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Victorian Response to New Issues for the 2022 Update

Treasury and Finance

The Secretary
Department of Treasury and Finance
1 Treasury Place
Melbourne Victoria 3002
Australia
Telephone: +61 3 9651 5111
dtf.vic.gov.au

Authorised by the Victorian Government
1 Treasury Place, Melbourne, 3002

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Glossary

Term	Definition
AASB	Australian Accounting Standards Board
AASB 1059	AASB 1059 Service Concession Arrangements: Grantors
AASB 15	AASB 15 Revenue from Contracts with Customers
AASB 16	AASB 16 Leases
ABN	Australian Business Number
ABS	Australian Bureau of Statistics
AHPPC	Australian Health Protection Principal Committee
AIHW	Australian Institute of Health and Welfare
APC	Actual per capita
CGC	Commonwealth Grants Commission
CoE	Characteristics of Employment survey
DTF	Victorian Department of Treasury and Finance
EPC	Equal per capita
GFS	Government Finance Statistics
GP	General practice
HFE	Horizontal Fiscal Equalisation
IHPA	Independent Hospital Pricing Authority
NDRRA	Natural Disaster Relief and Recovery Arrangements
NHFB	National Health Funding Body
NPCR	National Partnership on COVID-19 Response
SDC	Sociodemographic composition
SES	Socioeconomic status
States	States and Territories
ToR	Terms of Reference

Contents

Introduction

On 6 October 2021 the Commonwealth Grants Commission (CGC) provided Victoria with its 2022 Update New Issues Staff Discussion Paper (the discussion paper). Victoria appreciates the opportunity to provide its input on issues raised by CGC staff in the discussion paper and looks forward to continuing to engage with the CGC on these issues ahead of the release of the 2022 Update as new information becomes available.

Victoria notes that the issues identified in the discussion paper are in the absence of the Terms of Reference (ToR) for the 2022 Update, expected to be issued in early 2022. Once the ToR is issued, further consultation with jurisdictions may be necessary. In addition, several of the issues raised in the discussion paper will require changes to the ToR to enable the Commission to take an appropriate approach to the treatment of specific expenses.

Victoria notes CGC staff's recommendations in this year's discussion paper are more significant than for typical annual updates. The impact of the coronavirus (COVID-19) pandemic and its ensuing public health and economic responses is a once-in-a-generation event affecting all jurisdictions in a range of ways. Government responses to COVID-19 have been extensive. Careful and detailed consideration is required to determine appropriate assessments through the GST system, recognising the inadequacy of the current assessment methods capturing the impacts of COVID-19.

Victoria extends its thanks to CGC staff for their engagement on these complex issues and hopes these productive working relationships can continue to be built upon for future years.

Supporting Victoria's submission are the following attachments:

- Attachment A – Review of COVID-19 policy responses for the GST distribution, Melbourne Institute of Applied Economic and Social Research; and
- Attachment B – Supporting analysis on drivers of COVID-19 expenditure in Victoria.

Summary of issues

Topic raised by CGC staff	CGC recommendation	Victoria's recommendation
COVID-19 revenue assessments	Continue methods used in 2021 Update	Support
COVID-19 related health expenses assessment	Seek views of States	Change assessment methods for relevant COVID-19 related expenses
COVID-19 related economic support expenses assessment	Seek views of States	Change assessment methods for relevant COVID-19 related expenses
JobKeeper and wages cost assessment	Remove employees earning $750 from dataset	Tentative support, subject to further information
New Western Australia Native Title agreements	Assess Western Australia's expenses relating to Native title agreements in the year they are paid.	Support
Negative relativities	Adjust negative relativities to zero in the year they arise	Do not support
New accounting standards	Adjust GFS data to be consistent with new accounting standards	Tentative support, subject to further information
Health assessment – non-admitted patient data	Impute activity data from non-admitted patient GP-type	Tentative not support, subject to further information
New commonwealth payments	Proposed treatments listed in the discussion paper	Support

Impact of COVID-19 to Victoria

Health impacts to Victoria

The first case of COVID-19 in Australia was reported in Victoria in January 2020. The virus was declared a pandemic by the World Health Organisation on 11 March 2020.

The pandemic presented Australian governments with significant health and economic challenges, prompting changes to interjurisdictional governance structures.

National Cabinet was established on 13 March 2020 "to address the country's response to the coronavirus, COVID-19"[1]. National Cabinet would consider and agree on pandemic management policies, service delivery approaches as well as mitigation of economic impacts to ensure Australia did not experience a prolonged recession.

The parameters for Australian public health set by National Cabinet followed expert advice from the Australian Health Protection Principal Committee (AHPPC). The AHPPC comprises chief health and medical officers from each jurisdiction. In July 2020 the AHPPC released a strategic direction recommendation that its "strong public health advice is to pursue no community transmission"[2].

On 16 March 2020, the National Cabinet agreed to the first set of health restrictions responding to COVID-19 limiting international arrivals, banning cruise ships, introducing social distancing and restricting non-essential gatherings and public events.

Further restrictions were imposed by the National Cabinet on 24 March 2020[3] including limiting the activities of businesses including hospitality venues, retail, beauty and personal care and entertainment venues. Sporting events and facilities were closed, as were galleries, museums and places of worship.

The ongoing incidence of COVID-19 had the potential to overrun state health care systems, which posed significant risks to the community and economy. As a result, the National Cabinet agreed to a range of steps to reduce community transmission of COVID-19 which ensured consistency across the suite of public health restrictions put in place by States and Territories (States). States implemented consistent health controls, with any differences responding to their individual circumstances in terms of community transmission.

In late June 2020, when Victoria experienced a significant increase in case numbers, or a second wave, the same suite of restrictions was again imposed to manage the impact of COVID-19 caseloads. Victoria's policy response was consistent with both the National Cabinet approach in March 2020 and with the advice provided by the Victorian Chief Health Officer. In August 2020 the AHPPC noted its support for Victoria's intensified restrictions[4].

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[1] https://www.pm.gov.au/media/advice-coronavirus
[2] https://www.health.gov.au/news/australian-health-protection-principal-committee-ahppc-statement-on-strategic-direction
[3] https://www.pm.gov.au/media/update-coronavirus-measures-24-March-2020
[4] https://www.health.gov.au/news/australian-health-protection-principal-committee-ahppc-expression-of-support-for-additional-measures-to-improve-the-current-state-of-the-covid-19-outbreak-in-victoria

Health restrictions in Victoria were based on the advice of the Chief Health Officer, and the primary intent of the suite of public health restrictions was to reduce contact between people to limit the spread of the virus.

In 2020-21, Victoria experienced one long lockdown which lasted 111 days, and two short lockdowns that had a duration of less than two weeks. These lockdowns were necessary to manage potential outbreaks and mitigate the risk of longer-term lockdowns.

Victoria spent a significant number of days in lockdown in 2020-21, with over 100 days in strict lockdown, and 163 lockdown days in total. This is over triple the number of days of the next closest state (NSW), who had 45 days in moderate lockdown in comparison. The number of days in lockdown for each state over the 2020-21 year is shown in **Error! Reference source not found.**1 below.

