

COMMONWEALTH GRANTS COMMISSION (CGC) 2015 REVIEW
SIGNIFICANT CHANGES SINCE THE DRAFT REPORT
COMMISSION POSITION PAPER CGC 2014-04
NSW TREASURY COMMENTS
DECEMBER 2014

Summary

This submission responds to the Commonwealth Grants Commission's request for State comments on CGC Commission Position Paper 2014-04, *Significant Changes since the Draft Report*. It also takes the opportunity to respond to the CGC staff request for State views on commitments under the National Education Reform Agreement.

Commission Position Paper CGC 2014-04 notified States of the Commission's intention to make a number of significant changes to assessment methods proposed in the 2015 Review Draft Report. Proposed changes discussed include:

- Mining revenue assessment – contemporaneity and phasing. NSW Treasury does not agree that a GST distribution based on prospective 2015-16 conditions would be preferable to using average royalties for 2011-12 to 2013-14 as the basis of the 2015-16 GST distribution.
- Mining related expenditure. NSW Treasury considers the proposed assessments lack conceptual merit, supporting data and a reliable method.
- Health assessment. NSW Treasury supports the proposal to standardise bulk billed health services by socio-economic status and age as well as by Indigeneity and remoteness in calculating economic environment factors in the Health assessment. However, NSW Treasury considers that the Commission should reduce the size of the economic environment factor for emergency departments and community health given the issues raised by the consultants about data limitations and/or the magnitude of the substitutability factors in the Draft Report.
- Welfare assessment. NSW Treasury notes the Commission's decision to assess other general welfare expenses in the Welfare assessment using the relative proportions of State populations in the bottom quintile of the 2006 Census SEIFI, adjusted by the change in the relative proportions of State populations with Health Care Cards between the 2006 and 2011 Censuses to account for changes in social disadvantage over that period.

- Regional cost gradients. NSW Treasury notes that the proposed approach does not address our main concern regarding the suitability of using regional cost gradients based on School and Police services for other services that may use different mixes of labour and non-labour inputs than School and Police services.
- Urban transport infrastructure assessment. NSW Treasury notes the Commission's proposed approach and considers no discount would now be appropriate since the CGC notes the intended method reduces concerns about the sensitivity and non-policy neutrality of asset data.
- Treatment of nationally significant infrastructure projects. NSW Treasury still considers that all Commonwealth payments for infrastructure considered to be of national importance should have no impact on the GST distribution but, if that is not to be the case, the Commission's proposal to treat Commonwealth payments for road and rail projects affecting the national network so that 50 per cent will have no effect on the GST distribution is an improvement on the current practice which sees road and rail payments treated inconsistently (50 per cent discount for road payments, no discount for rail payments).

NSW Treasury disagrees with Queensland's view that commitments made by States under the original National Education Reform Agreement (NERA) are irrelevant following announcements in the Commonwealth's 2014-15 Budget. The NSW Government considers the NERA binding. The NSW Government will meet all its commitments under the NERA and has called on the Commonwealth Government also to meet all its commitments contained in the agreement signed on 23 April 2013.

NSW Treasury considers that many of the flaws in the current interpretation and implementation of horizontal fiscal equalization (HFE) could be improved – including a more contemporaneous GST distribution – through an equal per capita distribution of GST revenue between the States, supplemented by additional Commonwealth payments to the smaller States if further equalization were considered necessary.

Mining revenue assessment

The Commission:

- invites any further views of the States on Western Australia's suggestion that a GST distribution based on prospective 2015-16 conditions would be preferable to using average royalties for 2011-12 to 2013-14 as the basis of the 2015-16 GST distribution given the major fall forecast for iron ore royalties.

NSW Treasury does not agree that a GST distribution based on prospective 2015-16 conditions would be preferable to using average royalties for 2011-12 to 2013-14 as the basis of the 2015-16 GST distribution. NSW Treasury considers such an approach would be inconsistent, impractical, increase the volatility of the GST distribution and increase the need for judgment in calculating relativities.

The CGC recognises that the current system does not achieve precise equalisation in a year, and that average historical fiscal capacities may not be the same as those applying in the year the GST is distributed.¹ However, it is hoped that this does not have systematic and one-sided effects for any one State.

