



Treasury

New Issues for 2022 Update

Commonwealth Grants Commission

NSW Treasury Response

November 2021



Contents

1. Contents	1
2. Executive Summary	1
Introduction.....	1
Overview.....	2
3. NSW Treasury positions and recommendations.....	3
4. Issues and responses	4
New South Wales experience with the COVID-19 pandemic	4
Revenue issues	5
Health expenses	6
Services to Industry expenses	11
Property tax reform	14
Treatment of JobKeeper payments – wage cost assessment	14
Treatment of negative relativities	15
New Western Australian Native title agreements	15
New Accounting Standards.....	16
Health assessment – patient data.....	16
Treatment of new Commonwealth Payments commenced in 2020-21	17
Occasional Papers.....	18
5. Appendix – COVID-19 incidence and risk	19

Executive Summary

Introduction

- 1.1 NSW Treasury welcomes the opportunity to respond to the Commonwealth Grants Commission (the Commission) New Issues for the 2022 Update (the 2022U). The impact of the COVID-19 pandemic on the Australian economy and society is significant and profound. These impacts are continuing to change and evolve.
- 1.2 COVID-19 has affected all states and territories (states), but the timing and magnitude of impacts has differed considerably. This applies to the incidence of COVID-19 cases in the community, the extent to which health systems have had to adapt, the need for stay-at-home orders and their effect on the health of residents and economic activity.
- 1.3 In the short run, policy responses to the pandemic are policy neutral and therefore reflect and are consistent with average policy. All states sought to tightly contain infection and provide support to businesses to ensure their survival. Differences in how states have chosen to respond, for most part, are explained by longstanding system and institutional design and cumulative investment decisions.
- 1.4 There are instances of individual policy choices, but these are generally outliers. For example, Queensland's Designated COVID-19 Hospital Network Direction (no.4) requires a COVID-positive case to isolate in a COVID-19 hospital unless directed otherwise by an emergency officer.
- 1.5 In the broad, the types of activities states have undertaken in response to COVID-19 are broadly consistent and proportionate to the risk of community transmission and number of active cases.
- 1.6 Inter-jurisdictional agreements were developed to provide a consistent framework to support states to prepare and respond to COVID-19 outbreaks. Key frameworks were the National Partnership on COVID-19 Response and, in 2021-22, National Cabinet decisions on Commonwealth and state responsibilities for providing individual and business support.
- 1.7 In this context, the issues raised by the 2022U again reinforce the position of NSW Treasury that methods to distribute GST need to be more robust and efficient. Methods need to avoid penalising those states for progressing productivity reforms that improve the welfare of the nation.
- 1.8 The NSW Government's proposed property tax reform is one of the most productivity-enhancing reforms within state government control. But under 2020 Review (2020R) methods, NSW could lose up to \$1 billion in GST in a year if this reform is adopted. Upfront assurance that the risk of this perverse outcome will be mitigated will provide necessary surety to the NSW Government if it decides to proceed with property tax reform.

- 1.9 Separately, the Commission’s proposal to lift a negative relativity to zero at the expense of other states would increase the fiscal capability gap between the strongest state and other states — the opposite intention of HFE.
- 1.10 Broader reform to achieve a more efficient, equitable and simpler approach to HFE is necessary. In the interim, the Terms of Reference for 2022U need to allow the Commission to adjust its methods to measure relative fiscal capacity effectively during the pandemic.
- 1.11 An actual per capita (APC) based assessment is the simplest, most practical and fair way to deal with COVID-related expenditure. Based on our experience of the pandemic to date, it appears appropriate that an APC based treatment should be time-limited and expire once 80 per cent of the national population over the age 16 is fully vaccinated. This is consistent with the nation’s transition from an emergency response to a vaccination consolidation phase.
- 1.12 NSW Treasury welcomes the occasional paper series, which considers topical issues associated with HFE, but the Commission should consult states on future publications. *Occasional Paper No. 3: Mining Revenue* is a clear example. The paper focused on the volatility of GST relativities driven by fluctuations in mining revenues without providing key context on the primary objective of GST distribution. As a result, the paper risked elevating volatility to the status of a supporting principle used by the Commission to give effect to HFE – a position it has never held.
- 1.13 Discussions about the new HFE arrangements should align with the original policy intent agreed by governments, and jurisdictions are well placed to assist with this. The NSW Government has never accepted or supported stability in GST distributions as a basis for the Commonwealth’s 2018 changes to HFE.

Overview

- 1.14 This submission comprises three sections:
- **Part one:** Executive Summary and Overview
 - **Part two:** NSW Treasury positions and recommendations
 - **Part three:** Issues and Responses.
- 1.15 The submission sets out the views of NSW Treasury. In accordance with the Commission’s guidance, this submission is targeted to address specific issues raised in the New Issues Paper. NSW Treasury reserves an ongoing right to raise additional issues, new arguments or new data as the 2022U progresses.
- 1.16 Further information and questions regarding any aspect of this submission may be directed to: Ms Andrée Wheeler, Director, Federal Financial Relations, NSW Treasury (e. ffr@treasury.nsw.gov.au).

