

COMMONWEALTH GRANTS COMMISSION

STAFF DISCUSSION PAPER (CGC 2008/19-S) NEW ISSUES FOR THE 2009 UPDATE

NSW TREASURY COMMENTS

OCTOBER 2008

Summary

NSW Treasury:

- notes that important issues in relation to reformed Commonwealth-State financial arrangements, including the distribution of SPPs and the treatment of Health Care Grants, have yet to be agreed between the Commonwealth and State and territory governments and that Commission staff will consult the States on the treatment of payments under the new Commonwealth-State financial arrangements
- notes the Commission staff's proposed treatment of new SPPs beginning in 2007-08, and suggests further information on the Commonwealth's \$26.8 million payment to Queensland for the relocation of Amberley State School is needed before it can be concluded that the payment should be treated as out of scope
- recognises that the Commission's treatment of Northern Territory Emergency Response payments to the Northern Territory and Commonwealth payments in respect of Mersey Hospital in Tasmania may be determined by the Terms of Reference for the 2009 Update. However, NSW Treasury's view is that treating those payments by inclusion would be consistent with the methods of treatment of Australian Government payments to States established by the Commission in the 2004 Review
- notes Commission staff proposals in relation to data on public sector earnings for the payroll tax assessment, and updating 2005-06 SET based wage input cost relativities using the labour price index and
- notes an adjustment is proposed to ACT transfer duty revenue from 2007-08 to reflect common policy in relation to duty on the transfer of non-real business property, but questions whether an adjustment also should be made to 2006-07 revenue since the ACT abolished this duty from 1 July 2006.

Reform in Commonwealth-State Financial Arrangements

Commission staff note (paragraph 9) that because the change in Commonwealth-State financial arrangements to take effect from 1 January 2009, with reform of payments for health care to be implemented by 1 July 2009, “is a major change in Commonwealth-State financial relations, the relativities for the 2009 Update will need to reflect the new arrangements in the assessment period.”

However, the Council of Australian Governments (COAG) is yet to reach agreement on a number of issues relating to the reform of Commonwealth-State financial arrangements with the States, including importantly the possible distribution of Specific Purpose Payments (SPPs) on an equal per capita basis and whether the Commission will be instructed to treat Australian Government health care payments to the States by inclusion rather than absorption.

Commission staff note also (paragraph 11) that the Australian Government’s guarantee “that no State will be worse off than they were in the current forward estimates as a result of the proposed changes” may have implications for the 2009 Update.

NSW Treasury notes that Commission staff is not able to make recommendations to the Commission on these issues until the outcome of the COAG negotiations, and the “Commission staff will consult the States on the treatment of payments under the new Commonwealth-State financial arrangements.” (Paragraph 13)

Treatment of New Specific Purpose Payments (SPPs) Commenced 2007-08

NSW Treasury notes the Commission staff’s proposed treatment of new SPPs beginning in 2007-08 set out in Table 1.

NSW Treasury notes that Commission staff recommends the payment of \$26.8 million to Queensland for the relocation of Amberley State School necessitated by the expansion and upgrading of the Amberley military base be treated as out of scope because the payment does not have a direct impact on the State budget (Table 1, page 7).

NSW Treasury suggests the payment has the potential to affect directly the Queensland State budget if it involves an upgrading of the school or a reduction in maintenance expenses on the school that in the absence of the relocation would have fallen on the State budget.

NSW Treasury suggests that these potential direct impacts on the Queensland State budget, and their materiality, should be explored by Commission staff before it can be concluded that the payment should be treated as out of scope.

Northern Territory Emergency Response (NTER)

Australian Government grants to the Northern Territory Government for the NTER are estimated at \$75 million in 2007-08 and \$15 million in 2008-09 (Table 2, page 10). In addition, the Australian Government is providing substantial NTER expenditure through its agencies – total funding by the Commonwealth for the NTER in 2008-09 is estimated at \$232.8 million.¹

NSW Treasury notes that Commission staff proposes (paragraphs 18) to exclude any Australian Government payments relating to NTER from the Northern Territory's revenue and exclude the expenses funded by the Australian Government payment for NTER from the Northern Territory's expenses. Staff does not expect the Terms of Reference for the 2009 Update to change from the 2008 Update Terms of Reference, which required that these payments had no impact on the States' per capita relativities.

