Australian Government

Commonwealth Grants Commission

File ref 2011/0165

Mr Paul McCullough
Secretary
GST Distribution Review
The Treasury
Langton Crescent
PARKES ACT 2600

By email: gstdistributionreview@treasury.gov.au

Dear Mr McCullough

On behalf of the Commonwealth Grants Commission, I attach a submission to the GST Distribution Review relating to proposals raised in its interim reports.

Consistent with the approach outlined in the Chairperson's letter of 28 April, 2011 to the Secretary to the Review, the submission explains the background to past commission decisions where we consider this might be helpful and provides some practical insights into the implications of some of the proposals and options canvassed.

If you have any questions relating to the submission please contact Catherine Hull (02 6229 8813) or Catherine.hull@cgc.gov.au.

Yours sincerely

John Spasojevic
Secretary

10 July 2012

Enclosure

Phoenix House
First Floor
86-88 Northbourne Avenue
BRADDON ACT 2612

Tel: 61 2 6229 8800
Fax: 61 2 6229 8821
Email: secretary@cgc.gov.au
Internet: http://www.cgc.gov.au

Australian Government

Commonwealth Grants Commission

SUBMISSION TO GST DISTRIBUTION REVIEW ON ITS INTERIM REPORTS

July 2012

CONTENTS

SUMMARY

- The commission's current approach to equalisation results in comparable, not equal or same, State fiscal capacities. Lags in the system and data and method problems dealt with through reliability and materiality criteria mean that State fiscal capacities are not precisely the same after the distribution of the GST.
- If intentionally reduced comparability is sought, using a uniform approach, such as the use of materiality thresholds and discounts, might be preferred to methods which introduce more randomness into fiscal capacities. Specific measures or changes in scope that might impact on comparability are more likely to have an uneven impact across States and are best considered on their merits rather than as a way of addressing comparability.
- A simple change in the definition of HFE from 'same' to 'comparable' State fiscal capacities would not provide clear guidance on policy intent.
- If governments so choose, terms of reference should instruct the commission on how the scope of equalisation should be reduced or on which capital payments should be left out.
- Equalising to a standard below the average would be technically possible but interpreting the outcome would not be easy.
- Equalising to some 'theoretically ideal' tax or service delivery system would be technically feasible. Devising those ideals would not be easy, even for experts who would specify and quantify them. It would add an additional area of contention among States.
- Placing greater emphasis on drivers or disabilities in the presentation of commission results may enable people to more readily understand why fiscal capacities differ between States and change over time. However, data are not available in a form to allow the direct assessment of these.
- Equalising capital payments, and presumably capital expenses, over a longer period of time, would mean slower recognition of State capital requirements arising from economic development and population growth.
- Freezing expense disabilities between methodology reviews would be possible but the trade-off between short-term and medium-term stability/predictability should be considered. Less frequent changes may result in large adjustments. The impact in the 2011 Update of the wages revision based on a four yearly ABS survey is salutary. Some changes to data, such as updates for the Census, affect several parts of the HFE process, so freezing one part such as expenditure while allowing others to change may have asymmetric effects on the distribution.
- We are not attracted to announcing and quantifying the impact of decisions as we proceed through the annual update process. It would not lead to greater predictability because changes can offset each other and many decisions are quantitatively insignificant compared to others, such as the impact of royalty revenue data that become available very late in the process.

INTRODUCTION

1 The Commonwealth Grants Commission (the commission) notes that the GST Distribution Review Interim Reports released in April 2012 and June 2012 canvass long-standing and difficult issues, many of which have been considered by the commission in past method reviews. In particular, we welcome the efforts the panel is making to seek additional data or comment from States to clarify a number of the issues or proposals that have been raised.

2 In the same spirit as our previous submission[1] on the issues paper, this submission explains the background to past commission decisions where we consider this might be helpful and provides some practical insights into the implications of some of the proposals and options canvassed in the interim reports. The proposals addressed are as follows:

- what 'comparable' or 'not appreciably different' rather than the 'same' capacities might mean
- adopting a standard other than the average of 'what States collectively do'
- simplification gains from taking a 'drivers' approach to expense disabilities rather than a category approach
- equalising Commonwealth payments over time
- update issues, including the freezing of expense relativities between reviews and the suggestion that the commission might provide regular updates on commission decisions on new update issues.