On practical grounds, NSW Treasury considers it is not possible for assessments to be based on prospective estimates for 2015-16. Assessments are not based on State Budget data alone, but on extensive data sets from other sources, such as administrative data from other State agencies, the Australian Bureau of Statistics, the Independent Hospital Pricing Authority, the Australian Curriculum and Reporting Authority and so on. This information is not available on a prospective basis.

NSW Treasury agrees with the Commission's view that State, or independent, forecasts of revenues in the application year, for example for royalties, are not sufficiently reliable to use as the basis of the GST distribution. Forecasts can differ significantly from the final Budget outcomes, requiring consequent GST adjustments in later years. This would add an additional layer of complexity, uncertainty and volatility in later years and undermine the alignment of GST revenue payments in later years to conditions in those years. Using forecasts also brings the risk that actual outcomes could change as a result of policy decisions.

Moreover, even if States could forecast all tax and other revenue bases and accompanying revenues and all expenses with total accuracy, and all the other data that feeds into the CGC assessments could be projected with total accuracy, basing the GST distribution on one year of data would produce an unacceptable degree of volatility in GST revenue payments.

¹ CGC, 2014 Update, p. 32.

Contemporaneity has been considered in previous methodology reviews and all States and the Commission have generally taken the view that basing the assessments on the average of a number of years (five up to 2009-10, and three since then), which mitigates the impact of sudden data changes, is the preferable approach in order to avoid the volatility in year-to-year changes in State circumstances.

The CGC seeks responses from States on the broader issue of to what extent CGC methodology should, or should not, respond to sudden or large changes in State circumstances (stemming from either shocks on the spending side or the revenue side of the budget, though shocks are more likely to occur on the revenue side).

NSW Treasury has consistently put the view that the GST distribution should be based on clear, simple, transparent and policy-neutral criteria that leave little room for ‘interpretation’ and ‘judgment’. In our view the potential for making adjustments for exceptional circumstances raises precisely the types of issues associated with making judgments that should be avoided: what constitute exceptional circumstances in an environment where there are no set criteria for making such judgments, and/or principles exist but the ranking of the principles is indeterminate or some principles are stressed in certain circumstances and others are stressed in other circumstances.

NSW Treasury notes that fixing a systemic flaw in the current implementation of HFE should not be attempted by ad hoc changes to the system to suit the particular circumstances of any one State. It should be done by moving to a system that does not contain the flaws of the current methods.

An equal per capita distribution of GST would produce a totally contemporaneous GST distribution without the need for large revisions and reconciliations (given population numbers are much more stable than royalty revenues).

NSW Treasury notes that the Commission is still considering phasing-in the inclusion of iron ore fines in the iron ore category in the proposed mineral by mineral mining revenue assessment. NSW supports the Commission’s decision not to apply a discount to the mining revenue assessment. However, the proposed phasing is implicitly equivalent to a temporary discount of the mining assessment and contradicts the Commission’s general emphasis on equalisation.

Switching now to a ‘contemporaneous’ approach would introduce inconsistency over time. Western Australia now suggests the prospect of declining GST revenue payments based on past peaks in resource prices at a time when its revenue from resource royalties also is falling. However, in the upswing of the resources boom Western Australia’s reductions in GST revenue payments lagged the growth in its royalties revenue, so that arguably through that

period Western Australia received GST revenue payments in excess of those required by contemporaneous circumstances.

Mining related expenditure

The Commission:

- intends to introduce assessments of expenditure related to the planning and regulation of investment projects and capital grants to local government relating to community development and amenities and culture and recreation. These relate not only to support for the mining industry but to where private investment and population growth requires differential spending by states.

NSW Treasury does not agree with the Commission's intention to introduce assessments of spending related to planning and regulation of investment projects and capital grants to local governments relating to community development and amenities and culture and recreation. NSW Treasury considers the proposed assessments lack conceptual merit, supporting data and a reliable method.

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. The Commission considers States with expanding industries usually have higher levels of construction activity that result in higher project planning and approval expenses, including environmental assessment costs.

