Commonwealth Grants Commission 2021 Update

Tasmanian Government Submission in response to Staff Discussion Paper CGC 2020-01-S

(New Issues for the 2021 Update)

2 October 2020

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CONTENTS

INTRODUCTION

This submission responds to the Commonwealth Grants Commission (Commission) request for State comments on the Commission Staff Discussion Paper CGC 2020-01-S *New Issues for the 2021 Update*, (the Paper).

Tasmania supports most of the proposals outlined in the Paper. However, Tasmania suggests an alternative to the proposed treatment of taxation waivers and rebates, and the approach to JobKeeper payments, and does not support the use of non-admitted patient national weighted activity unit (NAP NWAU) data until issues with its scope and reliability can be investigated and resolved.

Response to the COVID-19 pandemic

Staff propose to recommend that, subject to Update terms of reference, the Commission:

- make adjustments to revenue datasets to ensure comparability, if such adjustments are material:
  - offset rebates against the relevant revenue category; and
  - assess deferred revenue in the year in which the liability arose.
- not attempt to remove JobKeeper payments from its payroll tax base on practicality grounds.
- assess COVID-19 health expenses from the NPCR on an APC basis, if it is material and reliable to do so.
- 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 to do so for the 2021 Update.
- not introduce a differential assessment of business development expenses due to the COVID-19 induced economic shock.

Tasmania supports, in general, the Commission Staff proposal to recognise states' additional COVID-19 related expenditure and business support measures that have been offered through the tax system or by other means.

Adjustments to revenue methods

Tasmania agrees that it is not necessary for the Commission to adjust its revenue assessment methods. However, Tasmania proposes alternative approaches to the treatment of waivers and rebates, and JobKeeper payments to those proposed by Commission Staff.

Treatment of waivers and rebates

Tasmania does not support the Commission Staff proposal to treat tax waivers and rebates provided by the States in response to COVID-19 as lower effective tax rates.

Tasmania is of the view that the intent of the waivers and rebates was to provide necessary cash flow to business, and that such measures are primarily business support programs and the benefit has largely accrued to businesses and industries.

It is argued that the nature of the tax relief measures provided by the States are not a result of tax policy choice, but as part of States' responses to COVID-19. It is therefore inappropriate to assess the reduction in taxation revenue using the taxation assessments. All States responded with packages of measures to give temporary support to businesses quickly and efficiently during adverse business conditions caused by the pandemic. Tasmania's first response in providing support to business was on 17 March 2020 and included payroll tax and fee relief in addition to grants and loans to targeted industry and business groups. Similar business support measures were provided by the other States as part of their early response to COVID-19.

Therefore, instead of reflecting the costs associated with waivers and rebates in the form of reductions to average tax rates, Tasmania proposes that they should be treated in the same way as other COVID-19 related support to businesses and industries through the services to industry expense assessment as business development expenses. Business development expenses include State expenses such as grants, subsidies or government services intended to assist or benefit business or industry.

Further, given that waivers and rebate programs can vary between states, it is more appropriate that they be treated on an equal per capita (EPC) basis as a business development expense than that they be assessed using the relevant revenue category disabilities.

This would necessitate an adjustment to the business development expenses in each of the three industry groups in the services to industry assessment by including tax waivers and rebates.

Treatment of deferrals

Tasmania supports the proposal to assess deferred tax liabilities in the year in which they arise. This option will help to reduce volatility in the Commission's revenue assessments.

COVID-19 related tax deferral policies are likely to vary between states. Assessing deferred liabilities in the year in which they arise will help to maintain policy neutrality.

Tasmania has implemented a land tax deferral for those experiencing financial hardship. This deferral is available by application only. Land tax deferrals are anticipated to represent only a portion of total land tax collected in 2019-20, and Tasmania anticipates being able to provide the information requested in the COVID-19 related tax rebates and deferrals data request.

JobKeeper payments

Tasmania notes Commission Staff advice that the Australian Bureau of Statistics (ABS) is unable to exclude JobKeeper payments from the Compensation of Employees data used by the Commission to estimate each State's payroll tax base. As all States have exempted in full, or in part, JobKeeper payments from payroll tax, the inclusion of JobKeeper payments in the ABS data is likely to inflate the Commission's assessed payroll tax base without a commensurate increase in actual payroll tax revenue collected by the States.

