



Submission to Commonwealth Grants Commission

2025 Review: Proposed Approach and Work Program – March 2023

These comments respond to the Commonwealth Grants Commission's (CGC's) *Proposed approach and work program for the 2025 Methodology Review* discussion paper.

Western Australia would like to thank the Commissioners for the multilateral meeting held on 15 March 2023 (the meeting). We found it very useful and although many of our concerns listed below were addressed (to varying degrees), they are reproduced here for completeness.

We are pleased at the comments on transparency and consultation that were reiterated throughout the meeting. We look forward to an open and robust 2025 Review. However, on that point, we note that the States' 2023 Update Wages submissions are yet to be published on the CGC website.

Scope of Review

As noted in the meeting, Paragraph 7 of the CGC's paper is of concern. It reads:

Since the Commission has been asked to review the current methods that underlie its assessments to calculate the GST relativities, it considers alternative approaches to GST distribution, such as on an equal per capita basis, to be outside the scope of the 2025 Review.

We agree that the 2025 Review should be based on the horizontal fiscal equalisation (HFE) principle. However, we do not believe that the CGC should presume that particular outcomes are inconsistent with the HFE principle, or that it should limit itself to only modifying current methods.

We note that the 2025 Review terms of reference require that the "Commission should undertake a review of the methods that underlie its assessments". This does not necessarily imply that the current methods should form the basis on which new methods are constructed. To completely revise methods in an assessment would be a perfectly valid interpretation. Hence, we do not think the CGC should read into the terms of reference an instruction as to how far it may revise its methods.

Regarding alternative approaches, we doubt that an equal per capita distribution could be justified as consistent with the HFE principle. However, if any State believes that it can argue for an equal per capita distribution under the HFE principle, then the CGC should be prepared to consider that State's arguments.

For example, our recent occasional paper on principles argues that a relativity floor is a justifiable option for the CGC, working purely from the issues involved in implementing the HFE principle. We consider that paper to be fully within the scope of the 2025 Review.

However, we acknowledge the CGC's position that considering approaches to HFE that are wholly different from the existing system (e.g., equalisation through a separate grants system) would not be practical.

Proposed Approach

To ensure that methods reflect current State circumstances and what States do is a valid reason to conduct periodical methodology reviews. However, to devote a review to only where State circumstances have changed assumes that methods were correct at the completion of the previous review. We have found this to be rarely the case, and certainly not following the 2020 Review.

While we agree with the Commission that the 2025 Review should be comprehensive, responsive, efficient, consistent, and rigorous (as stated in paragraph 12), we are of the strong view that by only addressing assessments where there has been a 'change in circumstance' or a 'development since the previous review' is not fulfilling the purpose of a methodology review. Our views concur with the definition of a methodology review on the CGC website:

A methodology review provides an opportunity to ensure the Commission's methods reflect what States do, incorporate the best available data sources, are policy neutral, and remain practical.

There are always unresolved issues following a review that need to be reassessed during the next review. To assume there were not, assumes that all States were satisfied (not necessarily happy) that the ensuing methods were reasonable and the best that could be achieved. For example, and in relation to your review definition above, we believe that the Wages assessment does not use the best available data; the Transport assessment is not policy consistent; and that many revenue assessments are not policy neutral or consistent, especially Mining. Indeed, at the conclusion of the 2020 Review, many States were unsatisfied with the decisions made in the Transport and Wages assessments. Western Australia was also concerned that remoteness and Indigeneity costs did not truly reflect reality.

In addition to seeking changes since the 2020 Review, we believe it is crucial to question if the methods used were appropriate and if the current methods are the best way to evaluate the assessment. This is how methods can be honed, sometimes over several review periods. It also took several reviews to convince the CGC and other States of the merit of the capital assessments (Net Borrowing and Investment), which are now considered solid assessments, and with which most States are comfortable.

A methodology review provides an opportunity to revisit assessments and examine if they are 'working' as intended, to address any outstanding issues, and possibly consider alternative methods.

In the closing months of the 2020 Review, Western Australia queried a change in the Welfare assessment that appeared illogical. We were told that it was too late to address; that we should raise the issue in the next review (see below in relation to decisions made after the Draft Report). However, if only changes since the 2020 Review will invoke a change in methods, discussion of this example of an unresolved issue would not be allowed.

Changes in data availability and new statistical methods

Although we agree that efforts should be taken to ensure a range of data sources and analytical tools are used to inform the 2025 Review, we had concerns about the terms 'big data' and 'machine learning' in paragraph 19 of the CGC's paper, and how this will be used to inform the approach.

At the meeting, the Commission stated that the availability and use of data has changed significantly in recent times and the paragraph largely reflected a broad statement that the CGC is open to innovative use of data, where appropriate.

Our concern was that selected data would be 'mined', and relied on too heavily to drive results, without being appropriately backed up by acceptable theory. Without appropriate evidence of data being fit for purpose, the Commission risks using data that is too selective and hinders the accuracy and effectiveness of the 2025 Review. We also see potential issues with verifying the data procured from sources that are not government agencies or provided by States, which may make the assessment outcomes less transparent.

We acknowledge that Commonwealth-State collaboration has made inroads in creating reliable, consistent datasets across States, and these could be useful. We support the Commission's endeavour to enhance datasets through collaboration with States over the course of the Review.

Work Program

We are generally comfortable with the work plan, including the allocation to tranches, the phases and associated timing. We acknowledge that the timeframe of the 2025 Review is shorter than for the 2020 Review, and there is less time for States to submit responses to consultation papers and the Draft Report. Nevertheless, we are comforted by the Commission's drive for open consultation, and that there will be opportunity for plenty of dialogue in between written submissions.

The work plan shows the Draft Report will be released in June 2024, with States to respond in August. In November the CGC will release a paper on changes since the Draft Report and States can submit responses in December. We have concerns with the lack of direct consultation with the States between the last response and the Final Report.

Without bilateral or multilateral meetings scheduled, there needs to be a channel through which we can approach the CGC to explain our position and our arguments, and hear the CGC's perspective. In the past we have found that some of our arguments have been misunderstood, and miscommunicated to the Commission, or States were not offered an opportunity to comment on late decisions. Once the Final Report is out, it is too late to correct this.

For example, in the 2020 Review final report, the decision was to not merge non-NDIS expenses into the 'Other welfare' expenses category in the Welfare assessment. The Commission stated¹:

'WA said other disability, aged care and National Redress Scheme expenses should be grouped with other welfare expenses. The Commission decided not to do this because wage costs and regional costs disabilities affect other welfare expenses but not the expenses in the other EPC component'.

However, we were not aware the CGC was considering this approach until the Final Report was released. Therefore, we were not given the opportunity to argue that such disabilities do affect these expenses. The decision could not be changed or discussed until the next review.

We are pleased that the Commission stated in the meeting that it would be open to have discussions as deemed necessary in the lead-up to the Final Report.

Department of Treasury
Western Australia
22 March 2023

¹ Commonwealth Grants Commission (2020), *Report on GST Revenue Sharing Relativities 2020 Review*, Volume 2 - Methodology for measuring State fiscal capacities (Part B), page 193, paragraph 69.