Table 1: State and Territory lockdown days for 1 July 2020 - 30 June 2021

	VIC	NSW	QLD	SA	WA	NT	TAS	ACT
Moderate Lockdown	56	45	3	0	7	0	0	0
Strict Lockdown	107	0	0	3	0	4	0	0
Total	**163**	**45**	**3**	**3**	**7**	**4**	**0**	**0**

Source 1: Scott et al. 2021, Victorian Department of Treasury and Finance

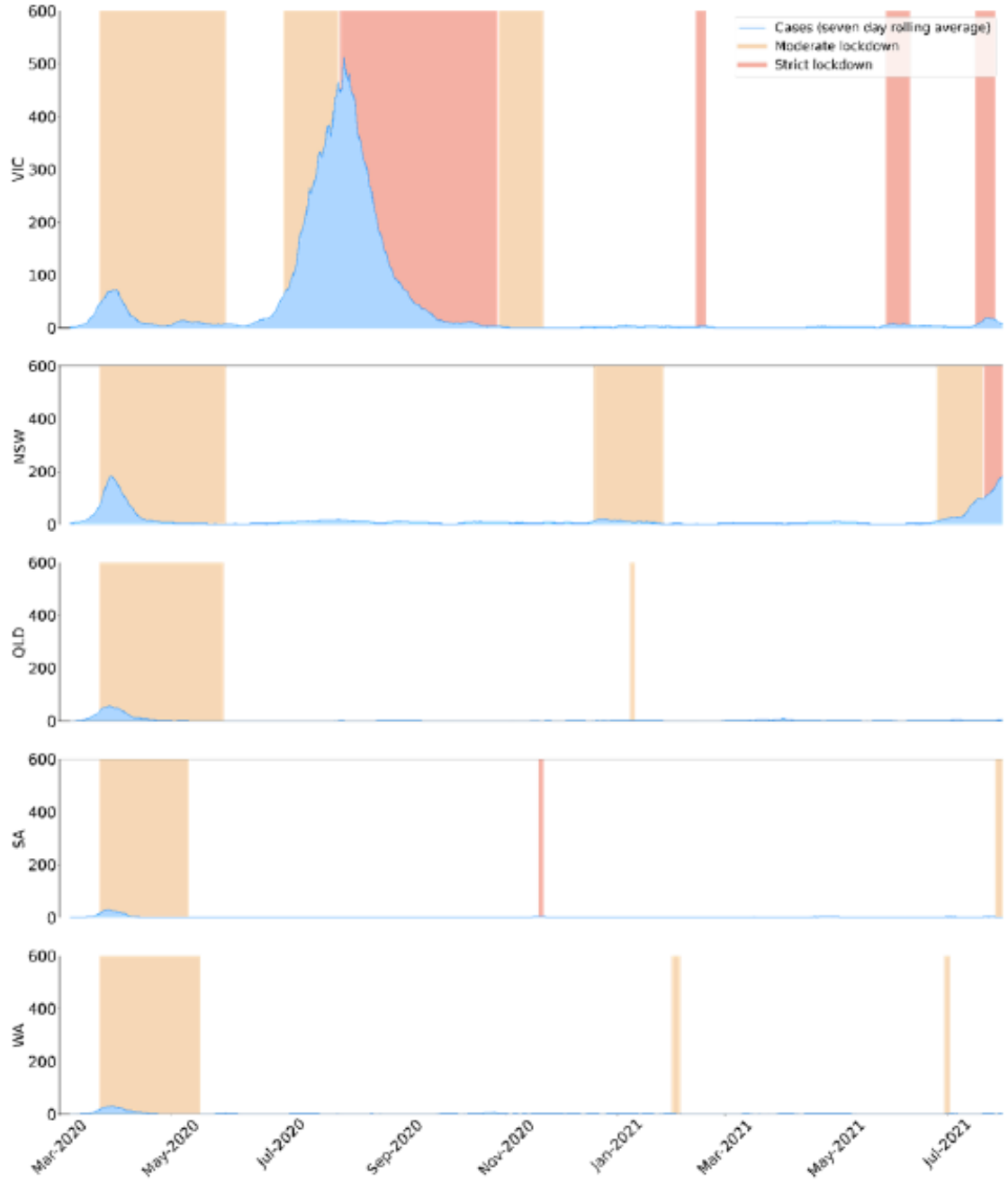
Victoria has worked with the Melbourne Institute of Applied Economic and Social Research (MIAESR) to understand the impacts of COVID-19 and policy responses to it. This report 'Review of COVID-19 policy responses for the GST distribution', is attached to Victoria's submission[5]. Victoria worked closely with MIAESR in order to better understand the impacts of COVID-19 on Victoria, particularly in terms of impacts to the health system. In addition, MIAESR was asked to consider Victoria's responses to the pandemic.

Scott et al. illustrate the differential incidence of COVID-19 in States and the greater case numbers and longer periods of health restrictions in Victoria over 2020-21, shown in **Error! Reference source not found.**.

They further find that 82 per cent of total cases of COVID-19 and 99 per cent of COVID-19 related deaths occurred in Victoria in 2020-21. These are both far greater than Victoria's population share of around 26 per cent.

[5] Anthony Scott, Jongsay Yong and Tianshu Bai, Review of COVID-19 policy responses for the GST distribution, Melbourne Institute of Applied Economic and Social Research, 2021

Figure 1: New confirmed cases, hospitalisations, and deaths due to COVID-19, Victoria compared with other states/territories, Match 2020 to July 2021



Source 2: Scott et al. 2021, Victorian Department of Treasury and Finance

Economic impacts to Victoria

Public health restrictions – which were necessary to slow the spread of COVID-19 and save lives – limited economic activity across a range of sectors in the June and September quarters 2020. Sharp falls in consumer and business confidence, and the closure of national borders to international students, tourists and migrants, also lowered economic activity.

As the original strain of the COVID-19 virus was contained and domestic restrictions were progressively eased, the Victorian economy rebounded strongly in the December quarter, and this momentum carried through into strong growth in the March quarter 2021, notwithstanding a very brief period of restrictions in February. Public health restrictions were also in place during the June quarter to contain a new variant of COVID-19, although state final demand still increased by 1.4 per cent in the quarter to be above its pre-pandemic level.

For 2020-21 as a whole, state final demand fell by 0.8 per cent. Consumer spending, which fell by 3.6 per cent, led this overall decline in domestic demand. This weakness in private demand was partially offset by an increase in government spending, driven in part by the Government's COVID-19 response. Public consumption (which rose by 7.6 per cent) and public investment (which rose by 10.4 per cent) both contributed to growth.

Victorian employment growth was the strongest of the states prior to the onset of the COVID-19 pandemic, averaging 3.1 per cent per year over the five years to 2018-19. The COVID-19 pandemic led to 238 600 Victorians losing work between March and September 2020. Unemployment in Victoria rose from 5.18 per cent in March 2020 to 7.35 per cent at the end of the first outbreak in June 2020. It is widely considered that the unemployment rate would have been significantly higher if not for the introduction of the Commonwealth's JobKeeper payments.

Following this, the easing of public health restrictions towards the end of 2020 and the subsequent economic recovery led to a significant rebound in employment, with 240 200 Victorians finding work between September 2020 and June 2021.

In year average terms for 2020-21, employment fell by 1.1 per cent, reflecting the weaker labour market earlier in the year. Full-time employment fell by 0.9 per cent, while part-time employment fell by 1.5 per cent.

The Victorian population fell by 0.6 per cent over the year to March 2021 (reflecting the latest available data). This was a significant change from the past five years when population growth averaged 2.2 per cent per year and was the highest in Australia.

Consistent with ongoing uncertainty and weak labour market conditions for much of 2020, wage growth in Victoria slowed to 1.5 per cent in 2020-21. Inflation in 2020-21 was also subdued at 1.4 per cent, reflecting weak price pressures in most major consumer spending categories.