NSW Treasury positions and recommendations

1.17 The table below summarises NSW positions on recommendations in the new issues paper.

Revenue	<ul style="list-style-type: none"> ▪ Treat tax waivers, rebates, tax deferrals and JobKeeper payments using the same approach as for the 2021U. ▪ No adjustment to revenue bases is required to account for differences in state policy responses to COVID-19.
Health	<ul style="list-style-type: none"> ▪ Key drivers of COVID-related health expenditure are higher COVID-19 patient intake, additional accommodation support, track and trace systems and increased mental health incidence. Underpinning these drivers is incidence of COVID-19 in the community. ▪ Commonwealth and state funding under the National Partnership on COVID-19 Response should be treated on an actual per capita (APC) basis. ▪ Costs associated with quarantining overseas repatriations net revenue should be treated on an APC basis. ▪ Mapping out where COVID-19 activities fit under each component of the 2020R health assessment would improve transparency. ▪ The Commission should review substitutability levels for ED and community health and make adjustments if they are material.
Services to industry	<ul style="list-style-type: none"> ▪ Treat business development expenses on an APC basis until the majority of the national population is subject to Phase C of the National Cabinet's plan to transition Australia's National COVID-19 Response. ▪ Review the split between regulation and business development for other industries. ▪ The Commission's methods need to account for states' responsibility for broad-based business and individual COVID-related supports, including through the welfare assessment.
Property tax reform	<ul style="list-style-type: none"> ▪ Early consideration of what data the Commission's needs to monitor and assess the reform is necessary to ensure data specifications can inform the design of reform as it progresses.
JobKeeper payments – wage assessment	<ul style="list-style-type: none"> ▪ Remove employees earning \$750 per week from the data used in the wage costs regression model given the limitations with identifying Jobkeeper participants in the data.
Negative relativities	<ul style="list-style-type: none"> ▪ The cost of lifting an affected state's relativity to zero for the relevant assessment year should not be borne by other states. The cost should be applied to the next assessment year when the affected state's relativity returns to positive.
New Western Australia Native Title arrangements	<ul style="list-style-type: none"> ▪ 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.

New accounting standards

- Adjust ABS GFS data to be consistent with the accounting standards AASB 16 and AASB 1059 if doing so is materially different from using ABS GFS data as published.
- Develop the adjustment method in consultation with states.

Health – patient data

- Include imputed National Weighted Activity Unit data for general practice and primary care, primary health care, family planning and general counselling services in the non-admitted patient assessment.
- Apply a 50 per cent discount to proxy data in the short term to manage risk until the reliability of the proxy is demonstrated.
- Reduce the additional service delivery cost adjustment for block funded hospitals to account for improvements to the Net Efficient Costing funding model to reflect the costs of block-funded hospitals.

Commonwealth payments

- Commonwealth payments relating to remote housing should impact relativities.
- Quarantine should have no impact on relativities. Consistency in treatment of expenditure and Commonwealth payments for quarantine services is necessary.

Occasional paper series

- The Commission to consult with states on the content of future publications.
- Discussions about the new HFE arrangements should align with the original policy intent agreed by governments.

Issues and responses

New South Wales experience with the COVID-19 pandemic

- 2.1 In 2020-21, New South Wales (NSW) operated in higher risk COVID-19 conditions relative to most states. Almost half of overseas arrivals were processed and quarantined in Sydney. As Sydney hosted quarantine facilities, NSW was less able to rely on interstate border closures to control risk and instead has had to maintain surge capacity to manage COVID-19 outbreaks. In addition, the NSW health system managed a continuous caseload from overseas arrivals in its health facilities, which required infection controls and the purchase of high levels of Personal Protective Equipment (PPE).
- 2.2 In 2021-22, NSW experienced significant infection outbreaks in Sydney and was required to implement prolonged stay-at-home orders as most of the population was unvaccinated at the time. In the absence of JobKeeper and in line with changes to Commonwealth and state responsibilities for business supports, NSW provided support to businesses disproportionately affected by the public health orders.
- 2.3 Through these experiences, NSW Treasury considers the key drivers of COVID-related expenses are risk of exposure to the virus, number of active cases in the community and prolonged stay-at-home orders. International experience with the pandemic indicates population density increases the risk of community transmission.

- 2.4 NSW experience demonstrates that drivers of COVID-19 expense in pre-vaccination settings poorly align with traditional cost drivers such as remoteness and Indigeneity. This is because NSW enforced containment strategies to prevent infection in these areas and cohorts. Other states have implemented similar strategies consistent with the National Partnership on COVID-19 Response (COVID-19 NPA) and National Cabinet's plan to transition Australia's National COVID-19 response.
- 2.5 While states have delivered the same types of activities and operated within national policy frameworks, there is variability in the costs and delivery methods across states. This variability reflects differences in states' systems and infrastructure, which are products of policy decisions over many decades. States have focused on delivering supports as quickly and safely as possible within existing system constraints. As a result, what 'average policy' looks like during a pandemic does not fit neatly into the Commission's definition even though such supports are policy neutral.
- 2.6 Regardless of variation in costs, all states share the same underlying drivers of COVID-19 related expenditure. These expense drivers need to be factored into the Commission's methods.
- 2.7 NSW Treasury's consideration of the treatment of COVID-related expenditure outlined in this paper is limited to pre-vaccination settings. During pre-vaccination settings, states have had to rely on suppression measures including stay-at-home orders and surge capacity in hospitals.
- 2.8 As Australia reaches vaccinations targets, there is likely to be less reliance on broad containment strategies and the incidence of COVID-19 will likely align with traditional cost drivers, though some uncertainty remains. States' responses to the virus will converge as COVID-19 becomes endemic.

