NEW ISSUES FOR THE 2023 UPDATE:

SOUTH AUSTRALIA TREASURY SUBMISSION

We welcome the opportunity to comment on the 2023 Update New Issues paper (new issues paper).

A summary of the views of the South Australian Department of Treasury and Finance (South Australia) on each issue raised is outlined below. Further information is contained in the main part of the submission.

The key issue for South Australia is the treatment of COVID-19 impacts if the Terms of Reference allow for the consideration of alternative assessment methods. The COVID-19 pandemic has required governments at all levels to respond to the health implications of COVID-19 and the economic impact of restrictions on business activities.

The Commission have expressed the view that COVID-19 expenditure has predominantly been a function of circumstances, however, the circumstances that individual states and territories had to ultimately address were a function of respective restriction and suppression policy decisions. That is, policy decisions have contributed to the circumstances for each state and territory. This view is supported by numerous independent assessments.

One of the main principles for HFE is policy neutrality. No reliable, policy neutral method of assessing COVID-19 health expenditure or business support has been identified to date. Actual per capita COVID-19 related expenditure is not a policy neutral indicator of jurisdictions' relative HFE needs.

Until a reliable policy neutral indicator(s) can be identified, there should be no changes to the methods used for the assessment of state revenues or expenditure. Any consideration of alternative assessment methods should include a comprehensive consultation process, similar to that followed as part of the major methodology reviews undertaken every five years.

The table below summarises South Australia's position on recommendations in the New Issues Paper.

Estimated residential population	• Based on changes between the 2011 and 2016 Census, South Australia is concerned that movements in the total Aboriginal and Torres Strait Islander Estimated Resident Population between Censuses may not be indicative of population changes at the sub-category level. • On balance, due to concerns around data accuracy South Australia supports using the 2016 Census-based projections for total state Aboriginal and Torres Strait Islander Estimated Resident Population by state as a temporary method until revised sub-state 2021 Census estimates are released.
Urban transport	• South Australia recognises that due to the timing of COVID-19 lockdowns in some jurisdictions, the method of travel to work data in the 2021 Census is not a fit for purpose representation of actual service use. • However, the COVID-19 pandemic has produced a shift in working arrangements and attendance at educational institutions that has reduced the overall demand for daily commutes, especially to CBDs. This change is not reflected in the 2016 Census data. • This issue should be considered in more detail as part of the 2025 methodology review. In the interim, a higher discount should be applied to the assessment or the weighting for urban characteristics reduced, recognising the increased data concerns associated with the retention of 2016 Census data.
Housing	• South Australia supports the integration of 2021 Census data on income and rent in the Housing assessment, which is consistent with the principle of using the most up to date data.
New data source for number of motor vehicles	• South Australia is comfortable with the use of the new BITRE data in the Motor Taxes category, on the basis that the new BITRE data is similar in scope to the previous ABS data and is produced in a consistent method used by the ABS.
Non-admitted patients' activity data	• It is recognised that the Commission is attempting to better align the scope of services covered by the activity data and the services covered by the expense data. South Australia supports the Commission's judgement in relation to imputing national weighted activity unit data for GP-type services in the non-admitted patient assessment.

Response to COVID-19	• The impact of COVID-19 on state expenses and business support has been driven by policy choices and state circumstances. • No reliable, policy neutral method of assessing COVID-19 health expenditure or business support has been identified to date. Actual per capita COVID-19 related expenditure is not a policy neutral indicator. • Unless a reliable policy neutral indicator can be determined, existing assessment methods should be retained.
New state taxes	• South Australia supports the Commission's proposal to include revenue from Victoria's Zero and Low Emission Vehicle road user charge in the Motor Taxes category, and revenue from Victoria's mental health and wellbeing surcharge in the Payroll Tax category.
Negative average no worse off relativity	• South Australia considers that there should be no adjustment for negative 'no worse off' relativities. • Adjusting these relativities would not be consistent with the previous system of full HFE. It would provide an advantage to the fiscally strongest state at the expense of all other states.
Commonwealth payments	• South Australia notes the proposed treatment of Commonwealth payments that commenced in 2021-22. • South Australia supports the Commission's proposal not to backcast any of the Commonwealth payments commencing in 2022-23.

1. Data Issues

1.1 2021 Census

1.1.1 Estimated resident population

2021 Census data has been progressively released since mid-2022. Some complex topics, such as distance to work and socio-economic indexes for areas (SEIFA), will be released in early to mid-2023.

The 2021 Census-based sub-state Estimated Resident Population for Aboriginal and Torres Strait Islander and non-indigenous Australians is one of the data sets that will not be released by the Australian Bureau of Statistics (ABS) until 2023. As such, for the 2023 Update the Commission will continue to use the 2016 Census based Aboriginal and Torres Strait Islander share of the total population. These shares could be applied to either:

- the 2016 Census-based projections for total state Aboriginal and Torres Strait Islander Estimated Resident Population; or
- the 2021 Census-based preliminary estimate of total state Aboriginal and Torres Strait Islander Estimated Resident Population.

