Government of **Western Australia**
Department of **Treasury**

Submission to Commonwealth Grants Commission

2021 Update New Issues

October 2020

Submission to the Commonwealth Grants Commission, 2021 Update New Issues

Further information relating to this report may be obtained by emailing igr@treasury.wa.gov.au

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KEY POINTS

Response to the COVID-19 pandemic

- We consider that States' policies and efficiencies significantly differ in responding to COVID-19.
  - The Commonwealth Grants Commission (CGC) should adjust down the revenue bases of States such as Western Australia, whose policies and efficiencies have reduced the economic damage from COVID-19 relative to the national average.
  - Health COVID-19 expenses should be assessed as part of the existing health assessments, rather than actual per capita.
- We agree with the proposed accounting treatment of waivers, rebates and deferrals.
- We agree with the CGC staff that the materiality of re-estimating the regulation/business development expenses split should be tested and that, if material, changes to this split should only impact the 'other industries' group.
- The impact of COVID-19 on public transport passenger numbers has implications for the urban transport assessment in the next method review.
- We agree with the CGC staff that an amended terms of reference for the 2021 Update is needed if the CGC is to make any method changes to account for COVID-19.

Implementation of the new HFE arrangements for 2021-22

- In order to increase transparency for the public, we request that the CGC develop a glossary of terms relating to horizontal fiscal equalisation (HFE) reform.

New data for the non-admitted patient component

- The CGC should apply the 2018-19 admitted patients remoteness adjustments to the 2018-19 non-admitted patients' data.

Revisions to stamp duty on conveyances and land tax data

- We support the CGC staff proposals to continue investigations on improving the data provided by States for stamp duty on conveyances and land tax.

Revised data in the wage costs assessment

- We agree with the CGC staff proposal to use revised Australian Bureau of Statistics (ABS) Characteristics of Employment survey (CoES) data.

Changes to the compilation of the adjusted budget

- We currently have no comments on this.

Assessing loans under natural disaster relief expenses

- We have no in-principle concerns with changing the treatment of concessional loans, but are concerned that materiality is not being tested.

Introduction

This submission responds to the CGC's discussion paper CGC 2020-01-S, which consults on new issues for the 2021 Update.

Response to the COVID-19 pandemic

Policy differences

CGC staff have expressed the view that differences in States' and Territories' (States') responses to COVID-19 reflect their differing circumstances, but there are no significant policy differences in their responses.

We do not agree with this assumption. Further, we note that the principle of HFE requires assessments based on the same efficiency across States. This also cannot be assumed.

We do not claim that all differences in the prevalence of COVID-19 are due to differences in State policies and/or efficiency. However, as discussed below, the CGC should recognise that observed spending and revenue bases are significantly affected by State policy influences.

Western Australia's Policies

We acknowledge the diverse impact that the COVID-19 pandemic has had on States, by reason of controllable (e.g. lockdowns, border restrictions) and uncontrollable, external influences.

In Western Australia, measures have been enforced through effective government-supervised quarantining directives for international arrivals; isolation measures for interstate arrivals; and highly mobile police patrols for minor border crossings and permanent checkpoints operating continuously at major border crossings. There are harsh penalties imposed on individuals in breach of COVID-19 guidelines.

Western Australia's ability to contain the disease in the community to a controllable level enabled the State to ease restrictions on 27 April 2020, under the first phase of the State's roadmap to recovery. Moreover, Western Australia was among the first, with Queensland and the Northern Territory, to ease restrictions under Phase 2, announced on 18 May 2020, which allowed a general return to work unless unwell or vulnerable, as well as partially relaxing Western Australia's regional restrictions. Phase 3, which allowed for the resumption of seated service at food businesses, re-opened most public services and further relaxed regional restrictions, commenced on 6 June 2020, and Phase 4 of the roadmap, permitting gatherings limited by the reduced 2sqm rule and major events, came into effect on 27 June 2020.

To the same extent that Australia has (overall) been able to respond swiftly by closing international borders, so has Western Australia taken a precautionary approach to prevent the importation of the virus from other States. As part of its suppression strategy, the State government has indicated its preference for imposing hard border closures rather than enforcing extended business shutdowns.

A key policy difference for Western Australia was the imposition of regional (i.e. intrastate) 'border' controls on 31 March 2020. This was designed to 'quarantine' any outbreaks to smaller regions for more effective testing and control. Due to their vulnerability, remote Aboriginal communities were classified as a 'region' and were subject to greater travel restrictions.

