COMMONWEALTH GRANTS COMMISSION 2022 UPDATE OF GST REVENUE SHARING RELATIVITIES

NEW ISSUES PAPER

ACT Government submission

ACT GOVERNMENT SUBMISSION

NOVEMBER 2021

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Contents

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INTRODUCTION

The Commonwealth Grants Commission (CGC) has released Staff Discussion Paper CGC 2021-01-S, New Issues for the 2022 Update.

The ACT welcomes the opportunity to comment on the issues and recommendations outlined in the paper. These issues and recommendations have been prepared in the absence of the Terms of Reference (ToR) for the 2022 Update.

The ACT supports most CGC staff recommendations for the 2022 Update. Regarding health-related assessments, the ACT acknowledges that COVID-19 has created difficulties in making these assessments. Recognising practicality and data limitations, the ACT considers that the current arrangements for health expense assessments should remain in place.

However, the ACT does not support CGC staff proposal to boost the single-year relativities to zero from a negative value at the expense of jurisdictions where this is not a consideration in any given year.

The ACT's comments on each issue and recommendation are provided in the following sections.

ISSUES FOR THE 2022 UPDATE

RESPONSE TO THE COVID-19 PANDEMIC

Background

The COVID-19 pandemic has resulted in large disruptions to economic activity and people movement across Australia and the world since March 2020 from the implementation of health restrictions to supress community transmission.

In response the pandemic Commonwealth, state and territory governments have provided significant support through public investment, direct support to households and businesses and adjustments to taxes and levies in order to reduce the burden of government charges.

These responses, however, have varied between jurisdictions, as has the overall impact of the COVID-19 pandemic. The latest Delta outbreaks have seen extended lockdowns in New South Wales, Victoria, and the ACT in particular. Consequently, COVID-19 has created differences in the fiscal capacities of the states and territories that otherwise would not be present. This is driven by differences in the impact to economic activity and demands on jurisdictional health systems.

Commonwealth Grants Commission Staff Position

The CGC observes the different experiences in relation to COVID-19 and the subsequent variation in policy responses across jurisdictions. Based on the most recent available measures, the CGC observe that Victoria experienced the greatest economic slowdown between 2019-20 and 2020-21 largely due to the extended COVID-19 lockdowns, followed by New South Wales.

The CGC, under its Terms of Reference for recent Updates, can change its assessment methods in response to data problems or significant changes in arrangements which govern Commonwealth-State relations. While many of the impacts of COVID-19 will be captured by the methods established by the 2020 Review, it is possible that some impacts would not be recognised by these methods.

As the 2022 Update depends on data from financial years 2018-19, 2019-20 and 2020-21, only differences in the impact of COVID-19 between the states and territories up to and including 30 June 2021 are relevant for the CGC's purposes. This reflects 16 months of the assessment period affected by COVID-19 developments. Crucially, CGC staff note that the 2022 health assessment will only include data up to June 2020 as latest year of health data is not available in time for the CGC's annual update processes.

ACT Position

The ACT shares the view that the length and severity of the lockdowns in 2020-21, along with the policy responses, are likely to have had different effects on the size of states' revenue bases in 2020-21 and hence states' fiscal capacities. The ACT notes that health assessments in the 2022 Update will not include health data for the 2020-21 financial year due to data being unavailable in time for the CGC's annual update processes.

It is important to note that the impact of policy responses to the recent lockdowns are generally not relevant to the 2022 Update, which only considers data from 2018-19 to 2020-21. The ACT observes that this issue must be reconsidered by the CGC and the states and territories for the 2023 and 2024 Updates as data from 2021-22 enters the assessment years (and possibly future Reviews or Updates depending on the duration of the pandemic). The recent extended lockdowns in New South Wales, Victoria, and the ACT, which were lifted in October 2021, are likely to have substantially affected revenue bases in these three jurisdictions.

REVENUE ASSESSMENTS COULD FOLLOW THE SAME APPROACH AS FOR THE 2021 UPDATE

Background

The CGC, in the 2021 Update, concluded that state revenue policy responses to the economic impact of COVID-19 in the 2019-20 assessment year were broadly comparable, and that any differences primarily reflected variation in states' circumstances, rather than differences in policy settings. This meant that the revenue assessments undertaken in the 2021 Update would largely capture the pandemic's effects on state revenue raising capacity.

Commonwealth Grants Commission Staff Position

CGC staff consider that revenue assessments could follow the same approach as for the 2021 Update, as the approach would remain appropriate to capture the pandemic's effects on state revenue raising capacity.