Deciding between the two measures requires a choice between the use of more up to date data at the total population level, versus potential data reliability issues.

Between the 2011 Census and the 2016 Census, movements in the total Aboriginal and Torres Strait Islander Estimated Resident Population were not indicative of population changes at the sub-category level, such as remote and very remote. Should a similar pattern be observed in the 2021 Census, then applying the 2016 Census shares to the most up to date total Aboriginal and Torres Strait Islander Estimated Resident Population may reduce the overall accuracy of the assessment, rather than improve its accuracy.

On balance, given this is a temporary issue, South Australia considers that the data accuracy concerns at the sub category level favours the use of the 2016 Census-based projections for total state Aboriginal and Torres Strait Islander Estimated Resident Population by state until revised sub-state 2021 Census estimates are released.

1.1.2 Urban transport

In the 2020 Review, the Commission advised that the Urban transport assessment would be updated to reflect 2021 Census data for actual passenger numbers and distance to work when they become available.

On 12 October 2022, the ABS released data on the method of travel to work by jurisdiction. Data on the method of travel to work (passenger numbers) is used by the Commission to assess the level of public transport services across jurisdictions. Data on the distance to work, which is used by the Commission to assess the public transport network complexity, will be released in early to mid-2023.

The Commission notes the urban transport usage data was affected by COVID-19 lockdowns on the day of the 2021 Census. The relationship between the use and supply of transport services is likely to have been distorted by exogenous factors for some jurisdictions, rather than actual demand for services. As a result, the data collected for passenger numbers in the 2021 Census may not be a fit for purpose measure of the level of service provision.

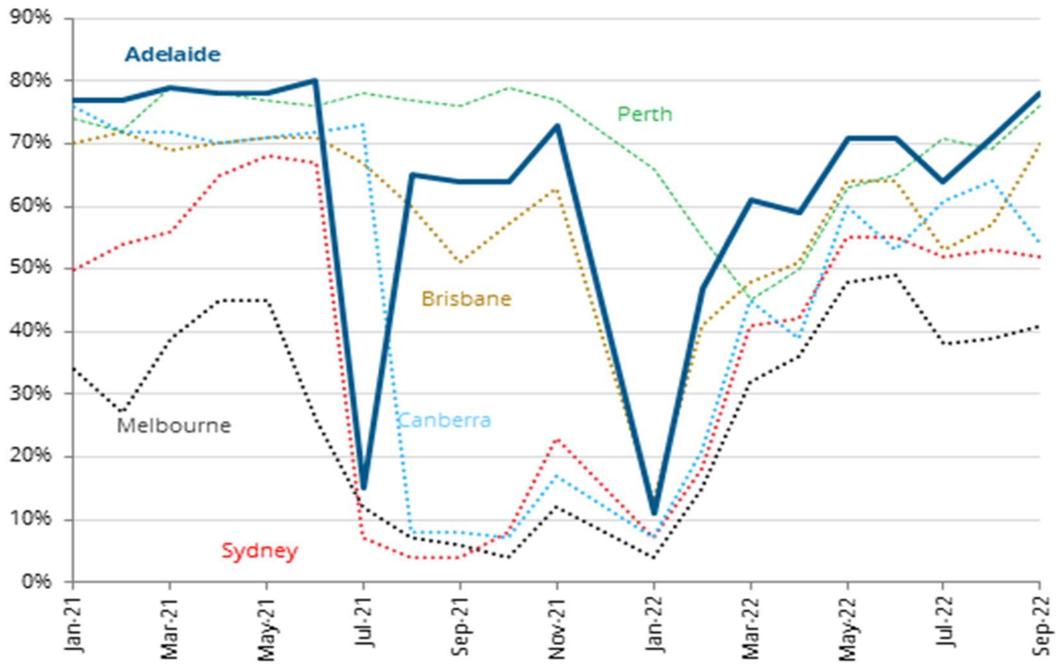
The Commission also acknowledges that strictly retaining the 2016 Census data will not capture expansions to urban transport service levels that have occurred between censuses, such as the expansion of light rail services in Sydney, Gold Coast and Adelaide.

Given the limitations of 2021 Census data, the Commission proposes to retain the 2016 Census data for passenger numbers by mode, with no adjustment to account for changes in the level of service provision or the addition of new modes of transport.

South Australia recognises that given the timing of COVID-19 lockdowns in some jurisdictions, the method of travel to work data in the 2021 Census is not a fit for purpose representation of actual service use. However, the COVID-19 pandemic has produced a shift in working arrangements and attendance at higher educational institutions that has reduced the overall demand for daily commutes, especially to CBDs. This change is not reflected in 2016 Census data.

The change in work patterns can be demonstrated by comparing current and pre-COVID CBD office occupancy levels across capital cities. In Adelaide, Brisbane, and Perth, office occupancy has only returned to between 70 and 80 per cent of its pre-COVID level. Despite the fact that all COVID restrictions have been lifted in New South Wales and Victoria, office occupancy in those states is only around 50 per cent of pre-COVID levels in Sydney and 40 per cent in Melbourne.

