COMMONWEALTH GRANTS COMMISSION 2021 UPDATE OF GST REVENUE SHARING RELATIVITIES

NEW ISSUES PAPER

ACT Government submission

ACT GOVERNMENT SUBMISSION

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CONTENT

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INTRODUCTION

Each year, the Commonwealth Grants Commission (CGC) conducts an annual Update of Goods and Services Tax (GST) Revenue Sharing Relativities (Update). These annual Updates determine the distribution of the GST grant between the states and territories in accordance with the principle of horizontal fiscal equalisation (HFE). As part of the Update process, CGC staff consult with the states and territories on any new issues that have arisen during the 12 months since the last Update that could impact on the CGC's assessments of state and territory fiscal capacities. The 2021 Update will be the first Update to use the methods determined by the CGC's 2020 Methodology Review of GST Revenue Sharing Relativities (2020 Review).

On 24 August 2020, the CGC issued Staff Discussion Paper CGC 2020-01-S, New Issues for the 2021 Update and requested comments from the states and territories by 2 October 2020. This paper identifies issues that have emerged over the course of the 2019-20 and 2020-21 financial years that may influence the Commission's 2021 Update.

The ACT welcomes the opportunity to comment on the issues that CGC staff have identified.

ISSUES FOR THE 2021 UPDATE

RESPONSE TO THE COVID-19 PANDEMIC

Background

An epidemic of novel coronavirus SARS-CoV-2 and its associated illness, COVID-19, has had a profound impact on the Australian and global economies. In response to this outbreak, the Commonwealth and state and territory governments have developed extensive responses through various forms of public investment, direct support to households and businesses and adjustments to the levying of many taxes and other revenue sources.

These responses, however, have varied between jurisdictions, as has the overall impact of the COVID-19 pandemic. Consequently, COVID-19 has created differences in the fiscal capacities of the states and territories that otherwise would not be present, reflected through differences in economic activity and demands on jurisdictional health systems.

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

As the 2021 Update depends on data from financial years 2017-18, 2018-19 and 2019-20, only differences in the impact of COVID-19 between the states and territories up to and including 30 June 2020 are relevant for the CGC's purposes. CGC staff note that the differences in lockdowns and other policy responses between the jurisdictions were relatively small up to this date.

Commonwealth Grants Commission Staff Position

CGC staff propose that, subject to the issuance of the Terms of Reference for the 2021 Update and materiality, adjustments be made to revenue datasets to ensure comparability between the states and territories, by offsetting rebates against the relevant revenue category and assessing deferred revenue in the year in which the liability arose.

CGC staff also propose to not attempt to remove JobKeeper payments from payroll tax base data, assess COVID-19 related health expenses from the National Partnership on COVID-19 Response on an actual-per-capita basis (subject to materiality), use state and territory budget data to recalculate the split between regulation and business development for other expenses for the Services to Industry assessment (subject to materiality) and to not introduce a differential assessment of business development expenses.

ACT Position

The ACT recognises that any prospective change in the methods used to determine the relative fiscal capacities of the states and territories for the purposes of HFE depend on such changes being allowed under the Terms of Reference for the 2021 Update. That said, the ACT considers that the principle of HFE would be best served if the CGC were given a mandate to alter their methods in response to material impacts of the COVID-19 pandemic on the fiscal capacities of states and territories.

The ACT agrees with the CGC staff characterisation of the differences in state and territory policy responses to COVID-19 prior to 1 July 2020; namely that such differences were generally not significant. Recent events, such as the extended lockdown in Victoria, may have changed this outlook from 1 July 2020 onwards, however, these differences are not relevant to the 2021 Update, which only considers data from 2017-18 to 2019-20. Consequently, the ACT does not consider that there is a need for adjustments to account for policy differences in the 2021 Update. This issue will need to be reconsidered by the CGC and the states and territories for the 2022 to 2024 Updates as data from 2020-21 enters the assessment years (and possibly future Reviews or Updates depending on the duration of the pandemic).

