Queensland Government

New issues for the 2021 Update

Queensland response

Contact Officer:
David Runge
Director
Intergovernmental Relations Team
Queensland Treasury
(07) 3035 1846
David.Runge@treasury.qld.gov.au

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1. Response to the COVID-19 pandemic – general comments

- The COVID-19 pandemic is having significant and unprecedented economic and health impacts in Australia and around the world. For this reason, Queensland supports the Commonwealth Grants Commission (the Commission) taking steps to re-examine its method to ensure it is capable of fully capturing the impact on states and territories' ('states') fiscal capacities and, by extension, on their shares of GST revenue.
- For the 2021 Update, Queensland is of the view that the impact on states in 2019-20 and their individual responses, while showing some differences, are sufficiently comparable to be largely accommodated by the Commission's current method. State responses have been informed by decisions made jointly at National Cabinet or nationally by the Australian Government. As a result, while states' fiscal capacities have decreased, there does not appear to be strong evidence to suggest that their relative fiscal capacities have significantly changed.
- However, Queensland anticipates that the differences in states' relative fiscal capacities will be more pronounced in 2020-21.
- Queensland agrees that the Commission's current method is mostly capable of assessing states' fiscal capacities and only small adjustments may be required for the 2021 Update. However, as the COVID-19 pandemic continues to unfold, method adjustments should be considered anew each year. This should be reflected in any Terms of Reference from the Australian Government that allow the Commission to investigate and implement method changes.

2. Response to the COVID-19 pandemic – revenue assessment issues

Commission staff proposal:

- Commission staff propose to:
  - offset rebates against the relevant revenue category in the year that the liability arose to ensure there is no distortion to the average tax rate
  - assess deferred revenue in the year in which the liability arose, and
  - not remove or account for JobKeeper payments in payroll tax bases.

Queensland positions:

- Queensland **supports in-principle** that rebates should be accounted for in the same financial year as the initial tax liability. This is important to ensure that the assessment of states net tax revenue, including rebates, aligns with the tax base that generated the revenue.
- For the same reason, Queensland **supports in-principle** accounting for deferred tax liabilities in the same financial year as the initial tax liability.
- However, Queensland does not expect the related method changes to have a large impact on states' relativities. Therefore, any method changes should only be implemented if they satisfy the Commission's materiality threshold and maintain the balance between assessment accuracy and complexity.
- Regarding JobKeeper, Queensland **accepts** that the ABS is unable to provide disaggregated data and therefore supports the proposal to not remove or account for JobKeeper payments in payroll tax bases. To do otherwise will require the Commission to judge the proportion of take-up of JobKeeper by businesses in each state based on little evidence. This is unlikely to result in a more accurate assessment.

3. Response to the COVID-19 pandemic – health assessment issues

Commission staff proposal:

- Commission staff propose to introduce a COVID-19-specific assessment for health expenses. Through this assessment, states with higher actual eligible expenses, less contributions from the Australian Government under the NP on COVID-19 Response, will be recommended greater shares of GST revenue. Commission staff propose this approach because expenses reported under the NP for COVID-19 should allow for reliable comparisons across states. This is similar to the natural disaster relief expenses assessment.
- The proposed assessment will initially apply only to the approximate four months of 2019-20 impacted by the COVID-19 pandemic. This is the limit of the Commission's considerations for the 2021 Update, which assess states' fiscal capacities for between 2017-18 and 2019-20. Commission staff suggest that state policy responses during this time were very similar.
- Queensland Treasury consulted with Queensland Health in developing the below position.

Queensland position:

- Queensland **supports in-principle** adjusting the assessment of health expenditure to respond to the COVID-19 pandemic in 2019-20. States' expenses on COVID-19 are significant and the current health assessment is not capable of fully capturing the impact.
- However, Queensland **does not currently support** implementing the proposed assessment unless:
  - It only applies to the 2019-20 assessment year;
  - The scope of eligible expenses under the National Partnership (NP) on Covid-19 Response is set;
  - The States are claiming broadly similar expenses; and
  - It is material and reliable to do so.
- Queensland **seeks assurances** that any new assessment or method adjustment will only apply to 2019-20. It should not automatically apply to the 2020-21 assessment year for the 2022 Update. Queensland is not aware of any significant differences in states' health policy responses in 2019-20 in managing the pandemic. However, beyond this time, states are managing the pandemic differently and this may need to be accounted for in future assessments.
- The NP for COVID-19 Response will not provide a consistent framework for comparing states' health expenditure until the scope of eligible expenses is finalised. The scope continues to be negotiated, expenses reported to date are projections, and estimates vary between states. Therefore, the data are not reliable, do not allow for the policy neutral comparison of expenditure and are not ready to be used by the Commission. GST outcomes based on this data will require adjustments in 2021-22.
- Queensland also **seeks confirmation** that actual health expense data reported under the NP for COVID-19 Response are reliable and fit for purpose. If the issues listed above remain, the Commission should postpone the adoption of such an assessment until the data become reliable.

4. Response to the COVID-19 pandemic – services to industry assessment issues

Commission staff proposal:

- Commission staff propose to revise the ratio between industry regulation and business development annually during Australia's recovery from the COVID-19 pandemic if the change is material. This will be based on additional spending in business development and will require indexing 2018-19 business regulation expenses.
- Commission staff do not intend to recommend a change to how business development expenses are assessed, i.e. a 'differential assessment'. This is because they have not identified the drivers of higher costs nor any unique features in the additional spending that warrant further changes.

Queensland position:

- Queensland **supports** the proposal to recalculate the ratio between industry regulation and business development. The previous approach was predicated on stability in this relationship and that no longer exists.
- Queensland also **supports** the proposal to not introduce a differential assessment for business development expenses because there is no strong conceptual case to support any differential assessment.

5. Implementation of the new HFE arrangements for 2021-22

Commission staff proposal:

- Commission staff propose to implement the legislative changes to HFE using a mix of both approaches:
  - The Commission will equalise to the standard state in each assessment year
  - The Commission will impose the GST floor in the application year
- Commission staff have proposed this approach because the Commission prefers to use historical data to estimate states relativities, but also needs to ensure states do not fall below the GST floor in the application year. However, the proposed approach significantly complicates an already complicated equalisation system.

Queensland positions:

- Queensland **does not support** the proposal.
- Queensland **recommends** the Commission implement the Australian Government's changes by equalising to the standard state in the application year, after calculating 3-year averaged relativities.
- This avoids having two separate methods for equalisation (that is, assessment year equalisation for standard state and application year equalisation for relativity floor) which significantly complicates the system.
- Likewise, it avoids problems that arise from equalising each assessment year individually which may over- or under-equalise states relative to the standard state.
- The forecast error from using population and GST estimates (because actuals will not be available) will be a minor trade-off as there is unlikely to be any material GST redistributions. Any forecast error can be reconciled at the FBO or in subsequent updates.
- On the issue of outcomes presentation, Queensland encourages the Commission to share with states a template of how it intends to display its assessment results that include the Australian Government's changes.

6. New data for non-admitted patient component

Commission staff proposal:

- Commission staff propose to adopt the use of IHPA's NWAU data on NAP for the 2021 Update and beyond. This is based on IHPA's advice that the coverage on its 2018-19 data has improved to 86%. Data coverage refers to the proportion of aggregate activity data reported at the patient level. It is an indicator of how comprehensive or representative the available patient level data is of total service use.
- Despite this improvement, the coverage of the 2018-19 data remains below the coverage rate for other health services (e.g. emergency departments coverage is 97%). It is also higher in major cities/inner regional areas compared to more remote regions. Consequently, using this data to assess states NAP service expenses would understate the costs of delivering NAP services, particularly in regional and remote areas.
- To compensate for discrepancies in coverage rates, Commission staff propose to use proxies for hospitals in regions where the data coverage rate is inadequate. This would be achieved by allocating them with the user profile of hospitals in the same remoteness region and the same funding type.
- One of the drivers for the Commission's proposal is that proxies that have been used previously may be unreliable and could over-estimate the additional cost and usage of NAP services associated within remote locations. The Commission has also found that these proxies could overstate the costs associated with social economic status and Indigenous status when compared to the 2018-19 actual NAP data.
- As only the 2018-19 data are currently available, Commission staff recommend that this data be used for all assessment years for the 2021 Update (i.e. 2017-18 to 2019-20 inclusive).