Scott et al. demonstrate the disproportionate economic impact of the pandemic on Victoria. They note:

> *"With more severe outbreaks and longer periods of lockdown in 2020/21, Victoria fared worse than other states and territories. Longer periods of stricter lockdown have caused major disruptions to everyday life and economic activities, adversely affecting businesses and workers. This is evident in consumption expenditures and employment in Victoria, which were impacted more than other states and territories in 2020/21."*

In addition, the economic impacts of public health orders on the economy must be weighed up against the alternative, being a situation where COVID-19 runs through the community unrestrained. Scott et al. outline that "fear is a significant contributory factor to the slowdown in economic activities in

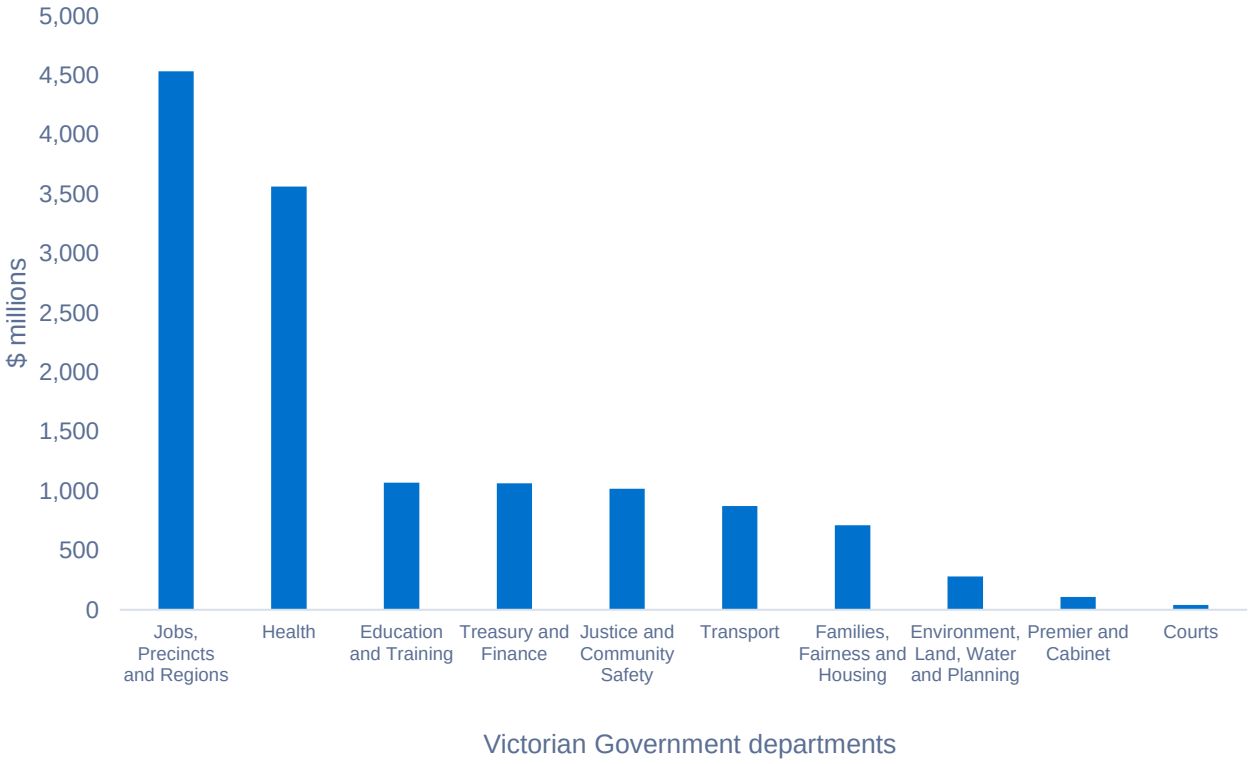
addition to the public health policies"[6]. It is likely that even without strict lockdowns, there would have been significant economic impacts if the virus had been left to spread unrestrained.

It should also be noted that the efforts in Victoria to contain the second outbreak not only benefitted the residents of Victoria, but all the residents of Australia. An unconstrained outbreak would invariably have led to the virus – and attendant economic damage – spreading to other areas of Australia.

Victorian service delivery response to the pandemic

Similar to other jurisdictions, Victoria has implemented significant responses to the pandemic across a range of service delivery areas that would not have been required in the absence of the pandemic. The Victorian 2020-21 Annual Financial Report notes a total expenditure of over $13 billion on COVID-19 initiatives in 2020-21. Figure 2 demonstrates the response across Victorian Government departments.

Figure 2: COVID-19 response and recovery - actual expenditure by department in 2020-21



Source 3: Department of Treasury and Finance

[6] Page 9, Scott et al.

Policy neutrality of COVID-19 impacts

In considering differential impacts of the pandemic on States' revenues or expenditures, it may be argued that differences were the result of State policy choices.

Victoria considers this to be false. Victoria considers States enacted policies responding to the uncontrollable and random impacts of the virus, following nationally agreed frameworks.

Any differences in responses to the pandemic by States were, and will continue to be, responding to very clear and major risks to public health and not due to policy choices. It would clearly be incorrect to suggest that any State had purposely put its residents at greater risk of economic or health damage through its policy measures in response to the pandemic.

As noted above, it was the agreed position of National Cabinet and the advice of the AHPPC to pursue suppression of the virus and no community transmission.

As such, before vaccination was widely available in Australia, it was the strategy of all jurisdictions to achieve suppression of the virus in the community. Further, there is wide consensus among academic sources in both health and economic fields that this approach was necessary to prevent further impacts. Academic evidence, summarised in Scott et al. shows more stringent measures resulted in lower health impacts, leading to fewer measures needing to be imposed in future[7].

National Cabinet agreed on the health restrictions that were imposed in the early stages of the pandemic. Subsequent outbreaks of the virus in States after this initial period were managed under this framework agreed by National Cabinet – which agreed and endorsed States' taking actions to respond to local circumstances[8].

However, States have experienced different circumstances in terms of incidence of the virus and have had to respond accordingly, see Figure 1. Victoria in 2020-21, and Victoria and New South Wales so far in 2021-22 have experienced greater outbreaks of COVID-19, which have necessitated greater government responses than in other States.

This is unsurprising, given Victoria and New South Wales are home to Australia's largest cities, Melbourne and Sydney. The spread of COVID-19 is through respiratory pathways and is more likely to spread in more densely populated areas[9]. As such, given an initial outbreak of the virus in the community, the virus has greater likelihood to spread in Melbourne and Sydney.

Outbreaks of the virus are driven by factors not under the control of any government. Scott et al. summarise academic sources noting the random and unpredictable nature of viruses. This includes that epidemiological models include random components and that epidemiological studies show the unpredictability in outcomes of virus outbreaks[10].

Much review and analysis has been done on hotel quarantine as a pathway for outbreaks of COVID-19. These include a national review recommended by the AHPCC, recognising common issues among States in quarantine. In addition, an independent review was undertaken in Victoria.

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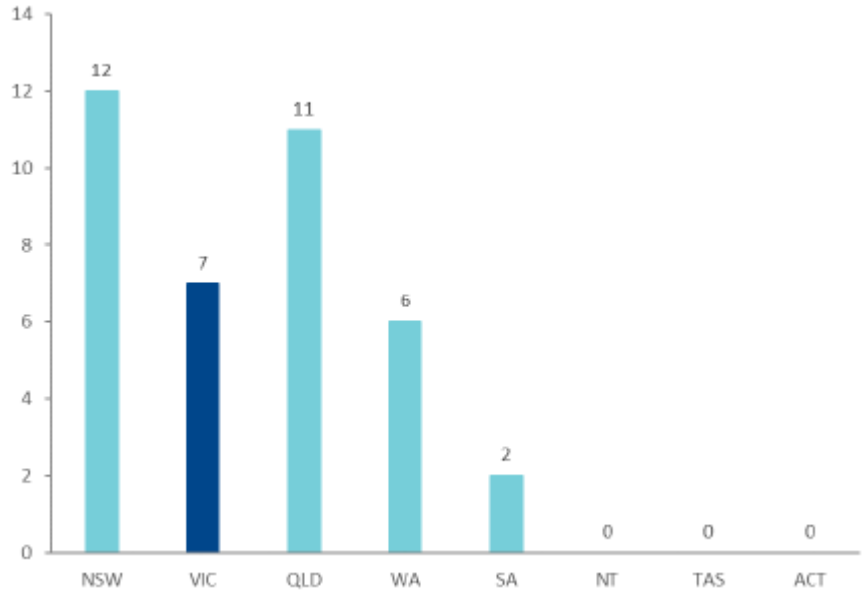
[7] For example, see Braithwaite, J., Y. Tran, L.A. Ellis, J. Westbrook (2021). The 40 health systems, COVID-19 (40HS, C-19) study. International Journal for Quality on Health Care. 33(1): 1–7 (doi: 10.1093/intqhc/mzaa113)
[8] https://www.pm.gov.au/media/statement-update-coronavirus-measures
[9] https://www.who.int/news-room/commentaries/detail/transmission-of-sars-cov-2-implications-for-infection-prevention-precautions
[10] Scott et al. page 47