Through effective stay-at-home directives and strict regional and interstate border controls, which came into effect on 5 April 2020, the Western Australian Government was able to restrain non-essential travel arrangements.

The approach to, and cautious easing of, restrictions has enabled a process to re-start the State's economy and facilitate Western Australians' return to near-normal life.

The Western Australian Government worked very closely with the mining industry at the start of the pandemic to ensure that the industry was effectively quarantined, but at the same time was able to have the flow of workers required to keep it operating. This included designating mining as an essential industry, and initially exempting mining employees travelling from other States from quarantining arrangements and later encouraging interstate employees and their families to move to Western Australia.

The Western Australian mining industry has continued to operate effectively to provide the necessary support to the Australian economy.[1]

The Secretary of the Federal Treasury, Dr Steven Kennedy, said at Senate Hearings:[2]

"For example, Western Australia, I think, deemed mining an essential service in the sense in which they were imposing their restrictions. These were important, carefully calibrated decisions. Mining represents 10 per cent of gross value added of the Australian economy and three per cent of employment. As long as the health risks are well managed in what's a reasonably low employment environment that's a very important economic flow."

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[1] Cholteeva, Y. (1 July 2020). *"Timeline: How Australian mining reacted during Covid-19."* Online at: https:/www.mining-technology.com/features/timeline-how-australian-mining-reacted-during-covid-19/;
Purnell, K. (30 July 2020). *"WA grows share of mining jobs despite COVID".* Online at: *The West Australian.*

[2] Senate Select Committee on COVID-19 (28 April 2020), *Australian Government's response to the COVID-19 pandemic* at https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22committees%2Fcommsen%2F422cff82-46f7-404d-9ca7-c83f558e9551%2F0001%22;src1=sm1

With the aim of supporting employment in the residential construction industry, the Western Australian Government is providing a $20,000 grant to eligible buyers that enter into contracts between 4 June 2020 and 31 December 2020 to construct new residential dwellings. These grants (the Building Bonus) are available to all persons (first home buyer, investor, owner occupier, foreigner, etc.) and no value cap is applied. The Building Bonus is in addition to the $10,000 First Home Owner Grant (for eligible buyers) and the Commonwealth's $25,000 HomeBuilder grant. The Building Bonus scheme is estimated to cost around $147 million.

- The result has been to emphatically ramp up the preparation and sale of land, and a substantial turn-around in residential construction.
  - In the four months since the announcement of the construction grants, Western Australian weekly lands sales have been around three times higher than the twelve months prior to COVID-19 (March 2019 to February 2020), prompting a very large ramp-up of work for developers and the civil-construction sector, and for some builders to close their books to new orders due to high levels of demand.
- Currently, only Tasmania and Queensland are providing additional building grants, aside from their First Home Owner Grants, but these grants are less generous than Western Australia's Building Bonus.
  - The Tasmanian $20,000 HomeBuilder grant has the same eligibility criteria as the Commonwealth's grant, but is not available if Tasmania's First Home Owner Grant has been paid, or is payable, for the same transaction.
  - The Queensland $5,000 Regional Home Building Boost grant, as the name suggests, is only available for new builds in regional Queensland and is not available to foreigners or investors.

Variation in State Policies and Efficiency

The CGC staff view that there are no significant policy differences among States also appears questionable in light of comments by Federal leadership.

Recently, the Reserve Bank of Australia Deputy Governor, Guy Debelle, has singled out Western Australia's economic performance and its contribution to national growth.[3]

Although we imply no judgment on Victoria's situation, that State has drawn sharp rebuke from the Federal Treasurer for failing to uphold quarantining standards and contact tracing protocols.[4] His statements imply that Victoria has operated below national average efficiency.

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[3] Ison, S. (22 September 2020). *"WA leads Australia's COVID-19 economic recovery, says Reserve Bank of Australia Deputy Governor Guy Debelle."* Online at: [The West Australian.]

[4] Coorey, P. (31 August 2020). *"PM ramps up pressure on reopening of borders".* Online at: [Australian Financial Review.]

The Prime Minister has also been arguing publicly that Western Australia should relax its border controls, putting forward New South Wales as best practice in tolerating some COVID-19 transmission.[5] While we remain silent about which policy is the best, we agree with the Prime Minister that there are significant differences among the States in their policies.

The CGC suggests that differences in State approaches do not inherently imply different State policies, just the implementation responses to differing circumstances.[6] However, we argue that different policies and efficiencies are large drivers of those different circumstances.

- The CGC concludes that the actual level of economic activity and health services is the best measure under consistent policy across States. Our evidence above suggests this is not valid. Below, under discussion of revenue and expense issues, we suggest the CGC consider reducing relevant States' revenue bases and argue against an actual per capita assessment of COVID-19 expenses.