Queensland position:

- Queensland **supports in-principle** using a comprehensive and nationally consistent data set for the assessment of NAP services but **does not support** adopting the IHPA NWAU data on NAP for the 2021 Update because it is not yet sufficiently reliable.
- Queensland Treasury is advised that:
  - IHPA NAP data set continues to report service usage based on the characteristic of the clinics but does not capture patient specific information such as length of patient episodes and resources required for each episode, which are the true drivers of service cost and usage variation.
  - IHPA's Tier 2 classification and counting rules used to classify NAP activities for the purpose of reporting NAP services are not easily understood and this has resulted in reporting variations.
- To resolve these issues, IHPA is currently developing an Australian Non-Admitted Care Classification (ANACC) to describe NAP according to patient characteristics and the complexity of care required.
- Further, measuring higher service delivery costs associated with increased remoteness for NAP continues to be an issue despite an increase in coverage rate.
- Estimates of loadings for remoteness that are calculated on actual NAP data are highly volatile and this may reflect poor data quality. For this reason, IHPA has itself applied the remoteness loadings of admitted acute and subacute patients to NAP for 2019-20.
- The proposal to adopt IHPA NWAU data on NAP will effectively swap the current remoteness loading (emergency departments) for another proxy (admitted acute and subacute patients). Swapping one proxy for another is unlikely to improve the assessment's capacity to measure states circumstances more accurately.
- Queensland **recommends** the Commission defer the use of this data until the ANACC is implemented and when NAP services are consistently reported so a reliable remoteness loading for NAP can be calculated.

7. Revisions to stamp duty on conveyances and land tax data

Commission staff proposal:

- Commission staff intend to cease the deduction of duties from the sale of major state assets from Tax Code 463 to avoid double counting. This has not impacted the treatment for corporate reconstructions and non-real property, which will continue being deducted from duties.
- Queensland's GST share is increased through this assessment because of the state's relatively small capacity to levy transfer duty. The Commission's proposal to cease the deducting duties from the sale of major state assets twice will increase the total transfer duty pool being considered and increase the GST distribution to Queensland because of the transfer duty assessment.

Queensland position:

- Queensland acknowledges that it has revised data in recent years despite making every effort to provide current, reliable and fit-for-purpose data. Where revisions have been significant, they were primarily due to major improvements to methodologies and data quality.
- This was the case in the 2017 Update when Queensland revised its land tax data which resulted in significant GST redistribution. This revision came after OSR improved its method of extracting and compiling values of land which resulted in more accurate and fit-for-purpose data. It replaced land value data previously provided which was based on indexation of historical land values. New land value data provided to the Commission is, as previously noted by the Commission, more consistent with other publicly available data sets.
- Like land tax, Queensland revised its mining value of production data for the 2017 Update. This occurred because an alternative and more reliable data set was provided to the Commission.
- Large data revisions such as these are unlikely to reoccur in the absence of system and legislation changes in Queensland, and significant methodology changes from the Commission. However, data revisions because of other factors (e.g. refunds, compliance activity, reassessments and late lodgements) are difficult to prevent.
- Queensland **supports** the Commission staff proposal to cease deducting duties from the sale of major state assets from conveyance revenue to avoid double counting. This is understood to be the intent of the changes implemented following the 2020 Methodology Review.

8. Revised data in the wage cost assessment

Commission staff proposal:

- Commission staff propose to adopt the re-estimated modelled outcomes for the 2021 Update and beyond.

Queensland positions

- Queensland **does not oppose** the use of the latest available data. Using the most up-to-date and reliable data to reflect states circumstances should deliver the best equalisation outcome.
- However, Queensland is concerned that revisions to the ABS Characteristics of Employee Survey data can create volatility in states relativities in the absence of any real change to states' circumstances.
- The Commission should seek to minimise data revision in the wage cost assessment, particularly if the data revision is minor. If data revisions cannot be avoided, the Commission should consider averaging the modelled outcomes across years or increasing the discount rate to reduce volatility in the assessment.

9. Changes to the compilation of the adjusted budget

Commission staff proposal:

- Following consultation with the ABS, Commission staff propose to use ABS' GFS data for expenses and investment in urban transport and housing. These were two assessments previously informed by individual states' unit record data.
- At the same time, Commission staff propose to reclassify some urban transport expenses to non-urban transport expenses where they identified data issues.
- Finally, in the future, Commission staff propose to confirm the accuracy of urban transport data against other sources and consult with states on emerging issues.
- The proposals should result in more reliable and consistent data.