It is clear that there have been shortcomings in the operations of COVID-19 quarantine across all States. Data reported by Scott et al. show breaches from quarantine have occurred in all States, even after national guidelines were published including into 2021. Scott et al. conclude:

> *"Breaches can occur in different settings and exhibit a degree of* ***randomness that is beyond the control of governments*** *at any level and so are* ***unrelated to the policy settings*** *of state/territory governments."*

Figure 3: Total number of quarantine breaches by States/Territory to October 2021



Source 4: ***Scott et al.***

Scott et al. also conclude the differences in responses between States reflect differences in circumstances, rather than polices:

> *"Governments at all levels moved quickly to provide significant economic support to businesses and individuals. The response included implementing public health measures such as social distancing rules and strict lockdown measures. Contact tracing systems were also put in place as states and territories sought to regulate movements across state/territory borders, in line with the virus elimination strategy that prevailed at the time.* ***These measures were universal across all states and territories****, and had the affirmation and support of the Commonwealth government and the National Cabinet."*

The issue of different State preparedness before the pandemic has been raised as an example where policy neutrality may not be applicable. Victoria considers the pandemic was an unforeseen event, and to ascribe any significant preparation for it before early 2020 is not reasonable. There is no evidence to suggest States' levels of preparedness for the pandemic were due to their knowledge that an event with the particular qualities of the COVID-19 pandemic would arise.

Even if it were the case that States had materially differing policies, which Victoria considers is incorrect, the CGC has already rightly stated that there is no technical basis to measure the impact on

fiscal capacities. In the 2022 Update discussion paper CGC staff state, referring to impacts to States' revenues: "if there were divergences from average policy, there is no reliable and practical method for identifying and measuring the effect". Victoria considers this applies to the impacts on States' expenditures as well as revenues.

Assessment of COVID-19 related impacts

Revenue assessment

2021 Update approach

The CGC previously reviewed the revenue assessment regarding the impact of COVID-19 in the 2021 Update which captured the first three months of the pandemic's impact in Australia.

In the 2021 Update, the CGC concluded that state policy responses to the economic impact of COVID-19 were broadly comparable. Any differences were likely due to state circumstances rather than differential policy settings. This meant that the current revenue assessment would capture the impact of COVID-19 on revenue raising capacity.

Specific revenue issues were considered by the CGC, mainly the treatment of tax waivers, rebates and deferrals, as well as the impact of JobKeeper on the payroll tax assessment.

Treatment of tax waivers and rebates

States made different decisions about how to reduce some tax liabilities in 2019-20, which were either a rebate or waiver, both having the same policy intent. While these were not material at the time, the Commission assumed that they would be for 2020-21 if the pandemic's economic impacts were prolonged. The CGC made adjustments to remove rebates from the relevant expense categories and offset them against the appropriate revenue category.

The CGC has proposed to use the same methodology for the 2022 Update.

Treatment of tax deferrals

Some States announced tax deferrals during 2019-20. This had an impact on the timing of the revenue collection, not the amount. The CGC made a decision to assess the deferrals on an accrual basis, which required adjusting three states. Again, this was not material in 2020-21, but was made in anticipation of the 2022 Update.

The CGC has proposed to use the same methodology for the 2022 Update.

Job keeper payments

States treated JobKeeper payments differently for payroll tax purposes. Victoria and NSW exempted top-up payments (payments above an employee's usual salary) while most other States provided a full exemption.

Due to Australian Bureau of Statistics (ABS) classifications and the inability to determine what portion of the data were JobKeeper payments, the CGC did not adjust the payroll tax base for JobKeeper payments.

The CGC has proposed to use the same methodology for the 2022 Update.

Comments on the CGC recommendation

Victoria considers, as the CGC recommend in the discussion paper, that State revenue responses to the pandemic were policy neutral, and any differences reflected differences in State circumstances, not policy choices.

As noted in the 2022 Update discussion paper, the CGC has already determined that differences in State revenue responses were due to differing circumstances, rather than policy settings. Victoria considers that this is the appropriate treatment for revenues. Victoria also considers as this has been established for revenues, it also holds for the States' expenditures.

> *"In the 2021 Update, the Commission concluded that state revenue policy responses to the economic impact of COVID-19 in the 2019-20 assessment year were broadly comparable. It* ***concluded that any differences primarily reflected differences in state circumstances, rather than differences in policy settings.*** *This meant that existing revenue assessments would largely capture the pandemic's effects on state revenue raising capacity."*

As the discussion paper notes, even if it were the case that divergences in States' responses to the pandemic were driven by policy choices, a position Victoria does not support, there would be no technical way to identify this effect. In addition to being incorrect on conceptual and policy grounds, an adjustment for supposed policy differences would not be feasible to implement in a practical way.

Victoria's recommendation

Victoria supports that the methods used in the 2021 Update on COVID-19 related revenue impacts are the basis for future Updates.

Victoria notes that this treatment implies revenue is impacted directly by COVID-19, and that the CGC's assessment should reflect this. Victoria's proposed approach regarding the treatment of expenses relating to COVID-19 balance this approach. To only make adjustments to revenue measures and not expenditure necessitated by the COVID-19 pandemic would be contradictory.

Health assessment

Impact of COVID-19 on delivery and funding of health services

The COVID-19 pandemic has had a significant impact on States' delivery of health services and associated funding. All States have announced substantial increases in health funding specifically to respond to the COVID-19 pandemic.

The Victorian 2020-21 Annual Financial Report notes actual spending of $3.6 billion by Victoria in 2020-21 by the Department of Health including on COVID-19 specific programs including:

- COVID-19 Response - Support for the health system;
- the COVID-19 vaccination program;
- Coronavirus (COVID-19) mental health response;
- COVID-19 Mandatory Quarantine;
- enhanced engagement approach with culturally and linguistically diverse communities and complex families; and
- creating a single digital solution for coronavirus (COVID-19) reporting.

This included $1.9 billion for the design of a specific health system roadmap and staged response to expand critical care beds across Victoria to meet COVID-19 demand, to buy ventilators, equipment and personal protective equipment, and to protect our healthcare workforce.

It is important to note this only includes aspects of programs administered by the Department of Health and does not include the total spending on health-related items by Victoria responding to the pandemic in 2020-21, as COVID-19 related health services may be delivered by departments other than the Department of Health, including some aspects of the programs listed above.