Revenue issues

- 2.9 No change to revenue assessment methods is required in the current assessment period. State policy responses to COVID-19 were largely similar in 2020-21. Restrictions in place across states have impacted economic activity to differing degrees reflecting differences in state circumstances rather than differing policy responses. To the extent that responses to COVID-19 are having differential effects on state revenue raising capacity, this is already captured through existing revenue assessment methods.
- 2.10 JobKeeper payments should continue to be assessed as part of the payroll tax base on practicality grounds.

NSW response

- Treat tax waivers, rebates, tax deferrals and JobKeeper payments using the same approach as for the 2021U.
- No adjustment to revenue bases is required to account for differences in state policy responses to COVID-19.

Health expenses

Key drivers in COVID-related health expenditure are related to the risk of COVID-19 incidence

- 2.11 The pandemic shock has changed the way services are delivered. This has resulted in increases to service delivery costs and anomalous activity levels.
- 2.12 Risk of a COVID-19 outbreak and active cases in the community are key determinants of COVID-related spending.
- 2.13 States with the busiest and most connected international airports were required to process most overseas arrivals, consistent with the Prime Minister's conference of 27 March 2020.
- 2.14 Processing higher volumes of international arrivals increases the probability of community infection through leakages in hotel quarantine facilities. As facilities must be in located near international airports in capital cities, these states are less able to rely on interstate border closures to control risk and must instead maintain surge capacity to manage COVID-19 outbreaks.
- 2.15 In addition to maintaining preparedness for community infections, these states need to manage a continuous caseload from overseas arrivals. This requires infection controls to minimise transmission within hospitals and more PPE. Infection control has implications for mainstream services – for example, effective infection control needs to apply to the entire hospital.
- 2.16 NSW has borne a disproportionate amount of these costs and risks. From April 2020 to June 2021, Sydney processed, on average, almost half of total overseas arrivals into Australia.
- 2.17 Active COVID-19 cases also drive expenditure. In 2020-21, around 80 per cent of cases occurred in Victoria with the majority occurring in Greater Melbourne.

Key drivers of COVID-related expense

- Higher COVID-19 patient intake increases need and associated cost for infection controls
- Additional accommodation supports for people who could not self-isolate at home and children of COVID-positive cases with no one to care for them
- Increased test and trace capacity
- Increased mental health incidence due to public health orders, e.g. 19 per cent of emergency department presentations from NSW special health accommodation hotels were mental health related.

Payments to Victoria made up 35 per cent of funding paid under the COVID-19 NPA in 2020-21, which is materially more than their population share of 26 per cent. In the same year, almost 75 per cent of COVID-19 hospitalisations occurred in Victoria.

- 2.18 Any assessment of state-funded health expenditure needs to recognise the differential incidence of COVID-19 between states. Under 2020R methods, COVID-19 NPA spending may result in GST being redistributed away from Victoria for disabilities such as remoteness and Indigeneity that have largely been unaffected by the pandemic.
- 2.19 Some jurisdictions have previously expressed concerns that the variability in COVID-19 NPA payments across states could be a product of individual policy choice rather than circumstance. Some of the variability in payment amounts is influenced by system design factors that are outside a state's direct control. For example, COVID-19 NPA payments include private hospital viability payments made to states to provide to private facilities are reflective of the size of the private hospital sector in each state.

Majority of COVID-related expenses were incurred in metropolitan areas and did not affect socio-demographic cohorts equally

- 2.20 The 2020R health assessment recognises higher service use rates amongst cohorts including people living in remote areas and Aboriginal and Torres Strait Islander people. Service use rates for COVID-19 activities has likely not followed this trend in pre-vaccination settings.
- 2.21 Effective strategies to protect regional and remote areas from infection may mean people in those areas have required fewer COVID-19 services compared to people in metropolitan areas. Around 95 per cent of locally acquired cases in NSW and Victoria during 2020-21 occurred in Sydney and Melbourne.
- 2.22 Effective strategies to prevent infections in regional areas meant COVID-related expenditure focused on metropolitan areas. This is reflected in the distribution of COVID-19 NPA expenditure across metropolitan and regional Local Health Districts (LHDs). In 2019-20, almost 80 per cent of funds spent under the State Public Health Component of COVID-19 NPA was incurred in metropolitan LHDs and around 85 per cent in 2020-21. During 2020-21 contact tracing efforts in NSW were almost entirely focused on metropolitan LHDs.
- 2.23 The Australian Institute of Health and Welfare (AIHW) reported a small number of cases in the Aboriginal and Torres Strait Islander community during 2019-20 and most of the 2020-21 financial year. This community comprises 3.3 per cent of the Australian population but only 0.5 per cent of all new cases. As at 25 April 2021, there had been 153 confirmed cases and no COVID-related fatalities among Aboriginal and Torres Strait Islander peoples had yet occurred.