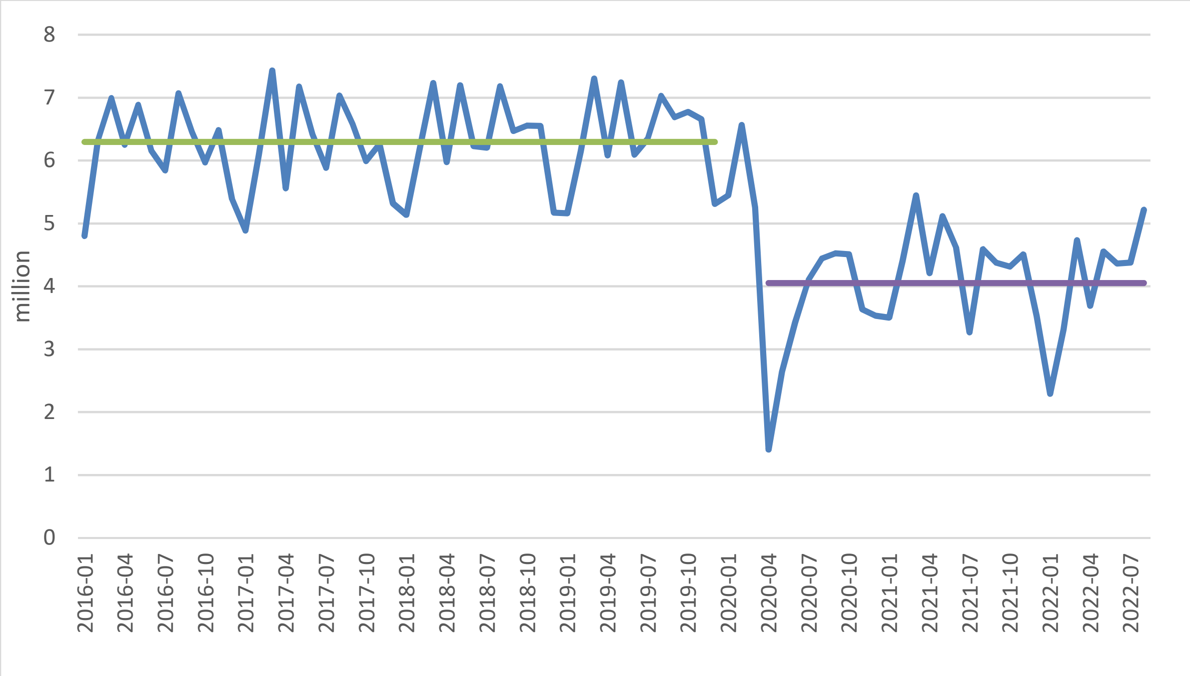
Figure1: CBD occupancy levels



Source: Property Council, https://research.propertycouncil.com.au/blog/office-occupancy-lifts-in-september

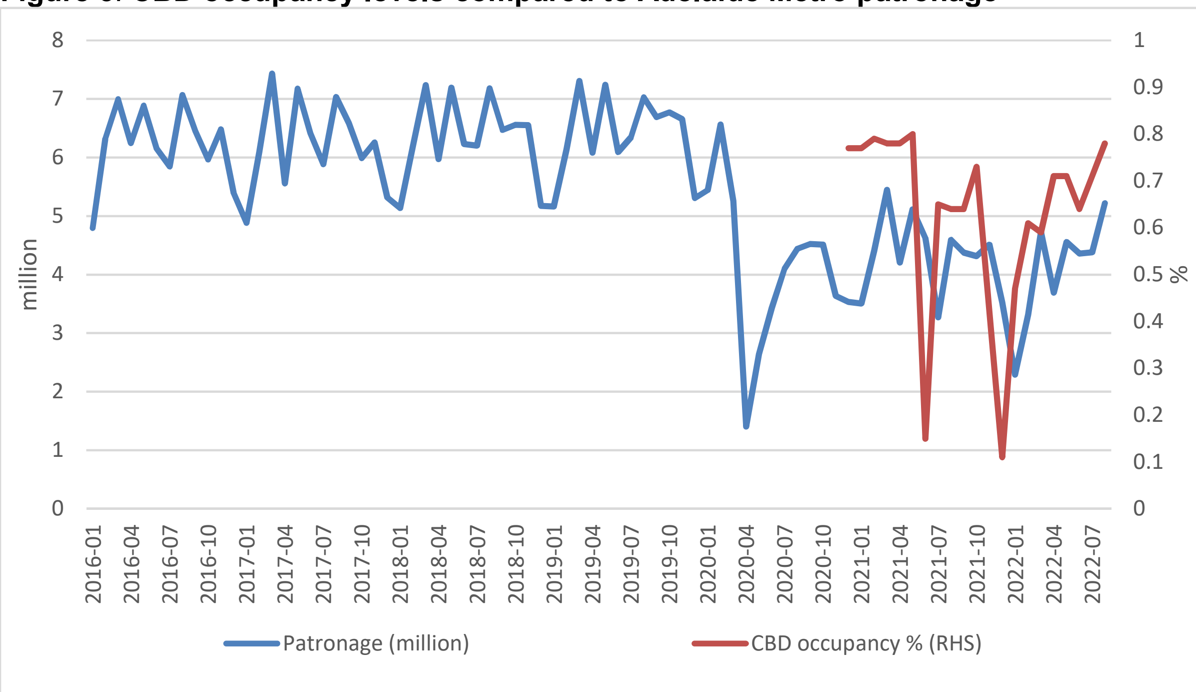
There has also been a reduction in public transport passenger boarding in South Australia – see Figure 2.