In relation to the revenue assessments, the ACT supports the CGC staff proposal to treat revenue waivers as lower effective tax rates for the relevant assessment categories. We note that the waiver of taxes and other fees has no direct impact on the underlying tax base for the relevant revenue sources – thus treating waivers in this manner simply implies a lower assessed revenue for each jurisdiction with no change in the relative capacity of each state and territory to generate revenue. The ACT also supports the CGC staff proposal to treat revenue rebates as an offset against the revenue category, as this would amount to a lower actual revenue generated for each state and territory, but with no change in the underlying tax base – lowering the national average effective tax rate. Treating rebates and waivers in this way would result in consistent treatment by the CGC of the two revenue measures employed in response to COVID-19 by the states and territories.

The ACT also supports assessing deferred revenue in the year that the liability arose, noting that this implies an accrual approach to the deferred revenue, which is consistent with the approach prescribed by the International Monetary Fund GFS Manual.

In relation to JobKeeper payments, the ACT notes that the Australian Bureau of Statistics (ABS) treats these payments from the Commonwealth to businesses as “Other Subsidies on Production” and the throughput of the payment to employees as wages.

Consequently, JobKeeper payments will have an impact on the ABS' Compensation of Employees (CoES) data used in the CGC's assessment of payroll taxes.

Jurisdictions, other than NSW, have exempted JobKeeper payments from payroll tax liability. These policy differences could potentially result in significant changes to the distribution of the payroll tax base if JobKeeper payments are large enough and their distribution differs significantly from the distribution of taxable payrolls across states. However, it is likely that states with greater negative impacts in employment, and hence on payrolls, will also have a higher relative level of JobKeeper payments, thus minimising any change in the total distribution of wage and JobKeeper payments.

The ACT understands that there are no reliable datasets that would enable the CGC to make an adjustment to remove JobKeeper payments from the CoES data. Inclusion of all the payments in the payroll tax base at least treats the payments for all states on the same basis and is consistent with the CGC's standard approach to the assessment of taxes which are not applied in all states.

On health expenditure, the ACT agrees with the CGC staff assessment that most new health expenditure in 2019-20 due to COVID-19 relates to the community health and other health services component of the health assessment. The ACT notes that the temporary suspension of non-urgent elective surgeries and severe cases of COVID-19 requiring hospitalisation would have affected admitted patient (AP) services, but overall, COVID-19 is not likely to have caused significant increases in AP or non-admitted patient (NAP) service provision in 2019-20.

Further, the ACT considers it unlikely that the socio-demographic distribution of COVID-19 presentations will have differed significantly from the distribution of all hospital presentations. For example, COVID-19 is known to have more severe health effects on the elderly, with age already a recognised disability in the Health assessment. In addition, the number of COVID-19 cases that have resulted in hospitalisations has been quite low in Australia, with a peak of 305 people hospitalised nationally in 2019-20 on 7 April 2020 according to covid19data.com.au. Consequently, COVID-19 is likely to have had only a minor and likely immaterial impact on AP health expenditure in 2019-20, nor does it appears likely that the socio-demographic incidence of hospitalisations are substantially different for COVID-19 patients than for patients in general.

The ACT shares the reservations that CGC staff have with the proposition that actual expenditure relating to the National Partnership on COVID-19 Response (NPCR) should be treated as an indicator for a specific COVID-19 disability. The ACT notes that there are ongoing disagreements between the Commonwealth and the states and territories regarding what funding can and cannot be considered relevant expenditure under the NPCR. There may also be substantial policy influence on this expenditure, such as through differences in state approaches to the pre-emptive purchase of personal protective equipment. In addition, the incidence of COVID-19 outbreaks themselves has also been strongly influenced by state and territory policy responses, suggesting that an APC assessment of NPCR expenses would not be policy neutral even if all states had followed the same policies to deal with outbreaks.

On this basis, the ACT supports making no adjustment to the 2020 Review assessment methods for health expenditure in response to the COVID-19 pandemic.