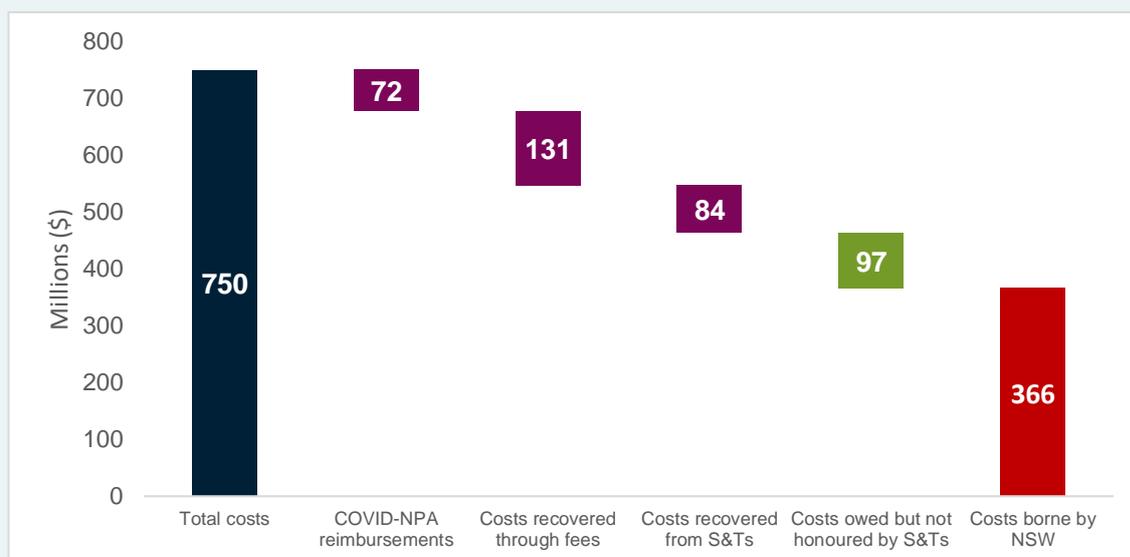
NSW government incurred COVID-related expenditure not covered by the COVID-19 NPA

- 2.24 NSW has borne significant COVID-related expenditure that was not covered by the COVID-19 NPA. In 2019-20, around four per cent of expenditure related to State Public Health spent by LHDs was not eligible for funding under the COVID-19 NPA, increasing to around seven per cent in 2020-21. The additional costs borne by NSW include cleaning expenses for non-health settings (e.g. correctional activities and social housing) and quarantine accommodation for overseas repatriations.
- 2.25 These COVID-related expenses were critical activities in the pandemic response. Mandatory quarantine during pre-vaccination settings played a significant role in minimising infection in the community. Key costs under the quarantine operations, however, were not recognised under the COVID-19 NPA; instead, these activities were partially reimbursed through other mechanisms.

Mandatory 14-day quarantine

- Sydney processed, on average, approximately half of all arrivals into Australia per month from April 2020 to June 2021 — a far greater number than any other state. This is due to Sydney’s existing role as an international gateway and other states reducing overseas arrivals intake to minimise infection risk.
- Cost sharing arrangements have evolved over the pandemic period. In April 2020, the Board of Treasurers agreed states would reimburse each other for the costs of processing their residents, and on 10 July 2020 National Cabinet agreed to partially recover costs of hotel quarantine from returning travellers.
- From March 2020 to March 2021, the arrangements cover up to half the costs of hotel quarantine. NSW has borne the other half of costs, which includes transportation, cleaning, catering and laundry services.
- NSW also bears all the risk of non-payment for quarantine services by returning travellers and states (including Western Australia, Queensland and Northern Territory).

Cost of quarantine March 2020 – March 2021



Impact of COVID-19 on National Efficient Pricing

- 2.26 The National Efficient Price (NEP) is based on the historic costs for delivering eligible hospital services and is central to how states are funded under the National Health Reform Agreement. Payments are made based on the number of National Weighted Activity Units (NWAU) paid at the NEP. It will take years for the full impact of COVID-19 on service delivery costs to be reflected in the NEP, and to determine if its impact on costs was temporary or prolonged.
- 2.27 COVID-19 has increased service delivery costs in some areas while creating opportunities to improve access to high-quality care, for example COVID-19 has:
- increased the cost of services due to increased infection, prevention and control measures (e.g. PPE and cleaning)
 - required a significant increase in the number of isolation rooms, representing a permanent increase in the underlying cost base for operating hospitals, and
 - increased uptake of innovative models of virtual care, which can help improve access to high quality care in regional and remote areas.
- 2.28 In the short-term, the NEP will understate the fiscal needs of states that have had to operate in high risk COVID-19 conditions and experienced higher COVID-19 patient intake. It is unclear how this risk will flow through to Commission's assessment of states' needs and revenues. The Commission should monitor for potential impacts as more data emerges.

COVID-19 has affected expenditure on care outside of traditional settings

- 2.29 COVID-19 has resulted in a significant increase in public health spending. All states sought to treat patients outside of traditional settings to free up hospital capacity and reduce risk of transmission in hospitals and in the community. Activities include virtual hospitals, contact tracing, establishing and operating testing clinics, special health accommodation, innovative models of care to help patients receive treatment at home, and micro COVID-19 strategies.
- 2.30 The Commission should consider the reliability and reasonableness of triage category 4 and 5 data as robust indicator for community and public health spending in pre-vaccination settings. It is counter-intuitive to use emergency department (ED) presentations as a proxy for activities that deliberately seek to divert care away from hospitals. ED presentations will unlikely capture the rapid growth in COVID-19 services.
- 2.31 Some COVID-related services likely captured under the community health component are poorly correlated with ED category 4 and 5 presentations. For example, the Public Health Emergency Operations Centre (PHEOC) is primarily

involved in contact tracing, providing expert advice, issuing public health orders, epidemiology research and other functions.