The Commission:

- used State provided data for 2010-11 to 2012-13 to set the national average net State expense on planning and regulation of investment projects at \$18 per capita in 2011-12. This amount will be indexed for years after 2011-12 based on real growth in private non-dwelling construction and the price index for State and local government final consumption expenditure
- will assess State expenses for project planning and approvals using State shares of private non-dwelling construction expenditure.

The proposed assessment redistributes \$103 million in GST revenue payments (compared with an EPC distribution) to Western Australia in 2012-13, \$37 million to Queensland and

\$20 million to the Northern Territory, and \$71 million away from Victoria and \$62 million away from New South Wales.

NSW Treasury considers this proposed assessment lacks conceptual merit; considerable uncertainty surrounds the estimated average expense per capita of \$18 in 2011-12; and no evidence has been provided that the method proposed for the assessment is reliable.

First, NSW Treasury considers the conceptual case for this assessment is far from conclusive.

- No evidence has been presented of any correlation between ‘expanding industries’ and State costs for planning and regulation of investment projects.
- Such costs could be heavily influenced by the type of industries that are expanding, e.g., whether ‘expanding industries’ necessarily mean new facilities for which project planning and approvals are required or could be accommodated within existing facilities for which little additional project planning and approval is required.
- Such costs could also be heavily influenced by State policies on both the requirements for project planning and approvals and the recoupment of project planning and approval costs from industry.

Second, NSW Treasury notes the Commission has provided no detail of the State expenses that have been used to calculate the national average per capita expense of \$18 per capita in 2011-12. It is not clear what costs have been included in this amount and States have been provided with no information on which to reach any conclusion that expenses have been reported by States on a comparable and consistent basis across all States.

NSW Treasury notes the considerable uncertainties in connection with the CGC’s data requests of February 2014 on regulatory expenses associated with investment projects for, on the one hand, agencies with direct planning assessment and approval functions and, on the other hand, expenses for agencies other than those with direct planning assessment and approval functions.

NSW Treasury was concerned then whether expenses being measured related to the net expenses for government in assessing private sector investment projects, or the expenses that governments themselves face in gaining local government approval for the construction of roads, schools, police stations, hospitals, courts and so on. State government expenses for planning and approval of private sector projects are already assessed in the regulatory expenses included in the Services to industry expenses assessment. We are concerned that expense returns even for agencies with direct planning and approval functions may include a significant quantity of expenses that are not directly related to the assessment of ‘industry expansion’ proposals.

The CGC provides no indication that these data issues have been resolved.

Third, NSW Treasury considers the method proposed for the assessment is not reliable. The CGC proposes to base the assessment on State shares of private non-dwelling construction expenditure.

The CGC has provided no evidence that State shares of private non-dwelling construction expenditure is a reliable indicator of State needs to spend on project planning and approval. Some industries may require large investments in a relatively small number of individual projects, which may inflate overall non-dwelling construction values but not necessarily project planning and approval costs; other industries may require smaller investments in a larger number of individual projects, which may reduce overall non-dwelling construction values but still involve significant planning and approval expenses for a larger number of individual projects.

NSW Treasury considers this assessment should not proceed given the lack of a conceptual case, the uncertainties in the data on which the average expense per capita is based, and the uncertainties in the proposed assessment method.

If the CGC decides to proceed with this assessment, it should be subjected to the highest possible discount, reflecting the uncertainties around the conceptual case and data.

Capital grants to local government

The Commission considers 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 and amenities and culture and recreation. The Commission considers local governments experiencing rapid population growth will undertake more investment, requiring more than a per capita share of capital grants from State governments to maintain their per capita levels of infrastructure. The Commission has assessed these grants using population growth rather than population shares.

The proposed assessment redistributes \$19 million in GST revenue payments (compared with an EPC distribution) to Western Australia in 2012-13, \$5 million to Queensland and \$1 million to the Northern Territory, and \$15 million away from New South Wales, \$6 million from South Australia and \$4 million from Tasmania.

NSW Treasury considers this proposed assessment lacks conceptual merit; considerable uncertainty surrounds the amounts States spend in this area; and no evidence has been provided that the method proposed for the assessment is reliable.