Figure 2: Adelaide Metro Patronage – all modes



The reduction in public transport usage broadly correlates with the reduction in CBD occupancy levels in South Australia – see figure 3. It is expected that similar patterns would be occurring in other jurisdictions, with a potentially larger decline in public transport usage reflecting the lower CBD occupancy levels.

Figure 3: **CBD occupancy levels compared to Adelaide Metro patronage**



The average number of passengers per year was relatively consistent before COVID, with comparable seasonal variations every year. Since COVID, the average monthly patronage has decreased by about a third and has remained at a lower level. More importantly, passenger numbers have not returned to their pre-COVID level even after the removal of restrictions.

The change in usage could be attributed to passengers' shifting work habits, such as working from home and teleconferencing, and other lifestyle changes, including online shopping. This supports the view that a changing long-term trend is emerging and that overall passenger usage is declining as a result of changes in work and educational patterns, not merely COVID lockdowns.

Further, given the correlation between public transport usage and CBD occupancy, the divergence in occupancy levels between jurisdictions despite the removal of all COVID-19 restrictions highlights the potential issues with using 2016 Census data in the long term.

It is acknowledged that jurisdictions sought to maintain service level provisions during the main peak of COVID. However, the ongoing reduction in demand for services may, if it already hasn't, lead to changes in the level of service provisions. Any relationships that existed at that time of 2016 Census are likely to have weakened or could be expected to significantly weaken or diverge or time.

This raises the issue of whether the 2016 Census data is still a fit for purpose measure for the Urban transport assessment.

This issue should be considered in more detail as part of the 2025 methodology review. In the interim, a higher discount should be applied to the assessment or the weighting for urban characteristics reduced, recognising the increased data concerns associated with the retention of 2016 Census data.

The Commission has also considered the need for an adjustment to recognise new modes of transport, in particular, new light rail services in Canberra and Newcastle that have been introduced since the 2016 Census.

South Australia supports the Commission decision not to include an adjustment for new modes of transport in the 2023 Update. There is no reliable data on which to base an assessment. It is not appropriate to assess Canberra and Newcastle usage based on the Gold Coast. The Gold Coast is not representative of Canberra and Newcastle. Having a similar population does not make them comparable. There could be other factors that influence usage, including demographics, car ownership rates, student population, SES, availability of free/cheap parking etc. South Australia believes it is preferable to leave this until the 2025 Review when alternative data may be available to assess usage.

1.1.3 Housing

South Australia supports the integration of 2021 Census data on income and rent in the Housing assessment. There do not appear to be any significant distortions in the data due to the COVID-19 pandemic (relative to data from the 2016 Census). This is consistent with the principle of using the most up to date data.

1.2 New data source for number of motor vehicles

South Australia notes that the Commission intends to use data from the new Motor Vehicle Census collection, developed by the Bureau of Infrastructure and Transport Research Economics (BITRE) and Austroads, as the basis for calculating state revenue bases in the Motor Taxes category. This would replace the previous ABS collection, which ceased following last year's release.

The new BITRE data is similar in scope to the previous ABS data, and we understand it has been produced in a manner that is consistent with the processes and methods used by the ABS. The data has been extracted from the National Exchange of Vehicle and Driver Information System (NEVDIS), a national database of information provided by licensing authorities in all jurisdictions. On this basis, South Australia is comfortable with the use of the new BITRE data in the Motor Taxes category.

1.3 Non-admitted patients' activity data

The 2022 Update New Issues Paper considered incorporating an estimate of national weighted activity units for the GP-type services delivered by states in non-admitted patient settings based on activity data. No decision was taken on this matter as the Commission did not have approval to share the source data and analysis with states and territories.

The Commission is now in a position to share the data and analysis with jurisdictions. It proposes to include imputed national weighted activity unit data for GP-type services in the non-admitted patient assessment.

As part of internal consultations on the proposal, we have been advised that there may be issues with the accuracy of data on the number of separations. This may be more pronounced in the short term due to COVID-19. While that is the case, we recognise that the Commission is attempting to better align the activity and cost data for the assessment and support the Commission's judgement in this regard. If it has not already, there may be value in the Commission consulting with the Australian Institute of Health and Welfare and the Independent Hospital Pricing Authority on the data and proposed assessment approach.

