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Commonwealth Grants Commission

2020 REVIEW

OTHER EXPENSES

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OTHER EXPENSES

- 1 The paper provides the Commission staff proposals for the assessment of Other expenses for the 2020 Review.

2015 REVIEW APPROACH

Services included in this category

- 2 The Other expenses category comprises expenses not separately assessed in other expense categories. It includes:
 - general public services — expenses for executive and legislative functions, and administration of treasury, finance and other centrally provided services not connected to particular functions
 - other services not assessed elsewhere — expenses for recreation, culture and religion (such as library and national park services), public safety services other than those provided by police (such as emergency services and fire protection), and support for local government services which cannot be allocated to a specific function
 - miscellaneous purposes and transactions — public debt transactions and general purpose inter-government transactions that cannot be allocated to other purposes
 - natural disaster relief expenses.
- 3 Associated user charges are included in the Other revenue category and assessed equal per capita (EPC).
- 4 The category also includes a location adjustment, recognising differences in regional costs faced by cities of similar remoteness, as well as expenses relating to:
 - all administrative scale allowances
 - all native title and land rights allowances
 - national capital allowances except those relating to police.
- 5 Administrative scale expenses are discussed in the Staff Draft Assessment Paper *CGC 2018-01/24-S, Administrative scale*. Native title and land rights and national capital expenses are discussed in Staff Draft Assessment Paper *CGC 2018-01/25-S, Other disabilities*. The location adjustment is discussed in Staff Draft Assessment Paper *CGC 2018-01/23-S, Geography used by the Commission*.

Category and component expenses

6 Table 1 shows State actual expenses in 2016-17 disaggregated by component.

Table 1 Category expenses by component, 2016-17

Component	Amount	Proportion of total expenses
	\$m	%
Service expenses	28 034	90.9
Natural disaster relief	483	1.6
Capital grants to local governments	61	0.2
Other assessments:		
Administrative scale (all categories)	2 073	6.7
Native title and land rights	176	0.6
National capital	21	0.1
Total	30 848	100.0

Note: The other assessments component also includes a location adjustment, which has a net zero effect on total State expenses.

Source: Commission calculation.

Data sources and assessment methods

7 The majority of expenses in this category are classified to the service expenses component and, apart from location disabilities, are assessed on an equal per capita (EPC) basis. Capital grants to local government are assessed using population growth based on ABS estimated resident population. Other assessments, including the administrative scale allowance for all categories, natural disaster relief, cross-border, national capital and native title and land rights, are based on State provided data or Commission estimates.

Service expenses assessment

8 The service expenses assessment recognises that the need for spending on services covered by this component largely reflects State population shares. A cross-border disability is assessed to recognise that the ACT's costs for library, sports grounds and other cultural and recreational services are higher due to the use of these services by New South Wales residents. Wage costs and regional costs effects are applied to expenses on recreation, culture, national parks, communications and pipelines, and public safety services; and to half of the expenses for general public services, intergovernmental transactions and other purposes.

Natural disaster relief

9 Natural disaster relief expenses include State net out of pocket expenses under the Natural Disasters Relief and Recovery Arrangements (NDRRA) framework. They are

assessed on an actual per capita (APC) basis because the Commission considered that the State expenses were not policy influenced and were sufficiently comparable to make a reliable assessment.

Capital grants to local governments

- 10 The assessment of capital grants to local governments recognises the impact of State population growth on the level of support for local government for cultural and recreation facilities and community amenities.

Other assessments

- 11 The Administrative scale, Native title and land rights and National capital assessments, along with the location adjustment, are discussed in their respective draft assessment papers.

Investment and depreciation

- 12 Other expenses accounted for 10% of total State assets in 2016-17. For most categories, the infrastructure assessments use expense weighted service use disabilities to calculate a category specific capital stock disability factor. The only service use disability included in the capital stock calculations for Other expenses is cross-border service use. Interstate differences in wage levels, the price of materials and other unavoidable factors affecting the cost of infrastructure are also taken into account.
- 13 In addition, the Investment assessment recognises the impact of differences in population growth between States on the need for infrastructure.

GST redistribution

- 14 In the 2018 Update, the category redistributed \$1 224 million primarily to Tasmania, ACT and the Northern Territory. Most of the redistribution was due to the administrative scale and natural disasters assessments. Table 2 shows the effect of the Other expenses category on the GST redistribution in the 2018 Update.

