



Queensland Treasury Response to
Commonwealth Grants Commission
2015 Methodology Review

Response to:

Staff Discussion Paper 2014-03-S

Update and Supplementary Issues for the 2015
Review

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Changes to econometrics used in schools and regional costs

Queensland's position

- Supports the proposed changes to the schools econometric model. The allocation of expenses to Indigeneity and remoteness factors is consistent with Queensland's experience.

Since the Draft report, the Commission has received 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.

In response to the consultant's comments, the staff discussion paper proposes a number of changes to the schools econometric model used in the Draft Report to estimate average differences in spending on students with different characteristics:

- Using a funding per student, rather than a funding per school model;
- Removing dummy variables for states;
- Allocating students to Indigenous/socioeconomic groups using the Indigenous Relative Socio-economic Outcomes index and the Non-Indigenous Socio-economic Index for Areas;
- Introducing a variable to capture the fixed costs of schools (and consequently removing the service delivery scale (SDS) dummy variable and no longer forcing the regression through the origin); and
- Including remoteness for non-government schools.

Queensland supports the proposed changes as they appear to suitably address the consultant's comments and recommendations. The removal of state dummy variables are likely to result in a model that better reflects what states do, and the revised approach to capturing SDS effects, which was recommended by the consultant, is an improvement on the Draft Report approach.

Queensland notes that adjustments to the model have resulted in changes to the remoteness and Indigeneity factors that are largely offsetting. The staff discussion paper notes that the allocation of high costs to Indigeneity or remoteness is sensitive to the exact specifications of the model, and asks whether states can provide information on whether the way the model allocates costs is consistent with state experience.

In Queensland, additional funding is allocated to Indigenous and remote schools using Index of Community Socio-educational Advantage (ICSEA) factors for Indigeneity and remoteness. Queensland's Department of Education, Training and Employment has reviewed the loadings in the staff discussion paper and advise that the way the model is allocating funding to Indigenous and remote schools is consistent with Queensland's experience.

Post-Secondary Education user charges

Queensland's position

- No objections to the proposal to net post-secondary education user charges off the related expenditure.

The staff discussion paper proposes to net all post-secondary education user charges off the post-secondary education expenses rather than including them in Other Revenue.

Queensland has no objections to this proposal, as revenue in this category meets state expenditure on training hours.

Low socio-economic status disability for other general welfare services

Queensland's position

- The proposed broad factor appears to be the best practical alternative given that 2011 SEIFI is not available.

The Draft Report outlined the Commission's proposal to assess other general welfare services using the bottom quintile of the ABS socio-economic Index for Individuals (SEIFI). However, the ABS has since advised that it is not intending to update the SEIFI using 2011 Census data and that there is no plan to release a family level index.

Queensland agrees with staff views that Indigenous Relative Socio-economic Outcomes and the non-Indigenous Socio-economic Index for Areas (IRSEO/NISEIFA) would not be a good measure of general disadvantage, as it would not recognise that some disadvantaged people live in more advantaged areas. Similarly, the 2006 SEIFI is already dated and is unlikely to reflect states' circumstances in the years the 2015 Review methodology will be applied.

The staff discussion paper suggests using a more up-to-date indicator of disadvantage than 2006 SEIFI, and proposes that the proportion of one parent families with dependents could be used to assess general welfare services. There are advantages to this proposal, as the indicator is policy neutral and up-to-date and would be reasonably well related to service users in each state. At the same time, the proposed indicator may not measure as broad a range of disadvantage characteristics as would have been captured by SEIFI. On balance, Queensland supports the staff proposal. The suggested broad factor appears to be the best practical alternative given that 2011 SEIFI is not available.

Revised weights for the Justice assessment

Queensland's position

- The Commission should approach combining data sources with caution to ensure a reliable result. Queensland otherwise does not object to the proposal in principle.