CGC staff propose to treat tax waivers, rebates, tax deferrals and JobKeeper payments using the same approach as for the 2021 Update. CGC staff note that a reliable adjustment for JobKeeper payments cannot be made to the payroll tax assessment in the 2022 Update.

In addition, CGC staff propose to make no adjustment to revenue bases for any differences in state policy responses to COVID-19 as the effect of COVID-19 on revenue bases resulted from divergences from average policy or from circumstances beyond a state's control cannot be reliably measured.

ACT Position

In relation to the revenue assessments, the ACT supports the CGC staff recommendation to treat tax waivers, rebates, tax deferrals and JobKeeper payments using the same approach as for the 2021 Update - treating revenue waivers as lower effective tax rates for the relevant assessment categories and revenue rebates as an offset against the revenue category, while assessing deferred revenue in the year that the liability arose and including all job keeper payments in the payroll tax base for all states.

Consistent with the ACT's view outlined in the 2021 Update, treating rebates and waivers in this way would result in consistent treatment by the CGC of the two revenue measures employed in response to COVID-19 by the states and territories. Assessing deferred revenue in the year that the liability arose also implies an accrual approach to the deferred revenue, which is consistent with the approach prescribed by the International Monetary Fund GFS Manual.

The ACT agrees with CGC staff suggestion that an adjustment to the payroll tax base to account for JobKeeper would be immaterial considering the features of JobKeeper payment. The inclusion of all the payments in the payroll tax base at least treats the payments for all states on the same basis and is consistent with the CGC's standard approach to the assessment of taxes which are not applied in all states. The ACT understands that there are no reliable datasets that could be used to adjust states payroll tax bases for JobKeeper payments.

The ACT also supports the CGC staff recommendation to make no adjustment to revenue bases for any differences in state policy responses to COVID-19. The ACT recognises that there is no reliable and practical method for identifying and measuring the effect of divergence from average policy in response to COVID-19 on revenue bases separated from circumstances beyond a state's control.

NEW DEVELOPMENTS IN EXPENSE ASSESSMENTS

Background

The CGC notes that there have been several developments in the expense assessments since the 2021 Update, partly due to more information relevant for the 2022 Update becoming available - particularly with which to measure the impact of COVID-19 on state expenditure needs.

Of note, the 2022 Update will be the first time National Weighted Activity Units (NWAU) data for 2019-20 are incorporated into the health assessments. This data will partially reflect the impact of COVID-19 on hospital activity. In addition, the Characteristics of Employment Survey (COES) data for August 2020 are available for incorporation into the wage cost assessment for the 2022 Update.

Health Expense assessments

Commonwealth Grants Commission Staff Position

CGC staff note that the 2022 Update will be the first time that the impacts of COVID-19 on hospital activity will be incorporated into the health assessment following the availability of NWAU data for 2019-20, which covers the first four months of the pandemic in Australia, provided by the Independent Hospital Pricing Authority (IHPA).

IHPA data shows that there was a decline in hospital activity for all components in 2019-20, partly due to restrictions on some hospital services, alongside measures to support social distancing and changes in community behaviour, which contributed to a less severe flu season. The most recent data published by the Australia Institute of Health and Welfare (AIHW) shows an increase in service utilisation up to the first quarter of 2021 provided through Medical Benefits Scheme (MBS) and Pharmaceutical Benefits Scheme (PBS), largely due to the introduction of a telehealth option for consultations[1]. CGC Staff expect a similar increase in hospital activity in the June quarter 2021 because of higher service use and costs (due to the increased need for protective gear and higher standards of hygiene and cleaning). CGC Staff also anticipate an increase in public health expenses for testing, contact tracing and vaccination.

CGC Staff have requested access to preliminary NWAU data from IHPA for 2020-21 that will include one full year of data influenced by COVID-19. This data may be available in December 2021 or early in 2022.

In relation to the distribution of Commonwealth funding under the National Partnership on COVID-19 Response, CGC staff note the data indicates there some differential health spending of the states in response to the pandemic, with New South Wales and Victoria received more funding under the national partnership than their population shares.

ACT Position

The ACT considers that existing health assessment methods should be applied to COVID-19 expenditures in the CGC's assessment. In the absence of available data, it is difficult to provide justification for alternative approaches.

Spending on Services to Industry

Commonwealth Grants Commission Staff Position

The CGC notes that based on data provided by states there was a large increase in state spending on services to industry in 2019-20. The increase most likely reflected business development measures, rather than regulatory changes, as states sought to help their industries deal with the restrictions caused by the pandemic.