NSW Treasury recognises that the Commission's treatment of NTER payments may be determined by the Terms of Reference for the 2009 Update.

In the absence of direction in the Terms of Reference, NSW Treasury believes treating those payments by inclusion would be consistent with the methods of treatment of Australian Government payments to States established by the Commission in the 2004 Review.

The NTER payments appear to be material, have a potentially direct impact on the Northern Territory budget, provide assistance for services included in the CGC's adjusted budget and are not distributed consistently across States on the basis of the Commission's assessments of State expense needs.

The practice of selectively quarantining some SPPs has the potential to undermine the pursuit of horizontal fiscal equalisation through the CGC's processes.

Mersey Hospital in Tasmania

The Australian Government is to provide \$180 million over three years to allow the continuation of the current range of services and facilitate purchasing new equipment

¹ Statement by the Hon Jenny Macklin, MP, Minister for Families, Housing, Community Services and Indigenous Affairs, 13 May 2008, *Budget: Closing the Gap between Indigenous and Non-Indigenous Australians*, p. 28.

at Mersey Hospital in Tasmania. The State will manage the hospital. (Paragraphs 21-22)

The 2008 Update Terms of Reference required that the Commonwealth's purchase of the Mersey Campus of the North West Regional Hospital from Tasmania should not directly influence the per capita relativities. Commission staff does not expect the Terms of Reference for the 2009 Update to change for the 2009 Update. (Paragraphs 17-18)

Staff propose (paragraph 24) to:

- exclude any Australian Government payments or expenses on Mersey Hospital from Tasmania's revenue;
- add back the expenses incurred by the Australian Government on the Mersey hospital to Tasmania's inpatient expenses and
- include Mersey Hospital's inpatient separations in the public hospital use figures.

NSW Treasury recognises that the Commission's treatment of the Commonwealth's payments in respect of Mersey Hospital may be determined by the Terms of Reference for the 2009 Update.

In the absence of direction in the Terms of Reference, NSW Treasury believes treating those payments by inclusion would be consistent with the methods of treatment of Australian Government payments to States established by the Commission in the 2004 Review.

As with the NTER payments, the payments in respect of Mersey Hospital appear to be material, have a potentially direct impact on Tasmania's budget, provide assistance for services included in the CGC's adjusted budget and are not distributed consistently across States on the basis of the Commission's assessments of State expense needs.

Excluding the Mersey Hospital payments from Tasmania's revenue, while adding back the expenses of the Mersey hospital to Tasmania's inpatient expenses, appears to provide an asymmetrical treatment of the Mersey arrangement. If expenses are to be added back and treated as Tasmanian Government expenses, it would seem logical to include the Commonwealth payments for those expenses as Tasmanian Government revenue.

Payroll Tax and ABS Public Sector Wages and Salaries Data

Commission staff use ABS data on public sector earnings to estimate the proportion of total wages and salaries that would be liable for payroll tax. With the switch from a quarterly to an annual publication for the Wage and Salary Earners Public Sector publication, the ABS will not publish 2007-08 gross earnings public sector data until at least end-January 2009.

If the data is not available for the 2009 Update, staff proposes (paragraph 28) using the trend estimate in public sector earnings over the previous five years to scale up the 2006-07 public sector earnings data to a 2007-08 estimate (and replace the estimated with the actual data when the actual data becomes available).

Staff note (paragraph 29) that if the proposed method had been used over the past five years, public sector earnings would have been underestimated by less than 3 per cent. NSW Treasury notes that the less than 3 per cent figure (Table 3) appears to be an average for five years for the whole of Australia. For one year, and for individual States, the variations can be higher.

NSW Treasury notes the proposal.