NSW Treasury considers the conceptual case for this disability has not been established. No evidence has been presented by the CGC to support the view that either local governments

experiencing rapid population growth will undertake relatively more investment, or that State governments will provide more than a per capita share of local government grants to those local government areas experiencing faster than average population growth. No evidence has been provided by the Commission that local government areas experiencing faster than average population growth undertake relatively more investment in community development and amenities and culture and recreation than other local government areas.

- Local governments experiencing faster than average population growth need not undertake relatively more investment: other alternatives are to provide for increasing demands on services in ways that need not necessarily require increasing investment in facilities by working existing facilities harder or more efficiently; by using pricing or other mechanisms to keep demand for services within limits allowed by current infrastructure; or to allow service levels per head of population to deteriorate (either temporarily or permanently).

No evidence has been provided by the Commission that State governments need to provide more than an average per capita share of capital grants to local governments experiencing above average population growth.

- Even if local governments experiencing faster than average population growth do invest more, the investment could be financed not by higher than average grants from State governments but by the higher general rates income that increasing numbers of residents might bring; higher developer contributions that increased investment in housing to accommodate an increasing population may bring; or higher local government borrowing backed by potentially higher future general rates or developer contributions revenue. Much also will depend on State government policy for distributing capital grants to local government areas.

The underlying need being measured in this assessment appears to be local government's ability to provide infrastructure relating to community development and amenities and culture and recreation. The CGC attempts to equalize what states do, not what local governments do. NSW Treasury considers the assessment of this expense equal per capita, i.e. recognising that increased population results in greater population shares of GST revenue payments, is entirely appropriate.

It is not clear what expenses the CGC is including in this assessment. The CGC has not provided information on the quantum of State capital grants to local government that are included in the assessment, or whether Commonwealth grants to local government passed through the States are included in these amounts. Commonwealth payments direct to local governments and financial assistance grants to local government passed through the States to local governments generally have no impact on the relativities.

However, State government capital transfers to local government included in ABS *Government Financial Statistics*, for the period 2000-01 to 2012-13 are shown in Table 1. Table 1 shows that one State – Queensland – has in most recent years accounted for around 70 per cent of all State capital transfers to local government. This assessment therefore will be influenced heavily by one State’s policy.

Table 1: State capital grants to local government

	NSW \$m	Vic \$m	Qld \$m	WA \$m	SA \$m	Tas \$m	ACT \$m	NT \$m	TOTAL \$m
2003-04	157	17	225	115	19	8	0	2	543
2004-05	214	17	290	129	28	14	0	2	694
2005-06	198	30	308	157	30	13	0	24	760
2006-07	178	14	446	134	29	11	0	14	826
2007-08	211	43	428	170	41	9	0	10	912
2008-09	180	78	491	213	36	16	0	7	1,021
2009-10	175	133	744	153	52	26	0	8	1,291
2010-11	168	107	1,151	151	49	24	0	9	1,659
2011-12	172	181	1,217	160	55	20	0	19	1,824
2012-13	138	162	1,389	164	31	11	0	7	1,902

Table 2 shows an assessment which broadly replicates the CGC’s GST impact of assessing capital grants to local government shown in CGC Commission Position Paper 2014-04, Table 2, p. 5, for 2012-13. It is based on including in the assessment around 9 per cent of total State capital payments to local government and using a relative population growth factor calculated as the ratio of State population growth to national population growth.

If this is the basis of the CGC’s assessment, the CGC has not detailed how it determines that around 9 per cent of State capital payments to local government are to support local government infrastructure provision relating to community development and amenities and culture and recreation.

Table 2: State capital grants to local government: a possible CGC assessment

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	TOTAL
Capital grants to local government, \$m									170
Average expense, \$ pc									7.42
Pop growth, 2012-13, %	1.3%	1.8%	2.0%	3.7%	0.9%	0.1%	1.8%	2.8%	1.8%
Population 2012-13, '000	7,357	5,681	4,609	2,480	1,662	512	378	239	22,918
Pop growth relativity	0.738	0.985	1.123	2.067	0.521	0.058	1.033	1.592	1.00000
Assessed expense, \$ pc	5.47	7.31	8.34	15.34	3.86	0.43	7.67	11.82	7.42
Assessed difference, \$ pc	-1.95	-0.11	0.92	7.92	-3.56	-6.99	0.25	4.40	0.00
Assessed difference, \$ m	-14	-1	4	20	-6	-4	0	1	25

Sources: ABS, *Government Finance Statistics, Australia, 2012-13 (5512.0)* and *Australian Demographic Statistics, Mar 2014 (3101.0)*: NSW Treasury calculations.

