



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

Western Australia's Submission to the

Commonwealth Grants Commission's 2020 Methodology Review

Significant Changes Since the Draft Report

December 2019



Key Points

- We support most of the proposed changes since the draft report, except for:
 - broadening the scope of small communities for water subsidies based on populations, rather than distance from potable water source;
 - the proposal to not apply a cost factor to negative assessed investment (for sales of assets); and
 - blending Rawlinsons factors with wage costs for interstate asset investment expenditure costs.
- Issues on which we have made compelling arguments which have not been addressed to date include:
 - treatment of first home owner concessions;
 - allocation of indigeneity to court defendants;
 - use of the consultant’s urban transport model;
 - assessment of ‘other industries regulation’; and
 - timing mismatches in the capital assessments.
- There should be a more comprehensive assessment of non-State services for Health. We propose a method using a single health category.
- Isolation costs for Western Australia should continue to be assessed.
 - Possible bases for a disability factor would include Rawlinsons construction costs or Federal parliamentary spending.
- The wages regression model should be replaced with a private average weekly earnings indicator, structurally adjusted for industry differences. If retained, the CGC should:
 - re-run the model to include the latest revised data available; and
 - if it remains anomalous, exclude the 2017-18 assessment year result, by extrapolating from the 2016-17 result.

This submission responds to the Commonwealth Grant Commission’s (CGC’s) discussion paper CGC 2019-02, which outlines ‘significant’ method changes since the CGC’s draft report.

This submission also provides:

- proposed approaches to assess non-State health provision and interstate non-wage costs (isolation), as foreshadowed in our September 2019 submission; and
- further comments on the wage costs assessment, considering the recently-provided wage results for the 2018-19 data year.

Significant changes since the draft report

Supported proposals

We have no major concerns with most proposals in the discussion paper. In particular, we support the proposals to:

- include local government net expenses in the natural disaster relief assessment;
- retain grants in lieu of royalties in the Mining Revenue category;
- assess Other Welfare Services expenses equal per capita;
- not discount the water subsidies regional cost weights;
- assess wage costs for electricity and water subsidies;
- use Rawlinsons to estimate regional cost factors for asset investment expenditures;
- discontinue the Stamp Duty on Conveyances off-the-plan and unit trust adjustments;
- include only 10% of the value of listed land rich transfers in the Stamp Duty on Conveyances assessment;
- increase the land tax aggregation adjustment for the ACT; and
- change how the assessed Northern Territory land tax revenue base is estimated.

Unsupported proposals

We do not support the following proposals in the draft report.

- We do not support the proposal to broaden the definition of small communities for water subsidies to include communities of less than 3,000 people (instead of less than 1,000 people). However, we continue to consider that certain communities, in particular, Kalgoorlie, face circumstances that require substantial water subsidies that can be unrelated to population size. Such communities should be included with those of less than 1,000 people rather than simply extending the definition to communities up to 3,000 people. The criterion for inclusion could be a threshold distance from the closest potable water source.
- We appreciate what the CGC is attempting with the removal of cost factors from negative assessed investment. However, any potential benefit would likely be lost under a gross assessment. Further, for States that have cost factors below one, such a method would assess them as being able to sell assets for more than they purchased them, so this change should not be pursued.
- We are not convinced that Rawlinsons should be blended with recurrent wage costs factors for interstate asset investment expenditure costs. Rawlinsons already reflects wage costs that are specifically relevant to asset construction.

Outstanding issues

Issues on which we think our arguments are compelling and can be implemented in the 2020 Review, but which have not been addressed in the CGC's latest discussion paper, include the following.