Staff propose to recommend to the Commission:

- derive and fix Indigenous use rates based upon state provided data for 2010-11 to 2012-13 on defendants;
- derive SES use rates for police and courts separately based upon state provided data for 2010-11 to 2012-13 for offenders and defendants respectively;
- recognise socio-economic status (SES) using IRSEO for Indigenous people and NISEIFA for non-Indigenous people;
- apply and fix the SES groupings and weights based on the two most disadvantaged quintiles, the middle quintile and the two least disadvantaged quintiles; and
- apply the courts SES use rates in prisons.

Queensland recognises the main driver of changes to the Justice assessment is the revised representation of Indigeneity through:

- new state data that shows Indigenous offenders at 19% (an amount considerably less than the 33% derived from the Australian Institute of Criminology (AIC) data); and
- the split of distribution to reflect Indigeneity and non-Indigeneity.

Queensland notes the state data, while allowing a better representation of Indigeneity, does not segregate by age and sex for the socio-demographic composition disability. To accommodate this staff are proposing to merge two data sets. Although Queensland understands the reasoning behind this, the Commission should approach combining data sources with caution to ensure a reliable result.

Queensland otherwise does not object to the proposed recommendations in principle as they appear reasonable and we are not aware of any adverse issues with the new data and change in methodology.

Adjustments to June disaggregated estimated resident population (ERP) data

Queensland's position

- No objections to the proposal to adjust June ERP data.

Queensland has no objections to the proposal to adjust disaggregated 30 June ERPs in proportion to match 31 December state population totals.

Backcasting of National Specific Purpose Payments and agreements (SPPs)

Queensland's position

- Queensland supports removing net cross-border adjustments from National Health Reform (NHR) funding.
- Queensland does not support the proposal to backcast NHR funding using 2014-15 MYEFO funding as this approach is unreliable.
- Queensland supports using the 2013-14 Final Budget Outcome distribution of NHR payments with an adjustment for cross-border, rather than using forward estimates to backcast.

Students First

Queensland provided comments on the backcasting of Students First funding in its response to the Draft Report, and does not have any further comments at this stage.

National Health Reform funding

The 2015 Review Terms of Reference include the following directive:

3. The Commission should prepare its assessments on the basis that:
 - a) National Specific Purpose Payments, National Health Reform Funding and National Partnership project payments should affect the relativities, recognising that these payments provide the States with budget support for providing additional state and territory services;
 - i. NHR funding and corresponding expenditure relating to the provision of cross-border services to the residents of other States should be allocated on the basis of residence.

The staff discussion paper raises two issues:

- How to give effect to the Terms of Reference requirements to allocate NHR funding on the basis of residence.
- Whether, and how, the payments should be backcast in this Review.

The staff discussion paper proposes to backcast the NHR funding using the 2014-15 National health reform distribution in MYEFO, adjusted for cross-border payments.

Queensland position

Queensland supports the use of Commonwealth Budget Paper and MYEFO figures for the removal of net cross-border adjustments from NHR funding going forward, to ensure that funding is allocated on the basis of residence.

Queensland does not support the staff proposal to backcast the NHR funding using the 2014-15 national health reform distribution in MYEFO. Queensland supports the alternative suggested in Paragraph 83 of the staff discussion paper - using the 2013-14 Final Budget Outcome distribution

of NHR payments with an adjustment for cross-border, rather than using forward estimates to backcast.

There are reliability issues with backcasting NHR funding. The 2015-16 distributions reflect States' projections of their level of activity, which is not a reliable basis for backcasting the payment distribution into the assessment years. The Commonwealth Budget notes that even for 2014-15, the efficient growth funding component of NHR funding is indicative only. It is doubtful whether the 2014-15 estimates are sufficiently reliable for backcasting purposes.

Queensland also considers that the purpose of backcasting is to apply the policies of the application year to state circumstances in the assessment year (as opposed to backcasting the application year circumstances). Backcasting the actual distribution of the payment in 2014-15 or 2015-16 would reflect the projected activity levels in those years, which are likely to have changed since the assessment years.