Updating Wage Input Costs

Commission staff estimate differences in the private sector cost of labour between States using ABS Survey of Education and Training (SET) data in an econometric model. Most recent SET data was for 2005, and since then the cost of labour has changed at different rates in different States.

In the 2008 Update, Commission staff used data from the biennial survey of Earnings, Employee Benefits and Trade Union membership (EEBTUM) to update the SET based estimate.

For the 2009 Update, staff propose an alternative method of updating the SET relativities using the ABS labour price index. Staff propose (paragraph 38) that the 2006-07 and 2007-08 wage input cost relativities use the labour price index to update the 2005-06 SET based relativities.

The LPI measures changes in the price of a representative sample of employee jobs, much as the CPI measures changes in the price of a representative basket of goods. As staff note, each States LPI index is based on their economic structure (paragraph 33). This economic structure remains constant between successive weighting base periods, so changes in the price of labour resulting from changes in the composition of the labour market in different States are excluded from the index movements.

Staff note that:

- the impact that the difference in industrial or occupational structure has on the actual data appears to be much less than the measurement errors associated with the assessment (paragraph 35) and
- ABS advice is that the approach, while conceptually imperfect, is “statistically valid analogous to the methods applied by the international statistical community to derive purchasing power parity measures.” (Paragraph 38)

Commission staff notes (paragraph 36) that “the impact of structural differences on this method of updating may be dealt with, if that is deemed necessary, through either a specific adjustment if it can be measured accurately, or by discounting the adjustment factors.” NSW Treasury suggests caution in the use of discounting, since it often is necessarily arbitrary in nature. If the impact of structural differences is considered sufficient to require “adjustment” or “discounting”, this could be a signal that the underlying method is flawed.

NSW Treasury notes the proposal.

Abolition of Stamp Duty on Non-Real Business Transactions in the ACT

All States have agreed to abolish stamp duty on non-real business property transactions, but will do so at different times. ACT abolished the duty from 1 July 2006. Since it is still common policy to impose the duty, it is necessary to increase the ACT’s revenue base data for 2007-08 to include the value of non-real business conveyances that will not have been taxed under its policy.

Staff note (paragraph 40) that, though the ACT abolished the duty from 1 July 2006, it is not necessary to add back revenue from the abolished duty for 2006-07, since the ACT received some revenue in 2006-07 on transactions from 2005-06 that had not been finalised by the close of 2005-06, and these revenues “were the same as the collections for a normal year”.

Currently, Victoria’s revenue base is adjusted upwards by 3 per cent to account for its exemption of goodwill in the sale of businesses, and by a further 4 per cent to reflect Victoria’s policy to levy duty on a narrower range of real property, personal property and business assets.

Staff propose an adjustment of 1 per cent be introduced for the ACT’s revenue base from 2007-08. The quantum of the adjustment is based on the evidence that over the 4 years of the assessment years when the ACT was fully collecting revenue from the

duty, revenue raised on non-real business property represented 0.8 to 1.0 per cent of ACT conveyance duty revenue.

NSW Treasury agrees an adjustment should be made to ACT revenue to reflect common policy.

NSW Treasury questions whether an adjustment should be made also for 2006-07. It seems odd that the ACT would collect in 2006-07 revenue of a magnitude that was “the same as collections for a normal year” from a duty that was abolished at the beginning of the financial year. Unless there was typically a one year lag in revenue collection – so that revenue in one year reflected transactions in the previous year – revenue from this source may have been even larger in 2006-07 had the duty not been abolished from 1 July 2006.

Based on the typical lag in revenue collection, there may be a case for applying a partial adjustment to revenue received from transactions other than transactions in non-real business property in 2006-07 (as well as including revenue that was collected from transactions in non-real business property in the revenue base).

For example, if the typical lag was six months between transaction and revenue collection, the adjustment could be 0.5 per cent of revenue (excluding non-real business related property revenue) in 2006-07; if the typical lag was nine months the adjustment could be 0.25 per cent; and if the typical lag was in fact one year, the adjustment could be 0.00 per cent (i.e., no adjustment would be necessary in 2006-07).