- Stamp Duty on Conveyances – first home owner concessions should not be treated differently from first home owner grants, as they can easily substitute for each other. The differing GST treatment could drive State policy on choices between the two or result in different GST outcomes because States deliver essentially the same policy through a different mechanism.
 - For example, Tasmania and the Northern Territory provide first home owner assistance for new homes through a grant whereas most other States split assistance for new homes across grants and duty concessions. Most States now provide assistance for established homes solely through a duty concession, but assistance was previously also available through grants.
- Justice – courts defendants who do not state their indigeneity should be allocated according to the proportion of indigenous and non-indigenous who did respond.
- Transport – the urban transport model is not justified as passenger use cannot be considered as a proxy for supply.
 - Given concerns with the reliability of the method, and that public transport expenditure is heavily policy influenced, the CGC should adopt an equal per capita public transport assessment.
- Services to Industry – the proposed equal per capita assessment for 25% of 'other industries regulation' does not give a materially different result from assessing the entire component by factor income.
- Investment and Net Borrowing – there are some timing mismatches in the assessment formulae.
 - Our September 2019 submission provided an algebraic proposal to remove the timing issues by basing assessed investment and net borrowing on start-of-year values instead of end-of-year values.¹

¹ Western Australia (September 2019), *Western Australia's Submission to the Commonwealth Grants Commission's 2020 Methodology Review - Draft Report*, pages 81-83.

Health: a proposed approach

Western Australia committed to provide the CGC with preliminary views on services that should be included or excluded in a subtraction-type Health assessment.² In this section, we aim to provide a backbone structure to a method that, although not entirely new, contains new suggestions that will address the CGC's concerns about data and substitutability. We provide possible data sources that could be used as a starting point for such an assessment. We urge the CGC to consider the approach immediately following the 2020 Review. Western Australia is willing to engage with the CGC on a possible way forward.

The CGC cited complexity of data needs as one of the reasons for moving from a broad subtraction approach in the 2010 Review (for 'community and other health services') to a narrow direct approach in 2015.³

As we have often noted, narrowing the assessment in this way provides no overall solution to the problem of data availability, as the narrow assessment introduces a bias that can only be calculated by reference to a broad assessment. In this submission we focus on how a broad assessment can be implemented in a pragmatic way.

Western Australia is of the opinion that data issues with the subtraction approach could be mitigated if the Health assessment were treated as a single category. A single category assessment would also fulfil recommendation 7.1 of the Productivity Commission Inquiry report on Horizontal Fiscal Equalisation:⁴

The Commonwealth Treasurer should direct the CGC (in accordance with the refocused HFE objective) to:

- examine simpler and more aggregated revenue and expenditure assessments that use more policy-neutral indicators, consistent with achieving a reasonable standard of services
- adopt significant increases in materiality thresholds, which would assist in determining and applying more policy-neutral category level indicators.

² Western Australia (September 2019), *Western Australia's Submission to the Commonwealth Grants Commission's 2020 Methodology Review – Draft Report*, page 38.

³ Commonwealth Grants Commission (2015), *Report on GST Revenue Sharing Relativities 2015 Review*, Volume 2 – Assessment of State Fiscal Capacities, page 213, paragraph 172.

⁴ Productivity Commission (2018), *Horizontal Fiscal Equalisation*, Inquiry Report No. 88, page 42.

Historically, the Commission has endorsed a subtraction model approach:⁵

The subtraction model approach is consistent with the top down approach to the development of assessments and the assessment guidelines. It allows us to assess a broad range of expenses in one assessment using reliable data that are fit for purpose. We prefer this broad approach to a service by service approach because reliable administrative data are not available to directly measure socio-demographic composition influences across most State community and other health services.

While there have been some administrative data quality improvements since 2008, gaps remain.

Western Australia's proposed approach involves a five-step subtraction model to assess health services in a single category:⁶

- Step 1: Derive national health expenditure
- Step 2: Assess total expenditure for each State (under average policy)
- Step 3: Estimate Commonwealth actual expenditures by State
- Step 4: Estimate private actual expenditures by State
- Step 5: Assess State government expenses, as Step 2 minus Steps 3 and 4.

We note that this approach was proposed in a CGC 2010 Review staff discussion paper,⁷ which set out technical details on how a single health services category can be assessed.