As such, the average payroll tax rate calculated by the Commission is likely to fall for the 2019-20 assessment year. This will arbitrarily reduce the total amount of GST redistributed under the payroll tax assessment because the Commission's assessed payroll tax revenue will fall for each State.

Tasmania notes that JobKeeper has been extended in 2020-21 and that the impact of JobKeeper payments on the assessed payroll tax base may be more material than for 2019-20.

Commission Staff expect the inflation of the assessed payroll tax base will be lessened because of eligibility requirements for the JobKeeper payments, and that NSW and Victoria are not fully exempting JobKeeper payments from its payroll tax collections.

However, Tasmania is concerned that Commission Staff propose not to attempt to remove JobKeeper payments from its payroll tax base. It is not clear without the data that the inflated tax base and its impact on average tax rates will not have a significant effect on horizontal fiscal equalisation (HFE).

It is noted that Commission Staff are already collecting payroll tax waivers and rebates through a recent data request. Commission Staff may wish to consider collecting further information from the States regarding the value of JobKeeper-related payroll tax exemptions. This would enable the Commission to include the value of the JobKeeper payroll tax exemptions in the tax collected. By doing so, both payroll tax collected and the tax base are inflated to a similar degree and thereby reduce the impact on average tax rates.

COVID-19 health expenses

Tasmania agrees that the current health assessment does not capture all COVID-19 related disabilities and expenses. For example, the current health assessment does not capture geographic concentration, which has been a relevant factor in the current pandemic, as a driver of health expenses. Other factors, such as international arrivals, have randomly affected incident rates for each State.

Tasmania considers that the National Partnership on COVID-19 Response (NPCR) data is reasonably policy neutral and provides the best available data to recognise COVID-19 expenses. However, if COVID-19 related expenses are to be assessed APC, then the Commission will need to be satisfied that the information provided by States to the National Health Funding Body (NHFB) on COVID-19 related expenses are accurate, reliable, not policy influenced, and within the scope of NPCR.

Tasmania notes that there may be some limitations with the policy neutrality of the NPCR expense data. While the NPCR data excludes the impact of border controls and quarantine costs, there may still be some variance between states' expenditure priorities under the NPCR when it comes to:

- capital works on health facilities;
- the purchase of medical equipment; and
- additional elective surgery performed before or after the national pause on elective surgery.

Where practical, Commission Staff will need to assess any significant variations in expenditure that are unrelated to the specific impact of COVID-19 in each State to ensure they are not policy influenced.

On balance, Tasmania supports assessing COVID-19 related expenses on an actual per capita (APC) basis for the 2021 Update using NPCR expense data.

Tasmania notes that the NHFB is still considering whether PPE expenses should be recognised on a consumption or purchases basis. Tasmania recommends that PPE expenses should be recognised on a purchase basis due to the extra expense incurred to establish a larger stockpile with a larger inventory, which would then be regularly circulated through the system and restocked. As all States would have undertaken a similar approach, it is not considered that this additional expenditure will be unduly policy influenced.

Tasmania supports the Commission Staff view that, given that the COVID-19 pandemic continues to evolve, the assessment of COVID-19 health expenses may need to be reviewed in future updates.

Services to industries

Subject to terms of reference that allow the Commission to make methodology changes for the 2021 Update, Tasmania supports the proposal to recalculate the split between regulation costs and business development costs in the services to industries assessment.

Tasmania's view is that industry regulation costs are unlikely to have increased significantly as a result of the COVID-19 pandemic, and that the additional expenditure captured by this assessment can largely be attributed to business development costs associated with State responses to COVID-19. As noted earlier, Tasmania considers that tax waivers and rebates are of a similar nature to other forms of business support and should be included in business development expenses.

Tasmania agrees with Commission Staff that the additional business development expenses in response to COVID-19 should not be differentially assessed for the same reasons other business development expenses are not differentially assessed. That is, the drivers of business development vary between States and it is noted that the Commission has not been able to identify a policy neutral disability measure.

Tasmania notes that to determine the new split between regulation and business development expenses, 2018-19 industry regulation expenses will require indexing in order to determine the residual business development expense. This approach appears to be reasonable. Tasmania does not have a particular preference on an appropriate indexation factor but suggests it should be at least in line with the growth in General Government expenditure.