- 2.32 NSW has longstanding concerns of categorisation of health services and the structure of the 2020R health assessment. Like other non-hospital services, COVID-related health services are a diverse mix that do not fit neatly into existing components of the health assessment.
- 2.33 There is significant uncertainty and a lack of clarity regarding the categorisation of COVID-related activities and how they should be reflected or incorporated within the structure of the health assessment. Mapping out where COVID-19 activities are assessed under each component of the health assessment would provide much-needed transparency and support states' engagement with HFE.

COVID-19 has decreased the substitutability levels of non-state services and state services

- 2.34 During stay-at-home orders, non-state services changed the way they operated to minimise the risk of community transmission, for example, General Practice (GP) clinics reduced in-person consultations, particularly for patients with respiratory or cold-like symptoms.
- 2.35 The changes in service delivery by and availability of GP clinics have significantly reduced the substitutability between non-state services and state services. NSW estimates 54 per cent of ED activity occurs when most GP services are closed. The Commission should review the substitutability levels for ED and community health and make adjustments where they are material.

Treatment of COVID-related health expenditure under the Commission methods

- 2.36 A key differentiator for governments' COVID-related health expenditure is the risk of exposure to the virus, particularly through the processing of overseas arrivals, and incidence of COVID-19 within the community.
- 2.37 Commonwealth and state funding provided under the COVID-19 NPA should be assessed APC. The COVID-19 NPA is the common policy framework for identifying COVID-related health expenses agreed by the National Cabinet, which is administered by the National Health Funding Body (NHFB). The NHFB requires states to provide substantial evidence that expenses are eligible for funding under the COVID-19 NPA in accordance with guidelines. All data must be accompanied by a statement of assurance from the state's senior official.
- 2.38 An APC based assessment would recognise COVID-related expenses are predominantly driven by factors outside the 2020R health assessment methods, such as incidence and risk of exposure to overseas cases, instead of cost drivers such as remoteness and Indigeneity. It would acknowledge that states with less exposure to COVID-19 still incurred expenses, albeit to a lower extent of other states.
- 2.39 Costs associated with quarantining overseas repatriations net revenue should be assessed APC.

- 2.40 The Terms of Reference for the 2022 Update will need to allow the Commission to make such method changes to factor in COVID-19 impacts and improve HFE outcomes.
- 2.41 The Commission should review the substitutability levels for ED and community health and make adjustments if they are material.
- 2.42 It will take time for NWAU data to accurately reflect true costs of COVID-19. As such, the Commission should be open to retrospective adjustments as data becomes available and impacts are quantified.

Future treatment of COVID-19 health related expenses

- 2.43 This submission is limited to addressing how COVID-related health expenditure should be treated in pre-vaccination settings. During the pre-vaccination stage, states have had to maintain surge capacity and divert care that would generally be treated in hospitals to non-traditional health settings. As Australia reaches vaccinations targets, there will likely be more flexibility in the health response.

NSW response:

- Key drivers of COVID-related health expenditure are higher COVID-19 patient intake, additional accommodation support, track and trace systems and increased mental health incidence. Underpinning these drivers is incidence of COVID-19 in the community.
- Commonwealth and state funding under the National Partnership on COVID-19 Response should be treated on an APC basis.
- Costs associated with quarantining overseas repatriations net revenue should be treated on an APC basis.
- Mapping out where COVID-19 activities fit under each component of the 2020R health assessment would improve transparency.
- The Commission should review the substitutability levels for ED and community health and make adjustments where they are material.

Services to Industry expenses

Impact of COVID-19 on state spending

- 2.44 During pre-vaccination stages of the nation's COVID-19 response, states relied on stay-at-home orders to manage high risk COVID-19 conditions. As a result of stay-at-home orders, some businesses were required to completely stop trading or trade in such a limited capacity that they lost the bulk of their revenue. Some of the most affected industries were arts and recreation, accommodation and food services.
- 2.45 All states have delivered support to help businesses remain intact while stay-at-home orders were in force and to recover afterwards. The support was largely comprised of job creation programs and business grants, and therefore affects the business development in other industry expenses sub-category, that is, not agriculture or mining.

- 2.46 Key determinants of business development spending were largely outside the direct control of states and are listed below.
- **Community transmission which dictated the severity and duration of public health orders.** For example, a venue operating under a four-month lockdown will require more support to remain intact than a venue complying with a capacity limit of 250 people over the same period.
 - **Numbers of businesses that were disproportionately affected by stay-at-home orders.** States commonly targeted business support by requiring applicants to demonstrate a decline in revenue compared to an equivalent pre-lockdown period.
- 2.47 States that experienced prolonged lockdowns spent more per capita on business support than other states which did not.
- By December 2021, states had announced a total of \$45 billion worth of measures related to small business and the economy. Almost 45 per cent of total announced spend was by Victoria, which had just started lifting prolonged stay-at-home orders. In contrast, NSW and South Australian measures equated to less than their population share of total announced spend.
 - From July 2021 to September 2021, states had announced a total of around \$16 billion of measures related to small business and the economy. Around 85 per cent of announced spend was by NSW, which had implemented stay-at-home orders while working with the Commonwealth to establish a new policy framework for funding broad-based business and employee supports.