Step 1: Derive national health expenditure

The health expenditure database from the Australian Institute of Health and Welfare (AIHW) provides a breakdown of expenditure in various areas from various sources. Total expenditure in the health sector, including services that are not State-like (i.e. services for which non-State expenses cannot reduce the need for State expenses) comprises:

$$\text{Total Health Sector expenditure} = \text{Commonwealth expenditure} + \text{private expenditure} + \text{State expenditure}^8$$

where:

$$\text{Commonwealth expenditure} = \text{Department of Veterans' Affairs} + \text{'Health and other'} + \text{premium rebates}$$

$$\text{Private expenditure} = \text{Health insurance providers} + \text{individuals} + \text{other}^9$$

⁵ Commonwealth Grants Commission (2008), *Community and Other Health Services, Commission Position Paper*, CGC 2008/20, page 3, paragraph 14.

⁶ In this section, 'non-State' refers to combined 'private' sector and 'Commonwealth' expenditure.

⁷ Commonwealth Grants Commission (2007), *Assessing Health Services in a Single Category*, Staff Discussion Paper CGC 2007/36-S, Supplement to Staff Discussion Paper CGC 2007/21-S.

⁸ As defined by AIHW.

⁹ Other non-government sources of funds include:

- workers compensation insurers;
- compulsory third-party motor vehicle insurers; and
- other privately funded health expenditure, such as some private hospital expenditure and research.

Subject to further future analysis, we propose that the following expenditure areas be excluded from the calculation due to data limitations.

- 'Dental services'
 - This covers a wide range of services (purely cosmetic to immediate medical necessity) with a wide range of alternatives (e.g. dentures to implants). Spending disabilities will give high weight to higher income persons, and it is not clear that data is available to quantify these disabilities to ensure they are properly assessed.
 - In principle, dental services should be part of the calculation of a non-State services factor, as a shortage in dentists is likely to limit private services for persons of low socio-economic status (SES) which, even if not offset by increases in State dental expenditure, will likely increase State spending in the longer run through related morbidity. It may be possible to include a subset of dental data if the broader dataset is not available or considered unreliable.
 - In this regard, we consider that private dental services for low income/SES persons should be included in the assessment if that data becomes available or can be reliably imputed.
- 'Other health practitioners'
 - This covers a wide range of practitioners, from nurses through to practitioners of traditional medicine. The quality of the data is uncertain (e.g. Western Australia has very low spending in this area). It is unclear that data would be available to understand disabilities in this area.
- 'All other medications'
 - This covers a wide range of products for which no Pharmaceutical Benefit Scheme (PBS) benefit is paid. The quality of the data is uncertain, and it is unclear that data would be available to understand disabilities in this area.
- 'Patient transport services'
 - This data is considered unreliable because of possible misclassification as administration spending.
- 'Aids and appliances'
 - These range from glasses to external prostheses. The quality of the data is uncertain, and equivalent products (e.g. glasses) can vary in price by a factor of 20. Spending disabilities will likely give high weight to higher income persons, and it is not clear that data is available to quantify these disabilities.

- 'Administration'
 - This data is considered unreliable because of misclassification issues noted above. Administration costs could also be affected by specific aspects of private sector operations that are not related to the quantity of services provided.
- 'Research'
 - This data may not be reliable because of possible misclassification as administration spending. In addition, the benefits of research can cross borders.

Table 1 summarises the proposed inclusions and exclusions of AIHW's total national health expenditure. For 2017-18, the proposed inclusions amount to 74% of total national health expenditure and 69% of total national non-State health expenditure.

Table 1: AIHW health expenditure areas to include in the assessment

	Include in the assessment
Hospitals	✓
Primary health care	
Unreferred medical services	✓
Dental services	✗
Other health practitioners	✗
Community health and other	✓
Public health services	✓
Benefit-paid pharmaceuticals	✓
All other medications	✗
Referred medical services	✓
Other services	
Patient transport services	✗
Aids and appliances	✗
Administration	✗
Research	✗

Step 2: Assess total expenditure for each State

This step calculates assessed total expenditure for each State under average policy by distributing the 'Total Health Sector expenditure' calculated in Step 1 between States. Possible drivers, which would inform the distribution, include age, gender, indigeneity, remoteness, service delivery scale and income/SES (although the positive relationship between income and private services needs to be balanced against the negative relationship between income and State services).

