SOUTH AUSTRALIAN DEPARTMENT OF TREASURY AND FINANCE COMMENTS ON THE NEW ISSUES FOR THE 2022 UPDATE STAFF DISCUSSION PAPER (CGC 2021-01-S)

South Australia welcomes the opportunity to comment on the 2022 Update

New Issues paper. Comments on each issue raised in the discussion paper are provided below.

Response to the COVID-19 pandemic

The COVID-19 pandemic has required governments at all levels to respond to both preservation of life/health implications of COVID-19 and the economic impact of restrictions on business activities. This has required additional financial outlays in a number of service areas from both state and territory governments and the Commonwealth Government.

From a HFE perspective, the CGC is considering how these government responses have resulted in changes to state fiscal capacities and the appropriateness of using 2020 Review methods in all assessments. This will require consideration of whether any alternative assessment approaches can be based on accurate/reliable data and whether alternative approaches are policy neutral.

South Australia does not believe that there are reliable/accurate data sources and policy neutral assessment approaches that would support any change to the 2020 Review assessment methods.

Revenue assessments

South Australia supports the staff recommendation to treat waivers, rebates, tax deferrals and JobKeeper payments using the same approach as for the 2021 Update.

Waivers

In South Australia, waivers have largely been provided through ex-gratia relief. Our revenue numbers will reflect the full revenue collection amount (i.e. before any waiver) with an offsetting expense relating to the ex-gratia payment. The exception to this is the JobKeeper payment exemption from payroll tax. This is a legislative exemption that exempts JobKeeper payments from consideration as taxable wages. South Australia will be able to provide the necessary data to allow waivers to be offset against the relevant revenue category.

Deferrals

In South Australia, COVID-19 related deferrals will be quantified and accrued in the year in which the tax liability arose. Accordingly, revenue related to deferrals in 2020-21 will be recognised in 2020-21. The inclusion of deferred revenue in the year in which the liability arose is supported. This provides the most accurate representation of revenue raised and capacity within a particular year.

Treatment of JobKeeper payments

South Australia notes that the approach to exempting JobKeeper payments between jurisdictions is not consistent. Exempting ‘top up payments’ above an employee’s standard wages is different to a full exemption of JobKeeper payments.

South Australia is not able to provide accurate data on the value of JobKeeper payments excluded from the payroll tax base to allow for an adjustment to be made to the ABS reported wages. South Australia agrees with the Commission proposal not to remove Jobkeeper payments from its payroll tax base data sourced from the Australian Bureau of Statistics (ABS).

Revenue bases

South Australia agrees with the staff recommendation to make no adjustment to revenue bases for any differences in state policy responses to COVID-19. State policy responses were not uniform and did not follow plans agreed at National Cabinet. If there were impacts to revenue bases that were beyond a state’s control, South Australia is not aware of a reliable or practical method for identifying and measuring the impact.

COVID-19 Health expenditure

South Australia believes that COVID-19 health expenditure should continue to be assessed using the 2020 Review methods. Although there may be some additional drivers of COVID-19 health expenditure, there is no policy neutral way of assessing this expenditure and no policy-neutral data source to support such an alternative assessment approach. The 2020 Review assessment methodology reflects age, Indigeneity, location and SES status which are still highly relevant in assessing COVID-19 health expenditure.

The alternative approach of using some form of actual per capita (APC) assessment, or an approach similar to the assessment of natural disaster net expenditure, is not appropriate. This is due to differences in policy responses between jurisdictions, the use of policy influenced data sources, and an expenditure framework that may not be consistent and reliable.

Expenditure on COVID-19 health responses in each jurisdiction will, to a significant degree, be influenced by the suppression and restriction of movement/activity approaches adopted in each jurisdiction – ie policy influenced. In the last three months of 2019-20, states and territories adopted relatively similar restrictions for similar periods of time. In 2020-21, differences emerged in the timing, length and severity of restrictions adopted. Differences in the initial time taken to place a geographical area into lockdown, the level of restriction on movement/activity (eg closing schools and aged care facilities), the timing and length of border closures and decisions on when to ease restrictions, all had an impact on the number of positive cases reported and the number of people requiring hospital care and other health services.