Treatment of state expenditure will need to be able to factor in changes in Commonwealth and State responsibility for individual and business supports in 2021-22

- 2.48 In 2021-22, the absence of JobKeeper left a significant gap in broad-based COVID-related supports to business and employees. States that experienced prolonged stay-at-home orders in this period took on an unprecedented role in providing broad-based business and individual supports.
- 2.49 From 26 June 2021 to 13 July 2021, the NSW Government was required to fully cover this gap in business supports while the new JobSaver scheme was negotiated with the Commonwealth Government. NSW's delivery of broad-based supports was largely dictated by existing state infrastructure and service delivery mechanisms.
- 2.50 During the initial 10 weeks of stay-at-home orders, the NSW Government committed \$7.7 billion in COVID-19 support measures, with a further \$3.4 billion from the Commonwealth Government.
- 2.51 In 2021-22, payments to support business and individuals during the pandemic will likely become material. States have provided support to workers throughout the pandemic, including payments to:

- Support individuals to self-isolate or care for someone with COVID-19, including pandemic leave disaster payments and test and isolate payments.
 - Fund Commonwealth COVID-19 Disaster Payments for those who lived outside designated COVID-19 hotspots. This was in recognition of the impact stay-at-home orders in metropolitan areas had on travel and economic activity in the regions.
 - Support individuals in extreme hardship because of public health orders who cannot access Commonwealth supports, including temporary or provisional visa holders and undocumented migrants.
- 2.52 The Commission's methods need to account for states playing a role in broad-based income support that is traditionally the responsibility of the Commonwealth. Currently, the 2020R welfare assessment only captures limited subsets of welfare supports relating to concessions and subsidies.

Improving the assessment of needs in this area

- 2.53 Under 2020R methods, a four-month lockdown would have no effect on how much a state needs to spend on the provision of business support.
- 2.54 The current method to assess business development expenditure does not adequately capture the need for states to provide business supports in response to restrictions on trading and movement. The 2020R assessment considers population as the sole determinant of spending on business development in the other industry component, and therefore state spending on business development is assessed on an equal per capita basis.
- 2.55 State expenditure on business supports provided in response to public health orders should be assessed on an APC basis. APC treatment would apply until 80 per cent of the national population age 16 years or over is double vaccinated. This is consistent with the nation's transition from an emergency response to a vaccination consolidation phase.
- 2.56 An APC approach is simple and recognises the direct and flow-on effects public health orders have on states. States with zero cases with a high proportion of businesses that are reliant on interstate tourism may also need to provide business supports, albeit to a lesser and more targeted extent than states subject to prolonged stay-at-home orders. The potential risk that an APC treatment would distort state behaviour is low because 80 per cent of the population is expected to be double vaccination by early 2022.
- 2.57 The increased spending on business development by all states indicates the split between regulation and business development for other industries should be reviewed. The Commission should use state budget data to recalculate the split between regulation and business development for other industries and adopt the revised split if it is material.

2.58 The Terms of Reference for the 2022 Update will need to allow the Commission to make such method changes to factor in COVID-19 impacts and improve HFE outcomes.

NSW response:

- Treat business development expenses on an APC basis until the majority of the national population is subject to Phase C of the National Cabinet's plan to transition Australia's National COVID-19 Response. An APC approach is simple, practical and appropriately recognises how public health orders have affected states to varying extents.
- Review the split between regulation and business development for other industries.
- The Commission's methods need to account for states' responsibility for broad-based business and individual COVID-related supports, including through the welfare assessment.

Property tax reform

2.59 At the 2020-21 Budget, the NSW Government announced a proposal to abolish stamp duty and replace it with an annual property tax. This proposal for property tax reform is one of the most productivity-enhancing reforms within state government control. If adopted. It would provide short-term fiscal stimulus, long-term structural reform and pays for itself over time (provided states are not penalised for reform through a reduced share of GST).

2.60 Under 2020R methods, NSW could lose up to \$1 billion of GST in a year if it proceeded with this tax reform. The Commission confirmed that in some circumstances, the implementation of NSW property tax reform can result in outcomes inconsistent with the objective of HFE.

2.61 The Commission had advised that it would need to monitor the proposed reform from the first day of implementation. Early consideration of what data the Commission needs to monitor and assess the proposed reform is necessary to ensure any data specifications can be appropriately factored into the design of reform as it progresses.

2.62 The Terms of Reference for the 2022 Update should allow the Commission to make such method changes in the event this proposed property tax reform is implemented to better capture states' relative fiscal capacities where a material impact is identified in the data available.

NSW response:

- Early consideration of what data the Commission's needs to monitor and assess the reform is necessary to ensure data specifications can inform the design of reform as it progresses.

Treatment of JobKeeper payments – wage cost assessment

2.63 The inclusion of JobKeeper payment in the ABS data used in the wage cost regression model would likely produce unreliable results. This is because JobKeeper

wages paid to recipients have no relationship with employment attributes that the model estimates as important determinants of wages.

- 2.64 A data adjustment to remove employees earning \$750 from the wage cost data is supported, subject to the Commission explaining the movements in coefficients.

NSW response:

- Remove employees earning \$750 per week from the data used in the wage costs regression model given the limitations with identifying Jobkeeper participants in the data.

Treatment of negative relativities

- 2.65 The Commission's proposal to lift an affected state's relativity to zero for the relevant assessment year and shares the cost of doing this among the other states would result in poorer HFE outcomes. This proposal is not supported.
- 2.66 Sharing the cost of lifting a state's relativity zero in an assessment year is a method change that provides a clear fiscal advantage to the strongest state at the expense of the other states. It would increase the fiscal capability gap between the strongest state and the other states — the opposite intention of HFE.
- 2.67 The affected state's relativity should be lifted to zero for the relevant assessment year and apply the cost of doing this in the next assessment year when the affected state's relativity returns to positive. There is precedent where the Commission has made retrospective downward adjustments across assessment years – for example, revisions in the natural disaster relief assessment in the 2021U.