In the 2021 Update, the CGC treated the assessments of spending on services to industry using the splits of spending on regulation and business development as part of the 2020 Review as states have different views on whether changing the splits is a method change or a data change. A change in methodology was not an option for the 2021 Update.

As states' spending on services to industry is likely to remain high in 2020-21, CGC staff are seeking views from states whether to change the splits to accurately reflect the composition of spending on services to industry.

[1] Impacts of COVID-19 on Medicare Benefits Scheme and Pharmaceutical Benefits Scheme: quarterly data, 14 September 2021

ACT Position

The ACT supports the CGC staff proposal to change the splits. The COVID-19 pandemic has seen significant increases in business development expenses and a change in the splits would be necessary to capture this effect.

In the 2020 Review the split between regulation and business development expenses was based on state data from 2015-16 to 2018-19 on business development expenses, with regulation expenses being calculated as residuals in the GFS once the state provided business development expenses have been deducted.

While this may have justification if the split of expenditure that states and territories provided for the two categories remained stable, the significant increase in business development expenses in response to COVID-19 means that the 2020 Review splits are likely outdated and will not capture the reality of spending in the assessment years for the 2022 Update and likely future Updates.

The ACT considers changing the splits of spending on regulation and business development to be a data update, and not a change to the assessment method. A change in the split should be based on the latest data and would not change how each part of the services to industry assessment is assessed. The ACT notes that it is critical for the CGC to obtain updated data from the states in time to undertake this adjustment.

WAGE COSTS ASSESSMENT

Commonwealth Grants Commission Staff Position

The wage costs assessment is based on the Characteristics of Employment Survey (COES) data, collected in August each year.

The COES August 2020 results shows six per cent of the respondents earned exactly $750 per week which likely reflects employees who received the $1500 per fortnight JobKeeper supplement (before the payments were reduced in September 2020).

CGC Staff propose to remove employees earning $750 per week from the data used in the wage costs regression model and note this represents a data adjustment instead of a change to the methodology adopted in the 2020 Review. CGC staff will perform relevant statistical tests on this in December 2021 and will share the findings with states along with the final regression results and estimates of state wage cost factors.

ACT Position

The ACT agrees with CGC staff that the 6 per cent of COES respondents earning exactly $750 per week in August 2020 likely represents employees receiving the $1500 per fortnight JobKeeper supplement (before the payments were reduced in September).

The ACT supports the CGC staff recommendation to remove employees earning $750 per week reported in the August 2020 COES results from the data used in the wage costs regression model. The ACT considers that this recommendation does not represent a methodological change adopted in the 2020 Review. We consider that earnings from these employees does not reflect real wage cost pressure and including these employees may affect the state coefficients resulted from the regression model.

The ACT notes that the opportunity for states to review and comment on the finding of the statistical tests and final regression results as well as estimates of wage cost factors, once they are available, would be welcome.

NEW WESTERN AUSTRALIAN NATIVE TITLE AGREEMENTS

Commonwealth Grants Commission Staff Position

In 2020-21, Western Australia commenced compensation payments in relation to the South-West Native Title Agreement and the Yamatji Nations Indigenous Land Use Agreement with a total cost of $1 billion to be paid over 15 years.

CGC staff recommend assessing Western Australia's expenses relating to the two Agreements in the year they are paid as opposed to Western Australia's proposal for these expenses to be assessed fully in 2020-21 assessment year. This is to ensure the alignment with how state expenses reported in GFS data.

ACT Position

The ACT supports the CGC staff proposal to assess Western Australia's expenses relating to the South-West Native Title Agreement and the Yamatji Nation Indigenous Land Use Agreement in the year they are paid. This treatment is consistent with the approach applied by the ABS to record the payments in GFS data, which CGC rely on for its assessments in the first two assessment years.

IMPLICATIONS IF A STATE'S ASSESSED REVENUES EXCEED ITS ASSESSED EXPENDITURES

Background

If a state's assessed revenues exceed its assessed expenditure, its assessed GST requirement is negative, meaning its assessed relativity is also negative.

If there is a negative relativity in any assessment year, CGC staff consider it appropriate to increase that relativity to zero.

CGC staff propose to use a similar method to achieve this increase as that used to transition a state's relativity to the relativity of the standard state under the new GST distribution arrangements - lifting the affected state's relativity to zero and lowering the relativities of the other states on a population basis.

CGC staff note that while the new arrangements ensure this will not affect GST relativities, if the situation arises it would impact the no worse off guarantee relativities.

