NSW GOVERNMENT | Treasury

New Issues for 2021 Update

Commonwealth Grants Commission

NSW Treasury Response

October 2020

NSW GOVERNMENT

Contents

1. Executive Summary

Introduction

1.1 NSW Treasury welcomes the opportunity to respond to the Commonwealth Grant Commission's (CGC) New Issues for the 2021 Update (the 2021U). The impact of the COVID-19 pandemic on the Australian economy and society is significant and profound. These impacts are continuing to change and evolve.

1.2 The COVID-19 pandemic is having an unavoidable impact on the revenue raising capacity and spending decisions for governments. The CGC has acknowledged that the health and economic effects of COVID-19 and the reaction to it have affected States to different extents.

1.3 On balance, NSW Treasury agrees with CGC staff's preliminary conclusion that actual levels of economic activity and health services is the best available measure of the level of activity that would have occurred under a nationally consistent policy framework for the assessment period from July 2017 to 30 June 2020. On this basis, NSW Treasury considers that to the extent these government responses have resulted in changes to state fiscal capacities, these are adequately recognised using 2020 Review methods. This position relates to the assessment period only.

1.4 The question of policy choice and the impact of States' individual decisions on the levels of economic activity of each State and the health needs of each State's population remains an open question that requires careful consideration in the context of the next assessment period spanning July 2018 to 30 June 2021.

1.5 NSW Treasury agrees with CGC staff's preliminary consultation that while some effects may not be material in this assessment period, the size and interstate distribution of pandemic effects in 2020-21 and beyond cannot yet be determined.

1.6 On this basis, NSW Treasury considers that the CGC must confine itself to those issues currently known to be material for the assessment period. In this uncertain environment, the CGC should not pre-empt consideration of those issues which may prove material in future updates. Accordingly, NSW Treasury's position as set out in this response is confined specifically to this assessment period.

1.7 Different state circumstances in part explain the policy choices of governments in the implementation of COVID-19 restrictions, including lockdowns, and their impact on economic activity. At the same time, it is unclear to what extent the variation in different state circumstances can fully explain these choices, rather than differences in risk appetite and policy intent between governments. This is an important question requiring careful consideration and robust evidence. Related questions regarding materiality and measurability and data adequacy may also arise.

1.8 NSW Treasury considers that if it is determined that the effect of COVID-19 on state fiscal circumstances is poorly captured by 2020 Review methods, and materiality and measurement are reliably established, horizontal fiscal equalisation (HFE) is best served by Terms of Reference (ToR) that are issued to the CGC to make such any such change.

1.9 Any ToR issued to the CGC must be undertaken following full consultation with states and territories to ensure transparency and accountability.

1.10. The issues raised by the 2021U, in the context of the COVID-19 pandemic again reinforce the position of the NSW Government that an equal per capita distribution of GST between states and territories presents the most robust and efficient means of distribution. Perverse incentives are avoided and complex questions involving policy choice and judgment are avoided. Further, fairness is enhanced as it ensures states are not rewarded for those decisions that impose an economic cost on other states.

Overview

1.11 This submission comprises two sections:

- **Part one**: Executive Summary and Overview
- **Part two**: NSW Treasury positions and recommendations
- **Part three**: Issues and Responses.

1.12 In accordance with CGC guidance, this submission is narrowly targeted to address specific issues raised in the CGC staff paper – New Issues for the 2021 Update.

1.13 This submission to the 2021 Update sets out the views of NSW Treasury, and not the NSW Government.

1.14 NSW Treasury reserves an ongoing right to raise additional issues, new arguments or new data as the 2021 Update progresses and new or changed methodological approaches, data and other issues are raised by the CGC or other jurisdictions.

1.15 Further information and questions regarding any aspect of this submission may be directed to: Ms Andrée Wheeler, Director, Federal Financial Relations, NSW Treasury (e. ffr@treasury.nsw.gov.au).