NSW Treasury also questions the reliability of the CGC's assessment method.

The CGC has not provided any evidence that State capital grants to local government to support local government infrastructure provision relating to community development and amenities and culture and recreation are correlated to relative population growth. Year-on-year changes in State capital transfers to local government calculated from Table 1 show little correlation to year-on-year changes in State populations or States' relative population growth compared to the national average.

In addition, the redistribution falls short of the \$30 per capita materiality level required for the assessment of individual disabilities. However, the Commission proposes to include this assessment because the population growth disability is already material elsewhere.² This justification for the inclusion of this assessment could set a problematic precedent for other assessments in the future.

² CGC 2014-04, Significant Changes since the Draft Report, page 5.

Health assessment

The Commission:

- intends, in the calculation of the economic environment factors for each component, to standardize bulk-billed services by Indigeneity, remoteness, socio-economic status (SES) and age (the Draft Report standardised just for Indigeneity and remoteness).

NSW Treasury supports the new proposal to standardise bulk billed services by SES and age as well as by Indigeneity and remoteness.

However, NSW Treasury continues to hold strong concerns regarding the magnitude of the economic environment factors in the Draft Report. These issues were highlighted by the consultants engaged by the Commission to review the proposed Health assessment for the 2015 Review.

The consultant reports prepared by Elizabeth Savage and James Downie reflect a number of strong concerns which New South Wales has raised in its various submissions to the methodology reviews in 2010 and 2015 regarding the impact of private sector health provision. For example, the reports conclude that:

- ‘the empirical basis of substitutability is weak and applied in an ad-hoc basis across the health components’ (p.1, Elizabeth Savage)
- ‘I am inclined to think that the 40 per cent level of substitution of ED services as outlined in the draft report is too high and is likely to be more in the range of 10-20 per cent, with 20 per cent being a suitable approximation level’ (p.2, Elizabeth Savage)
- ‘A more appropriate estimate for the CGC to use for the proportion of ED presentations that are potentially able to be provided by general practice is 15 per cent’ (p.5, James Downie)
- ‘This [community health] is a very difficult area to determine the level of substitutability. I agree with the States that argue that the level is too high. I think the level is likely closer to 50 per cent than 75 per cent’ (p.2, Elizabeth Savage).

NSW Treasury considers that the Commission should reduce the size of the economic environment factor for emergency departments and community health given the issues raised by the consultants about data limitations and/or the magnitude of the substitutability factors in the Draft Report.

The consultants conclude that emergency department substitutability is between 15 to 20 per cent which is consistent with NSW Health analysis provided in the NSW Third Submission to the 2015 Review.

The 40 per cent substitutability factor suggested in the Draft Report for emergency departments is based on the ABS Patient Experiences Survey which found that 23 per cent of people that presented at an emergency department thought care could have been provided by a GP and 15 per cent of people cited that the time or day was the main reason for not seeing a GP.

The NSW Third Submission queried the addition of this 15 per cent which is most likely due to the lack of GP availability after hours. Its addition results in a larger economic environment factor and assumed level of substitutability despite the lack of available GP services.

Elizabeth Savage's report does not support the results of this survey as the choice of 40 per cent substitutability given that 'surveys of patient intent or reasons are notoriously poor at explaining what people actually do.'³

James Downie's report notes that ABS Patient Survey data is difficult to draw robust conclusions from, and probably is not suited to making the estimates that the Commission needs to make for this methodology.

NSW Treasury notes that James Downie's report suggests that the Commission may also want to consider the impact of so called supply driven demand in emergency departments which challenges the assumptions about the degree of substitutability.

The report indicates that there is a body of thought that even if substitutable patients were able to get the care that they required in the private sector there would be little impact on the aggregate demand for emergency department services (i.e., the group of patients removed from the system would simply be replaced by new patients of similar levels of acuity).

