projects which the Department of Infrastructure and Regional Development advises affect the national road and rail networks in the same way.

Victoria supports the Commission's proposal to treat Commonwealth funding of road and rail infrastructure projects on a consistent basis. However, Victoria is concerned that the focus of the treatment is on transport infrastructure of national significance as this was not the original basis for the discount applied to funding for national network roads investment.

In the *2010 Methodology Review* the Commission stated that the discount was to be applied in recognition of "Commonwealth considerations which are not captured in our State based disability measures."[1]

This definition is clearly broader than the narrow reliance the Commission has placed in recent years on the national land transport network, which lists projects for a much more limited purpose. While the national network may have been a convenient device for assessing roads investment, the national network may not be an appropriate indicator for rail investment, especially urban rail investment.

A Commonwealth policy to reduce urban road congestion, limit air pollution or improve productivity through the more effective functioning of Australia's major urban economic centres could all be achieved through funding urban rail projects. None of these considerations would be fully captured (or in some cases, captured at all) by existing state-based disability measures.

Victoria considers that the national network may not be an appropriate indicator for rail investment and that the Commission needs to undertake a rail project by project assessment to determine the extent to which Commonwealth funding is influenced by Commonwealth considerations not captured in state-based disability measures. This would align much more closely with the original intent of this assessment.

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1. Commonwealth Grants Commission, *Report on GST Revenue Sharing Relativities—2010 Review, Volume 2—Assessments of State Fiscal Capacities*, p. 444.

8. Education Assessment

As a supplementary request for state comment, the Commission has asked for state views on whether states consider themselves bound to allocate Commonwealth school funding in a manner consistent with the student resource standard (SRS). Victoria has long allocated school funding based on student need for both government and non-government schools, through sophisticated funding models that take account of similar variables as those used to develop the SRS loadings. While Victoria periodically reviews these arrangements to improve the operation of funding distribution mechanisms, this broad approach has not changed.

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