Table 2 GST redistribution due to Other expenses, 2018 Update

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Redist
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Aggregate administrative scale	-448	-305	-174	57	118	219	252	281	928
Natural disaster relief	-84	-151	273	-7	-28	7	-6	-5	280
Native title and land rights	-55	-43	9	60	3	-4	-3	34	106
National capital	-8	-6	-5	-3	-2	-1	24	0	24
Regional costs	-49	-56	37	17	8	17	-7	33	111
Location adjustment	-10	-7	-6	91	-2	-41	41	-67	132
Wages	6	-15	-9	27	-9	-7	4	3	40
Total	-653	-571	123	239	84	188	310	280	1 224

Source: Commission calculation, 2018 Update.

ISSUES AND ANALYSIS

- 15 Staff consider that assessments for much of the Other expenses category will be similar to the previous review. The main issues to be considered are:
- whether natural disaster relief expenses are sufficiently comparable to warrant an APC assessment
 - how to treat natural disaster mitigation spending
 - whether to continue assessing capital grants to local governments
 - whether to assess expenses for national parks and wildlife services.
- 16 Assessment issues for the other assessment components are discussed in their respective draft assessment papers.

Natural disaster relief

- 17 Total net natural disaster relief expenses under the NDRRA framework were \$483 million in 2016-17.¹ These expenses tend to be very volatile. For example, in 2013-14 natural disaster relief expenses were \$1.7 billion.
- 18 The current methodology assesses States' net expenses for natural disaster relief under the NDRRA framework on an APC basis because the Commission considers that differences between the States under the framework are not subject to significant policy influences.
- 19 A new agreement, the *NDRRA Determination 2017*, applies from 1 July 2017 and replaces the *NDRRA Determination 2012 (version 2)*.² The new determination will

¹ Data by State are not provided due to confidentiality.

affect assessments for the 2019 Update and beyond. There appear to be no significant changes in the *NDRRA Determination 2017* that would preclude an APC assessment.

- 20 Emergency Management Australia (EMA) has been reviewing State NDRRA expenditure claims in the wake of an Australian National Audit Office audit report. EMA's assurance activities are complete for Queensland, South Australia, Tasmania and the ACT, and ongoing for other States. The assurance activities allow for greater confidence that States' reported claims are comparable and eligible under the NDRRA framework. Additional clauses regarding States' evidentiary requirements have been added to the *NDRRA Determination 2017* to ensure ease of assurance processes and greater accountability going forward.
- 21 Since this is an APC assessment, the Commission has measures in place to ensure State reported NDRRA expenditure and assistance data are accurate. The Commission collects data from EMA to validate State estimates, although EMA data are not available until 12 months after the end of the reference period. The Commission also uses the thresholds and reimbursement allowances in the determination to confirm the accuracy of State reported NDRRA assistance estimates. In addition, any material revisions to State data are immediately corrected to ensure the correct net expenses are included in the assessment for three inquiries.³
- 22 Most States agree that the assessment of natural disaster relief expenses should be based on eligible NDRRA expenditure net of Commonwealth assistance. The ACT has said there are policy differences between States in relation to insurance and natural disaster mitigation measures and expenses should be assessed on an equal per capita basis. Staff consider that the *NDRRA Determination 2017* includes sufficient safeguards to prevent significantly different insurance and mitigation measures between States. These issues are addressed below.

Insurance

- 23 The Commission investigated policy differences between States in relation to insurance in the 2013 Update. It observed there were policy differences, and that Tasmania and the Northern Territory did not have adequate insurance coverage.⁴ The

² Australian Government, Disaster Assist, [Natural Disaster Relief and Recovery Arrangements](https://www.disasterassist.gov.au/Pages/related-links/Natural-Disaster-Relief-and-Recovery-Arrangements.aspx), (https://www.disasterassist.gov.au/Pages/related-links/Natural-Disaster-Relief-and-Recovery-Arrangements.aspx), [accessed Oct 2017].

³ The correction is usually made by including a one off adjustment in the last assessment year. The size of the adjustment is based on the amount of the revision and the number of times the incorrect amount has been included in previous inquiries. A materiality test of \$10 per capita is used to determine if an adjustment will be made.

⁴ The Commission's conclusions were based on analysis of a review of State insurance arrangements undertaken by the then Commonwealth Department of Finance and Regulation under the 2011 Determination.