The ACT supports the CGC staff view that most new expenditure relating to services to industry is likely to be concentrated in other (i.e. not agriculture or mining) business development and the CGC staff position that there is no case for a differential assessment of business development expenses. The ACT considers that the latter issue was addressed and resolved in the 2020 Review and that all states have adopted similar economic support and stimulus responses to COVID-19 which would not warrant consideration of a major methodology change in this assessment. However, we support the CGC testing the materiality of the split between regulation and business development expenses when state budget data become available. In the ACT's view, changing the split based on new data would constitute a data change rather than a methodology change, as it does not alter the treatment of either regulation or business development expenses.

IMPLEMENTATION OF THE NEW HORIZONTAL FISCAL EQUALISATION ARRANGEMENTS FOR 2021-22

Background

On 14 November 2018, the Commonwealth Parliament passed the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018*, which put in place a new structure for the distribution of the GST between the states and territories, to be phased in gradually over a six-year transition period from 2021-22 to 2026-27.

Under this new structure, states and territories will receive GST grants such that they have equal fiscal capacity to the stronger of New South Wales or Victoria, with a minimum GST relativity of 0.7. From 2024-25, the GST relativity floor increases to 0.75. Further, the Commonwealth will provide two ongoing boosts to the total GST grant of $600 million from 2021-22 and $250 million from 2024-25. Both boosts will be indexed annually by the growth rate in total GST collections. This contrasts with the structure prior to 2021-22, in which each state and territory would receive a GST grant such that it has equal fiscal capacity to the strongest state or territory, with no minimum GST relativity.

The transition period will involve taking a weighted average of the GST relativities derived from the original structure and the new structure, with the weighting given to the new structure increasing in one-sixth intervals each year from 2021-22 until 2026-27.

In addition, the Commonwealth has provided a "no-worse-off guarantee" for the states and territories from 2021-22 to 2025-26, in which if a state or territory is assessed as having fiscal needs such that its GST grant in a year is lower than what it would have been if the new structure were not implemented, the Commonwealth will provide additional funding to that state or territory in order to bring their total GST grant up to the amount they would have received in the absence of the new structure.

Commonwealth Grants Commission Staff Position

The CGC provided initial views on how it would implement the new HFE arrangements in its 2020 Review final report. CGC staff propose that the CGC measure state and territory relative fiscal capacities in accordance with its usual methodology, then derive the GST relativities corresponding with the new HFE structure, including blending the relativities under the new and old structures as relevant for the transition period.

ACT Position

The ACT considers that there is an in-principle case for backcasting major changes in the GST pool caused by policy decisions – an example would be a decision to increase the rate of the

GST. However, as noted by CGC staff, the pool top-up payments are too small to have a significant distorting effect on the grant distributions.

In any case the underlying assumption is that state expenditures will increase over time, roughly in accordance with growth of the GST pool, with a lag between the assessment and application years as is the case across the GST assessment. Accordingly, the ACT supports the CGC staff proposal on the treatment of the new HFE arrangements, including its recommendation that the boost payment to the GST grant by the Commonwealth is not backcast.

NEW DATA FOR THE NON-ADMITTED PATIENT COMPONENT

Background

In accordance with the methodology set by the 2020 Review, the CGC uses National Weighted Activity Unit (NWAU) data from the Independent Hospital and Pricing Authority (IHPA) for the assessment of health expenses. The health assessment is separated between AP, emergency department (ED) and NAP services. While IHPA NWAU has been able to be used for AP and ED services, they are not used by the CGC for the NAP component of the health assessment as the data is considered unreliable for the CGC's purposes. Consequently, the CGC has historically used data on AP separations as a proxy indicator for NAP service usage.

In mid-2020, 2018-19 NWAU data on NAP services were made available by IHPA, including aggregate activity data and patient-level data, with patient-level data being available for 86 per cent of aggregate activity. The CGC indicated in its final report on the 2020 Review that it would analyse this data to determine whether it is suitable for use in its assessment of NAP services, in consultation with the states and territories.

Commonwealth Grants Commission Staff Position

CGC staff analysis suggests that the NAP NWAU data is reasonably comprehensive with 86 per cent coverage of aggregate activity, albeit with a potential urban bias given the higher level of coverage of aggregate activity for activity-based-funding (ABF) activity than for block-funded (BF) activity, with ABF activity being more concentrated in urban areas than BF activity. CGC staff note, however, that adjustments are made to account for possible urban bias – allocating activity with no patient-level data the user profile of hospitals in the same remoteness region and funding type. This type of adjustment, CGC staff note, is also used in its assessment of ED expenses.