2. Response to COVID-19

For the 2022 Update the Commission took the position that state responses to the COVID-19 pandemic largely reflected circumstances rather than state-specific policy choices. As the Terms or Reference for the 2022 Update did not allow for alternative assessments methods, no specific assessment changes were made. Although there was a Terms of Reference restriction, the Commission provided little justification in the 2022 Update Report to support its view that COVID-19 responses reflected circumstances rather than policy choices.

South Australia and a number of other jurisdictions provided examples and independent opinions that supported the view that the policy decisions made by states and territories did have a significant impact on COVID-19 case numbers and associated expenditure.

Since that time there has been further information supporting this view.

Rating agencies S&P and Moody's have publicly stated that:

> *'South Australia limited the extent of fiscal impacts from COVID on the local economy, relatively to its domestic peers, due to early and effective implementation of border controls.' (Moody's)*
>
> *'South Australia has to date successfully contained the spread of the virus, allowing its economy to open faster than its peers.' (S&P)*

In October 2022 a privately funded independent review into COVID-19 responses, led by Western Sydney University Chancellor Peter Shergold[1], found

> *'Too many of Australia's lockdowns and border closures were the result of policy failures in quarantine, contact tracing, testing, disease surveillance and communicating effectively the need for preventive measures like mask wearing and social distancing'.*

This is just a small sample, but further demonstrates that expenditure on health and business support can, in part, be attributed to policy choices at the jurisdictional level, not just state circumstances. These impacts varied by state.

Despite further post pandemic analysis of state and territory responses undertaken by independent experts and institutions, the Commission still proposes to maintain its position that responses were predominately driven by circumstances rather than policy choices for the 2023 Update.

This position is strongly refuted by South Australia. Both state circumstances and policy choices drove COVID-19 impacts.

One of the main principles of the GST distribution system in Australia is that states and territories should not benefit or be penalised for policy decisions.

The State Government's choice of policy has led to decreased financial impacts, notably less COVID-19 health and business support expenses. If policy influenced data is used for the assessment, South Australia will be penalised for its response to COVID-19.

The Commission is considering the use of actual per capita assessments for the two main areas of COVID-19 related expenditure – health and business support. Actual per capita assessments are only appropriate when there is complete policy consistency and data reliability. This is not the case for COVID-19 related expenditure. Data on actual per capita COVID-19 related expenditure is policy influenced.

No reliable, policy neutral method of assessing COVID-19 health expenditure or business support has been identified to date. Unless a reliable policy neutral indicator can be determined, existing assessment methods should be retained.

This is consistent with the position South Australia has adopted for revenue assessments. As outlined in our response to the 2022 New Issues paper, we are not aware of any reliable or practical method for identifying and measuring the impact of state policy responses to COVID-19 on revenue assessments. As such, we supported

[1] *Fault Lines, An independent review into Australia's response to COVID-19,* Peter Shergold et al, https://assets.website-files.com/62b998c0c9af9f65bba26051/6350438b7df8c77439846e97_FAULT-LINES-1.pdf

the decision to not make any adjustments to revenue bases for potential COVID-19 impacts.

2.1 Health

The policy-influenced suppression and restriction of movement/activity approaches used in each jurisdiction had an impact on the level of COVID-19 health expenditure in each jurisdiction.

Different approaches regarding the timing, duration, and severity of restrictions were implemented by States and Territories in the years relevant for the 2023 Update. The number of positive cases reported and the number of people needing hospital care and other medical services were in part influenced by the length of time it took to put a region under lockdown, the level of activity restrictions, the timing and length of border closures, and the decision to lift restrictions.

As an example of the different approaches between jurisdictions, in July 2021, South Australia entered a seven-day lockdown in response to the cluster linked to the Modbury Hospital. The uniform, state-wide lock-down was implemented early and included stay-at-home orders, closure of all businesses (including takeaway food), no exercise beyond 2.5 kilometres of home, school closures and other restrictions on activity. This approach assisted in quickly containing the outbreak.

In comparison, New South Wales' Delta outbreak commenced with the identification of cases in June 2021. In response to this emerging outbreak, stay-at-home orders were issued for some immediate local government areas, which were eventually extended to incorporate all of Greater Sydney. A whole-of-state lockdown was not imposed until 14 August 2021. These restrictions initially allowed exercise in groups of ten, leaving home for essential work and education. Many retail shops were allowed to remain open. Case numbers grew to a point where an accelerated vaccination strategy became the most viable solution.

The policies on lifting restrictions also varied between states. After the peak of COVID cases during the holiday season in early 2022, New South Wales repealed the indoor mask mandate and density restrictions in hospitality in February 2022. In contrast, South Australia relaxed COVID restrictions in a more gradual manner, eliminating density restrictions in March 2022 while keeping the mask-wearing requirement in place until later this year. Administration of quarantine, the appropriateness of quarantine accommodation and contact tracing policies were approached differently by states and territories. These decisions impacted on COVID-19 case numbers and associated expenditure.