As an example of the different approaches between jurisdictions, in November 2020, South Australia entered a snap “circuit-breaker” lockdown in response to the “Parafield” cluster. The state-wide lock-down was implemented early and included stay-at-home orders, closure of all businesses (including takeaway food), no exercise outside of the home, only one person per household could leave the home for a specified purpose, closure of schools and other restrictions on activity. A similar approach was adopted in regards to South Australia’s Delta outbreak in July 2021, where the state imposed a uniform, state-wide seven day lockdown. This approach assisted in quickly containing the outbreak.

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

Quarantine administration and accommodation arrangements also varied between jurisdictions. CBD hotels were used in the majority of jurisdictions, with non-hotel facilities being used to a lesser degree (eg Howard Springs in the NT and the use of home quarantine in the ACT). In relation to CBD hotel quarantine, there were initially significant differences in the choice of personnel employed to guard and restrict the movement of people into and within these buildings. Decisions on the level of engagement of private security guards as opposed to police/police security services officers was not uniform between jurisdictions. The use of private security guards, who were also able to work in other jobs and not subject to more stringent disciplinary arrangements, contributed to major outbreaks of COVID-19, especially in

Victoria. Other jurisdictions made policy decisions to use police and police security services officers to much greater degree which limited quarantine breaches and case numbers.

Contact tracing policy approaches also varied between jurisdictions which had an impact on the ability of states to manage and contain COVID outbreaks. New South Wales' decentralised approach, with local area health districts, meant that the state could use teams of people embedded in local communities to manage contact tracing. By comparison, contact tracing in Victoria was based on a centralised model with fewer allocated resources. This approach struggled to respond to the surge in cases and make the necessary linkages to quickly address outbreaks. Issues with contact tracing arrangements in Victoria were identified in the *Inquiry into the Victorian Government's COVID-19 contact tracing system and testing regime* undertaken by the *Victorian Parliament's Legislative Council Legal and Social Issues Committee* in December 2020. As an additional point of difference, South Australia adopted a "double-ring fenced" approach to contact tracing which involved identifying and quarantining both primary contacts and secondary contacts. This approach was responsible for the relatively quick and effective management of outbreaks.

Adoption of an actual per capita assessment approach would only be appropriate if there was a high level of policy consistency, which is clearly not the case. Given these circumstances, an APC assessment approach would effectively mean that jurisdictions are rewarded or penalised for their policy decisions through GST distribution adjustments. This is not consistent with agreed HFE principles.

It is also noted that the current *Disaster Recovery Funding Arrangements 2018* are based on a set of arrangements that have been developed over a number years. This has been refined over time to address anomalies, inconsistences and scope and coverage issues. Disaster recovery arrangements also require data to be assured by a state appointed auditor with the engagement of such an auditor being in accordance with Auditing and Assurance Standards Board obligations. The use of a mature and tested disaster recovery expenditure framework make the application of an APC assessment appropriate in this category. This is not the case for the expenditure framework under the National Partnership on COVID-19 Response that was developed rapidly, and has not had the benefit of time to ensure consistency and address anomalies. In addition, reported expenditure only requires a statement of assurance rather than an audit obligation (except for the private hospital provisions).

While we do not support an approach to separately assess COVID related health expenditure given that available data is policy influenced, if the CGC were inclined to consider an APC assessment for COVID-19 health expenditure, the maximum level of discount should be applied to reflect the untested nature of the data source.

Services to industry

South Australia acknowledges the Commission view that any change to the split between regulation and business development would be a method change and would require changes to the Terms of Reference (ToR) for the 2022 Update.

South Australia notes that the Commission has examined the potential drivers for a differential assessment of business development expenses in prior review processes without success. In relation to COVID-19 business support expenditure, we do not support the adoption of any differential assessment approach as there is no policy neutral way of assessing such expenditure.

COVID-19 business support expenditure is related to restriction of movement/activity responses and lockdown measures which were largely the result of state and territory policy decisions. In 2020-21, there was no uniform position between states and territories on when such payments should be made, the quantum of business support payments, the scope of payments and the time period that payments were available. Adoption of an actual per capita approach would be rewarding or penalising states and territories for policy decisions.