When comparing with the proxy indicator, the CGC consider that the NAP NWAU data more accurately measures spending on NAP services. As a result, CGC staff recommend that the CGC shift from using the proxy indicator to using NAP NWAU data. As NAP NWAU data is only available for 2018-19, CGC staff recommend using the data for all three assessment years.

ACT Position

The ACT agrees with CGC staff that the 86 per cent coverage of NAP aggregate activity from the 2018-19 NWAU data is an acceptable level to give sufficient confidence in the accuracy of the data. We also note that as this data continues to be collected into the future, the coverage rate could be expected to increase over time, further strengthening the case for its use in the assessment of NAP services. On this basis, the ACT supports the CGC using the NAP NWAU data instead of the proxy indicator for the 2021 Update.

Like CGC staff, the ACT recognises the potential for the uneven coverage of BF and ABF activities of the NAP NWAU data to introduce biases in the assessment of the cost of providing NAP services. The ACT therefore supports the CGC staff recommendation that the NAP patient level NWAU data be scaled up in line with the user profile of hospitals in the same remoteness region with the same funding type.

Given the limited duration of the NAP NWAU data set at the present time, the ACT is also supportive of the CGC using 2018-19 NAP NWAU data for all assessment years in the 2021 Update, as we consider that this data provides a more accurate measure of usage and costs than the proxy indicator.

REVISIONS TO STAMP DUTY ON CONVEYANCES AND LAND TAX DATA

Background

As part of the CGC's revenue assessments for stamp duty on conveyances of property and land taxes, it collects data from state and territory revenue offices on property and transaction values and revenues from those sources. However, both assessment categories have been subject to significant data revisions in recent years, causing noticeable shifts in the GST grants received by each state and territory on a year-to-year basis. These unexpected data revisions can increase the volatility of the GST relativities, making state and territory budget management more difficult.

CGC staff have discussed this issue with the three most populous states, seeking information on the processes that revenue offices use to collect the data, staff turnover and learning and the complexity of the CGC's data requests, with the aim of reducing large data revisions.

Commonwealth Grants Commission Staff Position

CGC staff note that the states have indicated some data revisions are expected, due to factors including revaluations and compliance activity. As such, the CGC notes that revenue revisions are likely to continue, but that when there are large revisions, the CGC will consult with the states and territories in order to determine the cause of the revision, subject to confidentiality considerations.

As part of their investigations, CGC staff became aware that duties relating to the sale of equity in publicly owned corporations are not included in the GFS code used by the CGC to reconcile state and territory conveyance revenue data. In the 2020 Review, the CGC deducted these duties from the GFS data. Thus, CGC staff propose to cease deducting duties relating to the sale of equity in publicly owned corporations from GFS conveyance revenue.

ACT Position

The ACT notes that revisions to state and territory provided data have a small impact on the ACT's GST grant. However, we support ongoing efforts to ensure that the CGC's assessments are as accurate as possible, and that data revisions are minimised. The ACT supports the proposal of CGC staff to consult with states and territories in the event of a large data revision impacting significantly on the distribution of the GST, though we consider that this consultation should not be limited to just data adjustments for the land tax and stamp duty on conveyances assessments.

Noting that GFS data does not contain duties from the sale of major state assets, the ACT supports the CGC staff proposal to cease adjusting GFS data to remove these duties.

REVISED DATA IN THE WAGE COSTS ASSESSMENT

Background

In the 2020 Review report, the CGC noted that the ABS had revised the Characteristics of Employees (CoES) data for 2016-17 and 2017-18. The CGC has used CoES data in its assessment of the differences in wage costs between the states and territories since the 2016 Update – a disability that applies to most expenditure assessment categories and thus has a significant impact on the overall GST distribution.