Commission concluded there was no way to reliably estimate an adjustment to the data for Tasmania and the Northern Territory to address these policy differences. Furthermore, the impact of making the adjustment was unlikely to be material.⁵

- 24 A 2014 Productivity Commission inquiry found that State and local governments generally had adequate insurance arrangements for most of their non-road assets.⁶ However, the inquiry also found that funding under the NDRRA and elsewhere likely reduces States' incentives to obtain adequate insurance.⁷
- 25 Recognising the incentives for States to under-insure, section 4.5 of the latest NDRRA determination requires States to have adequate capital or access to capital to fund liabilities or infrastructure losses, which may include via commercial insurance/re-insurance, prior to being granted access to Commonwealth assistance. States are also required to proactively explore a range of insurance options in the market place and assess available options on a cost benefit basis.⁸
- 26 Staff consider that despite some policy differences in the level of insurance coverage between States, the Commonwealth requires State governments to have adequate arrangements in place to be eligible for Commonwealth NDRRA assistance. The Commonwealth is best placed to decide if State arrangements are sufficient to satisfy the requirements of the determination and to receive Commonwealth assistance. Given the common framework applied by the Commonwealth, and no evidence of significant policy differences, staff consider these expenses should continue to be assessed on an APC basis.

Mitigation

- 27 New South Wales has noted that mitigation spending is treated differently in the expense assessments compared to natural disaster relief spending, which may also lessen incentives for mitigation spending. Mitigation expenses are assessed on an EPC basis.
- 28 In order to be eligible for funding through the NDRRA, States are required to develop and implement natural disaster mitigation strategies in respect of likely or recurring disasters. The Productivity Commission inquiry on Natural Disaster Funding Arrangements estimated that mitigation expenses across all levels of government was likely to be below optimal levels, given the incentives created by the NDRRA

⁵ For a full discussion of this issue, see Commonwealth Grants Commission, *Report on GST Revenue Sharing Relativities — 2013 Update*, pp. 52-54.

⁶ Productivity Commission, *Natural Disaster Funding Arrangements Inquiry Report*, Volume 2, 2014, p. 413.

⁷ *ibid*, p. 38 and p. 413.

⁸ Attorney-General's Department, *Natural Disaster Relief and Recovery Arrangements Determination 2017*, section 4.5.

arrangements. However, the inquiry was not able to determine the extent of the underinvestment in mitigation.⁹

- 29 Staff consider there is no practical alternative to the current EPC assessment of mitigation expenses. An APC assessment would not be appropriate because there is considerable scope for State policies to affect the level of spending despite the NDRRA requirement that all States have adequate mitigation strategies in place. A differential assessment based on a policy neutral driver would appear to be impractical because it is difficult to identify the relevant spending in State budgets. Furthermore, it is not clear what policy neutral measure of need would be applied. Actuarial studies may provide some indication of differential susceptibility to natural disasters and the need for mitigation measures. However, any indicator is likely to be affected by differences between States in insurance coverage as well as differences in planning and zoning policies. Due to these difficulties, staff propose not to make an assessment for mitigation spending.

Measurement issues

- 30 There are two practical issues affecting the measurement of State NDRRA net expenses. The first relates to the classification of natural disaster relief expenses in Government Finance Statistics (GFS), and the second to the treatment of local government net natural disaster expenses.
- 31 In GFS, long-term natural disaster reconstruction expenses are classified to the relevant function (for example, roads capital expenditure). To avoid the same expenses being assessed twice (for example, in the natural disaster relief assessment and roads assessments), staff reclassify roads expenditure related to natural disasters from the Roads category to Other expenses.
- 32 Staff have recently become aware that there may be potential for States to include net costs incurred by local governments following a natural disaster event in the net expenses reported to the Commission. Out of pocket expenses funded from local government revenue should not be included in the expenses reported by States because they do not affect State fiscal capacities. In addition, any NDRRA assistance payments which pass through the States to local government should be excluded from category expenses. Being aware of the potential for local government net costs and through payments to affect expenses, staff have processes in place to ensure these are both excluded.

⁹ Productivity Commission, *Natural Disaster Funding Arrangements Inquiry Report*, Volume 2, 2014, p. 39.