Implementation of the new HFE arrangements for 2021-22

Tasmania does not have any concerns with the proposed approach to implementing the new HFE arrangements for 2021-22, including the calculation of standard State capacities in assessment years, rather than application years.

Tasmania supports a presentation of results that clearly illustrates the impact on GST revenue to each state of the new arrangements.

New data for the non-admitted patient component

Staff propose to recommend that the Commission:

- endorse the use of NAP NWAU data for the 2021 Update and subsequent inquiries.

The Commission currently uses a proxy measure, based on admitted patient (AP) and emergency department (ED) activity, for the non-admitted patients (NAP) component of the health assessment. The proxy is used because the NAP data from the Independent Hospital Pricing Authority (IHPA) national weighted activity unit data (NWAU) has been historically unreliable. Commission Staff now propose to replace the proxy with NAP NWAU data for 2018-19, as it believes this data is now fit for purpose.

Tasmania has some concerns with this proposal. These concerns relate to the scope of information provided by the States to IHPA to produce NAP NWAU data, the lack of a remoteness adjustment in the 2018-19 NAP NWAU data, and the use of 2018-19 data for all three assessment years. For these reasons, which are discussed below, it is considered that the IHPA data is not suitable for the NAP assessment in the 2021 Update.

Not all NAP activity in hospitals is within the scope of the National Health Reform Agreement (NHRA) and collected by IHPA.

NHRA funding is for public hospital services and the rules governing the funding state that all AP services and ED services are public hospital services. However, for NAP services it is only those services that meet certain criteria that are classed as public hospital services and funded under the NHRA. Therefore, NAP activity that is out of scope of the NHRA is not provided by states to IHPA, and therefore excluded from NAP NWAU data.

An example of this relates to general practice and primary care clinics in public hospitals.

Under the ABS Classification of the Functions of Government (COFOG) used by the Commission for State expenditure data, where general practice and primary care clinics are run from hospitals, the expenditure is allocated to outpatient or general hospital services, rather than community health services.

However, IHPA excludes general practice and primary care clinics from the scope of public hospital services under the NHRA.

Data published by the Australian Institute of Health and Welfare (*Non-Admitted patient care 2017-18: Australian hospital statistics, table 3.4*) shows 1 420 849 non-admitted patient services in general practice and primary care clinics in 2017-18. This accounts for 11.7 per cent of all NAP services.

However, IHPA data for the same year appears to only contain approximately 18 000 (1.3 per cent) of these non-admitted patient services. Tasmania only has access to data up to 2017-18 and does not yet have access to the 2018-19 IHPA data for non-admitted patients analysed by the Commission.

Therefore, general practice and primary care clinic services are included in COFOG data but not in NAP NWAU data. This is one example of the difference in scope between the datasets and may be material given the relative number of general practice and primary care clinic services to total NAP services. This highlights the current inadequacy of the NAP NWAU data.

The State NAP NWAU data also does not fully capture NAP expenditure for private practice arrangements in public hospitals. These employment agreements provide doctors with a right of private practice to run private NAP clinics within the public hospital precinct. They provide a private practice option for patients that may not otherwise be available. Such services are eligible for MBS funding, however the MBS funding contribution that goes to the doctor only covers a portion of the full cost of the NAP service, which includes the costs met by the State in providing private practice facilities and services within the hospital. Data is not available on the State share of the cost but it is considered to be more than half of the total. The Australian Government is responsible for MBS data and may be in a position to provide national data on the volume of NAP services provided by doctors exercising a right of private practice from public hospitals.

Another potentially material consideration affecting the coverage of NAP services is the recognition of NAP services under the definition of public hospital services in 2010 under the NHRA 2011, (Schedule A, Clauses A11 - A17) and other grandfathering arrangements. Under clause A17 of the NHRA, IHPA has determined a list of services which would not normally be considered a public hospital service as defined by the General List of In-Scope Public Hospital Services Eligibility Policy, but which IHPA is satisfied was provided by a particular hospital in 2010.