The former Victorian Department of Health and Human Services' 2019-20 Annual Report[11] outlines some of the additional services implemented by Victoria responding to the health impacts of the pandemic:

- managing the rollout of public health directives and restrictions;
- stockpiling personal, protective equipment, ventilators and other essential medical supplies so Victorian health care workers are protected and well supplied during the COVID-19 pandemic;
- expanding intensive care units (ICU), including bed capacity, equipment, staff and physical space to meet the expected surge in demand;
- rapidly growing the public health contact tracing team, to ensure all close contacts of coronavirus (COVID-19) positive cases are found expeditiously and health advice is quickly directed to those in need;
- implementing a state-wide coronavirus (COVID-19) testing blitz, to gain a better picture of community transmission in Victoria;
- providing hotels for heroes ─ free accommodation for frontline workers who have been exposed or tested positive to coronavirus (COVID-19) and cannot safely self-isolate at home;
- investing in new research to better understand transmission, immunity and the long-term health impacts of coronavirus (COVID-19);

[11] The Victorian Department of Health and Human Services was reorganised through a machinery of Government change into two new entities, the Department of Health and Department of Families, Fairness and Housing on 1 February 2021

- rapidly expanding telehealth capacity for Victorian public health services to reduce transmission risks and support ongoing access to clinical services;
- providing surge funding to meet increased demand for mental health services during the coronavirus (COVID-19) pandemic and to ensure Victorians get the care they need to tackle stress, isolation and uncertainty; and
- earlier support for people experiencing homelessness including investing in Isolation and Recovery Facilities to help keep people experiencing homelessness safe whilst also reducing the potential for community transmission of COVID-19 and establishing Homelessness Emergency Accommodation Response Teams.

The Victorian Department of Health's 2020-21 Annual Report notes its work responding to the COVID-19 pandemic in Victoria greatly increased in volume, scope and complexity in 2020-21[12].

In addition, Victoria established a new entity, COVID-19 Quarantine Victoria to coordinate and safely manage the mandatory hotel quarantine task. COVID-19 Quarantine Victoria assumed responsibility for the mandatory quarantine program when it restarted in Victoria on 7 December 2020.

COVID-19 also changed the way individuals engaged with the healthcare system. Scott et al. analysed hospital activity and Medicare Benefit Scheme data, considering the impacts of the pandemic. Results show that there has been a decrease in some activity, driven by restrictions on non-essential care including elective surgeries. While activity declined as a result of the pandemic, from a funding point of view this has been more than made up for by the additional demands COVID-19 has presented for the health response. This includes keeping hospital capacity open to manage COVID-19 patients, training staff and buying additional equipment. In addition, the delay of less urgent or elective care has repercussions for future demands on the health system.

The Victorian 2020-21 Annual Financial Report notes that employee expenses of $30 billion for 2020-21 were $839 million (2.9 per cent) higher than the revised budget and $2.8 billion (10.4 per cent) higher than 2019-20. Compared with the previous year, this increase is primarily due to additional resources in the health sector for the COVID-19 response and additional staff required following the establishment of COVID-19 Quarantine Victoria[13].

It is clear that this is separate and additional spending to what would typically be required from State health services. This activity responds to the unique demands of the pandemic and would not have occurred otherwise. This is self-evident from the nature of many of the services purchased by governments, which would only be necessary in the event of a global health pandemic, including standing up significant additional testing and contact tracing capability over and above usual requirements.

Scott et al. use a counterfactual analysis of States' expenditures to show that spending under the pandemic in 2020-21 was materially different from what it might have been under a no-pandemic scenario, including for Health as classified under the Classification of the Functions of Government and the Government Financial Statistics (GFS) release from the ABS. Scott et al. note, referring to estimated impacts that:

[12] Note some of the responsibilities of the former Victorian Department of Health and Human Services have been transferred between the new Department of Health and Department of Families, Fairness and Housing
[13] Page 10 2020-21 Victorian Annual Financial Report

> *"The amount represents an estimate of the additional expenses incurred by the state in 2020/21 because of COVID-19;* ***these expenses would not have been incurred under normal circumstances had there been no pandemic****. As such, they could be regarded as a separate category of expenses distinguishable from normal budget expenses in the absence of COVID-19."*

Operation of the current health assessment

The current assessment of State health expenses is on a differential basis, that distributes GST based on factors relating to higher need for funding.

These 'disability factors' and their weighting in relation to the GST distribution are determined using data on the relative costs of delivering health services for different groups. The data are represented by national weighted activity units, provided by the Independent Hospital Pricing Authority.

The disability factors that comprise the current differential assessment of health expenses are:

- remoteness: more remote communities on average cost more to service;
- indigenous status: indigenous Australians on average cost more to service;
- socioeconomic status (SES): lower SES communities on average cost more to service; and
- age: older Australians typically have higher health costs.

There are separate assessments for admitted patients, emergency departments, non-admitted patients, community health and non-hospital patient transport, recognising that disabilities differ depending on the type of health service[14].

Applicability of the current health assessment to impacts of COVID-19

While the disability factors generally correspond to the health needs in a typical assessment period, there is substantial evidence that they do not accurately describe incidence and burden of COVID-19 cases on health systems. As such, to achieve HFE, Victoria considers these factors should not be used for the basis of the GST distribution of health expenses.

The Commonwealth Government has recognised the stress the pandemic will place on State health care systems and services in responding to state needs. As a result, on 13 March 2020 all States and Territories with the exception of the Northern Territory (NT) signed the National Partnership on COVID-19 Responses (NPCR). This agreement recognises the joint responsibility of the Commonwealth and States to act together to protect the Australian community and ensure that the healthcare system can respond effectively to COVID-19.

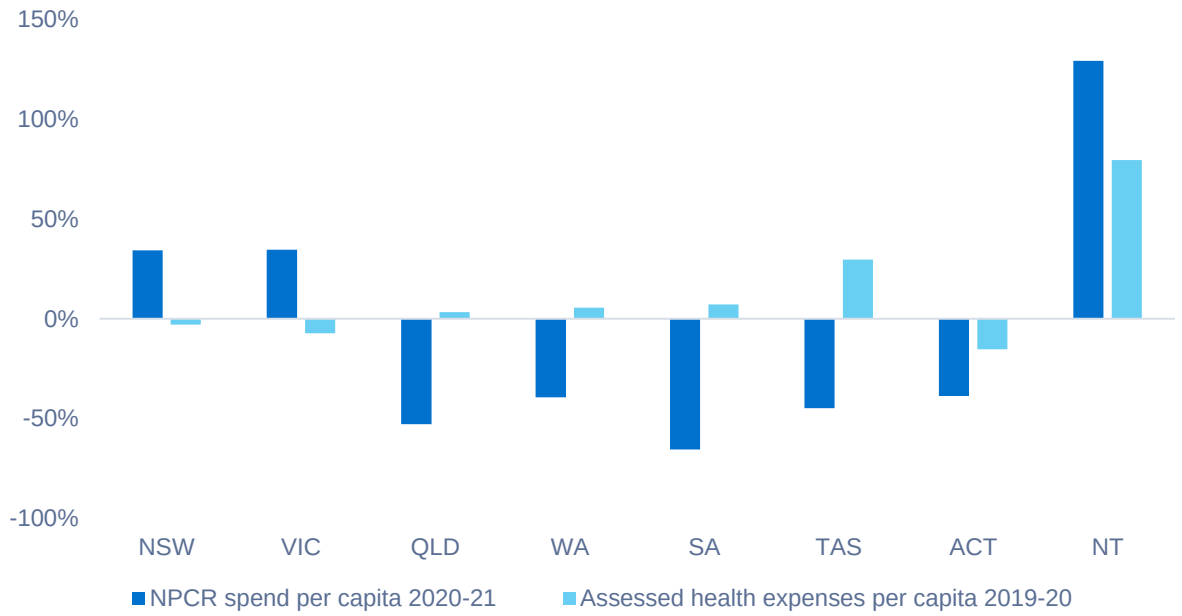
There is a significant difference between the way spending is assessed under the current health assessment and the drivers of spending on COVID-19. This is clear from data on States' spending under the NPCR included in the *Commonwealth Final Budget Outcome (FBO) 2020-21*, as presented in the discussion paper.