NSW response:

- The cost of lifting an affected state's relativity to zero for the relevant assessment year should not be borne by other states. The cost should be applied to the next assessment year when the affected state's relativity returns to positive.

New Western Australian Native title agreements

- 2.68 The Commission generally assess expenses in the year that they are made, not in the year to which they are accrued. The Commission should maintain a consistent approach to its' treatment of expenses.

NSW position

- 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.

New Accounting Standards

- 2.69 Recent changes to Australian Accounting Standards may affect the data used for the Commission's capital assessments and recognition of Commonwealth payments.
- 2.70 The changes to Australian Accounting Standards AASB1059 *Service Concession Arrangements* and AASB 16 *Leases* will mean some previously recurrent transactions will be treated as capital transactions (Assets acquired using Leases and Service Concession Arrangements) by states.
- 2.71 The NSW Government has applied the Leases Standard to 2019-20 reporting onwards and Service Concession Arrangements Standard to 2020-21 reporting onwards
- 2.72 The adoption of AASB 16 and AASB 1059 will contribute to convergence differences resulting in the different calculation of the key fiscal aggregates under AASB 1049 and in accordance with the ABS GFS manual. The ABS has advised it will remove the changes when incorporating state data into the GFS. This raises the risk of inconsistent data used in the capital assessments, which relies on GFS data and state data.
- 2.73 There is a risk the effect of the new standards may result in over \$300 million difference in the calculation of the key fiscal aggregates for NSW in 2020-21 under AASB 1049 and in accordance with the ABS GFS manual. GFS data should be adjusted to be consistent with accounting standards if this risk materialises.
- 2.74 The New Issues Paper has sought state views on whether the changes to the AASB 1059 and 16 standards will affect recognition of revenue from the Commonwealth. These new standards will unlikely result in a large imbalance between the unit record data provided by the states and the Final Budget Outcome data from the Australian Treasury.

NSW position

- Adjust ABS GFS data to be consistent with the accounting standards AASB 16 and AASB 1059 if doing so is materially different from using ABS GFS data as published.
- Develop the adjustment method in consultation with states.

Health assessment – patient data

- 2.75 The scope of services covered by the activity data on total non-admitted patient separations should align with the services covered by the expense data. The Commission considers services including general practice and primary care, primary health care, family planning and general counselling provided by states should be considered as part of the 2020R health assessment.
- 2.76 Actual activity data should be used wherever possible provided it is robust.

- 2.77 The robustness and reliability of NWAUs for medical consultations and allied health as a proxy for non-admitted services that are not in scope for National Health Reform Agreement is unclear. Analysis of the impact and the reasonableness of this proxy is necessary. The Commission should apply a discount of 50 per cent in the short term to manage risk until the reliability of the proxy is demonstrated.
- 2.78 The Commission should consider other proxies as well – for example, ED category 4/5 activity may be a better indicator for demand/utilisation of GP-type services than community health services (e.g., family planning and counselling).
- 2.79 The Commission should re-examine whether the need for additional Service Delivery Scale adjustment for smaller block funded hospitals is warranted to account for recent improvements to funding block funded hospitals. In 2020-21, the Independent Hospital Pricing Authority released a refined model, based on a fixed-plus-variable structure which will create more equitable funding for small rural hospitals. For 2020–21, the NEC comprised of fixed cost \$2.040 million and a variable cost of \$5,687 per NWAU. An additional loading of 3.91 per cent is applied for very remote hospitals.

NSW position

- Include imputed national weighted activity unit data for general practice and primary care, primary health care, family planning and general counselling services in the non-admitted patient assessment. Apply a 50 per cent discount to proxy data in the short term to manage risk until the reliability of the proxy is demonstrated.
- Reduce the additional service delivery cost adjustment for block funded hospitals to account for improvements to the NEC funding model to reflect the costs of block-funded hospitals.

Treatment of new Commonwealth Payments commenced in 2020-21

- 2.80 Commonwealth payments relating to remote housing should impact relativities. The provision of remote housing is a state-like service and should be included in HFE.
- 2.81 Commonwealth payments to support quarantine arrangements in Tasmania and the Northern Territory should have no impact on relativities. NSW has incurred significant cost in providing quarantine facilities, yet in the absence of a method change, this recurrent expenditure will be subject to 2020R methods.

NSW position

- Commonwealth payments relating to remote housing should impact relativities.
- Quarantine should have no impact on relativities. Consistency in treatment of expenditure and Commonwealth payments for quarantine services is necessary. An APC based assessment is the simplest way to achieve equitable treatment across states.