2. NSW Treasury positions and recommendations

2.1 The following table summarises NSW positions on recommendations in the new issues paper.

Response to the COVID -19 pandemic – Revenue	▪ No change to revenue assessment methods are required in the current assessment period ▪ Make adjustments to revenue datasets to ensure comparability, if such adjustments are material ▪ Remove JobKeeper payments from the payroll tax base on practicality grounds
Response to COVID -19 pandemic – Expenditure	▪ Assess COVID-19 health expenses from the NPCR on an APC basis ▪ Use state budget data to recalculate the split between regulation and business development for other industries and adopt the revised split if material ▪ Do not introduce a differential assessment of business development expenses due to the COVID-19 induced economic shock
Implementation of new HFE arrangements for 2021-22	▪ Support proposed presentation of the previous and new HFE arrangements
New data for non-admitted patients (NAP) component	▪ Endorse the use of NAP National Weighted Average Unit (NWAU) data for the 2021 Update and subsequent inquiries
Stamp duty on conveyances and land tax data revisions	▪ Cease deducting duties from the sale of major state assets from GFS conveyance revenue for the first two years of the assessment period only ▪ Continue to deduct duties from the sale of major state assets from GFS conveyance revenue for the final assessment year only
Wage cost assessment – data revisions	▪ Use the modelled outcomes based on revised CoES data for 2017-18 and 2018-19. ▪ Make a one-off adjustment to account for this revised data being omitted from the 2020 Review given its materiality
Changes to compilation of the adjusted budget	▪ For years 1 and 2 — use the ABS GFS NFPS data to estimate user charges, expenses and investment for urban transport and housing ▪ For year 3 — continue the 2020 Review approach of consolidating the State GG and PNFC data ▪ Check the accuracy of the year 3 urban transport data accuracy against published information ▪ NSW Treasury seeks further advice on what are the implications of reclassifying COFOG-A 1132
Assessing loans under natural disaster expenses	▪ Change the natural disaster relief expense assessment of concessional loans to only assess net cost of providing the concessional interest rate

3. Issues and responses

Response to the Covid-19 pandemic

Revenue issues

3.1 No change to revenue assessment methods are required in the current assessment period. State policy responses to COVID-19 were largely similar throughout 2019-20. Restrictions in place across states have impacted economic activity to differing degrees reflecting differences in state circumstances rather than differing policy responses. To the extent that responses to the COVID-19 are having differential effects on state revenue raising capacity, this is already captured through existing revenue assessment methods.

3.2 NSW Treasury supports adjusting revenue datasets to ensure comparability, if such adjustments are material:

- offset rebates against the relevant revenue category, and
- assess deferred revenue in the year in which the liability arose.

3.3 JobKeeper payments should be assessed as part of the payroll tax base on practicality grounds.

Expenditure issues

3.4 COVID-19 pandemic health related expenditure should be assessed on an actual per capita (APC) basis as the drivers for such expenditure have greater similarity to those drivers underpinning the assessment of natural disaster relief expenses.

3.5 NSW Treasury supports the conclusion of CGC staff that an APC based assessment presents the most appropriate methodological approach in the absence of a vaccine or other human defence.

3.6 The multi-dimensional nature of both society and government responses to COVID-19 is more closely comparable to the government-wide responses for a natural disaster. The cost of these responses fundamentally differ to those more narrowly targeted responses appropriate to address a health condition, and which are adequately captured by the 2020 Review health assessment methods. As noted by the CGC, a key differentiator for governments' health-related COVID-19 expenditure is that it does not reflect socio-demographic differences between states, rather differences in exposure to the virus.

3.7 This difference is further reinforced by the significance of non-health related factors, including population density and other random factors such as the concentration of infections and contact with overseas returning travellers, as a driver for COVID-19 pandemic health related expenditure reported in accordance with the National Partnership on COVID-19 Response (NCPR).

3.8 The rightness of the conclusion that government expenditure on COVID-19 pandemic related health costs be assessed on an APC basis is further reinforced by consideration of the objectives of HFE which is to take into account the differences in states' economic, social and demographic characteristics that affect each state's fiscal capacity. Inclusion of COVID-19 pandemic health related expenditure utilising 2020 Review health assessment methods would negate this objective.

3.9 The COVID-19 pandemic, and the nature of each government's response, is evolving rapidly and its impacts have not been fully realised. Further consideration in the context of the 2021 Update is appropriate.

3.10 In addition to the use of NCPR expenditure by the CGC as a measure of state health expenditure relating to the COVID-19 pandemic, there is a range of potentially significant further costs that fall outside the scope of the NCPR. These costs are wholly funded by states. A number of these costs have had a disproportionate and potentially material impact for NSW, particularly, the cost of hotel quarantining of overseas repatriations. The additional costs borne by the State include

- 'Police' hotels – non-symptomatic overseas arrival quarantine
- 'Health' hotels – symptomatic overseas arrivals quarantine
- 'Health' hotels – symptomatic local resident quarantine
- those costs associated with the Ruby Princess.

3.11 States and territories have agreed in principle to the reimbursement of costs for government expenditure relating to quarantining overseas repatriations. The NSW Government is pursuing reimbursement of full costs from other states and territories for their residents repatriated into New South Wales. To the extent any additional costs associated with quarantining overseas repatriations falls outside the scope of this cost recovery framework, an APC assessment is supported.

Services to Industry

3.12 Government expenditure in response to the economic shock induced by COVID-19 has largely been directed to job creation programs and business grants and therefore relates to other industry business development. The current split between regulation and business development for other industries is not appropriate for 2019-20.