The CGC, consistent with its Terms of Reference for the 2020 Review, had wanted the ABS to rerun its regression model of wage costs for earlier years, but as there was not sufficient time to consult the states and territories, the CGC decided to retain the modelled outcomes for 2016-17 and 2017-18 from the 2019 Update. Since the release of the 2020 Review report, the ABS has rerun the CGC's model using revised CoES data for 2017-18 and 2018-19.

Commonwealth Grants Commission Staff Position

CGC staff consider that as it is likely the Terms of Reference for the 2021 Update will require the CGC to use the most up-to-date data in its assessments, the modelled outcomes based on the revised data should be used.

ACT Position

The ACT agrees with the CGC staff and considers that as the revised CoES data is more contemporaneous, the modelled outcomes for the wage costs assessment should use the updated econometric model outcomes.

CHANGES TO THE COMPILATION OF THE ADJUSTED BUDGET

Background

CGC staff have reviewed the approach used for deriving consolidated expenses, user charges and investment in the urban transport and housing assessments in consultation with the ABS. CGC staff have noted that ABS GFS data is not available for the final assessment year for the 2021 Update. Further, experience from the 2020 Review indicates that state and territory GFS data for urban transport are not as reliable as ABS GFS data.

CGC staff have also identified that most transactions in Classification of the Functions of Government – Australia (COFOG-A) code 1132 (urban water transport freight services) relate to port services and not urban transport. These expenses have in the past been included in the CGC's assessment of urban transport expenses. The CGC has also identified expenses relating to the provision of non-urban transport services in Queensland (expenses and user charges for Queensland Rail) and Victoria (subsidies for V/Line) that are recorded as urban transport expenses in the GFS.

Commonwealth Grants Commission Staff Position

CGC staff recommend that the assessment of user charges, expenses and investment for urban transport and housing use ABS GFS non-financial public sector data for the first two assessment years of the 2021 Update and consolidated state and territory general government and public non-financial corporation GFS data continue to be used for the final assessment year. CGC staff intend to check the accuracy of the final assessment year data against published information.

CGC staff also intend to reclassify COFOG-A 1132 urban water transport freight services from the urban transport component to the non-urban transport component and to ensure that the general government subsidy expenses incurred by Victoria for V/Line are included in the non-urban transport expenses component. CGC staff intend to adjust Queensland Rail expenses to remove non-urban expenses using ABS GFS and state unit record data but make no adjustment to Queensland Rail user charges unless a reliable measure of the non-urban share of user charges can be identified.

CGC staff will consult with the states and territories before making significant changes.

ACT Position

Noting that COFOG-A 1132 does not relates to urban transport, but rather to port services, the ACT supports the removal of these expenses from the urban transport assessment and their reclassification to non-urban transport expenses. The ACT also supports the proposed adjustments to the urban transport expenses of Victoria and Queensland, as this would improve the overall accuracy of the assessment.

ASSESSING LOANS UNDER NATURAL DISASTER RELIEF EXPENSES

Background

The CGC assesses the expenses of various supports provided by state and territory governments relating to natural disasters, including grants, concessional loans, and rate subsidies. In previous Updates and Reviews, the CGC has assessed concessional loan expenses based on loan values. CGC staff note that only New South Wales, Queensland and Tasmania have provided concessional loans in recent years in response to natural disasters.

Commonwealth Grants Commission Staff Position

CGC staff propose to change the natural disaster relief expense assessment of concessional loans to only assess the net cost of providing the concessional interest rate – the state or territory's interest rate subsidy. To facilitate this, the CGC has requested data from the states and territories on concessional loans and state and territory costs of borrowing.

ACT Position

The ACT considers that the proposal by CGC staff would result in a more accurate assessment of natural disaster relief expenses and thus supports only assessing the net cost of providing the concessional interest rate. The ACT has received the data requests from the CGC and will be able to provide the requested data.

The ACT does, however, note that the data request for this information was not clear on what should be regarded as the state and territory cost of borrowing. Further clarification, such as the provision of a common measure of the cost of borrowing, agreed in consultation with the states and territories, would be a beneficial addition to this assessment, to ensure that state and territory borrowing costs are being measured on a like-for-like basis.

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ACT Government

Chief Minister, Treasury and Economic Development Directorate

October 2020