New South Wales has highlighted in previous submissions that the conceptual case for substitutability between no-cost Emergency Department and bulk-billed GP services does not hold given the above-average level of ED presentations and GP attendances in New South Wales. NSW Treasury considers this to be a further reason to limit the economic environment factor in the emergency department component as recommended by the consultants.

The NSW Third Submission noted that the level of substitutability for community health is significantly lower than 75 per cent for most services based on consultation with senior health

³ Elizabeth Savage, *Consultant comments on the 2015 Review Draft Report health category assessment*, page 3.

service managers from one of the largest Local Health Districts in NSW. Elizabeth Savage agrees that this component factor is too high and suggests:

Obtaining a more accurate figure would be on a micro basis (similar to the partial work undertaken from New South Wales). I would investigate each area of community health separately (immunisation, mental health, family planning etc) and expense weight the determined level of substitutability.⁴

James Downie's report also acknowledges the difficulties in calculating the economic environment factor for the community health component and suggests that although the 75 per cent substitutability factor may be reasonable there are major data limitations based on this assumption.

NSW Treasury considers that given the data limitations and the comments by both consultants the Commission should reduce the economic environment factor in community health to at most 50 per cent as recommended by Elizabeth Savage. In the CGC Staff Telepresence Papers provided to the States on 3 April 2014, Staff suggested that a 50 per cent substitutability factor was appropriate for this component.

NSW Treasury agrees with the approach for admitted health which the Commission proposed in the 2015 Review Draft Report which does not have an economic environment factor given that the substitutability of these services is already accounted for in the SDC calculations.

Welfare assessment

The Commission:

- intends to assess other general welfare expenses using the relative proportions of State populations in the bottom quintile of the 2006 Census SEIFI, adjusted by the change in the relative proportions of State populations with Health Care Cards between the 2006 and 2011 Censuses to account for changes in social disadvantage over that period. The Commission will continue to use this measure, pending the availability of a household level index from the 2011 Census.

NSW Treasury notes the CGC's position.

Given the unavailability of 2011 Census SEIFI data, and the problems associated with the alternative measures suggested in Staff Discussion Paper CGC 2014-03-S, *Update and Supplementary Issues for the 2015 Review*, there appears to be little alternative but to use

⁴ Elizabeth Savage, *Consultant comments on the 2015 Review Draft Report health category assessment*, page 3.

2006 Census SEIFI data adjusted for some measure of the change in relative social disadvantage in States since then.

In the 2015 Review Draft Report the CGC proposed to assess State expenses in the other general welfare component of the Welfare assessment using relative proportions of people in the bottom quintile of the ABS's Socio-Economic Index for Individuals (SEIFI) based on 2011 Census data. Having learned that the ABS does not intend to update SEIFI using 2011 Census data, the CGC canvassed alternative assessment indicators in Staff Discussion Paper CGC 2014-03-S.

The CGC now intends to use relative proportions of State populations in the bottom quintile of the 2006 Census SEIFI indexed by the change in the relative proportions of State populations with Health Care Cards between the 2006 and 2011 Censuses as a proxy for changes in States' relative social disadvantage over the period between the 2006 and 2011 Censuses. The CGC intends to use this method pending the availability of a household level socio-economic index based on 2011 Census data.

The CGC considers the 2006 measure based on relative proportions of State populations with Health Care Cards correlated well with the 2006 Census based SEIFI measure.

NSW Treasury notes the income variable in any relative disadvantage index may not adequately measure relative disadvantage. A specified income level in one part of Australia would not provide the same 'access to resources' as in another part of Australia given that costs of living, and particularly housing, vary between States and between regions within States.

Regional cost gradient

The Commission:

- intends to use a general regional cost gradient where a regional cost disability is to be extrapolated to expense assessment categories other than Schools Education or Justice
- the general regional cost gradient has been calculated as the average of the Schools Education and Police gradients
- a 12.5 per cent discount has been applied to the regional cost factors for all categories in which the general cost gradient has been used.

In the 2015 Review Draft Report the Commission proposed to use a general regional cost gradient based on regression analysis of Australian Curriculum and Reporting Authority

(ACARA) data for schools for categories, other than Schools and Justice, where a regional cost disability is assessed.