Queensland positions

- Queensland **supports** the Commission staff proposals.

  For years up to year 2 — use the ABS GFS NFPS data to estimate user charges, expenses and investment for urban transport and housing

- Queensland **supports** the use of ABS GFS NFPS data to estimate user charges, expenses and investment for urban transport and housing for the first two assessments years.

  For year 3 — continue the 2020 Review approach of consolidating the State GG and PNFC data

- Queensland **supports** the use of State GG and PNFC data, noting that it remains the only feasible way to measure the most current assessment year to the Commission's specifications until ABS figures become available.

  Check the accuracy of the year 3 urban transport data accuracy against published information

- Queensland **supports** the Commission seeking to confirm the accuracy of urban transport data.

  Reclassify COFOG-A 1132 Urban water transport freight services from the urban transport component to non-urban transport component

- Queensland **supports** the Commission's reclassification of COFOG-A 1132 from urban transport to non-urban transport. These are like port services, which are assessed under non-urban transport.

  Ensure that the GG subsidies to V/Line are included in the non-urban transport expenses component

- Queensland **supports** the Commission in ensuring that V/Line expenses are appropriately captured in the non-urban transport, as keeping these expenses in urban transport may interfere with both the current urban transport model and future analysis on non-urban transport expenditure.

  Adjust Queensland Rail expenses to remove non-urban expenses using the ABS GFS GG and the State unit record data

- Queensland **supports** the disaggregation of Queensland Rail transport expenses using other provided data where possible to better reflect actual urban and non-urban expenditure.

  Make no adjustment to Queensland Rail user charges unless the non-urban share can be identified reliably

- Queensland **supports** the Commission's proposal to retain any unidentifiable Queensland Rail user charges in the urban transport component in absence of any reliable method to separate the two components, noting that any approach to do so would be immaterial.

  Consult with affected States before making significant changes.

- Queensland **supports** and welcomes any further consultation from the Commission regarding the changes to the adjusted budget.

10. Assessing loans under natural disaster relief expenses

Commission staff proposal:

- Commission staff propose to only assess the interest on concessional loans in the future. As a result, only the net interest expense (interest expense from state borrowings to provide concessional loans minus interest revenue collected from concessional loans) will be considered as state expense for providing these loans.
- Queensland does not borrow specifically for natural disasters. Commission staff have suggested using general government borrowings as a proxy for such a borrowing, but the interest rates on these borrowings are unlikely to be similar to the interest rate on borrowings specifically for disasters or the interest rate on interest rate subsidy schemes.

Queensland position:

- Queensland **does not support** changing the natural disaster relief expense assessment of concessional loans until an appropriate alternative method is established. For the 2021 Update, there are two at least two unresolved issues with the proposal.
- First, the proposed changes will require additional reporting on disaster relief loans from states. Only three states have provided data on loans in previous years and some states may be unable provide this information.
- Second, the appropriate interest rate required to calculate the net interest expense for providing concessional loans is the interest rate on state borrowings specific to fund concessional loans, but most states do not borrow to fund concessional loans and a proxy rate is required.
- An option is to use the interest rate on government borrowings, however:
  - Government borrowings have a different risk profile to borrowings for the provision of disaster relief loans and therefore the interest rates on these loans are likely to be different. For the same reason, interest rates on government borrowings are not comparable to the interest rates on interest rate subsidy schemes which are disaster specific. Therefore, interest expenses calculated on these rates are not consistent and cannot be compared for the Commission's assessment.
  - Interest rates on government borrowings can be interpreted and calculated in a number of ways. It can refer to the interest on general government debt, or the interest on whole of public sector debt. It can also refer to the interest on new debt or existing debt. Without specifying what interest rate is required, states will report their own interpretation of interest rate on government borrowings and they would not be consistent for cross state comparison for the purpose of the Commission's assessment.
- Finally, the proposal is unlikely to result in a material change to GST distribution.
- Queensland **recommends** the Commission establish an appropriate alternative by resolving the issues above and only implement a change to the assessment if it also has a material GST impact.