For some States it shows the opposite, that is, many States that are assessed as requiring higher than average health expenditure under typical conditions spent relatively less responding to COVID-19 under the NPCR.

[14] Page 131, CGC 2020 Review, Volume 2, Part B

Figure 4 below demonstrates this, showing the difference to the per capita national average spending under the NPCR and the assessment of health needs under the current GST system. For example, Victoria spent 35 per cent more than the national average per capita under the NPCR. In contrast, Victoria's assessed health expenses were 7 per cent below the national average under the standard health methods, in the most recent assessment year 2019-20.

Figure 4: Deviation from national average spending, COVID-19 public health responses 2020-21 and CGC assessed health expenditure 2019-20



Source 5: FBO, CGC 2021 Update

Informed by analysis of available data sources, Victoria concludes that the current disability factors used in the existing health assessment do not relate to the drivers of COVID-19 related health expenditures. As such, the current method cannot be used as the basis for assessing States' need for health funding responding to COVID-19 and an alternative treatment that better recognises the nature and scale of the required health sector expenditure is needed.

As an attachment to this submission Victoria has included slides detailing further evidence considered to reach this conclusion. A summary of this analysis is presented in the following sections of this submission.

Analysis of data on cases of COVID-19

Detailed data typically used in the health assessment from the Independent Hospital Pricing Authority (IHPA) on service usage is lagged, meaning it does not yet provide a complete picture of COVID-19 service use and cost. It would not be acceptable to wait until these data are available before making a determination as to how COVID-19 expenditure should be treated. First, approximate measures are already available that demonstrate the divergence between the current drivers and the impacts of COVID-19 on health systems.

Further, COVID-19 has caused a significant disruption to service delivery at a specific point in time, meaning the usual mismatch between timing of demographic data and spending data is not

acceptable. The scale of States' responses to the pandemic and the potential impacts on the GST distribution means this must be dealt with for the 2022 Update.

As such, Victoria has undertaken an analysis of the sociodemographic characteristics of COVID-19 confirmed cases, using publicly available data from most States. It has concluded these do not follow the relationships the current differential assessment is predicated on.

Due to contact tracing efforts, case numbers contain detailed demographic information and are a useful source of information on the impacts of COVID-19 on different groups.

Case numbers relate directly to States' public health responses, and the demographics of those with COVID-19 cases directly indicate the demographics of those who have used testing services, and who have required contact tracing and suppression responses. In addition, case numbers indicate the demographics of those who require more intensive clinical health responses, as a subset of those who contract the virus experience serious effects. This is an imperfect indicator however, as there may be factors within the groups more likely to contract coronavirus that lead to more serious health impacts.

For example, younger people were more likely to contract COVID-19. This is intuitive and relates to their greater mobility in the community than the elderly. As such to achieve HFE, general public health responses relating to COVID-19 should include as a disability the presence of greater younger populations, the opposite of the current system which weights towards the elderly. However, COVID-19 mortality rates are higher among older Australians. As such, HFE may be best served by retaining the weighting towards older populations for more extreme health services including COVID-19 related emergency department activity, but not for public health responses.

Indigenous populations

Data from a number of sources corroborates that indigenous Australians – fortunately – experienced relatively few COVID-19 cases, both in absolute terms and relative to population share.

According to the Commonwealth Department of Health's Aboriginal and Torres Strait Islander COVID-19 Epidemiology Report 1, Aboriginal and Torres Strait Islander people comprised 0.5 per cent of total COVID-19 cases in Australia, which is corroborated by The Australian Institute of Health and Welfare[15]. This is lower than the population share of Indigenous Australians, who comprise 3.3 per cent of the total population[16].

The Commonwealth Department of Health additionally reports that the rate of cases among Aboriginal and Torres Strait Islander people was significantly lower on a population basis. Aboriginal and Torres Strait Islander people experienced cases of COVID-19 at a rate of 19 persons per 100 000, compared to 116 per 100 000 for non-indigenous Australians, a rate over six times lower.

This certainly does not diminish that Indigenous Australians may experience on average poorer health outcomes and require more intensive health services generally. This is captured in the current health assessment. However, to the extent that there are services and additional expenses by States specifically to respond to the impacts of COVID-19, it does not appear reasonable to weight the need

[15] AIHW 2021. The first year of COVID-19 in Australia: direct and indirect health effects. Cat. no. PHE 287. Canberra: AIHW

[16] https://www.abs.gov.au/statistics/people/aboriginal-and-torres-strait-islander-peoples/estimates-aboriginal-and-torres-strait-islander-australians/latest-release

for these responses to the presence of greater Indigenous populations in aggregate, as the GST assessment currently does.

Remote communities

COVID-19 is a respiratory virus, and transmission of cases is now established to be driven through respiratory means[17]. As such, the virus has had greater transmission and subsequent impact on health systems in more densely populated environments. The virus spreads more quickly where greater numbers of people have close contact and there is greater movement, such as employment, high density living, large multi-person households among other factors. This is reflected in key health measures to combat the virus enacted by all States that have limited people's movement and attendance at settings requiring close physical proximity.

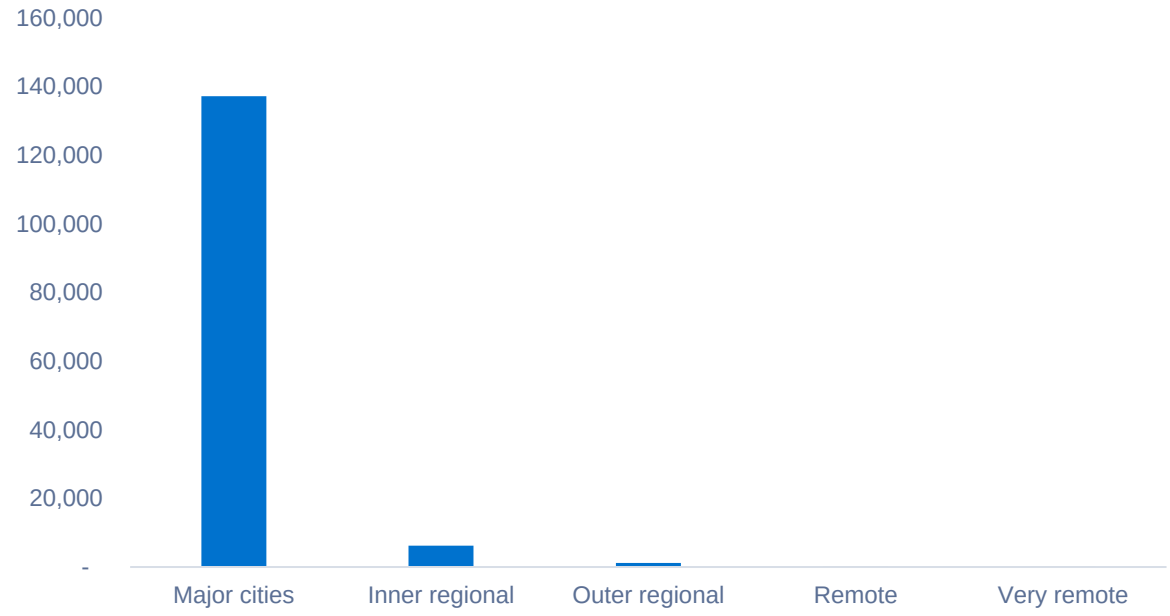
As such, it is unsurprising that data on COVID-19 cases show the impacts of the virus have been dramatically concentrated in Australia's two largest cities, Melbourne and Sydney. Conversely, regional areas, particularly remote areas, have had significantly lower case numbers. In Victoria's second wave of COVID-19, the impacts were largely concentrated in metropolitan Melbourne, with regional areas experiencing limited health controls.