'COMPARABLE', 'NOT APPRECIABLY DIFFERENT' OR 'SAME'?

3 The debate about whether equalisation should give States the same, not appreciably different or comparable fiscal capacities is longstanding.

4 When all States were brought into the equalisation process in 1982, the definition was based on 'not appreciably different'. That changed in the 1990s to 'same'. More recently, in 2010, the commission used 'same' but made it clear that only material differences between the States would be included in its assessments.

5 This evolution has been motivated by several reasons including:

- A desire to make it as clear as possible what the commission was actually attempting. Because it has always used a mathematical approach where fiscal capacities were aligned, moving to same rather than not appreciably different was more consistent with practice.

---

[1] All material provided to the Review so far is available at http://www.cgc.gov.au/gst_distribution_review

- A desire to better reflect 'what States were doing'. The commission adjusted the scope of activities it was equalising to capture all activities that impacted on State fiscal capacities. For example, roads and housing were added in the 1993 Review and depreciation in the 1999 Review. The activities of PTEs were gradually moved out of scope as these were corporatised, although the subsidies States paid continued to be recognised. This more accurate reflection of State fiscal requirements meant a move away from 'not appreciably different' which the commission considered important to recognise.
- A desire to make clear that the commission should not exercise judgement about the degree of equalisation that should occur. When the definition was 'not appreciably different' States could, and did, propose that the commission could interpret this as giving it scope to adopt a degree of equalisation which did not align fiscal capacities. The commission considered that the degree of equalisation was one for governments to decide and changed the definition it used in its reports to reflect this.

6 The commission currently considers it achieves equalisation, subject to recognising measurable and material differences among the States. By adopting materiality and reliability thresholds the commission has clearly moved from attempting to achieve precise equalisation. Data and methodological problems, including lags in the system, mean that there could be far from precise equality in fiscal capacities in the year its recommendations come into effect.

7 Current practice could therefore be characterised as aiming for comparability.

8 It is also the commission's view that if an intentional reduction in comparability is sought by governments, reducing comparability using a uniform approach would be better received by the States. This can be achieved by the use of materiality thresholds and discounts. As to specific measures or changes in scope that might impact on comparability, they are more likely to have a more uneven impact across States and are best considered on their merits rather than as a way of addressing comparability.

9 The commission considers that if governments decide that they want less comparable outcomes, they should go beyond changing the definition of fiscal equalisation and give specific advice to the commission on how the degree of comparability should be measured and what would constitute appropriate comparability.

10 If the definition were simply changed, for example, from 'same' to 'comparable', then in giving effect to the definition in its assessments, the commission would be left with the task of deciding what degree of equalisation would best meet the diverse needs of the States or between equalisation and other policy objectives. The Commission considers this more properly a function of government.

11 We provide some comments on a number of the proposals which could reduce comparability below.

Reducing scope

12 Excluding some revenue or expenditure items has been proposed by a number of States in the course of commission reviews. For example, there have been proposals that equalisation should only encompass the main areas of State spending — Education, Health and Welfare.

13 The commission has consistently said that if it were to exclude some areas of revenue or expenditure that would mean, or could be portrayed as, it choosing what revenues should be raised or what were important areas of State spending.

14 Leaving some categories out, such as mining or urban transport, would mean GST shares would not be as representative of State economies or as responsive to changes in relative economic conditions as they are with a comprehensive scope.

15 Further, if there were restrictions on categories, for example a narrowing to only the main areas of spending outlined above, then addressing some of the problems identified by the panel relating to the non-assessment of needs relating to mining related infrastructure - ports, electricity, rail – would be very difficult. To address this concern it might be necessary to broaden the scope to include the operations of the public trading enterprises which operate these services.

16 Options to reduce scope would mean less comparability, but States would be affected differentially with significant 'winners' and 'losers'.

17 Nonetheless, if a narrower scope were defined by terms of reference, it would be a simple matter to adjust the calculations.