Total expenditure for each State can be assessed using a bottom-up or top-down approach.

- A bottom-up approach would consist of two components.
 - The first component would assess **State** expenditure using the CGC's socio-demographic and cost factors. The economic environment adjustment should not be included.
 - The second component would assess **non-State** expenditure, potentially using as a proxy a combination of factors derived from Medicare Benefit Scheme (MBS) statistics for the 'number of services for total Medicare', similar PBS statistics, and national database statistics on private hospital inpatients.
 - Using national socio-demographic sub-group shares for age/gender, indigeneity and location would allow disabilities to be calculated for age/gender, indigeneity,¹⁰ SES and remoteness costs (using spatial SES measures and remoteness costs patterned from the State assessments).
 - Hospital indigeneity data may be limited to acute inpatients. If so, factors could be based on acute inpatients, or alternatively acute and sub-acute inpatients with the indigenous impact proxied from acute inpatients.
 - Allowances for private wage costs could be patterned on the State wage costs assessments or a private health specific assessment.
- A top-down approach could be constructed by examination of various data sources.
 - AIHW has published data on indigenous and non-indigenous shares of health spending.¹¹ If considered out of date, a new dataset could be commissioned.
 - Age/gender/indigeneity data for public hospitals, private hospitals, MBS and PBS should allow a factor to be estimated.
 - Remoteness prevalence can be estimated from Medicare and hospital data by location. State remoteness cost weights can be applied to this data.
 - SES can also be estimated from Medicare and hospital data by location, using spatial SES measures.

Step 3: Estimate Commonwealth actual expenditures by State

The AIHW publishes 'Australian Government' expenditure by State.

¹⁰ We understand that indigeneity data would be available for PBS, as Medicare identification is required to access PBS benefits.

¹¹ AIHW, May 2017, *Aboriginal and Torres Strait Islander Health Performance Framework*, Online Data Tables, Measure 3.21: Expenditure on Aboriginal and Torres Strait Islander health compared to need, Table 3.21.1: Expenditure on health for Indigenous and non-Indigenous Australians, by area of expenditure, 2013-14.

Step 4: Estimate private actual expenditures by State

The AIHW also publishes private funded expenditure by State.

Step 5: Assess State government expenses

For each State, subtract Step 3 and Step 4 from Step 2, to derive policy-neutral expenses for each State. If necessary, rescale the expenses so they sum to the CGC's total State expenses in its adjusted budget.

There should be a more comprehensive assessment of non-State services for Health.

Western Australia would like the CGC to consider our proposed subtraction approach to assess non-State services, under a single category.

- We welcome discussion immediately following the 2020 Review on a possible way forward.

Interstate non-wage costs: a proposed approach

The CGC concluded there is a conceptual case to assess interstate non-wage costs and that Perth is more isolated than other large capital cities including Sydney, Brisbane and Melbourne.¹² We agree.

Assessments from previous reviews identified and measured cost drivers such as freight and travel allowances, labour-related costs and medical travel-related subsidies. However, data limitations on the cost implications of isolation resulted in the CGC moving to judgment-based assessments. Despite no significant change in Perth's isolation since the 2015 Review, the CGC currently proposes to cease the assessment in the 2020 Review.

- This proposal was not expected, as the draft assessment papers stated that CGC staff proposed recommending that the CGC 'maintain 2015 methods to measure Interstate non-wage costs'.¹³
- We contend that there has been insufficient time to conduct the detailed analysis required to present reliable data that adequately reflect needs arising from isolation.
- However, we consider that the assessment should continue in order to capture a known and accepted cost disability.

