SOUTH AUSTRALIAN DEPARTMENT OF TREASURY AND FINANCE COMMENTS ON THE NEW ISSUES FOR THE 2021 UPDATE STAFF DISCUSSION PAPER (CGC 2020-01-S)

South Australia welcomes the opportunity to comment on the 2021 Update New Issues paper. Comments on each issue raised in the discussion paper are provided below.

Response to the COVID-19 pandemic

Policy changes

The COVID-19 pandemic is unprecedented and all jurisdictions have introduced policy responses with the aim of trying to minimise the spread of COVID-19. While the overall aim of policy responses have been similar, there have been variations in the policy approach and their overall impact.

For the purposes of the 2021 Update, which focuses on data to the end of 30 June 2020 only, we agree with the staff view that the actual level of economic activity and health services can be considered as a measure of the level of activity that would have occurred under a nationally consistent policy framework.

This view takes into consideration that the relevant period focuses on the States' initial response to the pandemic and the lack of availability of alternative data. This may not be the case from 2020-21, which may involve differences in policy impact and response. The Commission should consider this issue with States ahead of the 2022 Update with sufficient time to consider potential alternative approaches.

Method changes

South Australia believes that the Commission should undertake further analysis on the materiality of COVID-19 issues before the Commonwealth Treasurer issues Terms of Reference for the 2021 Update. If the analysis determines that there are no material impacts from COVID-19 related expenditure in 2019-20 then there will be no need for any modification to the methods outlined in the 2020 Review.

If the analysis determines that there are material COVID-19 impacts for the 2021 Update, any changes to the ToR should be specific in the assessment(s) that can be modified.

At this stage, the potential for material impacts have only been identified in the Health and Services to Industries assessments, although there may be future material impacts in some revenue categories. Should other COVID-19 related assessment issues emerge in the development of the 2021 Update, states and territories should be consulted on the proposed approach.

Revenue issues

Adjustments required to revenue assessment methods

South Australia supports the staff view that method adjustments are not necessary for revenue assessments in the period to 30 June 2020 and that only data adjustments to retain data comparability are required. This view reflects that there is no viable approach for adjusting for the impact of differences in the period to 30 June 2020.

The impact on periods from 2020-21, and the ability to reliably measure any potential differences should be considered further ahead of the 2022 Update.

Waivers

In South Australia, waivers have largely been provided through ex-gratia relief. Our revenue numbers will reflect the full revenue collection amount (i.e. before any waiver) with an offsetting expense relating to the ex-gratia payment. The exception to this is the JobKeeper payment exemption from payroll tax. This is a legislative exemption that exempts JobKeeper payments from consideration as taxable wages. As such, our revenue collections will be lower reflecting the reduced taxable base.

South Australia will be able to provide the necessary data to allow waivers to be offset against the relevant revenue category.

Deferrals

In South Australia, COVID-19 related deferrals will be quantified and accrued in the year in which the tax liability arose. Accordingly, revenue related to deferrals in 2019-20 will be recognised in 2019-20. The inclusion of deferred revenue in the year in which the liability arose is supported. This provides the most accurate representation of revenue raised and capacity within a particular year.

Treatment of JobKeeper payments

South Australia notes that the approach to exempting JobKeeper payments between jurisdictions is not consistent. Exempting ‘top up payments’ above an employee’s standard wages is materially different to a full exemption of JobKeeper payments.

South Australia agrees with the Commission proposal not to remove Jobkeeper payments from its payroll tax base data sourced from the Australian Bureau of Statistics (ABS).

South Australia is not able to provide accurate data on the value of JobKeeper payments excluded from the payroll tax base to allow for an adjustment to be made to the ABS reported wages. Information on the value of JobKeeper payments excluded from taxable wages is requested from taxpayers as part of the payroll tax return process, but the information is provided on a voluntary basis. We support the staff proposal not to remove JobKeeper payments from the payroll tax base.

Expense issues

South Australia supports the staff view that for the majority of expense assessments, the methods determined in the 2020 Review continue to reflect the drivers of need and are appropriate for additional expenditure in the 2021 Update.

Health

Commission staff have identified two possible approaches to the assessment of COVID-19 related health expenditure. The first approach is to use the 2020 Review Methods for all health expenditure including COVID-19 related expenditure.