Staff propose to recommend the Commission:

- continue to assess natural disaster relief expenses on an APC basis
- not make an assessment for natural disaster mitigation expenses, due to the difficulty in obtaining expense data and identifying a reliable driver
- continue to make adjustments to the adjusted budget to ensure:
 - natural disaster relief expenses under the NDRRA framework are only assessed once
 - net natural disaster relief expenses funded from local government revenue are not included in the assessment because they do not affect a State’s fiscal capacity
 - Commonwealth NDRRA assistance payments through States to local government (for example, for roads) are not included in category expenses.

Capital grants to local government for community amenities

33 The capital grants to local governments component was introduced in the 2015 Review to recognise the need for State support to local government for cultural and recreation facilities and community amenities. The assessment used population growth as the disability, as the Commission expected that States with above average population growth would incur higher costs. The assessment was not material by itself. However, it was included as the assessment of population growth in total was material. In the 2018 Update, the component did not redistribute more than \$3 per capita for any State. Actual component expenses for 2016-17 are shown in Table 4.

Table 3 Capital grants to local government, actual expenses, 2016-17

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
\$ million	3	0	21	30	0	0	0	7	61
\$ per capita	0	0	4	11	0	0	0	29	2

Source: Commission calculation, 2018 Update.

34 During the 2015 Review, only Queensland, Western Australia and the Northern Territory supported this, or a similar assessment, as part of an assessment of mining-related expenditure. These are the only States with above average expenses (Table 4).

35 Since the 2015 Review, staff have reconsidered whether population growth is the main factor driving expenses for this component. Our analysis indicates the grants are generally part of regional economic development programs and it is not apparent how States determine their level of support for these programs.

36 Some of the spending in Queensland occurs under Building our Regions, an infrastructure program for local government projects. The program is designed to

provide funding for critical infrastructure in regional areas of the State, while also generating jobs, fostering economic development and improving the liveability of regional communities.¹⁰

- 37 Western Australia provides similar programs through the Royalties for Regions' funds including the Country Local Government Fund, the Regional Community Services Fund and the Regional Infrastructure and Headworks Fund.¹¹
- 38 Staff consider that population growth may be a factor in determining the level of funding provided to local governments in regional areas, but that employment creation or the weaknesses of local government revenue bases linked to population decline may also influence State spending. As the drivers of expenses for this component are unclear, staff recommend ceasing the assessment.

Staff propose to recommend the Commission:

- cease assessing the capital grants to local governments for community amenities component because the driver of this spending is unclear.

National parks and wildlife services

- 39 During the 2015 Review, we investigated an assessment of national parks and wildlife expenses. At that time we found that despite national guidelines on the establishment of designated protected areas, significant differences remain between the States in the numbers of parks and areas protected. The historical development of protected areas will continue to mean that some States will have considerably larger proportions of their jurisdictions protected. While it is difficult to attribute all these differences to State policies, undoubtedly, these have had a major impact. The Commonwealth also has had a major influence on the size of areas protected, particularly in Tasmania and the ACT.
- 40 Expenses for national park and wildlife services were around \$1 billion in 2016-17. Under the ABS *Australian System of Government Finance Statistics: Concepts, Sources and Methods, 2015*, which will come into effect during the 2019 Update, national park and wildlife services will no longer be a separate expense classification and will instead be combined with other environmental protection expenses.¹²

¹⁰ Department of State Development (Queensland), [Building our Regions](https://www.statedevelopment.qld.gov.au/regional-development/building-our-regions.html), (https://www.statedevelopment.qld.gov.au/regional-development/building-our-regions.html), [accessed Oct 2017].

¹¹ Department of Regional Development (Western Australia), [Final Report 2017](http://www.drd.wa.gov.au/Publications/Documents/DRD%20Final%20Report%202017.pdf), p. 16, (http://www.drd.wa.gov.au/Publications/Documents/DRD%20Final%20Report%202017.pdf), [accessed Oct 2017]; and Department of Regional Development (Western Australia), [Country Local Government Fund](http://www.drd.wa.gov.au/rfr/Programs-and-Schemes/Pages/Country-Local-Government-Fund.aspx), (http://www.drd.wa.gov.au/rfr/Programs-and-Schemes/Pages/Country-Local-Government-Fund.aspx), [accessed Oct 2017]

¹² National parks and wildlife expenses will be included under Protection of biodiversity and landscape, (Classification of the functions of government - Australia (COFOG-A) 0541).

- 41 At this time we do not propose developing an assessment for national parks and wildlife services, given the uncertainties surrounding the policy influences on the number and size of national parks and the difficulty in obtaining reliable data to measure relative cost influences. In addition, the new GFS classification will not separately identify these expenses.