Further research on interstate cost differences should be considered for the next review, with the current disability for at least Perth continuing in the meantime.

¹² Commonwealth Grants Commission (2019), (Draft) *Report on GST Revenue Sharing Relativities, 2020 Review*, Attachment 25, page 18, paragraphs 66, 68 and 75; Commonwealth Grants Commission (2018), *2020 Review Geography Used by the Commission, Staff Draft Assessment Paper CGC 2018-01-23-S*, page 17, paragraph 77.

¹³ Commonwealth Grants Commission (2018), *2020 Review Geography Used by the Commission, Staff Draft Assessment Paper CGC 2018-01-23-S*, page 18, paragraph 78.

Data concerns could be mitigated through employing a proxy to generate a disability factor, which is then applied to isolation-related expenses.

Rawlinsons construction cost indices could, for example, be used to show cost differentials between State capital cities. Although the data have a construction focus, they could be used to create factors that reflect State differences. An appropriate discount could be used to acknowledge that it is a proxy.

Alternatively, the CGC could look to data sources that can provide an indication of State travel cost differences.

Despite an increase in the use of video and teleconference facilities, States still often need to travel to the eastern States (principally Canberra, Sydney and Melbourne) for interstate meetings. This would not comprehensively capture isolation costs but may be an appropriate proxy while other data sources are researched.

Spending by Federal parliamentarians on interstate scheduled fares is a potential indicator to reflect the additional costs incurred to perform duties away from their home base. Parliamentarians' interstate travel fares are based on quarterly data provided by the Independent Parliamentary Expenses Authority (IPEA) – an independent constitutional authority that monitors and audits all work expenses claimed by parliamentarians.^{14,15}

Parliamentarians who incur travel-related expenses include Senators and Members of the House of Representatives.

- There are currently 76 Members of the Senate – 12 Senators in each State and two Senators in each Territory.
- The House of Representatives consists of 151 Members each representing an electorate consisting of approximately 150,000 people.

Whilst IPEA reports on a range of period-specific parliamentarian expenses related to travel, we only consider the component related to interstate travel. Intrastate fares are excluded to remove any possible double counting with regional costs.

The data set ensures State policy neutrality as it comprises Commonwealth settings. In addition, the disability factor is standardised by deriving an expenditure-per-parliamentarian measure.

Table 2 sets out the isolation factors for 2018-19, which is derived from total expenses incurred by parliamentarians travelling interstate to and from their home base. This data includes both attending Parliament and parliamentary duties.

¹⁴ The Independent Parliamentary Expenses Authority, *Travel within Australia*. Accessed on 19 November 2019. Available online at: <https://www.ipea.gov.au/travel-parliamentarians-travel/travel-within-australia>.

¹⁵ The Commonwealth compensates for travel expenses incurred by parliamentarians as prescribed by a reviewed principles-based framework. See: <https://www.ipea.gov.au/travel-parliamentarians-travel/principles-based-framework>.

Table 2: Parliamentarian expenses on interstate travel fares

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
Expenses (\$m)	1.3	2.1	1.8	2.3	1.1	0.6	0.1	0.3	9.7
Expenses (\$pc) ^a	22,335	42,623	41,694	83,190	50,694	37,192	24,424	74,284	42,714
Isolation factor (raw)	0.52	1.00	0.98	1.95	1.19	0.87	0.57	1.74	0.95
Isolation factor (scaled)	0.55	1.05	1.03	2.05	1.25	0.92	0.60	1.83	1.00

Source: Western Australian Department of Treasury calculation, based on IPEA data.

(a) Per capita expenditure refers to 'per-parliamentarian'.

Expenditure differentials can be the result of distance from Canberra (i.e. flight costs) and frequency of travel; some parliamentarians being part of Cabinet and/or involved with Committees.

Disability factors generated from such a method would be applied to national isolation-related expenditure. Such expenditure could be extrapolated from previous assessments, or the CGC could request data from States.