Remove some current disabilities

18 This could be done by raising materiality thresholds (but as pointed out by the panel these thresholds would have to rise significantly to remove many current disabilities) by moving to broader indicators or by specific direction to the commission.

19 The first is easy for the commission to implement because its current approach to developing methodology remains but with higher thresholds. With common thresholds there would be equal treatment across the scope of equalisation.

20 In its last review, the commission started its work with the highest level of aggregation of revenue and expenses and with the broadest indicators. It only introduced more detail when that made a material difference to the GST distribution. Implicit in a move towards broader or global indicators is either a willingness to exclude the impact of currently material indicators (for example, by reinterpreting what is average policy to remove the finer detail) or an increase in that threshold. For example, a value distribution adjustment could be removed because the commission no longer considers it average State policy to tax higher valued transactions or property at higher rates. Alternatively, it could be removed because it no longer

meets a higher materiality threshold. The latter may appear to be more neutral and so better meets the criteria the review identified as set out above.

21 Global or broader indicators could come into the calculations in two ways. The current category structure could remain but with a range of category specific indicators replaced with one single measure. For example, all the socio-economic measures could be replaced with a measure of relative unemployment rates. Alternately, some categories could be collapsed and a broader aggregate assessed with a simpler indicator. For example, all State income related taxes could be assessed relative to Gross State Product (GSP).

22 Implicit in both approaches is an acceptance of higher materiality thresholds when comparing the broader assessment with the more specific. However, if broader indicators were arbitrarily mandated, these materiality differences could differ across assessments which would degrade the internal consistency of the commission’s approach.

23 While the review seeks to explore the use of global indicators, such as GSP, it acknowledges potential difficulties with the approach. In the 2010 Review, the commission initially explored global measures, such as GSP and Household Income. It noted that they gave very different measures of capacity compared with a tax by tax approach. There are influences on revenue raising capacity not captured in these measures. The ACT is not able to levy any taxes on Commonwealth employees in the Territory and Victoria and Western Australia are not able to collect royalties from offshore mining even though these activities are captured in State GSP estimates. It also concluded that States’ revenue capacity could change independently of these measures, such as through agreements to abolish certain taxes.

24 The commission also explored measuring revenue bases using broader measures, without allowances for exemptions, thresholds or progressive tax rates. However, many States opposed those proposals because they did not adequately reflect what States did. In particular, they did not take account of common features of State revenue raising policies (such as exempting small business from payroll tax and applying progressive tax rates in stamp duty on conveyances and land tax) which have materially different effects across the States.

25 The commission did use a broader indicator of payroll tax capacity in the 2010 Review, namely ABS data on compensation of employees but also adjusted that to remove small employer payrolls since all States exempted them. Analysis showed that removing this exemption had a material impact on GST shares of $39 per capita for one State and more than $20 per capita for another two.

26 This example also illustrates the types of arguments the commission often faces when designing assessments. One State argued that removing the exemption would promote greater efficiency in the design of State payroll tax regimes. The latter

argument effectively sought an additional objective for GST distribution that goes beyond, and conflicts with, achieving equal fiscal capacities. The commission concluded that it is more properly the role of government to weigh competing objectives for GST distribution.

27 The panel suggests that ABS housing finance data could be used to assess stamp duty on conveyances. The commission rejected the ABS data since it was a poor reflection of capacity of States to raise revenue from this source. It did not capture commercial property sales or reflect differences that may exist between States in the degree of non-debt financed sales. Nor was it less policy contaminated than State-provided data since it is still ultimately driven by the value and volume of property sales (although in a less comprehensive way than State data).

28 On the expenditure side of the budget, we also considered the use of econometric techniques to develop broad indicators of cost drivers across all services and for broad-banded groups of services. The study undertaken by external expert consultants found that unless extensive work were undertaken to improve the data available on State spending and disabilities, 'it would be difficult, if not impossible to estimate State services disabilities using conventional econometric techniques'[2].

Ignore some Commonwealth capital payments

29 While the primary reason to exclude some Commonwealth payments from the HFE process would be to achieve other policy objectives (as is the case with payments already excluded), doing so would have an impact on the comparability of State fiscal capacities.