Wage costs

South Australia notes the staff recommendation to remove employees earning $750 per week from the data used in the wage costs regression model. Given the significant issues with data reliability for the assessment, that will be compounded by a reduction in the sample size, the discount applied to the assessment should be increased.

In the context of the CGC's assessment approach for wage costs (using private sector wage movements as a proxy for public sector movements), the payment of a fixed amount that has no relationship with hours worked, skills or other attributes does not reflect wage determination pressures in either the private or public sectors. In addition, the JobKeeper program was purely aimed at private sector employees with no application to the public sector.

However, the New Issues paper notes that 6% of Characteristics of Employment Survey (COES) respondents earned exactly $750 per week. This provides an indication of the total level of data points that may be removed, but not a state-by-state breakdown. The COES data used for the wage cost assessment is already volatile and varies significantly from year to year. As noted in previous submissions, including in response to the 2021 New Issues Paper, these annual movements are not consistent with broader relative movements in wage costs. The COES also has a relatively small sample size, with the ABS cautioning the use of data at a state level due to high sampling errors. Excluding 6% of sample from the analysis will compound existing issues with the regression analysis used by the Commission. These effects may be more pronounced at the State level, particularly for small jurisdictions, increasing the possibility for erratic estimates.

The inclusion or non-inclusion of JobKeeper recipients is also not going to address the key limitation of this assessment, being the assumption that private sector wage movements are a good proxy for public sector wage movements.

Whilst private sector wage movements are an influence on public sector wages, this influence alone does not explain movements in the wages for the majority of public sector employees (e.g. nurses and teachers). Public sector wage movements reflect sectorial conditions in job specific labour markets (both locally and nationally) and fiscal strategies in each jurisdiction.

Regional labour market factors have some impact on public sector wages but for the majority of public sector employees, wage movements in other jurisdictions are an equally or more important factor.

Observed inter-jurisdictional wage differentials are more likely to be the result of differences in responsibilities, differences in employment status (e.g. tenure), timing differences from when pay adjustments take effect, the impact of non-wage benefits and other policy choice differences.

South Australia has previously expressed concerns about the true comparability of employees across jurisdictions. Jurisdictions with larger labour markets can offer greater and more diverse employment opportunities than smaller jurisdictions. This raises the issue that workforce compositional differences will lead to differences in the standard or quality of services provided between jurisdictions.

South Australia is still of the view that that there is sufficient uncertainty with the conceptual validity of the wage cost assessment to support the Commission reducing the distributional impact of this assessment.

The Commission currently applies a 12.5 per cent discount to the wage cost assessment to reflect concerns about how accurately the data captures wage costs, how accurately the regression model controls for productivity differences and how well private sector wages provide a proxy for public sector wage pressures. South Australia considers that a larger discount should be applied to this assessment. This is further supported by the proposed reduction in the sample size of data after the removal of JobKeeper recipients.

Other expenses

South Australia has not identified any other expense categories that would require a change in assessment approach. COVID-19 may have temporarily changed expenditure patterns in some areas (eg additional IT in schools) and the volume of service usage (eg public transport and courts) but the underlying drivers of expenditure still appear relevant and valid.

New Western Australian Native title agreements

South Australia notes the commencement of compensation payments totalling $1 billion (payable over the next 15 years) for the South-West Native Title Agreement and the Yamatji Nations Indigenous Land Use Agreement.

South Australia agrees with the staff recommendation to assess Western Australia's expenses relating to these compensation payments in the year in which they are paid rather than solely in the 2020-21 assessment year. This will allow consistency with GFS data.

Negative relativities

South Australia does not support the staff proposal to lift an affected state's annual relativity to zero and share the cost of doing this among the other states on a population basis.

The concept of a negative relativity means that a state's assessed revenues exceed its assessed expenses resulting in a negative GST revenue requirement and a negative relativity. Practically, this situation is only likely to occur when a state has access to a large revenue source(s) that is not available to other jurisdictions.