Appendix A - Advantages and disadvantages of different equalisation methods

Table 2- Advantages and disadvantages of different equalisation methods

	Equalising to the assessment year	Equalising to the application year
Advantages	• Relativities provided in the draft report rely on historical data and is consistent with the Commission's standard approach.	• Any state with relativity lower than the standard state will always be equalised to the same level as the standard state and relativity floor for the application year.
Disadvantages	• The strongest state may still have a lower application year relativity than New South Wales or Victoria, if the standard state changes over the assessment years. Can be resolved by identifying a single standard state across all assessment years. • A state that is on average weaker than the standard state and/or above the relativity floor may have their relativities increased if single years are below the relativity floor.	• Relativities provided in the draft report are based on forecast data or are subject to revisions.

<u>Equalising based on the assessment year</u>

By equalising to either the standard state or relativity floor, the Commission is able to avoid relying on forecasted data to determine application year relativities. As it stands, the Commission's current system is almost entirely historically based, and this method would seemingly align better with the current system. Further, Update reports are based on population estimates from the Australian Government's Mid-Year Economic and Fiscal Outlook (MYEFO) which is estimated more than a year before the ABS release final population figures for the corresponding application year.

However, there are several disadvantages with assessment year equalisation. One disadvantage pertains to where the standard state swaps between New South Wales and Victoria over the three assessment years. Where this happens, it could be argued that the strongest state has not been equalised to the standard state, since it would still have a lower averaged relativity than both New South Wales and Victoria. Table 2 below shows what would happen if relativities in the 2016 Update were equalised to the standard state by assessment year.

Table 3 – Example of assessment year equalisation to the standard state

	Assessment year 1 relativity	Assessment year 2 relativity	Assessment year 3 relativity	Application year relativity (i.e. 3-year averaged)
Western Australia pre-equalisation	0.37367	0.12534	0.41091	0.30330
New South Wales post-equalisation to the 'standard' state	0.87282	0.83655	**0.81868**	0.84268
Victoria post-equalisation to the 'standard' state	**0.83136**	**0.78343**	0.92834	0.84771
Western Australia post-equalisation to the 'standard' state	**0.83136**	**0.78343**	**0.81868**	0.81116

This example shows since the standard state swaps between New South Wales and Victoria during the three assessment years, Western Australia's relativity is lower than both New South Wales and Victoria in the final application year relativity. The Commission is proposing to use this method for equalising to the standard state.

Similarly, implementing the relativity floor on an assessment year basis also poses problems. As per the example in Table 3 below (based on the 2011 Update relativities and an assumed 0.7 relativity floor), a state may already be equal to or above the relativity floor in the application year, but receive the benefits for individual years being below the relativity floor. Queensland does not consider this to align with the Australian Government's intentions or to be implied in the relevant legislation.

Table 4 – assessment year equalisation to relativity floor example

	Assessment year 1 relativity	Assessment year 2 relativity	Assessment year 3 relativity	Application year relativity (i.e. 3-year averaged)
Western Australia pre-equalisation	0.75126	0.77423	0.62637	**0.71729**
Western Australia post-equalisation to the 0.7 relativity floor	0.75126	0.77423	0.70000	**0.74183**

Table 3 shows that, despite Western Australia having a relativity (0.71729) above the relativity floor of 0.7, implementing a floor on individual assessment years would further increase its relativity (0.74183). The probability of these scenarios occurring is small, but they illustrate the possibility that under this approach, a state could conceivably receive less GST than the standard the state or what is required for under a GST floor on a per capita basis. Therefore, they raise the question of whether equalising at the assessment year is in accordance with the intended legislated changes and whether states are willing to accept such outcomes.

<u>Equalising based on the application year</u>

Equalising on the bases of application is cleaner and more simplistic. It avoids the issues with equalising in the assessment years shown above and presents the Commission and stakeholders with fewer sets of relativities and calculations.

However, the key disadvantage of this approach is its reliance on forward looking estimates. This means that all GST sharing relativities estimated under this approach will be calculated on data forecasted in advance, which could present some accuracy concerns. Under this approach, the Commission will have to choose to revise its relativities after the release of its annual update report (if its permissible) or choose to allow the relativities used to distribute of GST to be based on population and GST pool estimates.