Following the draft report, CGC Staff Discussion Paper 2014-03-S, *Update and Supplementary Issues for the 2015 Review* was released along with the report from the consultant engaged to examine the econometric modelling used to estimate differences in spending on students with different characteristics using ACARA data. The Commission also received 2012 ACARA data.

Commission staff proposed to make a number of changes to the models estimated for government and non-government schools. Given our concerns with the specifications of the regression model and the underlying data, NSW Treasury was not convinced of the accuracy of the resulting student cost weights. Specifically, the relationship between remote and Indigenous student costs raised concerns for the accuracy of the general regional cost factor that was to be extrapolated to other expense categories.

The Commission now intends to use a general regional cost gradient calculated as the average of the Schools education and Police gradients, derived from ACARA and State provided police data. This approach draws on two different service delivery models, creates a smoother gradient and assists in reducing the sensitivity of the gradient to changes in ACARA data over time. A 12.5 per cent discount has been applied to the regional cost factors for all categories in which the general cost gradient has been used.

While NSW Treasury notes the smoother gradient that is now proposed (along with a 12.5 per cent discount), taking an average of two different service delivery models has not addressed our concern regarding the suitability of using a regional cost gradient for other services that may use different mixes of labour and non-labour inputs than School and Police services upon which the general cost gradient is based.

The Commission proposes to apply the general gradient to the following categories/components:

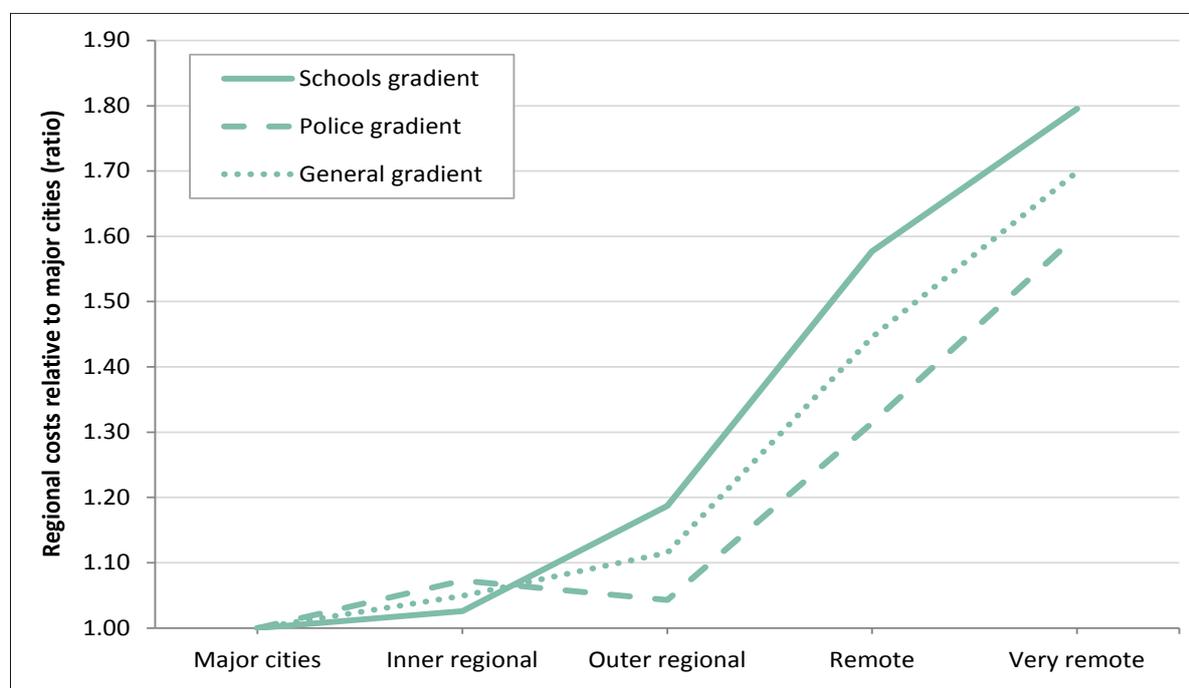
- Health – outpatients
- Housing
- Welfare
- Services to communities – community development, community amenities and small communities utilities subsidies
- Transport services – non-urban subsidies
- Roads – rural roads (road length expenses)
- Services to industry – regulation and

- Other expenses – 50 per cent of service expenses.