3.13 The CGC should use state budget data to recalculate the split between regulation and business development for other industries and adopt the revised split if it is material. The CGC should calculate the regulation component by indexing 2018-19 business regulation expenses.

3.14 A differential assessment of business development is not supported. The CGC should continue to assess business development related expenditure on an equal per capita basis consistent with 2020 Review methods.

Implementation of the New Horizontal Fiscal Equalisation arrangements for 2021-22

3.15 The proposed presentation of previous and new HFE benchmarks and related transitional arrangements aid clarity and transparency.

New data for the non-admitted patient component

3.16 NSW Treasury has previously raised concerns regarding reliance on a proxy indicated, based on Admitted Patient (AP) separations which results in an over-estimation of Non-Admitted Patient (NAP) spending due to lower usage rates for NAP services, compared to AP for high cost groups, and the application of remoteness adjustments to the proxy indicator.

3.17 In general, NSW Treasury considers reliance on proxy indicators should be avoided as they provide introduce a measure of false precision in CGC assessments and embed judgment within CGC assessment methods. This is demonstrated by the large differences in NAP spending based on the proxy indicator in comparison to actual NAP National Weighted Average Unit (NWAU) data.

3.18 Using NAP National Weighted Average Unit (NWAU) data for the 2021U would ensure better alignment of NAP with AP and Emergency Department (ED) data. The use of NAP NWAU data will improve the comprehensiveness and overall reliability of this assessment.

Revisions to stamp duty on conveyances and land tax data

3.19 Efforts to improve data quality are underway and NSW Treasury is working closely with Revenue NSW to address the alignment between Revenue NSW data and budget data and, to the extent possible, mitigate large revisions. At the same time, some revenue data revisions are unavoidable. This includes future revisions due to revaluations and reversals as well as compliance activities.

3.20 NSW Treasury is willing to provide additional information that can be shared with other states in the event any large revisions are necessary in future.

3.21 It is appropriate for the CGC to cease deducting duties from the sale of major state assets from GFS conveyance revenue for the first two assessment years only. This is because ABS GSF data classifies duties relating to the sale of equity in publicly owned corporations to Tax Code 465. This means as a matter of practice, GFS conveyance revenue data used by the CGC for the first two assessment years does not include these duties.

3.22 Duties must continue to be deducted from the sale of major state assets from GFS conveyance revenue in the final assessment year. This is because the conveyance revenue supplied by states for the last assessment year includes the sale of major state assets. The issue in question only relates to ABS-sourced data. The CGC must ensure no change is made to the treatment of state provided data for the stamp duty on conveyances and land tax revenue assessments.

Revised data in the wage cost assessment

3.23 The CGC should adopt the modelled outcomes based on revised data for the 2017-18 and 2018-19 Characteristics of Employment survey (CoES) in the wage cost assessment. This is consistent with the standard terms of reference for an update inquiry, which require that the CGC use the latest available data.

3.24 The CGC should also make a one-off adjustment to account for this revised data being omitted from the 2020 Review given its materiality. This is a simple adjustment and is necessary to improve the robustness of HFE outcomes set out in the 2020 Review.

3.25 The adjustment undertaken by the CGC as part of the 2020 Review relating to the natural disaster assessment provides a recent precedent of a similar adjustment given effect by the CGC in its assessment method. This wage cost adjustment is less complex in nature to the natural disaster adjustment which required the CGC to calculate the assessed contribution for each state’s local government expenses.

3.26 In the course of the 2020 Review, the CGC relied on ABS advice that revisions to the CoES data used to calculate wage cost modelled outcomes for 2016-17 and 2017-18 may not significantly affect the results from the CGC’s regression model. However, the results set out by the CGC in the 2021U New Issues paper demonstrates this previous reliance was unfounded and should be reversed to achieve a more robust and defensible outcome consistent with the principle of HFE.

Changes to the compilation of the adjusted budget

3.27 The CGC should use ABS GFS Non-Financial Public Sector (NFPS) data to derive consolidated expenses, user charges, and investment for urban transport for housing up to year 2. The CGC should continue to use the 2020 Review approach to rely upon consolidated General Government (GG) and PNFC data for year 3.

3.28 This approach is consistent with NSW Treasury's recommended approach to deduct duties from the sale of major state assets from GFS conveyance revenue in the final assessment year outlined above.

3.29 NSW Treasury seeks further advice on what, if any, implications are anticipated arising from the reclassification of COFOG-A 1132 Urban water transport freight services from the urban transport component to the non-urban transport component.

Assessing loans under natural disaster expenses

3.30 The CGC should only take into account the net costs actually incurred by states in the provision of concessional loans under the natural disaster relief expense assessment. This cost should only include that portion of the interest rate subsidy for concessional loans (including risk costs) incurred by states.