Staff propose to recommend the Commission:

- not assess national parks and wildlife services, due to uncertainties surrounding the policy influences and difficulty in obtaining reliable data to measure cost influences and expenses.

Cross-border expenses

- 42 The cross-border assessment is being reviewed as a whole. Previously, the cross-border adjustment in this category was intended to reflect the increased expenses for the ACT to provide library, sports grounds and other cultural and recreational services to New South Wales residents. Staff propose not to assess a cross-border disability for these services unless the ACT is able to provide current data to substantiate an assessment. For further information, refer to Staff Draft Assessment Paper *CGC 2018-01/25-S, Other disabilities*.

Staff propose to recommend the Commission:

- not assess a cross-border disability for library, sports grounds and other cultural and recreational services provided to New South Wales residents unless the ACT is able to provide current data to substantiate an assessment.

Administrative scale

- 43 Staff are seeking advice from States on whether administrative scale expenses should be included as a component of the Other expenses category or separately identified in each expense category, before making a recommendation to the Commission. For further information, refer to Staff Draft Assessment Paper *CGC 2018-01/24-S, Administrative scale*.

Other issues including location

- 44 Proposals have been made in other draft assessment papers to include additional expenses in this category if the Commission continues to assess them EPC. This would bring together most of the expenses which are assessed EPC and simplify the presentation of functional categories.
- 45 We propose to continue applying the regional costs and wage costs disabilities to expenses where it is appropriate. We do not expect to recommend any changes to

current treatments, either for expenses currently included in Other expenses, or for expenses staff are proposing to include in Other expenses.

- 46 Staff propose to retain the location adjustment in the 2020 Review. See Staff Draft Assessment Paper *CGC 2018-01/23-S, Geography used by the Commission* for details.

Staff propose to recommend the Commission:

- include most State expenses which are assessed EPC in this category
- continue to apply location disabilities to the same expenses as the 2015 Review.

User charges

- 47 User charges for the category were \$2.8 billion in 2015-16 or 9% of service expenses. Most user charges were recorded in the other general public services and recreation and culture classifications. In the 2015 Review, these user charges were assessed EPC in the Other revenue category.
- 48 User charges for the category relate to a number of different activities all of which are assessed EPC. There is no basis to conclude that States' capacities to raise revenue from these activities are affected by anything other than population. Staff propose to continue assessing this revenue EPC. It is simpler to do this in the Other revenue category.

CONCLUSION AND WAY FORWARD

- 49 The Other expenses category remains a residual category for expenses not elsewhere assessed. There are unlikely to be any significant changes to most of the components.
- Staff recommend the APC assessment of net natural disaster relief expenses under the NDRRA be retained, but will continue to monitor the status of the *NDRRA Determination 2017* as it is implemented by the Commonwealth.
 - Staff propose to remove the capital grants to local governments assessment.
 - Staff propose not to assess cross-border and national capital disabilities unless the ACT is able to provide current data to substantiate an assessment.
 - States may wish to comment on the proposal to include the majority of expenses which are assessed EPC in the Other expenses category, and whether this presentational change would be useful.

Proposed assessment structure

- 50 Staff propose the following assessment structure for this category in the 2020 Review (Table 6).

Table 4 Proposed Other expenses category structure

Component	Disability	Influence measured by disability
Service expenses	Share of population	Recognises States' population shares are the main influence on State expenses.
Natural disaster relief	Actual State net expenses under the NDRRA framework	Recognises State net out of pocket costs for natural disaster relief under the Commonwealth Government's natural disaster relief arrangements. Commonwealth Government assistance is netted off before making the assessment.
Other assessments	Administrative scale (a)	Recognises the unavoidable costs each State incurs to provide the policy and administrative infrastructure necessary to provide the minimum unavoidable service, regardless of the size of the task.
	Native title and land rights	Recognises State costs of settling native title and land rights claims made under Commonwealth Government legislation.
	Location adjustment (b)	Recognises differences in regional costs faced by cities of similar remoteness.

Notes: Staff propose no change to the expenses to which the wage cost and regional cost disabilities are applied.

(a) Depending on State views, administrative scale may be functionalised to expense categories.

(b) See Staff Draft Assessment Paper *CGC 2018-01/23-S, Geography used by the Commission* for the staff proposal for the location adjustment.

Source: Staff proposal.

Information sought from States

51 No additional information has been requested from States for this category at this time.