The services on this list are eligible for Commonwealth funding and have largely been unchanged since 2010. In the list of services (National Efficient Price Determination 2020-21, March 2020, pages 29-35) it is noted that New South Wales accounts for 161 out of 187 services on the list of services that would not normally be considered a public hospital service. This suggests that the list may lack a consistent treatment for all States and thus the extent of in-scope services. Tasmania has only recently been successful in getting its first inclusion on the list. This expenditure will be reported to IHPA for the first time in 2020-21.

There are blurred boundaries between some hospital services that can either be treated as NAP or same day AP services.

While AP and ED data and definitions have been refined over many years, NAP services are less well defined. There is a permeable boundary between NAP patients and same-day AP, with State administrative policies often determining whether services are categorised as one type of patient or the other. For example, the Northern Territory is unique in that dialysis patients are treated as AP. IHPA has taken steps to minimise NHRA funding impacts for certain services in its pricing framework, such as pricing high volume dialysis and chemotherapy services that can be provided either in an AP or NAP setting. This indicates that IHPA itself recognises that differing state policies can affect what is in scope AP and NAP services and has made pricing adjustments to account for those differences. Likewise, the Commission should also ensure that the data it uses adequately captures all relevant NAP services provided by the States.

In paragraph 72 of the Paper, Commission Staff note that IHPA receives two types of NAP NWAU data from the States (the aggregated activity data and patient level data). Commission Staff state that the comprehensiveness and representativeness of NAP NWAU data can be measured by comparing patient level data to aggregate data and that a coverage of 86 per cent is reasonable. However, given that there has not been an assessment of the comprehensiveness and representativeness of aggregate NAP data, this makes this method for assessing the quality of the patient level data flawed. As noted, Tasmania is of the view that there is out of scope NAP activity that is not captured in either measure of NWAU data.

Remoteness adjustment

In Figures 1 to 3 in the Paper, Commission Staff make a number of comparisons of spending and usage between the current proxy indicator of NAP activity and the NAP NWAU data for 2018-19 and argue that the current NAP proxy overestimates NAP spending.

However it is not a consistent comparison because the NAP NWAU data will not have a remoteness adjustment until 2019-20 whereas the current NAP proxy includes a remoteness adjustment (paragraph 89 of the Paper).

This inconsistency in the comparison made by Commission Staff in part explains why the proxy measure produces higher NAP expenditure than the NAP NWAU data. While Commission Staff acknowledge this in paragraph 90 of the Paper, they nevertheless recommend the use of NAP NWAU data without a remoteness adjustment for 2018-19. Commission Staff note it may understate spending in remote areas for high cost groups but argue that this is offset by the overestimation of NAP activity in previous years.

Until NAP NWAU data includes the remoteness adjustment, Tasmania is not convinced the current proxy overstates NAP spending. Further, knowingly using understated data in an assessment year because it is believed that previous years were overstated is not considered a sufficient justification for doing so. This was not an error that is being corrected, rather it was the best data available to the Commission at that time. For example, the administrative scale adjustment estimated in 2004 Methodology Review was not re-estimated until the 2020 Methodology Review and showed that it understated administrative scale expenses compared to the indexed 2004 estimation.

In addition to issues relating to the comprehensiveness of NAP NWAU data, it is considered that the Commission should wait until the data include regional adjustments before using it in its assessments.

Three year averaging

In paragraph 95 Commission Staff note that, as only 2018-19 NAP data is currently available, this data will be used for all three assessment years. Tasmania considers that the data is currently not representative of actual NAP expenditure and to use it for all three years is inappropriate.

The Commission should refrain from using the NAP NWAU data until three years of assessment year data is available to determine the reliability and completeness of the data given its relative infancy. Notwithstanding Tasmania's concerns with NAP NWAU data, if the Commission does decide to use it in the 2021 update, then it should use the proxy NAP data for 2017-18, and the 2018-19 NWAU data for the other two assessment years to produce a three year average.

In summary, Tasmania does not agree with the Commission Staff proposal to use NAP NWAU data because, unlike NWAU data for AP and ED services, it is not representative of all NAP services. Tasmania recommends that the current method continue until the NAP NWAU data is more comprehensive for each of the assessment years. This will require the Commission to make adjustments to the data to ensure it accounts for under representation of NAP services.