If the Commission decide to backcast NHR payments, an estimate would need to be made of the payments that would have occurred in the assessment years, if the application year policy had been applied. It is unclear how the Commission could make such an estimate and difficult to see how it could be done reliably. However, if the Commission decides to backcast, it must ensure it is backcasting application year policies rather than circumstances. A far simpler alternative is to use the 2013-14 NHR funding. As the payment is not materially different from an EPC distribution, an adjustment for changing activity levels would not be necessary.

Treatment of payments not made in the application year

Queensland's position

- Supports not backcasting the cessation of payments made in the assessment years but not in the 2015-16 application year.

Queensland supports the proposal in the staff discussion paper to not backcast the cessation of payments made in assessment years but not in the 2015-16 application year. The cessation of these payments does not represent a major change in federal financial relations. Backcasting their cessation would not achieve HFE.

While Queensland supports the conclusion reached in the paper, Queensland is concerned that the discussion is overly focused on the size of aggregated ceased payments, and whether the impact of backcasting payments would be material. For example, paragraph 85 states that:

The Commission noted that individually they [ceased payments] do not constitute a major change in Commonwealth-State financial relations, but in aggregate, they may have a material impact on GST distribution.

This paragraph appears to be suggesting that payments could constitute a major change in federal financial relations if their aggregate impact on the GST distribution is material. Queensland considers backcasting to be a conceptual issue, and the size of the impact should not affect the decision as to whether a payment constitutes a major change in federal financial

relations. Materiality should only be relevant when deciding whether an adjustment should be made, after conceptual issues have been resolved.

Treatment of other Commonwealth payments

Queensland's position

- Queensland does not support the proposal to only apply discretion to the treatment of Commonwealth payments (as per clause 4 of the Terms of Reference) when doing so would have a material impact.

In the Terms of Reference, the Commission is asked to prepare its assessments on the basis that Commonwealth payments are treated a particular way (clauses 3 a to c) but is given discretion to treat some payments differently (clause 4). For example, the Commission is advised to treat facilitation payments so they do not affect the relativities, but may also treat them so they impact on the relativities if this is judged to be more appropriate.

The staff discussion paper proposes to only use this discretion when doing so would have a material impact (using the disability materiality threshold, currently proposed to be \$30 per capita).

In general, Queensland does not support using materiality thresholds to make decisions on the treatment of Commonwealth payments, as the grouping of Commonwealth funding under different agreements is somewhat arbitrary. Funding for similar purposes could be provided in the form of smaller individual agreements, or could be provided as part of a larger agreement with multiple outcomes. The application of materiality thresholds could lead to the inconsistent treatment of payments due to arbitrary groupings.

Further, Queensland does not consider there would be any benefit to applying materiality thresholds to Commonwealth payments. Treating a payment so that it affects the relativities does not create additional complexity and good information is available on the Commonwealth funding states receive, so assessments can be made reliably.

In the Draft Report, the Commission decided not to adopt materiality thresholds for Commonwealth payments. The Report noted that if a materiality threshold were applied, it would need to apply to Commonwealth payments in aggregate, and the treatment of every payment would need to be considered because the aggregate effect of impacting payments would be material.

Queensland considers that similar issues are encountered if materiality thresholds are applied to the question of whether the Commission should use its discretion to treat some Commonwealth payments differently than advised in the Terms of Reference. Decisions on the treatment of payments would be affected by their individual size and distribution amongst the states, rather than the size and distribution of Commonwealth payments overall.

Queensland does not support the proposal to only apply discretion when doing so would have a material impact. If the Commission chooses to apply judgement to the treatment of some payments (such as facilitation payments), this should not be affected by materiality considerations.

Treatment of Commonwealth payments commencing in 2013-14

Queensland's position

- No objections to the proposed treatment of Commonwealth payments as set out in Table B-1 of the staff discussion paper.