Commonwealth Grants Commission Staff Position

The CGC recommend lifting the affected state's annual relativity to zero and share the cost of doing this among the other states on a population basis.

ACT Position

The ACT does not support CGC staff proposal to lift the affected state's annual relativity from negative to zero.

The ACT notes that a negative relativity is likely to only effect a single assessment year, hence the average relativity that is used for the GST distribution will likely remain positive. Thus, lifting the negative relativity for that assessment year to zero will only increase the average relativity of the affected state or territory. Moreover, the GST relativity floor of 0.7 introduced by the new GST arrangements will take effect in 2022-23. Thus, a state with a negative assessed relativity will not be adversely affected, as it will be guaranteed the floor relativity of 0.7.

Further, the coupling of the GST relativity floor and the no worse off guarantee in place from 2021-22 to 2026-27 implies that lifting the negative relativity to zero will only reduce the difference in the relativity that will be used to distribute the GST in 2022-23, compared to what the relativity would have been under the old arrangements. This would reduce the support provided by the Commonwealth to the states and territories adversely affected by the new arrangements under the no worse off guarantee, with no additional GST granted to the beneficiaries of the new arrangements. Importantly, this would also reduce transparency for the public.

NEW ACCOUNTING STANDARDS

Background

The recent changes to the Australian Accounting Standards, namely Australian Accounting Standard Board (AASB) 16 *Leases* and AASB 1059 *Service Concession Arrangements*, will affect the data flowing into the Capital assessments as some previously recurrent transactions will now be treated as capital transactions. This will increase the value of asset stock and investment reported by states and decrease recurrent spending. The AASB 16 came into effect for periods beginning on or after 1 January 2019 and the AASB 1059 came into effect in the 2020-21 financial year.

The ABS regards these changes as inconsistent with its national accounts standards and will not incorporate these changes into its GFS data. The ABS removes the effect of the new standards from data received from states to produce GFS data. As the investment and net borrowing assessments use data from both the ABS and states, these assessments could be based on inconsistent data.

The ABS may be able to reverse the effect of the new accounting standards when providing GFS data to CGC, though it has not yet confirmed whether that is a practical option.

The ABS has advised that under AASB 16, investment is likely to be higher by up to $100 million per year – or around $4 per capita – with AASB 1059 changes expected to be smaller than this.

Commonwealth Grants Commission Staff Position

CGC staff expect there will be increases in the stock and investment data. Initial analysis by CGC staff indicates the adjustment unlikely to be material when compared with the $15 per capita data adjustment materiality threshold. This is due to the increase in investment being offset by a decrease in recurrent expenses, and the increase in assets being offset by an increase in financial liabilities.

CGC staff consider that changes to accounting standards for revenue recognition would not have a significant impact on relativities. This is due to any unreconciled balance between the value of Commonwealth payments that impact or do not impact relativities and grant revenue received by states is distributed on an equal per capita basis so as not to affect relativities. The value of Commonwealth payments is calculated based on Final Budget Outcome (FBO) data from the Treasury, while grant revenue is calculated using GFS data (first two assessment years) and states' unit record data (third assessment year).

CGC staff have requested data from the ABS to be consistent with the new standards. If the ABS can provide this data, and the impact is material, CGC staff intend to recommend using the adjusted data. This would mean the investment and net borrowing assessments would use consistent definitions.

ACT Position

The ACT supports the recommendation of CGC staff to use adjusted GFS data to reflect the new Standards, should the ABS be able to provide the data. The ACT notes the importance of ensuring consistent definitions used in the investment and net borrowing assessments, and that the CGC's proposed treatment is unlikely to lead to a significant impact on the relativities.

The ACT notes that at this stage changes resulting from AASB 1059 will not have a material impact on the ACT's assessment. In 2020-21, $9.5 million in cash investment was made for arrangements under this standard in PNFC transport. These arrangements are reflected in the Statement of Cash Flows and ABS unit record flow as repayment on borrowings (ETF 2521) and operating payments (ETF 21") consistent with the requirements of the accounting standard. Stock is reflected under the relevant asset class. Capital investments made under AASB 16 have been included in the CGC data return for 2020-21 and are not material to the assessment at this stage.

HEALTH ASSESSMENT – NON-ADMITTED PATIENT DATA

Background

CGC uses cost weighted activity data as part of its health assessment. In the 2020 Review, CGC decided it will not use a proxy indicator for non-admitted patient cost weighted activity derived from GFS classification of non-admitted patient activity once the Independent Hospital Pricing Authority (IHPA)'s NWAU data were sufficiently robust. However, unlike GFS data, the IHPA non-admitted patient activity data excludes GP-type services as these services do not meet IHPA's criteria to qualify for funding under the National Health Reform Agreement (and therefore excluded from the NWAU data). These services are general practice and primary care, primary health care, family planning and general counselling.