This list contains varied service types which are delivered through a range of labour and non-labour inputs. It is not clear that it is appropriate to apply a ‘general’ cost gradient to all of these category components, as the relationship between schools and police costs has not been established to be a sufficient proxy for other types of services.

Figure 1 from Commission Position Paper CGC 2014-04 shows the gradients under consideration. It shows quite different cost gradients for Schools and Police in regional areas, with similar gradients in remote areas. This suggests that cost gradients for different service types may be quite different, and that cost gradients calculated for some services might not be applicable for other services.

Figure 1 Schools education and illustrative police Regional costs gradient



Source: Commission calculation using ACARA data, 2010-11 and State provided data, 2008-09.

Urban transport infrastructure assessment

The Commission:

- intends to base the assessment of State urban transport infrastructure requirements in each year on the sum of the square of the population of each urban centre above 20,000 in each State, with assessed investment calculated by subtracting the opening stock required in each State from the closing stock
- is inclined to reduce the placeholder discount of 50% adopted in the Draft Report.

The urban transport infrastructure assessment is a new component of the broader infrastructure assessment. The urban transport investment component covers the consolidated urban transport investment of the general government and public non-financial corporation (PNFC) sectors. It does not cover inter-urban passenger transport investment.

NSW Treasury agrees with the Commission's assessment that the conceptual case that larger cities require more assets per capita to deliver urban transport services has been established and is supported by the available data.

NSW Treasury agrees with the Commission view that the sensitivity and non-policy neutrality of asset data have been reduced. Consequently, NSW Treasury considers no discount should be applied to this assessment.

Nationally significant infrastructure projects

The Commission:

- intends to treat all Commonwealth payments for projects which the Commonwealth Department of Infrastructure and Regional Development advises affect the national road or rail networks in the same way. Commonwealth payments to the states which the Commonwealth Department of Infrastructure and Regional Development advises affect the national road and rail networks will impact on the relativities and national needs will be assessed in relation to 50 per cent of them on the basis of their distribution among states. As a result 50 per cent of them will have no effect on the GST distribution.

NSW Treasury still considers that all Commonwealth payments for infrastructure considered to be of national importance should have no impact on the relativities. This would ensure that payments provided to States for specific nationally important projects are not equalised across all States. A body such as Infrastructure Australia would be best placed to identify nationally significant infrastructure projects.

However, if that is not to be the case, the Commission's proposal limits the equalisation of Commonwealth payments for national road and rail network payments to 50 per cent of the payments, is an improvement on the current practice which sees road and rail payments treated inconsistently (50 per cent discount for road payments, no discount for rail payments).

National Education Reform Agreement (NERA) instruction in the CGC Terms of Reference

An email from CGC staff invited State views, in light of the changes announced in the Commonwealth Government's 2014-15 Budget, on whether States that have agreed to implement new funding models consider the agreements binding, and whether States consider they are bound to allocate Commonwealth funding in a manner consistent with the student resource standard (SRS)

In its response to the draft report, Queensland said that given the changes to National Education Reform Agreement (NERA) funding announced in the 2014-15 Budget, the various commitments made by States under the original agreement are now irrelevant, and if States choose to implement changes to their schools funding models despite the withdrawal of Commonwealth commitments this should be considered a State policy choice.

New South Wales disagrees with Queensland's view that commitments made by States under the original NERA are irrelevant following announcements in the Commonwealth's 2014-15 Budget.

The NSW Government considers the NERA binding. The NSW Government have made various statements that it will meet all its commitments under the NERA and have called on the Commonwealth Government to also meet all its commitments contained in the agreement signed on 23 April 2013.⁵

As a consequence, New South Wales considers it is bound to allocate Commonwealth funding in a manner consistent with the student resource standard (SRS), as per our obligations under the NERA.

⁵ See *NSW Budget 2014-15*, Budget Paper 3, page 2-4, <http://www.smh.com.au/national/education/gonski-funding-flows-to-most-needy-of-nsw-schools-20141120-11qlbq.html>