As such, Victoria considers the weighting of the current system towards the greater need for health expenses in remote areas should not apply to COVID-19 related health expenditures.

Nearly all cases of COVID-19 to October 2021 have occurred in major cities; 95 per cent of cases have been recorded in local government areas in major cities, as classified by the ABS' Accessibility and Remoteness Index of Australia (ARIA). Remote and very remote areas had fewer than one per cent of total cases.

[17] https://www.who.int/news-room/commentaries/detail/transmission-of-sars-cov-2-implications-for-infection-prevention-precautions

Figure 5: Total COVID-19 cases in Australia by remoteness category to October 2021



Source 6: Analysis of COVID-19 cases compiled by Victoria, see Attachment B for detail

Applicability of current method

As the factors used in the current differential assessment do not relate to the need for spending on COVID-19 related health services, spending on these services should be treated separately.

This would be the case even if more current data were available to reflect the sociodemographic composition (SDC) of health utilisation during the pandemic from the IHPA. Waiting for SDC data to be incorporated will not remedy this issue.

Firstly, even if fully incorporated SDC data were an accurate representation of need, there will be a timing mismatch of a year between when spending is assessed and when the SDC is reflected. As noted, outbreaks of COVID-19 have significant impacts at specific points in time and responses are required immediately. Therefore, COVID-19 related spending would be assessed on an inappropriate basis.

Further, even once the COVID-19 related SDC data are incorporated into the assessment (i.e. once data from 2020-21 onwards are available), without a change to methods, these would be averaged over all health services. As established, COVID-19 related health services and typical health services have different drivers of need. For example, COVID-19 impacts are greater in inner cities and densely populated areas, whereas typical health expenses are greater in remote communities. As such, using one set of SDC data would be an unsatisfactory outcome for both COVID-19 and non-COVID-19 related services. Being combined with all other health expenditure categories would effectively mean the COVID-19 specific SDC would not be accounted for, but would also weaken the relationships that the current health expenses are assessed on.

This is displayed in the figures presented by the CGC in the discussion paper presenting national weighted activity units of admitted patients by remoteness and age (Figures 4 and 5 in the CGC discussion paper). It is clear that in 2019-20, only containing the first four months of the pandemic, more patient admissions were from major cities and younger populations.

It may be stated that there are other diseases or health activities that also do not align with the drivers of need in the current health assessment, which are also not given separate treatments. This is not a rationale for not creating a separate assessment of COVID-19 expenses.

There is a need however for the GST assessment to balance achieving HFE, materiality and simplicity. It is clear that COVID-19 is a unique health condition that is sufficiently material for a separate assessment. This may not be the case for other endemic or ongoing health issues currently captured by the health assessment.

COVID-19 has had clear and tangible impacts on the healthcare system, and there are data to support this. Data on States' spending under the NPCR presented in the discussion paper make clear that the impacts of responding to COVID-19 on States' fiscal capacities are significant and material. Further, the impacts of COVID-19 are unprecedented and unexpected, requiring significant deviation from typical health service delivery. They also occur at a specific point in time and should not persist in the long term. As such, a separate treatment is considered appropriate, where it may not be for other health issues.

Potential alternative treatments to COVID-19 health expenses

Given the current method is inappropriate, Victoria has considered several alternative options for the treatment of COVID-19 related health expenses. Among these, an actual per capita treatment is most preferable, balancing the need to achieve HFE with practical concerns with implementation.

The data on State spending under the NPCR already demonstrate the materiality of COVID-19 specific health spending.

Possibilities for the treatment of COVID-19 related health expenses include:

- continuing the current differential method;
- an equal per capita treatment (EPC);
- establishing a new differential assessment; and
- an actual per capita treatment (APC).

As detailed above, continuing the current differential method would be unsatisfactory for achieving HFE, given the differing drivers and incidence of COVID-19 impacts on health systems compared to typical expenses.

Further, an EPC treatment appears inappropriate given the CGC has already noted in the discussion paper that the NPCR spending data indicates a "differential health spending of the States in response to the pandemic". An EPC approach implies that the costs were distributed equally amongst the population.

A new differential assessment would not be without merit, as it could capture the differential incidence of the impacts of COVID-19, a key issue with the current system. An issue with this approach, however, is the availability of suitable data to base a new assessment on. As noted, reliable data on the incidence of COVID-19 impacts from the IHPA appear unlikely to be available in time for the 2022 Update. After data are available, States and the CGC would have to consider an appropriate treatment, which would be a complex, time consuming process. As such, this may not be able to be developed in time for the 2022 Update.

In addition, there are several reasons an APC treatment is preferable including the policy neutrality and consistency of spending under the NPCR and the likeness of COVID-19 to a natural disaster.

In its 2021 Staff Discussion Paper, the Commission raised the potential for COVID-19 related expenses to be treated on an APC basis. CGC staff noted they considered this was appropriate as

the current assessment would not capture the different incidence of the virus between States, and that the NPCR provides a common policy framework for identifying COVID-19 related health expenses.

Spending under the National Partnership for COVID-19 Reponses

In the discussion paper for the 2022 Update, the CGC raise the potential to use the state spending under the NPCR as the basis for an APC assessment of COVID-19 related health expenditures.

Victoria considers the NPCR is an appropriate basis for an APC assessment. The National Health Funding Body (NHFB) goes through a process with States to determine what spending falls under the agreement and is 'COVID-19 related'. As such, spending reported under the agreement is satisfactorily consistent between States and policy neutral to form the basis of an APC assessment. It provides assurance that States only spent what they had to, and that all spending is related to COVID-19.

Spending under the NPCR is categorised under both hospital and public health. There is the potential to conduct two separate APC assessments, one per category, or a single assessment. The CGC has advised that a separate assessment of hospital spending under the NPCR would not be material. It may still be preferable to assess these separately, if there is the possibility that a separate assessment is material in the future. On balance, Victoria considers a combined assessment appropriate for simplicity.

There is however a significant discrepancy between funding on health services recorded by Victoria responding to the pandemic and what is reported by the CGC in the discussion paper as spending under the NPCR in 2020-21. Victoria's 2020-21 Annual Financial Report identifies spending of over $3.5 billion by the Victorian Department of Health alone responding to COVID-19 in 2020-21. As reported in the discussion paper, preliminary spending by Victoria under the NPCR was $1 billion in 2020-21.

This is partly due to a timing issue, given the NHFB is yet to complete a reconciliation to arrive at final COVID-19 expenditure under the NPCR for 2020-21. Victoria understands there is significant COVID-19 related expenditure that was accounted for under the pre-existing National Health Reform Agreement (NHRA) mechanism to fund hospital and acute activity. COVID-19 activity under the NHRA will be reclassified under the NPCR by the NHFB later in 2021. When this occurs, COVID-19 related spending under the NPCR will more closely reflect Victoria's own reporting.

However, there are additional discrepancies in areas where Victoria has had requests for expenditure on health services not accepted by the NHFB to be related to COVID-19. A significant example of this includes expenditure supporting hospitals to maintain capacity during the pandemic, despite decreases in activity as noted above.

Public hospitals rely in part on funding sources that are dependent on activity, including carparking fees and activity-based items under the Medicare Benefits Scheme. As such, they experienced a shortfall to maintain pre-COVID capacity which the Victorian Government provided for. This was not agreed by the NHFB to be COVID-19 related spending under the NPCR.

To rectify this CGC should consider using total expenditure claimed by the States under the NPCR rather the total amounts considered and paid under the agreement. This is already reported to the NHFB and agreed as legitimate health expenditure, only not reaching agreement that it should be cost-shared between the Commonwealth and States.

