

**From:** Anthony Nichols  
**Sent:** Tuesday, 20 January 2015 2:20 PM  
**Subject:** Options for improving the contemporaneity of assessments

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.

#### *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.

#### *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.

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@cgcs.gov.au](mailto:secretary@cgcs.gov.au).

Regards

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