Although the data to some degree are Canberra-centric (a large proportion of fares are to and from Canberra), this is arguably valid as Canberra is centrally located in the eastern seaboard, where the nation's population, economic activity and government meetings are also centred.

Western Australia would like the CGC to reinstate an isolation assessment in the 2020 Review.

- Possible bases for a disability factor would include Rawlinsons construction costs or Federal parliamentarian spending.

Further research on interstate non-wage cost differences should be considered for the next review.

Wage costs

Western Australia continues to support the assessment of wage differences across States. However, we are disappointed the issues raised in our previous submission were not considered in the *Significant Changes Since Draft Report* Commission position paper.

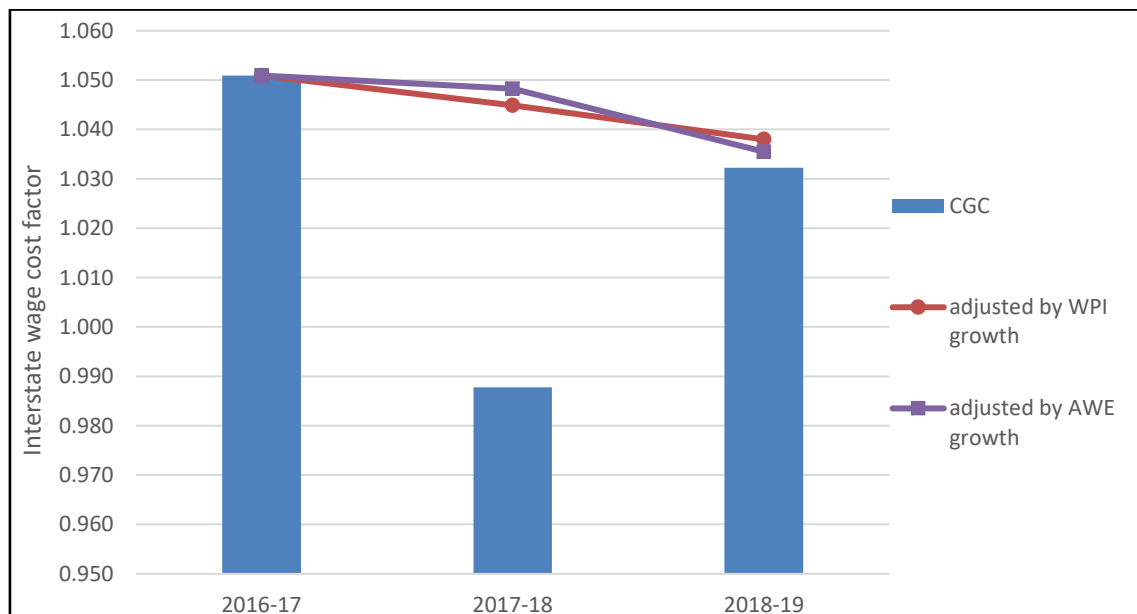
2020 Review – CGC 2020 wage costs assessment regression results

We are pleased the CGC has released its 2018-19 wage costs assessment regression results ahead of the 2020 Review. However, we believe the latest results further justify our concerns with the CGC's regression model and further support our position that the volatile regression results for 2017-18 in particular should not be used.

The CGC's results over the last three years suggest that the estimated wage pressures in Western Australia fell from 5% above the national average in 2016-17 to 1% below the national average in 2017-18, before increasing to 3% above the national average in 2018-19 (all prior to the 12.5% discount). Again, we could not find any other data that supports these results.

Chart 1 shows the CGC's interstate wage costs factor for Western Australia (as determined by the regression model) over the three data years 2016-17 to 2018-19. The chart also shows trajectories of the latest Australian Bureau of Statistics (ABS) wage growth measures, if they were applied to the CGC's interstate wage factor for 2016-17.¹⁶

Chart 1: Interstate wage costs factors – CGC versus ABS growth indices, Western Australia, 2016-17 to 2018-19



Source: Western Australian Department of Treasury calculation.