AIHW data indicates that GP-type services represent around 5-10 per cent of total separations. AIHW classifies GP-type services under two clinic types, that is either medical consultations or allied health.

CGC staff could impute national weighted activity units for GP-type services using the disaggregated IHPA data for GP-type services, which includes activity data on total non-admitted patient separations. CGC staff could then estimate the NWAUs for GP-type services by multiplying the data on total separations with the average number of NWAUs per total separation for medical consultations and allied health. This assumes that the average cost weight for medical consultations and allied health is the most closely related to GP-type services.

The implication of using the non-admitted patient activity data from IHPA would mean excluding 5-10 per cent of non-admitted patient services at an aggregate level, with a disproportionate impact on services provided to Indigenous people and in very remote area. Adjusting the IHPA data to account for activity data on GP-type non-admitted patient services from the imputation is likely to materially increase the cost weight used in the assessment for Indigenous people and people in remote and very remote areas.

Commonwealth Grants Commission Staff Position

CGC staff propose to include imputed NWAU data for GP-type services in the non-admitted patient assessment to ensure the scope of services covered by the activity data aligns with the services covered by the expense data.

ACT Position

The ACT supports the CGC staff proposal to include imputed NWAU data for GP-type services in the non-admitted patient assessment. The ACT notes that the CGC has access to data that will allow it to delineate services that are funded under jurisdiction's block funding claims under the NHRA. Given this, the ACT considers that the proposed treatment will maintain consistency between services and activity data.

NEW COMMONWEALTH PAYMENTS

Background

CGC Staff have examined and proposed treatments to the new Commonwealth payments commencing in 2020-21, as listed in the Final Budget Outcome, 2020-21. This includes the projects listed under the City and Regional deals that commenced in 2020-21.

Commonwealth Grants Commission Staff Position

CGC staff proposals are based on the following guidelines adopted in the 2020 Review.

- Payments which support state services, and for which expenditure needs are assessed, will impact on state fiscal capacities. If needs are not assessed, it will have no impact on state fiscal capacities
- If a payment has multiple components, and CGC decides that one or more component should not affect state fiscal capacities, CGC staff will collect information to split the payment to ensure the appropriate treatment is applied.

The proposed treatment of some new Commonwealth payment would change following the directions from the Terms of Reference for the 2022 Update, though the treatments for some payments would remain unchanged as directed by the Terms of Reference for the 2021 Update. These payments are for road safety projects that fall under the Government's *JobMaker Plan — Infrastructure Investment — road safety and upgrades* announced in the 2020-21 Budget, a payment to Queensland of $105 million relating to remote housing, and a contribution of $93.9 million relating to Tasmania's Marinus Link Project. The treatment of a payment for the proton beam therapy facility commenced in 2020-21 will also remain unchanged as directed by the Terms of Reference for the 2019 Update.

ACT Position

The ACT supports the CGC staff proposed treatments of Commonwealth payments commencing in 2020-21 and supports CGC staff proposal to not backcast new payments commencing in 2021-22 since they do not represent a major change in federal financial arrangements.

CROSS BORDER – HEALTH INFRASTRUCTURE

As part of the 2020 Review, the CGC committed to providing the ACT a cross-border capital stock factor adjustment for Health infrastructure. As per paragraph 134 of the 2020 Review's chapter on the health assessment:

"The cross-border adjustment to Commonwealth hospital funding and the Cross Border Service Agreement between the ACT and New South Wales includes no allowance for

crossborder capital costs. Using NWAU data from the Administrator of the National Health Funding Pool, the Commission calculated a cross-border capital stock factor for the Investment assessment and found the assessment to be material for the ACT. A cross-border capital stock factor has been included in the assessment to reflect this level of cross-border use. Interstate differences in construction costs are also recognised."

However, review of the CGC's assessment simulator for the 2021 Update indicates that no such adjustment to the capital stock factor for cross-border use of hospital services is present – indicating that this methodology change introduced in the 2020 Review has not been included in the CGC's calculations since the 2020 Review.

The ACT asks that the CGC rectify this oversight in the 2022 Update by including the capital stock factor adjustment in its assessment of health infrastructure, as specified in the assessment methods from the 2020 Review.

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ACT Government

Chief Minister, Treasury and Economic Development Directorate

November 2021