NSW Treasury considers that contemporaneity has been comprehensively addressed in previous methodology reviews, with the Commission deciding on the current lagged three year averaging approach in the 2010 Review.

NSW Treasury 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. Changing the mining revenue assessment now, for example, would mean that over-payment in GST revenue during revenue upswings is never offset on the down side of the cycle.

NSW treasury does not believe there is time to address this issue adequately at this late stage of the 2015 Review and believes it should be addressed in the Federation White paper.

Nonetheless, Staff have requested State views on the following three options in response to the Australian Treasurer's letter to the Commission on the appropriate treatment of large and volatile revenue shocks:

- Option A: Absorption approach
- Option B: A lagged five year moving average
- Option C: Smoothing through an adjustment to GST outcomes.

New South Wales considers that the pros and cons of any change in treatment to the current three year average must be balanced against the issues of data availability, contemporaneity, judgement, predictability and volatility.

In general, the Staff options would require significant judgement in determining which revenue assessments are subject to any change in the treatment of contemporaneity. If the Commission was to recommend changes to the treatment of contemporaneity, states would need to be provided with adequate details of the basis on which the changes were to be applied and the justification, with an adequate time period to allow informed discussion of any proposals.

More detailed comments are provided following each proposal.

From: Anthony Nichols
Sent: Tuesday, 20 January 2015 2:20 PM
Subject: Options for improving the contemporaneity of assessments [SEC=UNCLASSIFIED]

Dear colleagues

We thank States for their responses to recent requests for State views on the related issues of dealing with volatile revenues and contemporaneity. These arose both in response to issues raised by States in the course of the current review and in response to the Treasurer's request for advice made on 23 December 2014.

In its paper on significant changes since the draft report the Commission sought State views on the general principles, guidelines and processes which should surround any adjustment process to sudden or large scale shocks to revenue bases. For example:

- How to identify exceptional circumstances warranting an adjustment, recognising that forecasts of prospective conditions are subject to large errors.
- Avoiding any possibility for a State to game the system, or generate other policy neutrality concerns.
- The impact in each year, and over time, on other States.

- The appropriateness of having any adjustment processes dealing symmetrically with exceptional changes in State circumstances.

More recently Commission staff asked if States wished to make any additional comments following receipt of the Treasurer's letter. In particular, it sought advice on:

- The principle of improving contemporaneity in the Commission's assessments between the assessment and application years (should it be done)
- How any improvement in contemporaneity could be implemented (how can it be done).

In their responses States have addressed both the principle and identified a range of options which could be considered by the Commission as it prepares its response to the methodology review and the Treasurer's letter.

Within the current approach to HFE States proposed

- Extending the averaging period
- A shorter averaging period
- Differential weightings to assessment years to give greater weight to more recent years
- Using forecasts as the basis for assessments.

The Commission has already commented that it does not consider that State, or independent, forecasts of revenues in the application year, for example for royalties, are sufficiently reliable for us to use as the basis of the GST distribution.

The Commission is still considering the broader question, including possible options, drawing on State submissions to date.

To provide the Commission with further advice staff seek any additional State views on the pros and cons of three illustrative options. The options we would like your views on are:

a. An absorption approach
b. A lagged five year moving average
c. Smoothing through an adjustment to GST outcomes, that would be reversed over subsequent years.

For illustrative purposes we have used iron ore revenues as the item for differentiated treatment. For option (b) Illustrative GST effects are shown as the difference between the option and a lagged three year average approach based upon iron ore royalties in the assessment years. Illustrative GST effects of the other two options are not provided as the impact of option (a) depends on royalty outcomes in the application years and the impact of option (c) depends on the quantum of the adjustment selected.

Absorption

Under this option assessment year relativities would be calculated for a combined pool of GST revenue and iron ore royalties, with an average relativity across the three assessment years to be applied in the application year.

States would be entitled to their relativity weighted population share of the pool of GST revenue and total iron ore royalties in the application year. A State's GST revenue would be calculated as its share of the pool less its actual iron ore royalties in the application year (possibly adjusted to remove the impact of any policy choice). Adjustments could be made through the year as actual iron royalties become known, or as an ex-post adjustment in the following year as is the case for the actual GST revenue.

Presumably, this would be equivalent to the approach previously adopted for health care grants prior to the 2010 review. However, HCGs were distributed across all states and were relatively stable, whereas iron ore royalties are effectively sourced from one state only and can be volatile. These differences could lead to variations due to policy changes and added volatility to revenues, with adverse effects on predictability.

The need for adjustments throughout the year as actual iron ore royalties became known would add to the uncertainty generated by this approach.

This distribution would take some account of the actual circumstances in the application year, but I think that it would have significant problems in implementation.

NSW Treasury does not support this option.

A lagged five year moving average

Under this option, the Commission would use a lagged five year moving average of assessed revenues that were identified as being a large and significantly volatile part of State own revenues (illustrated here for iron ore royalties) and a lagged three year moving average for all other assessments to generate application year relativities.

Illustrative GST impact of this option, 2015-16

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
	$m	$m	$m	$m	$m	$m	$m	$m	$m
Difference	-206	-161	-130	547	-28	-9	-11	-2	547

Note: Difference between a lagged three year average assessment and a lagged five year average assessment of iron ore royalties.

This option

- needs CGC judgement to determine which revenues would be subject to different averaging
- Doesn't adjust GST for immediate movements in royalties.
- Actually lengthens the lag between the application year and the data.

NSW Treasury does not support this option.

An adjustment to GST outcomes

Under this option, the Commission would provide relativities as per its general methodology for the distribution of GST revenue in the application year.

An adjustment would then be made for States affected by large and volatile revenues (for example to increase its GST in years where its own source revenue is downwardly volatile), with the adjustment financed by reductions in GST grants to other States allocated on an EPC basis. The size of the adjustment would be determined based upon the fiscal circumstances of the affected State in the application year. This could be done either in advance of the application year (based on expected circumstances) or in the course of the application year (based on actual emerging circumstances).

In subsequent years the adjustment would be reversed. The reversal could (optionally) be made in one, two or three subsequent years.

It is unclear to me how any adjustment would be calculated – rolling forecasts of the application year, over what time periods?

This approach would need judgement to determine the basis for the adjustment and the timing of any adjustments. This approach seems to have many of the difficulties inherent in using forecasts to determine GST in the first place and would add to volatility and unpredifctability. I believe this approach would be very difficult to implement.

NSW Treasury does not support this option.

Given the time constraints, we do not seek a formal submission and understand that some States may choose not to provide comment in addition to that already provided. For States which choose to do so we ask for a response by email by COB Friday 30 January, to secretary@cgc.gov.au.