30 Generally, the commission considers Commonwealth payments are a revenue source that enables the States to deliver services, fund infrastructure or accumulate financial assets. Their differential distribution among States provides a means of meeting differential State fiscal requirements, allowing the GST distribution to be more even if the differential distribution mirrors State requirements or less even if it does not. In broad terms, the sum of Commonwealth payments and the GST distribution mirrors differential State fiscal requirements.

31 Excluding some Commonwealth payments where the commission assesses differences among the States means that the States receive these payments and GST revenue to meet the assessed differential fiscal requirement to which the payment is directed. In the parlance there would be 'double dipping' (if the commission attempted to circumvent this through its calculations, it would have the same impact as including the Commonwealth payment). The extent would vary among States depending on how the Commonwealth distributed its funds relative to the assessed

2 Chan, F, MacDondald, G & Petchey, J (2006-07), *Measuring State Expense Needs: Report to the Commonwealth Grants Commission*.

fiscal requirement. The differential impact on States would not be apparent and this might make the broader process of Commonwealth-State financial flows less transparent and more open to question.

32 Also, as noted by the panel, this approach would result in Commonwealth and State funded expenditure being assessed differently and this added complexity would need to be weighed against the policy benefits of excluding some Commonwealth payments.

33 If the commission were told which payments to ignore, they could be easily excluded, although decisions would need to be made about how to appropriately treat the expenditure they fund and the assets they create.

34 However, if the commission had to choose between objectives and decide the appropriate treatment of Commonwealth payments, the process would be more complex, and predictability and certainty reduced for the States. The commission has in the past stated that it prefers that choosing between conflicting government policy objectives be done by government, rather than becoming an issue on which it should adjudicate.

A STANDARD OTHER THAN 'WHAT STATES DO'

35 Previous commissions have chosen the weighted average of what all States do as the preferred standard. This is because:

- it is simple, reflecting the average revealed policies of the States
- it reflects the average level of service delivery efficiency[3]
- the commission does not need to make a judgement about what States should do or what constitutes some 'best practice'.

36 While, it is not totally policy neutral, because States can influence it through their population, revenue and service delivery policies, there is little evidence that States do this deliberately. In most cases, they would need to make big changes to their policies for small uncertain gains, several years in the future. Experience suggests their budgetary policies are determined on the basis of their State circumstances, rather than attempts to 'game' the GST distribution process. For example, Western Australia recently increased the concessional royalty rate on iron ore fines even though it expected to lose more than it raised through the GST sharing process.

---

3 States are given the capacity to operate at the average level of efficiency or inefficiency. However, differences between a State's actual service delivery efficiency and the average efficiency do not affect the GST shares. States which are more efficient than the average keep the benefits of their extra efficiency to use as they see fit, while less efficient States bear the costs (see CGC (2012) *Report on GST Revenue Sharing Relativities - 2012 Update*, Box 2.1, p31).

37 The First Interim Report discussed setting the standard to an observed minimum or something lower than the average.

38 While this could be done, the commission's previous consideration of the issue suggests that selecting such a standard is fraught with practical and conceptual difficulties. For example, simply setting an expenditure standard to that of the State with the lowest spending would not necessarily represent the most efficient level of service delivery, but could represent the poorest quality service or where State services are low because more services are provided by the Commonwealth or the private sector.

39 Using the lowest spend compared to the average can be significant. For example, Tasmania is spending the least on Transport Services (and we draw no conclusions as to why this is so). It spent $130 per capita over the three years of the 2012 Update compared with an average spending of $338 per capita. Had the lowest spending been chosen rather than the average, New South Wales's GST revenue would have been reduced by $90 million because less weight would have been given to the higher costs it faces in providing transport services in Australia's largest city.

40 Of course, this would lead to arguments about the inappropriateness of the current assessment and to arguments about the need for different or additional disabilities which reflected the difference between the transport service environment in Tasmania and other States. This could make assessments more complex.

41 In this example, Tasmania would be the sole determinant of the standard and could potentially manipulate this more than any one State when an all-State average standard is used.