Adoption of an actual per capita assessment approach for health expenditure would only be appropriate if policy choices were consistent. This was not the case during the relevant assessment period.

South Australia believes that COVID-19 health expenditure should continue to be assessed using the 2020 Review methods in the 2023 Update. No policy neutral method of assessing this expenditure and no policy-neutral data source to support an alternative assessment approach has been identified to date that would support any other form or reliable assessment.

While we do not support an approach to separately assess COVID related health expenditure, if the CGC were inclined to consider an actual per capita assessment, the maximum level of discount should be applied to reflect the impact of policy choices and the use of untested and unaudited data.

2.2 Business support

The COVID-19 pandemic has required the Commonwealth and State governments to respond to the economic impact of restrictions on business activities. This support took many different forms; from exemptions, waivers or deferrals of state taxes and charges, to direct financial assistance grants.

During the initial stage of the pandemic, support measures were largely delivered independently by the different levels of Government. In 2021-22, the Commonwealth and states jointly funded some financial assistance measures to businesses affected by lockdowns and restrictions in response to COVID-19.

While some support measures were jointly funded under Commonwealth project agreements, the types of measures and eligibility criteria varied between jurisdictions. A number of support measures for similar items/circumstances were not jointly funded.

According to the Commission's analysis, the distribution of Commonwealth payments under the COVID-19 business support national partnership agreements deviated from the Commission's assessment of needs under existing assessment methods.

The level and type of business supports required at a jurisdictional level was impacted by the suppression and other policies introduced to respond and control the spread of COVID-19. Even ignoring this issue, there has been no policy consistency between states and territories for COVID-19 business support payments. In particular, there were differences in eligibility criteria, the monetary value, and the duration of business support payments.

South Australia does not believe that any reliable, policy neutral method of assessing COVID-19 business support has been identified to date. Furthermore, there is no accurate comparison of the scope of COVID business support expenditure between jurisdictions to use as the basis of a differential assessment.

Scope of business spending captured

If the Commission is given Terms of Reference approval to consider alternative COVID-19 assessment approaches, it has raised two options to define total COVID-19 related business support spending.

- Option 1: spending on programs covered by COVID-19 business support national partnerships. This data is accessible from the Commonwealth 2021-22 Final Budget Outcome.

- Option 2: business support payments that were made non-assessable non-exempt (NANE) by the Commonwealth for income tax purposes. States would need to provide the relevant expenditure data treated as NANE in time for the 2023 Update.

South Australia believes that the scope of expenditure captured under either option is not comparable between jurisdictions and is not a reliable base to form an assessment.

In relation to option 1, while the Commonwealth jointly funded certain state COVID-19 business support payments, the types of payments jointly funded varied based on the decisions of the Commonwealth Government about which measures it would fund and specific jurisdictional policy choices around the type, size and eligibility for support measures.

This can be clearly seen by comparing the eligibility, size and types of payments covered by the national agreements across jurisdictions[2].

By way of example, New South Wales received joint Commonwealth funding for its JobSaver scheme. Very broadly, this provided funding to eligible businesses of up to 40% of weekly payrolls for work performed in New South Wales from 18 July 2021 to late 2021, up to a maximum payment of $100,000 per week. Eligibility criteria included that the applying business must have had an annual turnover of between $75,000 and $250 million and have experienced a reduction in turnover of at least 30% in a 2-week period. Businesses were also required to maintain their employee headcount if they received JobSaver payments.

In contrast, the Victorian agreement with the Commonwealth includes seven different appendices outlining support packages announced and agreed at different times with the Commonwealth Government from 28 July 2021 to 30 September 2021. Each package/appendix contains a number of different grant programs with different eligibility criteria and payment amounts.

There is no policy consistency between these two different approaches.

In relation to option 2, Section 59-97(3) of the *Income Tax Assessment Act 1997* (Cth) sets out the requirements to be declared an 'eligible program' for NANE status. This is broadly that:

- The programs were first publicly announced on or after 13 September 2020.
- The programs are responding to the economic impacts of COVID-19.
- The programs are directed at supporting businesses that are the subject of public health directives applying to a geographical area in which the businesses operate; and whose operations have been significantly disrupted as a result of the public health directive.
- The grants are only available for small and medium sized businesses.

In addition to meeting these criteria, the payment had to be formally declared by the Commonwealth Minister under a legislative instrument.

While there were established criteria for NANE treatment, a range of South Australian COVID-19 related business support measures that we consider met these criteria were ultimately not afforded NANE treatment by the former Commonwealth Treasurer. These business support programs included:

- Tourism, Hospitality and Gym Grant – December 2021
- Tourism, Hospitality and Gym Grant – January 2022
- Business Hardship Grant – December 2021

[2] See: https://federalfinancialrelations.gov.au/agreement-finder?combine=covid

- Business Hardship Grant – January 2022
- Business Hardship Grant – February 2022
- Regional COVID-19 Support Grant – Lower South East

Specific detail on each individual grant program and information on how it aligned with the eligibility criteria established for NANE treatment can be provided.