Method changes

We agree with the CGC staff that an amended terms of reference for the 2021 Update is needed if the CGC were to make method changes to account for COVID-19. However, the onus lies on the Commission to verify that its method recommendations are demonstrably and transparently policy neutral.

Revenue issues

As discussed above, we consider that there are differences among the States' policies and efficiencies in responding to COVID-19. We expect those differences will significantly influence State tax bases, including making Western Australia's (and possibly some other States') revenue bases higher than they would have been had they adopted national average COVID-19 policies and efficiencies.

We propose that the CGC reduce relevant States' revenue bases by some percentage (equivalently, the CGC could increase the remaining States' revenue bases by that percentage). Although judgement would be required in determining the appropriate percentage, the CGC could inform this judgement by comparing the percentage write-down in States' revenues since their 2019-20 mid-year reviews.

If the CGC is not prepared to do this, we believe that it should clearly state in its 2021 Update report that there are policy differences on the observed revenue bases, which it has been unable to remove.

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[5] Cockburn, P. (8 September 2020). *"NSW is the 'gold standard' for COVID-19 management according to the PM — here's why".* Online at: *ABC news*.

[6] Commonwealth Grants Commission (2020), *2021 Update, New Issues for the 2021 Update, Staff Discussion Paper CGC 2020-01-S*, page 2, paragraph 9.

We agree with the proposed treatment of waivers, rebates and deferrals for the 2019-20 year. However, if deferrals are to be assessed in the year in which the liability occurs, the CGC should clarify the treatment of deferred tax payments that do not eventuate because the taxpayer becomes insolvent.

Expense issues – health

We believe that COVID-19 health expenses in 2019-20 are too influenced by differences in States' policies and efficiency to be assessed actual per capita. Hence, they should be assessed as part of the existing health assessments.

Policy Neutrality

Number of COVID-19 cases

As discussed above, we do not believe that the CGC can assume that differences across States in the number of COVID-19 cases reflect average State policies and efficiencies.

Cost per COVID-19 case

Table 1 demonstrates that funding under the NPCR varies substantially across States and does not appear to be directly linked to the number of cases in each State. Likewise, the cost per case differs greatly in each State, from $0.16 million per case in the Northern Territory up to $1.44 million per case in the ACT, thereby implying large policy or efficiency differences between States. The variation is not restricted to smaller population States, with Victoria receiving more NPCR funding than New South Wales by 30 June 2019, despite only having two-thirds as many cases in that year.

Table 1

2019-20 COVID-19 Health Response

	NSW	VIC	QLD	WA	SA	TAS	NT	ACT	Total
COVID-19 cases by 30 June 2020	3,189	2,159	1,067	611	443	228	108	29	7,834
National Partnership on COVID-19 Response funding ($m)	1,074	1,097	345	188	115	75	18	42	2,955
Commonwealth funding per COVID-19 case ($m/case)	0.34	0.51	0.32	0.31	0.26	0.33	0.16	1.44	0.38

Source: 2019-20 Commonwealth Payments, GovTEAMS report

The large variance between the number of cases and funding for COVID-19 reflects that the majority of COVID-19 health expenses are not directly related to cases, but rather include non-clinical costs such as cleaning of hospitals and schools, additional costs for public health communications, and investment in stocks of PPE. Given there is no clear driver of these costs, these expenses appear to be too influenced by policy for the proposed actual per capita assessment of COVID-19 related expenses to be appropriate.

The existing health assessment is appropriate to assess COVID-19 related health expenses. Any resultant changes to the average socio-demographic profile of hospital users will be captured by the current assessment, in particular the use rate of hospital services by the elderly will be increased. The differential incidence in the number of COVID-19 cases across States results at least partly from policy differences, as discussed above, which help form the standard of 'what States do' in the existing health assessment.

Intertemporal issues

At the multilateral meeting between CGC staff and State Treasuries on COVID-19 of 29 July 2020, one State indicated that it had built up a large inventory of PPE. Its intention was to maintain high stock levels. These stocks levels were not intended to be run down over several years; rather, this is a shift in its desired PPE stock levels. This illustrates not only that States' spending is policy influenced, but that spending associated with COVID-19 can in practice offset spending in other years that would not be associated with COVID-19.

Expense issues – services to industry

We agree with the CGC staff that the materiality of re-estimating the regulation/business development expenses split should be tested. In addition, we agree that any change to the split between regulation and business development expenses, if found to be material, should only impact the 'other industries' group, not mining or agriculture.