Revisions to stamp duty on conveyances and land tax data

Staff propose to recommend that the Commission:

- note States are continuing investigations on improving the data they provide.
- note revenue revisions are likely to continue.
- note where there are large revisions, additional information will be sought from the relevant State that can be shared with other States.
- cease deducting duties from the sale of major State assets from GFS conveyance revenue.

Tasmania agrees that additional information should be provided to the Commission if substantial revisions to stamp duty on conveyances or land tax data occurs.

Tasmania supports the proposal to cease deducting duties from the sale of major State assets from GFS conveyance revenue, given the Commission Staff advice that such revenue is not actually reported in GFS data.

Revised data in the wage cost assessment

Staff propose to recommend that the Commission:

- use the modelled outcomes based on revised CoES data for 2017-18 and 2018-19.

Tasmania accepts the use of revised ABS Characteristics of Employment Survey (CoES) data for 2017-18 and 2018-19 in the Commission's econometric model for assessing public sector wage costs, provided the use of updated data is within the Commission's terms of reference for the 2021 Update.

Given the significant redistributive effect of the wage costs assessment, the model should have a high level of econometric accuracy. The model includes a large number of variables, which can lead to inflated standard errors for the regression coefficients and reduce the consistency of the results.

Tasmania is concerned that the updated data has not improved the statistical reliability of the relationship between public and private sector wages growth or improved the estimates of wage cost differences between States. In fact, the updated data has reduced the statistical significance of this relationship.

Many states expressed concerns with the model as part of the 2020 Review, suggesting a lack of confidence that the model produces the best estimates of wage costs differences between States. Therefore, Tasmania maintains its position that that the Commission should apply a greater discount on the wages assessment to better recognise the limitations of the model.

Changes to the compilation of the adjusted budget

Staff intend to:

- for years up to year 2 — use the ABS GFS NFPS data to estimate user charges, expenses and investment for urban transport and housing
- for year 3 — continue the 2020 Review approach of consolidating the State GG and PNFC data
- check the accuracy of the year 3 urban transport data accuracy against published information
- reclassify COFOG-A 1132 Urban water transport freight services from the urban transport component to non-urban transport component
- ensure that the GG subsidies to V/Line are included in the non-urban transport expenses component
- adjust Queensland Rail expenses to remove non-urban expenses using the ABS GFS GG and the State unit record data
- make no adjustment to Queensland Rail user charges unless the non-urban share can be identified reliably
- consult with affected States before making significant changes.

Tasmania supports the changes to the compilation of the adjusted budget, given the use of ABS GFS non-financial public sector data will simplify the adjusted budget calculations and improve the reliability of the data.

Tasmania also supports the Commission Staff proposal to reclassify certain State urban transport data to ensure they are classified into the correct COFOG-A categories.

Tasmania also supports the Commission Staff consulting affected States before making significant adjustments to the State GFS data.

Assessing loans under natural disaster relief expenses

Staff propose to recommend that the Commission:

- change the natural disaster relief expense assessment of concessional loans to only assess the cost of providing the concessional interest rate, and not to assess the initial loan value.
- request data from States on concessional loans and States' cost of borrowing in the natural disasters data request.

Tasmania does not have a conceptual concern with the proposal to change the natural disaster relief expense assessment of concessional loans from one which assesses the initial loan value to one which assesses the cost of providing the concessional interest rate.

However, Tasmania is concerned that there are a variety of ways that States may estimate their cost of borrowing on an annual basis, and that this may result in inconsistency in the data provided by states.

The concessional loans reported by Tasmania in the data return relate to the Flood Recovery Loan Scheme. Given the small quantum of Tasmania's total natural disaster recovery loans, it is likely that this scheme was funded from consolidated revenue, rather than by taking out a specific borrowing to which a definitive interest rate can be reported.

The Tasmanian Government borrows from the Tasmanian Public Finance Corporation (Tascorp), whose lending rates change frequently. The rate at which Tascorp lends to the Tasmanian Government is also dependent on the term of the borrowing. Loans under the Flood Recovery Loan Scheme have a maximum term of seven years. Therefore, Tasmania has estimated an annualised average cost of borrowing for each year based on a notional borrowing term of seven years.

Other states may choose alternative methods of calculating an annualised cost of borrowing rate. Commission Staff should seek states' views to establish a consistent method of calculating an annualised cost of borrowing rate.