42 Equalising to a standard which was, say, 5 per cent less than the average, would be possible. It would equalise States to the same standard and would be as policy neutral as the average. While not raised in the report, whether the adoption of such a discount would also apply to infrastructure spending would need to be addressed.

43 Equalising to an external standard (one independent of what States do in practice) requires a decision on how it should be set. It could be some ideal or desirable level of services or tax policy.

44 To make decisions about what constitutes an 'ideal' would be difficult and data intensive. It may be technically possible to assess revenue on the basis of a stylised ideal tax system based on the view of experts. It may also be technically possible for experts to formulate theory which would guide the relative merit of different types of State spending and an appropriate level of efficiency.

45 However, this process would introduce another layer of complexity at the front end of the GST distribution process. Choosing the external standard would itself become an arena for interstate debate.

46 The use of an average standard has many advantages. It is observable, technically simple to calculate and represents the standard of State services received and the State revenues paid by the 'average Australian'. However, the commission has observed that even using the average standard can be misinterpreted as representing what States should be doing. Divergences from it are interpreted as either States failing to deliver the right level of services or over servicing, rather than divergences reflecting State priorities which differ from the average. With an external standard the scope for such misinterpretation might increase.

47 If the commission were to be told to equalise to a nominated lower standard or to some specified and quantified 'ideal' prepared by an external process, there would be no significant technical barriers for the commission itself to overcome and it could be done quickly.

A DRIVERS APPROACH TO EXPENSE DISABILITIES?

48 The panel sees merit in using drivers instead of expense categories to assess expenditure needs. We agree that a change to the way assessments are presented to a drivers or disability approach may be beneficial. However, it would be difficult to change how the assessments are undertaken.

49 The commission currently presents its assessments in both a drivers and category approach. Our experience suggests there is little to be gained from changing from categories to drivers in the assessment process itself. Indeed because State budgets and related ABS statistics are centred on revenue and expenditure categories, it is somewhat easier to use data in that format.

50 The assessments can be viewed as a matrix where each of the drivers has an impact on particular functions. The calculations can be summed down or across. The same information will be required whatever the presentation because each driver has a different impact on each category. For example, Indigenous people are heavy users of health services but Indigenous students use schools less intensively than non-Indigenous students. The same drivers cannot be assessed in the same way for each. Table 1 illustrates the two alternatives.

51 In each of the 'drivers' assessments to which the First Interim Report refers (location including wages, and administrative scale), category specific information is required to tailor the assessments. The methods would be the same but the presentation different.

Table 1 Assessments presented as disability factors (drivers) or expense categories

Category	Socio-demographic composition	Cross-border	Interstate location	Regional location	Service delivery scale	Administrative scale	National capital	Native title and land rights	Population	GST impact of combined disabilities
Schools education	X	X	X	X	X	X				Z'
Post-secondary education	X	X	X			X				Z'
Admitted patients	X		X			X				Z'
Community and other health services	X	X	X	X	X	X				Z'
Welfare and housing	X	X	X	X	X	X		X		Z'
Services to communities	X		X	X		X		X		Z'
Justice services	X		X	X	X	X	X	X		Z'
Roads			X	X		X	X	X		Z'
Transport services			X			X				Z'
Services to industry			X			X		X		Z'
Other expenses		X	X	X		X	X	X		Z'
Depreciation	X	X	X	X	X	X	X	X		Z'
Investment	X	X	X	X	X	X	X	X	X	Z'
Net lending									X	Z'
GST impact of combined categories	Z	Z	Z	Z	Z	Z	Z	Z		$\sum$ (Z) = $\sum$(Z')

52 The review also encourages the commission to explore whether assessments could be developed to more directly measure needs due to disabilities than the category of spending approach currently adopted.

53 The commission could only measure needs due to disabilities more directly if States could tell us how much they spend on people with different characteristics (age, sex, location, socio-economic status, Indigenous status) or on different locations (big city, urban, rural). To date, we can readily obtain disaggregated data on users of services but total costs by type of user, or differences in unit costs, are limited. Most of the necessary information on admitted patient services and schools is now available, but outside these services, disaggregated cost data are not available.