Occasional Papers

- 2.82 The introduction of the Occasional Paper series is a welcome initiative.
- *Occasional Paper No.1 Impact of the COVID-19 pandemic on GST distribution* was useful in the context of consultation on new issues in the 2022 Update and assists states to consider the impacts of COVID-19 on HFE.
 - *Occasional Paper No. 2: GST distribution and State tax reform* has supported both Treasurers' and treasuries' consideration of potential impacts of NSW proposed property tax reform on the GST distribution and HFE outcomes.
- 2.83 However, *Occasional Paper No. 3: Mining Revenue* risks conflating stability in GST distributions with the Commission's supporting principles, implying that volatility has a status not provided for in the principles and which it has never held. The NSW Government has never accepted or supported stability as a basis for the Commonwealth's 2018 changes to HFE.
- 2.84 The elevation of volatility in *Occasional Paper No. 3* could imply that the GST distribution has a role in managing the revenue stability of state budgets, which was never the intention of HFE. These are matters solely for state governments, which have a range options for managing short-term fluctuations in their GST revenues, just as they do across other state revenues.
- 2.85 The Productivity Commission has noted previously that GST represents a relatively stable revenue source when compared to other sources, and for several states the least volatile source. Over the past 10 years in NSW, transfer duty has been five times more volatile than GST, while payroll tax, considered a stable revenue source, has been one and a half times more volatile.

NSW position

- The Commission to consult with states on the content of future publications.
- Discussions about the new HFE arrangements should align with the original policy intent agreed by governments.

Appendix – COVID-19 incidence and risk

Figure 1 Share of COVID-19 cases and national population by state in 2019-20

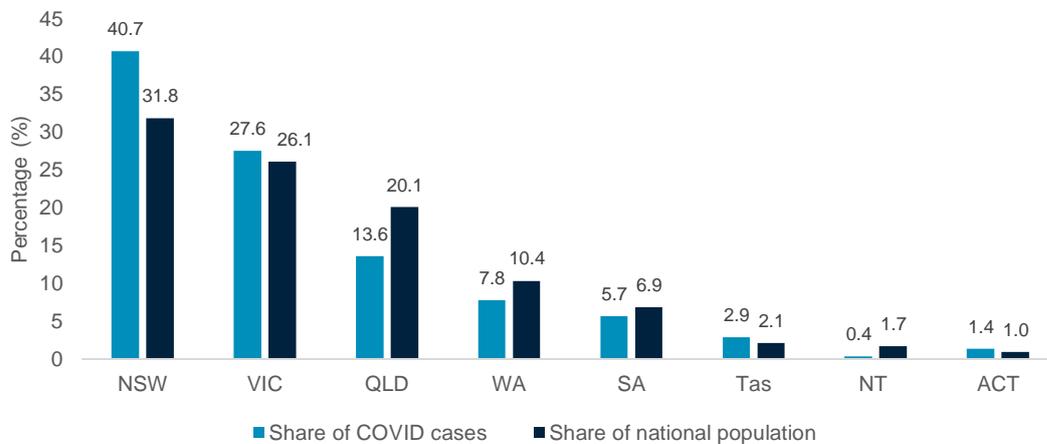


Figure 2 Share of COVID-19 cases and national population by state in 2020-21

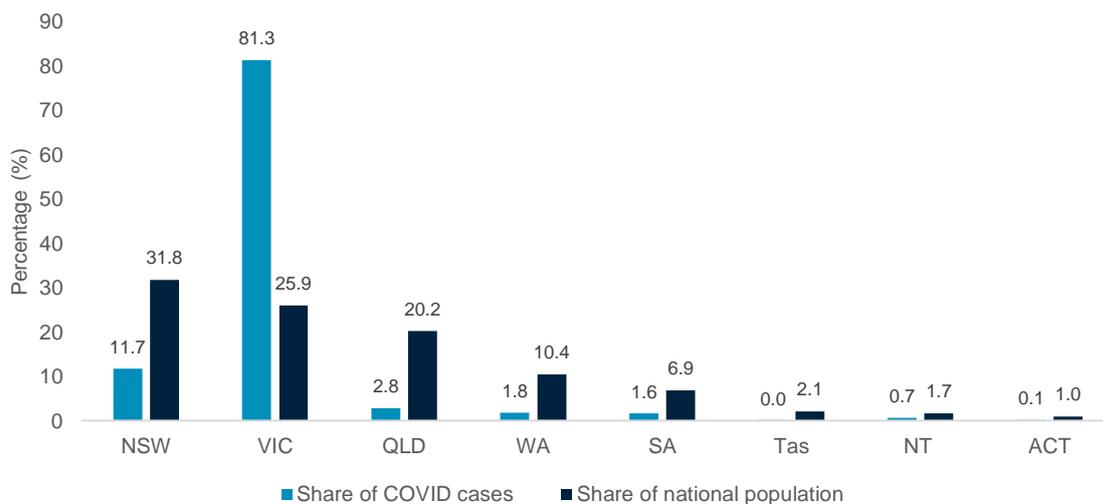


Figure 3 New South Wales - locally acquired COVID-19 cases by metropolitan and regional areas in 2019-20 and 2020-21

Year	Local acquired cases	% of total cases	Cases per 10,000
2019-20, total local cases	1206		
Metropolitan LGAs	1104	91.5	2.0
Regional LGAs	102	8.5	0.4
2020-21, total local cases	1060		
Metropolitan LGAs	1024	96.6	1.8
Regional LGAs	36	3.4	0.1

Figure 4 Figure 3 Victoria - locally acquired COVID-19 cases by metropolitan and regional areas in 2019-20 and 2020-21

Year	Local acquired cases	% of total cases	Cases per 10,000
2019-20, total local cases	1264		
Cases in metropolitan LGAs	1180	93.4	2.3
Cases in regional LGAs	84	6.6	0.5
2020-21, total local cases	18175		
Cases in metropolitan LGAs	17183	94.5	33.8
Cases in regional LGAs	992	5.5	6.1

Figure 5 Processing overseas arrivals by state from March 2020 to June 2021