The second approach is to assess COVID-19 related expenses actual per capita (APC) based on a nationally consistent expenditure recognition framework. Additional state and territory health expenditure on COVID-19 related hospital and public health activity is covered by a 50:50 cost sharing arrangement with the Commonwealth under the National Partnership on COVID-19 Response (NPCR). Relevant expenses are reported to the National Health Funding Board (NHFB) based on eligibility criteria in the NPCR. Commission staff propose that this would be the most likely data source for an APC assessment approach.

South Australia currently believes that the only appropriate assessment approach for the 2021 Update is to use the 2020 Review methods. Our Health Department has advised that at this point in time, it is not clear that the data being reported to the NHFB is being prepared on a consistent basis and is not impacted by policy differences. Some states may be including certain expenditures that other states are not including. An assessment of the policy neutrality of this data will be required before any consideration of its use as a basis for assessing COVID-19 expenditure can be determined.

Moreover, there are also future concerns about the assessment approach chosen in annual Update going forward. Health expenditure could be influenced by State policies responding to COVID-19. The actual level of health services may not be appropriate to be considered as the level of activity under a nationally consistent policy framework. The approach used in future updates will need further consideration and discussion with States and Territories.

Services to industry

South Australia supports the staff recommendation to use state budget data to recalculate the split between regulation and business development for other industries and adopt a revised split for the 2021 Update if the distribution impacts are material.

It is clear that the majority of additional state and territory industry support provided throughout the COVID-19 pandemic would fall under business development for other industries in the Services to Industry assessment. The current 53:47 split between regulation and business development will not reflect where the additional expenditure is being directed.

South Australia notes that the Commission has examined the potential drivers for a differential assessment of business development expenses in prior review processes without success. We support the staff recommendation not to attempt to introduce a differential assessment of business development as a result of the COVID-19 economic shock.

Implementation of the new HFE arrangements for 2021-22

South Australia supports the Commission's proposed presentation approach for the new GST distribution arrangements. It is important that there is a transparent presentation of the relative fiscal capacities under both the previous distribution arrangements and the new arrangements. All adjustments during the transitional arrangements and the impact of the relativity floor should be clearly shown.

We are comfortable with the calculations for the no-worse-off arrangements being presented separately as these payments are being provided from outside the GST distribution pool.

New data for the non-admitted patient component

South Australia does not support the Commission staff's proposal to use Non-Admitted Patient (NAP) National Weighted Activity Unit (NWAU) data in the 2021 Update. We consider that the data is not sufficiently robust for the Commission's purposes.

The South Australian Health Department (SA Health) has raised concerns about the quality of NAP NWAU data at the patient level, which is sourced from individual sites (local hospital networks or hospitals) and does not provide a complete picture of the services delivered at an aggregate level. There are often discrepancies in record counts between patient level data and aggregate data that is used by the Administrator of the National Health Funding Pool to determine funding entitlements under the NHRA. While SA Health is undertaking measures to improve the quality of South Australia's patient level data, this data is currently not considered fit-for-purpose.

On this basis, South Australia does not consider it appropriate to use NAP NWAU data in the 2021 Update, particularly as Commission staff propose to effectively backcast this data to all assessment years. South Australia recommends that the Commission defers use of NAP NWAUs until patient level data across all jurisdictions is sufficiently robust.

Revisions to stamp duty on conveyances and land tax data

South Australia supports the staff proposal to continue seeking data quality improvements from states and territories and seeking additional information when large prior-year revisions are made.

South Australia also supports the staff proposal to cease deducting duties from the sale of major state assets from GFS conveyance revenue, on the basis that the sale of major public assets should not be captured in the ABS GFS code utilised by the CGC.

Revised data in the wage costs assessment

South Australia notes that the Australian Bureau of Statistics (ABS) has revised the 2016-17, 2017-18 and 2018-19 Characteristics of Employment Survey (CoES) data used in the wage cost assessment and that Commission staff propose that this updated data be used in the 2021 Update.