The Australian Taxation Office website includes a list of state and territory COVID-19 business support grants that may be treated as NANE, see:

https://www.ato.gov.au/General/COVID-19/Government-grants,-payments-and-stimulus-during-COVID-19/Tax-implications/Eligible-COVID-19-business-grants-and-support-programs/

According to this list, no COVID-19 business assistance payments provided in Western Australia, Tasmania or Northern Territory are eligible for NANE treatment. This is despite these jurisdictions receiving Commonwealth funding for initiatives under the COVID-19 business support national partnerships.

To further highlight issues around the scope of business support payments jointly funded under partnership agreements and those afforded NANE treatment, we note the Western Australian business support payments partnership agreement, see:

https://federalfinancialrelations.gov.au/sites/federalfinancialrelations.gov.au/files/2022-07/Agreement%20for%20WA%20Business%20support.pdf

The attachments to the agreement outline the business support programs that are eligible and other relevant details. Of note is a letter from the Western Australian Premier to the Commonwealth Treasurer supporting an increase in the value of eligible business support payments funded under the agreement in lieu of not providing NANE status for these payments. The letter includes the following:

> The former Treasurer wrote to me on 10 April 2022 offering to fund a 25% increase in the value of relevant COVID-19 Business Support payments to be made to eligible businesses by the Western Australian Government, up to a maximum Commonwealth contribution of $53.9 million. This was in lieu of not providing non-assessable non-exempt (NANE) tax status for these payments as was provided for some grant programs in other States.

This appears to have been accepted based on a reply from the Commonwealth Minister for Small Business also contained in the Attachment. This example supports the case that there is very little consistency in the level of COVID business support payments in either the partnership agreements or those eligible for NANE treatment. Individual decisions determined the eligibility of various support payments, not a consistent policy neutral eligibility framework.

The approach for COVID related expenditure is very different to funding under the Disaster Recover Funding Arrangements, which form the basis of an existing actual per capita expenditure assessment by the Commission. The disaster recovery arrangements require data to be assessed by an auditor, with the audit undertaken in accordance with Auditing Assurance Standards Boards obligations. The use of a mature and tested disaster recovery expenditure framework makes the application of an actual per capita assessment appropriate for this category. This is not the case for COVID-19 related expenditure.

For the reasons outlined, South Australia does not support either the use of COVID-19 business support payments funded under partnership agreements or those treated as NANE as a reliable base for an assessment.

In relation to the question of data availability, unlike the level of assistance under the partnership agreements, information on the value of business support payments afforded NANE status is not published.

Potential assessment methods

The new issues paper outlines two potential assessment approaches for COVID-19 business support expenditure if allowed under the Terms of Reference:

- A driver of need for state COVID-19 business support expenditure
- An actual per capita assessment of state expenditure

These two options are addressed below.

Driver of need

South Australia agrees that any assessment of COVID-19 expenditure must be driven by a policy neutral indicator of need.

The issues paper notes that the Commission considers a measure based on a reduction in business turnover would reflect what states actually did, and reflect average state policy regarding support payments. It also notes that the Commission would be unlikely to get access to such data in time for the 2023 Update.

As an alternative, the Commission has explored the use of a reduction in hours of work in each state as a driver of need.

The Commission has undertaken an analysis on the relationship between the need for business support and a reduction of hours of worked in the Longitudinal Labour Force Surveys (LLFS) published by the ABS. The Commission has identified that three selected reasons of working less than usual hours are more correlated with COVID-19 lockdowns, and investigated the relationship between the hours reduced for these selected reasons and states and territories' lockdowns

For reasons outlined earlier, a measure of need that directly picks up either a reduction in business turnover or hours worked in a state would be policy influenced. The policy responses of jurisdictions in relation to the management of COVID-19 would directly impact the change in the level of turnover or hours worked in that jurisdiction.

Ignoring this point, support was generally provided to businesses that met certain reductions in turnover. The reduction in turnover and level of support available at different turnover reduction levels varied both within and across jurisdictions reflecting individual policy choices. Access to some support measures was also based on the main industry classification code of a business.

While a reduction in hours worked may have some relationship to business turnover, there are a range of other factors that drive turnover levels. For example, a business may have been able to increase online activities that require less staffing hours, breaking the relation between turnover and hours worked.

From the charts presented by the Commission in the new issues paper, the hours reduced for selected reasons are not necessarily consistent with lockdowns, especially for smaller states and shorter lockdown periods. For example, apart from what could be considered seasonal variations, there is no noticeable difference in the hours worked for the selected reasons during certain lockdown periods in Western Australia, South Australia, Tasmania and the Northern Territory.