If the aim of full horizontal fiscal equalisation is to equalise the fiscal capacity of states and territories and GST revenue is the funding pool used achieve equalisation, then it may be valid for a state to have a negative GST entitlement. In such circumstances, the fiscal capacity of the state experiencing a negative relativity must be significantly greater than other jurisdictions and this requires a negative adjustment. To arbitrarily increase a negative relativity to zero (at the expense of other jurisdictions) undermines the equalisation process. This will further exacerbate the departure from full equalisation brought about by the 2018 Commonwealth legislative changes.

There is also a distinction between a jurisdiction experiencing an assessment year negative relativity and an application year negative relativity. If an assessment year relativity is negative but the overall application year relativity is still positive (after the 3 year averaging), then it is reasonable and appropriate for the negative relativity to flow through unadjusted. If a jurisdiction faces an application year negative relativity it implies that the jurisdiction would have to make a contribution to the GST pool. While appropriate, at present, there is no legal mechanism for this to occur, nor any likelihood given the GST floor for Western Australia. Theoretically, options could include reducing future years GST payments to account for the benefit achieved from a negative application year relativity.

Accounting policy changes

South Australia supports the staff recommendation to use Australian Bureau of Statistics (ABS) GFS data adjusted 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.

South Australia has implemented AASB 15, AASB 16 and AASB 1059 as our data is prepared on a Generally Accepted Accounting Principles (GAAP) basis. The impact of these standards is therefore included in the data we provide to the ABS and CGC.

Health Assessment – non-admitted patient data

South Australia does not support the staff recommendation to include imputed national weighted activity unit data for GP-type services in the non-admitted patient assessment to ensure the scope of services covered by the activity data aligns with the services covered by the expense data.

Our Health Department has advised the estimate, based on AIHW data, that GP-type services account for 5-10% of non-admitted patient separations is unlikely to be accurate. There are concerns that the data reported may not allow GP-type services to be identified as this component is not relevant for national funding purposes. Further work would be required to determine a more accurate estimate of GP-type separations.

If the CGC were inclined to make an adjustment for GP-type services then the adjustment should be based on the lower end of the estimate range ie 5 per cent.

New Commonwealth payments

Treatment of Commonwealth payments that commenced in 2020-21

South Australia generally supports the treatments proposed by Commission staff with a few exceptions discussed further below.

South Australia **does not support** the proposed treatment for the following payments:

Kangaroo Island nurse outreach program

This should be treated as non-impacting as the funding is being provided for primary health care which is a Commonwealth responsibility. The following is an extract from a media release issued by the Federal Member for Mayo on 6 October 2020:

> *Federal Member for Mayo Rebekha Sharkie has secured $1.2 million in the 2020/21 Budget for a nursing outreach program for Kangaroo Island.The program, announced in today's Federal Budget, is expected to provide a Primary Health Care Nurse Practitioner to complement the existing public and private health services on the Island. The service could include visits to patients living outside the main centre of Kingscote.*

Future Drought Fund – Farm business resilience and Regional drought resilience planning

Funding under this program is primarily related to drought planning and mitigation strategies. Needs are not assessed for responses to drought and the assessment of business development expenses does not recognise the spend needs of states in response to droughts.

Horticultural Netting Trial Scheme

The South Australian Government is administering the horticultural netting program on behalf of the Commonwealth. This view has been confirmed in writing by the Commonwealth Treasurer and a copy of this correspondence can be provided. The ultimate beneficiaries of this funding are horticultural producers, not the South Australian Government. Funding under this agreement should be treated as non-impacting.

Adelaide City Deal

Commonwealth funding under the Adelaide City Deal includes some funding that will be passed-on to local government and non-South Australian Government entities. Funding for Smart Technology – Free WiFi, Smart Technology – CCTV and Smart Technology – CCTV are being passed onto the Adelaide City Council in accordance with the funding arrangements agreed with the Commonwealth Government and should be treated as non-impacting.

Treatment of Commonwealth payments that commence in 2021-22

South Australia supports the recommendation of Commission staff that the Commonwealth payments commencing in 2021-22 should not be backcast. This reflects that they are not the result of a major change in Commonwealth-State financial arrangements.