Expense issues – urban transport

In our submissions to the 2020 Review, we argued that the number of passengers using public transport is not an appropriate proxy for supply of public transport. Rather, available capacity of public transport reflects quantity supplied. We also argued against using regression analysis for recurrent expenditure to assess the capital requirements for public transport.

The COVID-19 pandemic resulted in significant changes in public transport passenger use. Although there was a reduction in some public transport services, for example cancellation of late-night trains, the quantity of public transport passengers decreased substantially more than the decrease in the quantity supplied (as measured by the capacity of trains and buses operating at the time). This is evident by trains and buses clearly operating significantly below full capacity.

The CGC justifies using passenger numbers as a proxy for supply by assuming an equilibrium condition, where theoretically, quantity demanded should equal quantity supplied. However, the COVID-19 pandemic supported Western Australia's thinking that equilibrium in the public transport sector is not a realistic assumption. This is also evident in "dead runs" and inability to expand infrastructure incrementally, as well as inability to expand or contract infrastructure at will without a time lag.

The COVID-19 pandemic further illustrates why the recurrent assessment is not the best indicator of future public transport capital needs. Under current assumptions and proxies, the quantity supplied decreased significantly (as proxied by a reduction in the number of passengers). However, applying the coefficients from the recurrent regression analysis to the capital public transport assessment leads to positive investment needs. This seems counter intuitive.

Although we realise this is more pertinent to the next review, we thought it prudent to draw the CGC's attention to the implications of COVID-19 for the underlying assumptions of the transport assessment method.

Implementation of the new HFE arrangements for 2021-22

We suggest that it would be helpful for the CGC to develop and make public a glossary of terms relevant to HFE reform. This would increase transparency by allowing better public understanding. In particular, a potentially confusing term is the CGC's "relative fiscal capacities", as an increase in a State's fiscal strength corresponds to a decrease in its "relative fiscal capacity".

Otherwise, we are happy with the presentation proposed in the discussion paper.

New data for the non-admitted patient component

The CGC staff propose that, commencing with the 2021 Update, the CGC use non-admitted patients (NAP) total national weighted activity unit (NWAU) data from the Independent Hospital Pricing Authority (IHPA), with regional cost and service delivery scale adjustments. This will replace its existing proxy derived from admitted patient (AP) separations data.

Only 2018-19 NAP NWAU data will be available for the 2021 Update, so CGC staff propose it be used for all three data years. For future updates, CGC staff propose replacing the 2018-19 NAP NWAU data in each year that new data becomes available.

We agree with using the NAP NWAU data. We also agree with CGC staff proposals to scale up the patient level NWAU data to match aggregate NWAU data, and to allocate the user profile of a hospital in the same remoteness region and with the same funding type.

However, the problem is that IHPA will not adjust 2018-19 NAP NWAU for any remoteness loadings, although these adjustments will be made from 2019-20 onwards. We propose that the CGC make remoteness adjustments to the 2018-19 NAP NWAU.

According to the CGC:[7]

"While this will mean spending in remote areas for high cost groups may be understated in the 2021 Update, it will partially offset the overestimation of spending in recent updates. In the 2022 Update the 2019-20 NAP NWAU data with remoteness adjustments will be used for two of the three assessment years."

We do not agree that apparent historical overestimation as a result of using a proxy variable (which was used due to the absence of reliable data) should be offset by a deliberate underestimation in the future.

- It is not standard practice for the CGC to offset past over- or underestimations by deliberate future under- or overestimations.
- The apparent 2018-19 NAP proxy overestimation is halved if the 2018-19 NAP NWAU's are correctly adjusted for remoteness.

There is a clear and proven case for remoteness adjustments to AP data, emergency department data and NAP data. This is also reflected in the remoteness adjustments from 2019-20 onwards.

- There is no reason to expect additional remoteness costs for NAP to increase from zero in 2018-19 to around 40% in 2019-20 for very remote patients, especially since there are only small changes in additional remoteness costs for AP between 2018-19 and 2019-20.
- The 2019-20 and 2020-21 remoteness cost adjustments for AP and NAP are exactly the same by patient address and hospital address for each remoteness classification. There is no reason to expect that additional remoteness costs for AP and NAP were significantly different from each other before 2019-20.