South Australia has well documented concerns about the conceptual validity of this assessment (discussed further below). These concerns are compounded by the increasing volatility of the underlying data used in the wage cost model. Not only is there significant volatility resulting from the annual incorporation of new assessment year data, there is now significant volatility from revisions to prior year data. There is also no certainty regarding the future frequency of data revisions meaning that highly volatile movements in GST distributions could be experienced on an ad hoc basis.

For South Australia, 2017-18 relative private sector wages were revised from -4.0% to -5.6% which represents a 40% decline. The data revisions also exacerbate movements between years. South Australia's relative private wages varied from -4.0% (2017-18) to -3.4% (2018-19) below the national average private sector wages in the original data. This variability has increased to a range of -5.6% (2017-18) and -3.8% (2018-19) below national average private sector wages under the revised data. A movement of 1.8 percentage points to the national average wage level (32%) between two years is clearly absurd and not consistent with broader relative movements in private sector wage levels (eg movements in unadjusted Wage Price Index data). This volatility in the underlying data between years is evident for a number of jurisdictions.

The degree of revision from re-benchmarking state population estimates, the use of imputed data and a lack of consistency in the definition of an employee suggest that the underlying data should not be used as the basis for the wage cost assessment, or if it is, it requires a significantly larger discount.

Issues with the use of CoES data

When the Commission moved from the Survey of Education and Training to the CoES as the data source underpinning the assessment of interstate wage differentials, it noted this would improve the contemporaneity of the assessment. The trade-off, as the Commission has also acknowledged, is the greater volatility associated with the CoES. In the 2020 Review, the Commission reaffirmed its view that the three-year averaging of relativities was sufficient to address any volatility arising from using the CoES data.

South Australia does not consider a 1.6 percentage point revision (40 per cent change) to its relative private sector wages in a single year (2017-18), or a movement between years in private sector wages to the national average of 1.8 percentage points (32% between 2017-18 and 2018-19) to be an acceptable level of volatility, even with three year averaging. This volatility is not reflective of broader wage movements.

The volatility of the CoES data is one of numerous issues limiting its suitability as a reliable, policy neutral source of information on interstate wage differences. For example, the ABS's explanatory notes for the CoES advise that the survey was designed to primarily provide estimates at the Australia level, and urges caution in attempting to use data at a state level due to high sampling errors[1].

Relative standard errors (RSEs) are also very high for many of the components used in the CGC's wages model, such as earnings for the main education categories by 3-digit ANZSIC industry group, and 3-digit ANZSCO occupation, both of which contain RSEs greater than 25%[2]. Some components have RSEs greater than 50% and the ABS considered these to be too unreliable for general use.

The limitations of state level CoES data are compounded by their use in the CGC's regression model, which is highly specified with a high number of variables and categories of levels within these, but with a relatively small sample size of about 17,400. The high level of specification in the model means that the sample size restricts the number of terms that can be appropriately added to the model without producing erratic estimates.

In addition, analysis of August 2019 CoES data revealed large information gaps, with an average 17 per cent of earnings information not supplied by respondents. In some cases, up to 20 per cent of earnings information was not provided, which necessitates a high level of data imputation to maintain the sample size and reduces the reliability of the data.

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[1] 'Accuracy' section, https://www.abs.gov.au/methodologies/characteristics-employment-australia-methodology/aug-2019#explanatory-notes

[2] ABS Cat. No. 6333.0 – *Characteristics of Employment, Australia, August 2019, Tables 6.4 and 6.5.*

To highlight some of these issues on the reliability of the modelled outcomes, the results of CoES can be compared against movements in broader wage indicators. An alternative measure of employment cost changes is available from the ABS in the wage price indicator (WPI)[3] which includes state level data on private sector wage inflation, controlling for hours worked and the 'quality' of the labour.

As shown in the table below, the CoES wage increases in many jurisdictions and at the national level are much higher than the wage price index (WPI). For example, Western Australia has growth in hourly earnings under the CoES of 10.3 per cent in 2018-19 compared to growth of 1.7 per cent for the WPI, a variation of 8.6 percentage points between the two data sets. In contrast, earnings fall by 0.6 per cent in South Australia under the CoES, but increase by 2.3 per cent under the WPI (and at a similar level to the national growth rate of 2.2 per cent).

There is also a significant increase in the variation between the states minimum and maximum growth rates under between the CoES (10.9 percentage points) compared to the WPI (1.6 percentage points).