As identified by the Commission, the LLFS data has significant limitations. The monthly surveys only cover the first two weeks of each month. Therefore, the impacts of lockdowns, particularly lockdowns of shorter duration, may not be accurately captured in the data. The impact of an assessment based on LLFS data would depend on the timing of the lockdowns relative to the survey period. This may be what is contributing to some of the discrepancies outlined above.

Importantly, the sample size of the surveys is also constrained. The surveys include approximately 26,000 dwellings nationally, which covers only 0.32% of the civilian population aged 15 years and over. There is significant concern about the ability of a sample of this size to produce accurate and reliable results at an individual jurisdictional level. This issue is more pronounced for small jurisdictions.

For these reasons, the indicator of a reduction in hours worked identified in the new issues paper is not considered to be a reliable policy neutral indicator for an assessment of COVID-19 Business Support.

South Australian Treasury have not identified any other reliable, policy neutral drivers of COVID-19 business support payments suitable for an assessment.

Actual per capita expenditure

As already noted, an actual per capita approach is not supported. The level of expenditure on payments covered by national partnerships or payments granted NANE status is policy influenced.

In the case of business support grants this includes the impact of decisions made in relation to suppression activities on the need to provide support, in addition to the form and level of support provided.

South Australia does not consider it appropriate to assess business support expenses on an actual per capita basis.

If the Terms of Reference allow for a change in assessment methods and the Commission decides to use an alternative assessment approach for COVID-19 business support, the maximum level of discount should be applied to reflect the impact of policies on actual expenditure levels and the unreliability of the data.

3. New state taxes

South Australia supports the Commission's proposal to include revenue from Victoria's Zero and Low Emission Vehicle road user charge in the Motor Taxes category, as this is consistent with the classification of this revenue in the ABS's Government Finance Statistics collection.

South Australia also supports the proposal to include revenue from Victoria's mental health and wellbeing surcharge in the Payroll Tax category, as the surcharge applies to the same tax base assessed in this category and is raised under the same state legislation as the revenue currently included in the category.

4. Other issues

4.1 Negative average no worse off relativity

South Australia notes that in the 2022 Update the Commission considered it appropriate to allow any negative annual relativity in the three-year assessment period to flow through to the calculation of the three-year average relativity. The Commission is now seeking views on what should occur if a three-year average relativity under the old full HFE process is negative. This is only relevant for the calculation of the no worse off relativities.

South Australia considers that there should be no adjustment for negative no worse off relativities. As the Commission has noted, the no worse off relativities reflect what would have happened had the 2018 legislated changes not been enacted. In other words, the no worse off relativities reflect full HFE, as opposed to the current 'partial HFE' arrangements. Adjusting the no worse off relativities would not be consistent with full HFE – it would provide an advantage to the fiscally strongest state at the expense of all other states.

A negative relativity reflects that a state's assessed revenue capacity exceeds its assessed expenditure requirement for the achievement of HFE. In practice, this means the state has the capacity to raise more revenue than it needs to deliver the same standard of services and infrastructure as other states in that year.

The Commission notes that if a negative relativity had arisen under the previous equalisation arrangements, its approach could have been to either:

- bring the negative relativity up to zero, with a downward adjustment to other states' relativities based on their population shares, recognising that there is a limited pool of GST revenue available for equalisation; or

- allow the negative relativity to stand, noting this would have meant the GST pool was insufficient to achieve equalisation and either the state with the negative relativity or the Commonwealth would have needed to supplement the GST pool.

South Australia considers that the first approach would not have been equitable or consistent with the underlying principles of HFE. The Commission's assessments are developed specifically to produce a set of relativities aimed at achieving HFE. Adjusting every other state's outcomes because one state's relativity happens to be negative would alter the assessment. In other words, it would be inconsistent with HFE and it would also be a method change.

The second approach would recognise that the fiscally strongest state has a significant fiscal advantage over other states. Importantly, it would not adjust the overall HFE outcome. However, it is recognised that it would not be practical to expect the state with a negative relativity to directly "supplement" the GST pool, though it would technically be possible for the Commonwealth to do so.

With a finite GST pool, this approach would mean states would not receive their full HFE shares of the GST pool in the year in which the negative relativity arises, however, a reconciliation adjustment could be applied in a future year (or years) once the affected state's relativity returns above zero.

The above approach would be required in a system where the GST pool is the only source of equalisation funding. However, the current equalisation arrangements include Commonwealth-funded HFE transition payments, which aim to ensure no state is financially worse off during the six-year transition period compared to the previous system. It is therefore possible under the current arrangements to ensure that each state receives its full HFE share of GST in the year in which a negative relativity arises. In addition, the state with a negative relativity would still receive funding in line with the new legislated arrangements.

4.2 Commonwealth payments

Treatment of Commonwealth payments that commenced in 2021-22

South Australia notes the proposed treatment of Commonwealth payments that commenced in 2021-22.

Treatment of Commonwealth payments that commence in 2022-23

South Australia supports the Commission's proposal not to backcast any of the Commonwealth payments commencing in 2022-23, as none of them are the result of a major change in Commonwealth-State financial arrangements.