THE TIMING OF CAPITAL PAYMENTS

54 The panel has raised the option of equalising Commonwealth capital payments over a longer period of time to improve State budget stability.

55 This would not address any budget instability caused by infrastructure spending or by the receipt of Commonwealth payments. The lagging and averaging process followed by the commission provides some stability and certainty into the GST response to Commonwealth payments.

56 However separating the receipt of Commonwealth payments from their treatment in the GST processes raises other issues. Under this approach, States with assessed infrastructure needs actually funded by Commonwealth payments would, in the early years of the lagging process receive 'excess' GST revenue, unwound in the later years. This 'excess' would be at the expense of other States.

57 If the current infrastructure assessment were changed to align it with a lagged treatment of Commonwealth capital payments then it would take longer to recognise State infrastructure requirements, making it more difficult to respond to the infrastructure implications of the mining boom and rapid population growth.

58 These implications would need to be weighed against the impact of the proposal on State budget stability, especially as those infrastructure needs then unrecognised by the GST distribution or funded by Commonwealth payments, but still undertaken, are themselves a source of budget instability.

UPDATE ISSUES

Reduce the frequency of updates, freeze expense relativities, do not revise data

59 These proposals have been suggested as a way of simplifying the HFE process.

60 The less frequently assessments are updated, the greater the prospect that they move away from the underlying fiscal positions of the States (unless there was no change in relative state circumstances over that period). There is also no assurance that the pattern of divergences across States would stay the same; that is, some States GST shares could move to one that would correspond to equalisation, while others moved in the opposite direction. This approach introduces more randomness into the distribution rather than a more uniform move towards less comparability.

61 Not updating assessments in the ways suggested in the First Interim Report could, for example, mean the following:

- If there were no updates between reviews, it could mean that the relativities calculated in a review which captured the height of a property boom would remain in place for several years, creating severe problems for States when their property markets cooled.
- If expense relativities were frozen between reviews, it could mean that basic changes in State spending priorities or their population characteristics over the period would not be reflected.
- If data were not revised when, for example, the ABS issued revised data or released a new data set for the latest year, the commission would be ignoring material information. Known errors would affect GST shares for several years. States would receive GST on this basis and this would never be corrected. For example, it would include not replacing:

– wages relativities which have moved significantly in response to the mining boom. Even though changes in these can only be measured every four years when the ABS survey data become available, if the wages relativities had not been updated in the 2011 Update, Western Australia would not have received enough for its rapidly increasing wage levels ($226.2 million too little).

– population data when the new Census is released. $108 million in GST was redistributed when the 2006 Census results were included in the calculations.

62 The table below shows how the distribution of GST revenue would have differed in the 2009 Update had the expense disabilities been frozen since the 2004 Review. The Northern Territory would have received $175 million less than the 2009 Update relativities suggested it needed and Queensland $301 million more than it needed. States' ability to deliver comparable services would be compromised and some States would have found it hard to adjust to the new relativities once the expense disabilities were updated. In addition, the actual changes to the expense disabilities in the 2009 Update (from the 2008 Update) were material for all States, and very material for Tasmania and the Northern Territory. However, the changes are much smaller for most States than the change that would have occurred after 5 years of not updating the expense disabilities.

Table 2 Illustrative GST distribution[(a)] in 2009 Update compared with distribution resulting from 2009 Update relativities with 2004 expense disabilities[(b)]

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
	$m	$m	$m	$m	$m	$m	$m	$m	$m
2009 Update relativities	13 712	10 081	7 653	2 980	4 098	1 609	902	2 396	43 430
2009 Update relativities (2004 expense disabilities)	13 585	10 039	7 954	2 984	4 051	1 731	866	2 221	43 430
Change	127	42	-301	-4	47	-122	37	175	0
Change due to expense disabilities in 2009 Update	75	-53	-33	-23	36	-25	8	15	0

(a) Calculated using pool and population for 2009-10 shown in 2009 Update Report.
(b) Revisions to and updating of disabilities only. Changes to expense standards allowed to flow through.
Source: CGC calculation.

63 The commission has considered that more accurately capturing the changes in State fiscal positions and having more responsive annual relativities was a worthwhile trade-off to annual predictability and stability.