Note: The WPI and AWE wage cost factors for 2017-18 and 2018-19 are derived by applying the ABS' WPI growth and the ABS' AWE growth to the CGC's 2016-17 wage factor (prior to the discount), respectively.

We acknowledge that ideally the ABS Average Weekly Earnings (AWE) should be adjusted for industry structure differences but given we are looking at growth rates rather than levels we expect the difference to be small. In particular, the chart shows that the relationship between the CGC's 2016-17 and 2018-19 factors for Western Australia can be largely explained by the growth in either the ABS Wage Price Index (WPI) or unadjusted AWE.

Chart 1 shows that, even if we accept the CGC's 2016-17 interstate wage factor of 1.051 (which we argue is too low), if we apply the WPI private sector growth, it generates an implied wage cost factor of 1.045 for Western Australia in 2017-18. If we apply AWE private sector growth, the implied wage cost factor is 1.048. All factors are prior to the 12.5% discount.

¹⁶ Notwithstanding that we consider the 2016-17 factor to understate Western Australia's wage costs disability.

The considerable difference between these factors and the CGC's interstate wages factor of 0.988 for 2017-18 raises questions about the validity of the regression results.

- It suggests the CGC's 2017-18 results are anomalous and should not be used.
- The CGC should exclude the 2017-18 assessment year result, and at the very least extrapolate from the 2016-17 result.

If the 2016-17 wage factor with the WPI growth were used for the 2017-18 interstate wage factor the difference would increase WA's GST grant by over \$200 million for each grant year impacted.

Further, as with last years' regression model results, the recently-received 2018-19 results reveal very large standard errors for some States. New South Wales, Western Australia and the ACT are statistically significant only at the 23%, 57% and 69% level, respectively. This implies that these States wages are statistically the same as the Northern Territory.

Characteristics of Employment (COE) survey data

The ABS has recently released its publication of *Characteristics of Employment (COE), Australia, August 2019* (cat. no. 6333.0). The publication also provides significant revisions to previous years' data.

The ABS states 'improvements have been implemented and applied to the 2014-2018 period, resulting in revisions'¹⁷ and recommends that the revised estimates be used:

When comparing results from the 2018 and 2019 issues of COE to previous surveys, it is recommended to use the revised and re-published estimates provided within the current issue. In previous publications, caution should be exercised when comparing results, as the definition of employees is not always directly comparable to the current definition.¹⁸

Consistent with the CGC's usual practice to use the latest revised data, if the CGC continues to use its regression model, it should be re-run to incorporate the latest revised data available.

The latest (revised) COE results for 'median weekly earnings in main job', from 2016-17 to 2017-18 found the median weekly earnings in Western Australia was 10% above the national median wage in 2016-17 and 8% above in 2017-18. This is significantly different from the CGC's regression results that suggest that the estimated wage pressures in Western Australia fell from 5% above the national average in 2016-17 to 1% below the national average in 2017-18.

¹⁷ Australian Bureau of Statistics, *Characteristics of Employment (COE), Australia, August 2019* (cat. no. 6333.0), Summary, Improvements in the quality of earnings data.

¹⁸ *ibid.* Explanatory Notes, paragraph 31.

Notwithstanding the above discussion, Western Australia stands by its proposal¹⁹ that the CGC should replace the wages regression model with a private AWE indicator, structurally adjusted for industry differences, as described in our previous submissions to the 2020 Review.

Western Australia would like the CGC to replace the wages regression model with a private AWE indicator, structurally adjusted for industry differences.

If the CGC continues to use its flawed regression model, it should:

- re-run the model to include the latest revised data available, to remain consistent with the CGC's usual practice of incorporating revised data; and
- if it remains anomalous, exclude the 2017-18 assessment year result, by extrapolating from the 2016-17 result.

¹⁹ Western Australia (September 2019), *Western Australia's Submission to the Commonwealth Grants Commission's 2020 Methodology Review – Draft Report*, pages 85-92.