We have two proposals to ensure consistency and account for a well-established remoteness disability in the NAP assessment:

1. apply 2018-19 AP remoteness adjustments for NAP, in all data years when the 2018-19 NAP NWAU data are used; or
2. use 2017-18 AP remoteness adjustments for NAP, when 2018-19 NAP NWAU data are used as a proxy in the 2017-18 data year, 2018-19 AP remoteness adjustments for NAP when 2018-19 NAP NWAU data are used in the 2018-19 data year, and 2019-20 AP remoteness adjustments for NAP when 2018-19 NAP NWAU data are used as a proxy in the 2019-20 data year.

Table 2 shows the current CGC proposed remoteness adjustments, and two more appropriate alternative proposals from Western Australia, as indicated by the bold numbers.

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7 Commonwealth Grants Commission (2020), *2021 Update, New Issues for the 2021 Update, Staff Discussion Paper CGC 2020-01-S*, page 19, paragraph 90.

We prefer Proposal 1 because it would ensure consistency with 2018-19 data, especially since the CGC staff intend using 2018-19 data as a proxy for the other years.

Table 2

Remoteness adjustments

	2017-18	2018-19	2019-20	2020-21
Admitted patients				
By patient address				
Outer regional	8	8	8	8
Remote	20	25	27	27
Very remote	25	29	29	30
By hospital address				
Remote	-	8	8	7
Very remote	-	12	10	14
Non-admitted patients – CGC proposal				
By patient address				
Outer regional	-	-	8	8
Remote	-	-	27	27
Very remote	-	-	29	30
By hospital address				
Remote	-	-	8	7
Very remote	-	-	10	14
Non-admitted patients – WA Proposal 1 [(a)]				
By patient address				
Outer regional	**8**	**8**	8	8
Remote	**25**	**25**	27	27
Very remote	**29**	**29**	29	30
By hospital address				
Remote	**8**	**8**	8	7
Very remote	**12**	**12**	10	14
Non-admitted patients – WA Proposal 2				
By patient address				
Outer regional	**8**	**8**	8	8
Remote	**20**	**25**	27	27
Very remote	**25**	**29**	29	30
By hospital address				
Remote	**-**	**8**	8	7
Very remote	**-**	**12**	10	14

Source: Data from Commonwealth Grants Commission (2020), *2021 Update, New Issues for the 2021 Update, Staff Discussion Paper CGC 2020-01-S, Table 3, page 13.*

(a) The 2018-19 AP remoteness loadings would also be used when 2018-19 NAP NWAU data are used in the 2019-20 data year (in just the 2021 Update).

Revisions to stamp duty on conveyances and land tax data

We support the CGC staff proposals to continue investigations on improving the data provided by States for stamp duty on conveyances and land tax.

We will continue to work with CGC staff to improve the data we provide. However, we note that difficulties will continue given our State revenue office (RevenueWA) systems are designed for different purposes to the CGC's requirements. Nevertheless, we are hoping the work undertaken by RevenueWA in last year's data request (which resulted in significant data revisions) will have mitigated these issues and the data will closer align to CGC requirements, without large revisions in future annual updates.

Revised data in the wage costs assessment

We agree with the CGC staff proposal to use revised ABS CoES data in the calculation of wages costs for 2016-17 and 2017-18. We agree that this would be in line with the usual terms of reference direction to use the latest available data. In addition, the ABS must consider the revised data to be better quality (i.e. more accurate), otherwise it would not have undertaken the revision.

As the ABS intends to alter the current CoES release, we recommend the CGC confirm with the ABS the most appropriate indicators for the CGC wages assessment purposes, that depict States' wage cost pressures most reliably. Western Australia has argued for some time that CoES data, and the regression method used by the CGC, do not correctly reflect State wages differences.[8] It is worthwhile to note that the revised ABS CoES data moves the results of the wages assessment closer to other ABS wage indicators (Average Weekly Earnings and Wage Price Index) and closer to an outcome consistent with our observations and understanding of State circumstances.

Changes to the composition of the adjusted budget

We currently have no comments on this.

[8] We stand by our proposal that the CGC should replace the wages regression model with a private AWE indicator, structurally adjusted for industry differences, as described in our submissions to the 2020 Review.

Assessing loans under natural disaster relief expenses

The CGC staff are proposing to only assess the cost of providing the concessional interest rate on loans instead of assessing the initial loan value itself.

We have no in-principle concerns with this proposal. However, we consider that the natural disasters data request has become increasingly onerous for the relevant State agencies, considering the small impact that net cost of concessional loans has on the assessment.

In addition, we are concerned that in making this correction, the materiality is not considered. This is inconsistent, for example, with the CGC 2020 Review decision in the Housing assessment to reject scaling the Census data with AIHW data, due to a lack of materiality from the change, despite the data being more accurate.