64 At issue is the fairness of not reflecting changing State circumstances in the GST distribution compared to the benefit to State budgetary processes of a more stable GST distribution between reviews. This might be encapsulated by asking if a changing GST distribution is best described as being 'responsive' or 'volatile'.

65 If big changes in shares are to be avoided when shares are recalculated at each review, some phasing arrangement may also be needed. This would mean that in all years the lag between data used and the application would be extended. The responsiveness of the relativities to changes in State fiscal circumstances, including meeting emerging infrastructure requirements would be further reduced.

66 Current arrangements provide incentives for States who are 'first movers' in improving service delivery efficiency and by incorporating those gains into average service delivery costs penalise States which do not follow suit. If GST shares, or expense averages are frozen, that mechanism would be weakened. In that case, greater simplicity and stability could reduce the incentive to improve service delivery efficiency.

Implications of regular updates on new issues

67 The First Interim Report identifies a number of options for improving the predictability and stability of the relativities. We offer some comments on the proposal that:

> the CGC should include in its *New Issues* paper as accurate an estimate as possible of the effect on States' GST payments of possible commission decisions and provide regular updates as decisions are made on them.

68 The commission has already advised States in the Chairman's letter of 16 May 2012 that staff will include in the new issues paper for the next update, where possible and appropriate, the GST impact of proposed changes. While we have not included the GST impact of all new issues in the past, we have done so when we could, or shown the likely change to a disability factor, such as for the changes to the wages disability in the 2011 Update. We have not considered it necessary to include the GST impact of every new Commonwealth payment because we considered States had a good knowledge of how alternate treatments of Commonwealth payments might affect their GST revenue. For example, States know that getting a share of Commonwealth payments greater than their population share reduces their GST share.

69 In relation to providing regular updates on issues that might affect future relativities prior to the release of the update report, such as advising treasuries of decisions regarding the treatment of new issues as they occur, and the impact of significant data revisions, the commission considers that the update report is the appropriate place to set out those decisions and their impact. We intend to continue this approach for future updates. Beyond that, we do not believe providing regular updates on our decisions would contribute to improved predictability of GST outcomes. Indeed because issues can move State GST shares in different directions, 'snapshots' through the process would not necessarily reduce volatility and uncertainty, not least because the details for mining royalties which have a large impact do not become available until very late in the process. The table below shows

how the change in mining dominated the total change in the GST distribution in the 2012 Update.

Table 3 Change in GST distribution[(a)] in the 2012 Update

Change due to mining	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Redis
	$m	$m	$m	$m	$m	$m	$m	$m	$m
Mining	264	378	-75	-719	65	27	24	35	794
Other	-341	-190	614	-102	-18	-48	38	47	698
Total change	-77	189	539	-821	47	-21	62	82	919

(a) Based on 2011-12 GST revenue and December 2011 State populations. The table, therefore, only shows the impact of changes in relativities.

Note: The redistribution is calculated as the sum of the positive (or negative) items in the row. Numbers may not add due to rounding.

Source: CGC, 2012 Update Report, Table 4 as adjusted to reflect updated ACT conveyance data.

CONCLUSION

70 In the 2010 Review, the commission noted that there may be scope for trade-offs between the principles — for example, between what States do and policy neutrality and between practicality and contemporary relativities. The commission did not set rules for how it would decide the appropriate approach in any such cases, nor did it establish a hierarchy among the principles. Each case was considered on its merits and judgment used to devise the best overall result consistent with the aim of achieving fiscal equalisation. Primacy was given to equalisation.

71 The comments we have provided above suggest that every review proposal requires some trade-off. Reducing comparability might allow other policy objectives or facilitate simpler more stable assessments. However, that would need to be weighed against the consequential divergence in the capacity of States to deliver services to their residents, a divergence that might occur at different and unknown rates for different States.

72 If the Review Panel and governments want to achieve a different outcome from that determined by fiscal equalisation as currently practised, it would be desirable to do more than change the definition of equalisation from ‘same’ to ‘comparable’ because the range of new issues that would raise are matters best answered by governments. The commission could then draw on those answers in recommending an appropriate GST distribution.