Queensland has no objections to the proposed treatment of each Commonwealth payment commenced in 2013-14 (as set out in Table B-1 of Attachment B) being recommended to the Commission as they appear reasonable and Queensland is not aware of any issues.

Treatment of Commonwealth payments commencing in 2014-15 and 2015-16

Queensland's position

- Queensland supports not backcasting Commonwealth payments to states commencing in 2014-15 or 2015-16.

The staff discussion paper proposes to not backcast Commonwealth payments to states commencing in 2014-15 or 2015-16. Queensland supports this proposal as these payments are not the result of major changes to Commonwealth-State financial arrangements.

It is proposed to not backcast payments from the DisabilityCare Australia Fund in 2015, because the Commission does not expect to backcast the introduction of NDIS until 2016-17, when states have agreed to enter the transition phase of the program. Queensland also supports this proposal. The issue of whether these payments should be backcast can be revisited in the 2016 Update.

Water for the future

Queensland's position

- Support retaining the current approach to all three components of the program as impacting on the relativities.

The Water for the Future NPP is treated as impacting on the relativities because the majority of the payments were for projects relating to agriculture (irrigation) and urban water supply, for which needs are assessed.

Staff refer to the *Federal Financial Relations, Budget Paper No. 3 2013-14* where Water for the Future is broken down into three components. Staff advise each component is viewed as a separate NPP. The components are:

1. National urban water and desalination plan
2. National water security plan for cities and towns
3. Sustainable rural water use and infrastructure

Staff propose to recommend the Commission retain the current approach to all three components of the program unless data and other information from the States can establish that

environmental spending is now the main purpose of the third component of the program and that the interstate pattern is not overly influenced by State policy.

While Queensland notes that South Australia has provided evidence to suggest that the third component contains projects relating to protection of the environment, and that staff are requesting further state data in this regard, the predominant purpose of the NPP is improving the efficiency, productivity and sustainability of water management and usage¹. It follows that the predominant purpose of the NPP is the main determinant of the allocation of the monies under the NPP.

While South Australia has indicated that half of its funding from the third component² has been for protection of the environment, that State has only a relatively small share of the total NPP. A more thorough analysis of the NPP by the Commission would require consultation with each State and Territory of the environmental impact of each individual project. However, as there is significant interaction between water supply and environmental issues, determination of the proportion of the NPP that is for the protection of the environment would require considerable judgement on the part of the Commission. This is compounded by the payment structure for the NP which has multiple levels with payments flowing to a large number of specific local projects across the States and Territories.

Staff have noted even if data is made available by states, the Commission will need to consider whether the split between environmental and other purposes is the result of State policy and have requested information on how decisions on how funding is used. We understand states propose projects for funding and each project is different and has diverse reasons for being proposed. This process implies the split between environmental and other purposes is very policy influenced.

The Water for the Future NPP is unique in that there is no expiry date, rather the agreement will expire when any state or territory has completed all agreed projects (excluding any Project terminated in accordance with the Agreement³. Some projects, and therefore the agreement for one state will expire in a few years; some states' agreements extend far beyond this. As the projects under this NPP vary from year to year, the determination of this proportion would need to be reviewed on an annual basis. This process could be quite complex and onerous.

While Queensland supports reviewing the treatment of Water for the Future, unless data from all states can establish that environmental spending is the major purpose of the third component of the program and that the interstate pattern is not greatly influenced by state policy then the third component should continue to be treated as impacting on the relativities.

Queensland supports staff retaining the current approach to all three components of the program.

¹ *Federal Financial Relations, Budget Paper No. 3 2014-15, page 77.*

² South Australia's advice regarding Water for the Future NP as forwarded by the Commission via email dated 7 January 2014.

³ *National Partnership Agreement on Water for the Future 2009, Terms of agreement, page2, paragraph 6(a).*