Comparison of annual % change - CoES and WPI

	CoES weighted mean hourly earnings, 2019 data update 2018-2019 annual % change	WPI annual % change from June 2018 to June 2019[a]	Difference between CoES estimated change and WPI estimated change
New South Wales	3.3	2.3	+1.0
Victoria	4.0	2.5	+1.5
Queensland	2.9	2.2	+0.7
South Australia	-0.6	2.3	-2.9
Western Australia	10.3	1.7	+8.6
Tasmania	2.7	3.0	-0.3
Northern Territory	3.0	1.6	+1.4
Australian Capital Territory	4.3	2.2	+2.1
Total or Australia	4.0	2.2	+1.8

Sources: ABS CoES Tablebuilder https://www.abs.gov.au/websitedbs/D3310114.nsf/home/About+TableBuilder and Wage Price Index, Australia, June 2020, Table 3a. Total Hourly Rates of Pay Excluding Bonuses: Private Sector by State, Original (Financial Year Index Numbers for year ended June quarter)[4]

The Commission currently applies a 12.5 per cent discount to the wage costs assessment to reflect concerns about how accurately the data captures wage costs, how accurately the regression model controls for productivity differences and how well private sector wages provide a proxy for public sector wage pressures. South Australia considers that given the issues raised

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3 https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/wage-price-index-australia/latest-release#data-download

4 https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/wage-price-index-australia/latest-release#data-download ; the annual % change 2018-19 published in June 2019 https://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/6345.0Main+Features1Jun%202019?OpenDocument

above, it warrants a significant increase in the discount applied if this data is to be retained.

The conceptual case

As discussed above, South Australia continues to hold concerns regarding the conceptual basis for the current assessment. In particular:

- The assumption that private sector wage movements in a state are a good proxy for public sector wage movements.
- Public sector wages are predominantly influenced by wage movements in local or regional labour markets.
- Comparability of public sector workers across jurisdictions.

Whilst private sector wage movements are an influence on public sector wages, this influence alone does not explain movements in the wages for the majority of public sector employees (e.g. nurses and teachers). Public sector wage movements reflect sectorial conditions in job specific labour markets (both locally and nationally) and fiscal strategies in each jurisdiction.

Regional labour market factors have some impact on public sector wages but for the majority of public sector employees, wage movements in other jurisdictions are an equally or more important factor.

Observed inter-jurisdictional wage differentials are more likely to be the result of differences in responsibilities, differences in employment status (e.g. tenure), timing differences from when pay adjustments take effect, the impact of non-wage benefits and other policy choice differences.

South Australia has previously expressed concerns about the true comparability of employees across jurisdictions. Jurisdictions with larger labour markets can offer greater and more diverse employment opportunities than smaller jurisdictions. This raises the issue that workforce compositional differences will lead to differences in the standard or quality of services provided between jurisdictions.

South Australia is still of the view that that there is sufficient uncertainty with the conceptual validity of the wage cost assessment to support the Commission reducing the distributional impact of this assessment.

In addition, there are also future concerns about the validity of the assessment approach due to the impacts of COVID-19. Significant changes have occurred in private sector industry labour markets as a result of COVID-19. Equivalent employment changes to those in the private sector (whole industry sectors have had large employment falls, with great variation across industry and occupation) have not occurred in the public sector, where there has been growth reported at the national level reflecting the increased need for public services during the pandemic.

Because of the opposite directions of the growth impacts of COVID-19 on public/private employment and the likely earnings, private sector wages cannot be seen a policy neutral proxy for relative public sector wage costs between jurisdictions.

Changes to the compilation of the adjusted budget

South Australia has no objections to Commission staff's proposed approach to deriving consolidated expenses, user charges and investment for urban transport and housing.

South Australia also notes that difficulties in classifying transport expenditure between urban and non-urban further highlights the data reliability issues inherent in the Transport assessment. This assessment is now redistributing over $1.5 billion in GST revenues and the existence of further data reliability issues supports the case for a moderation of the distribution impact through discounting.

Assessing loans under natural disaster relief expenses

South Australia supports the staff proposal to amend the natural disaster relief expense assessment of concessional loans to only assess the cost of providing the concessional interest rate and not assess the initial loan value.