An alternative to using the costs under the NPCR could be to use data from the Australian Institute of Health and Welfare's (AIHW) Health Expenditure Australia report. This would capture a broader range of services than the NPCR and be accounted for on a consistent basis across jurisdictions.

Again, there are data limitations in using the AIHW report, with the 2018-19 report only released in late 2020. As noted, COVID-19 requires contemporaneous data, and to achieve HFE alignment between assessment expenditures and SDC data is key.

Victoria would like to continue to work with the CGC on the detail of implementation of any potential separate treatment of COVID-19 health expenses.

COVID-19 as a natural disaster

An APC treatment is also used for natural disasters by the CGC. In the 2015 Review Report the CGC noted this is applicable because State expenses are not policy-influenced and natural disaster relief expenses reflect the net costs to States. This is accounted for through the Commonwealth Natural Disaster Relief and Recovery Arrangements (NDRRA).

Victoria considers all of these considerations are also true for the COVID-19 pandemic. Victoria considers States have responded to the health and economic crisis posed by COVID-19 in the same way they would to any other natural disaster. In addition, the NPCR provides a consistent basis to make an APC assessment on actual costs, similar to the NDRRA for other natural disasters.

In their report to Victoria, authors Scott et al. conclude that COVID-19 is, or should be considered as, a natural disaster. The cite the randomness and uncertainty around the impacts of the pandemic, similar to other natural disasters like bushfires or floods.

Scott et al. reference the Australian Government Crisis Management Framework which defines pandemics as natural events, along with bushfires, storms floods and so on.

They also point to the enactment of emergency powers among all States to respond to the pandemic. Many of these are the same as those used for other natural disasters. For example, in Victoria a State of Disaster was introduced on 2 August 2020 under the *Emergency Management Act 2013*. This is the Act used during Victoria's bushfires in early 2020. The Act defines 'a plague or an epidemic' as an emergency alongside other natural disasters like earthquakes and floods.

Further, the Commonwealth has more recently recognised the pandemic as a natural disaster through the implementation of COVID Disaster Payments to individuals by the National Recovery and Resilience Agency.

Victoria's recommendation

Victoria considers the current health assessment is an inappropriate basis for COVID-19 related health expenses. There should be a separate assessment made for COVID-19 related health expenses by States.

Balancing the aim of achieving HFE, administrative simplicity and the need for contemporary data, Victoria recommends an APC assessment of COVID-19 related health expenses.

Victoria notes this will require authorisation from the Commonwealth Treasurer in the ToR for the 2022 Update.

Victoria considers the NPCR forms an appropriate basis to make this assessment, however, seeks to work further with the CGC on detail of options for implementing an APC assessment of COVID-19 related health expenses.

Services to industry assessment

COVID-19 has had a significant impact on States' economies, with specific detail regarding Victoria outlined in the **Error! Reference source not found.** section. Governments have responded by implementing a range of support measures. The discussion paper asks States' views on how this expenditure should be treated by the GST system and whether the current assessment method is applicable.

Current assessment method

State spending on economic support is assessed under the services to industry category by the CGC. The spending is split into two parts; industry regulation and business development. Regulatory spending includes business registration, licensing of tradespeople, regulation such as chemical regulation and energy market regulation, occupational health and safety and more. Business development includes activities like mining exploration, geological mapping, tourism and trade promotion, marketing, and industry research and development.

The current services to industry assessment "recognises that states face differing costs for industry regulation but not for spending on business development"[18]. The services to industry assessment includes regulatory expenses for agriculture, forestry, fishing, mining and other industries separately as they are regulated differently from state to state[19].

The categories 'regulation' and 'business development' are then assessed differently. They are split according to the ratios set out in Table2 below.

Business development expenses are assessed EPC as population is considered to be the driver[20]. Regulation expenses are assessed using a differential assessment, with disability factors including sector size, regional costs factors and wage costs factors.

Table 2: 2020 Review ratios for regulation and business development.

Industry	Regulation	Business development
Agriculture	50 per cent	50 per cent
Mining	80 per cent	20 per cent
Other industries	53 per cent	47 per cent

2021 Update approach

In 2019-20 there was a large increase in state spending on services to industry driven by States' responses to the economic impact of the coronavirus (COVID-19) pandemic.

The CGC consulted with States on changing the ratios which split spending between regulation and business development. The final determination by the CGC for the 2021 Update was that a change in

[18] Page 351, CGC 2020 Review Volume 2, Part B
[19] *Health regulation expenses are assessed under the health category.*
[20] Page 360, CGC 2020 Review Volume 2, Part B

ratio constituted a method change which was not been permitted under the final ToR issued by the Commonwealth Treasurer.

2022 Update approach

In the New Issues Paper, the CGC notes that States' spending on services to industry would remain high in 2020-21 due to the coronavirus (COVID-19) pandemic's ongoing economic impact.

The CGC is again inviting States' views on the matter given that business development spending in 2020-21 is likely to be higher than historical averages. However, any changes are likely to require changes to the ToR for the 2022 Update.

COVID-19 industry support programs

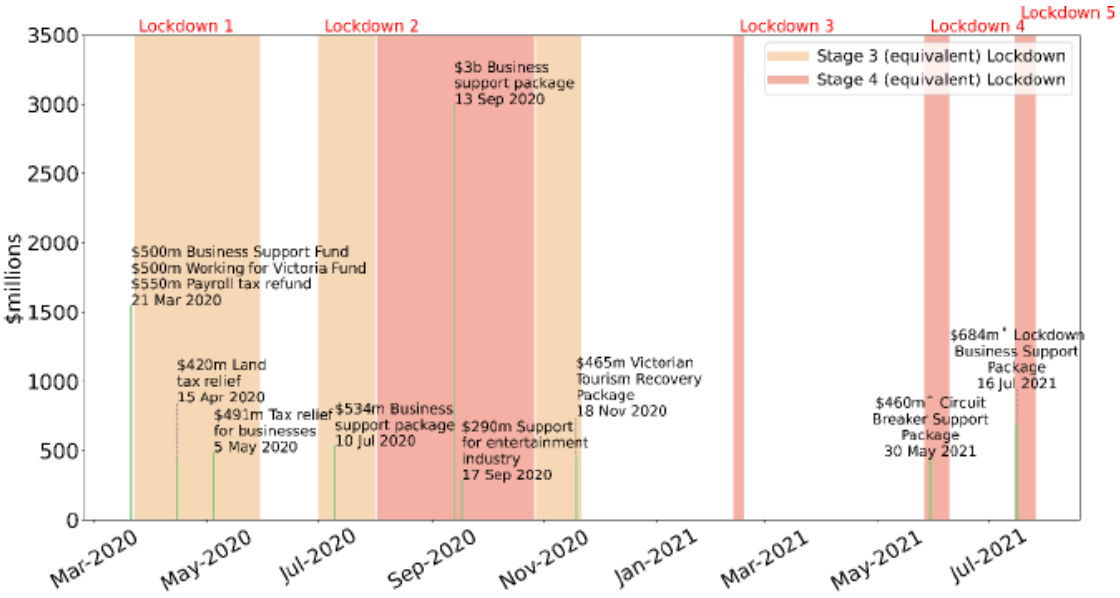
The COVID-19 pandemic has had severe impacts on the economies of all States, with significant impacts in Victoria over 2020-21. This created the necessity for States to respond with commensurately significant measures to support economies and communities.

A number of key industries in Victoria were impacted by the introduction of both Commonwealth and state restrictions. The nature of the public health measures employed resulted in particular cohorts being impacted more than others. In essence, there were business and industries that could not operate remotely and were required to close completely, business that could only operate in a reduced format such as takeaway food services and click-and-collect for retail, as well as industries whose customer base were impacted by the restrictions, particularly the case for regional tourism.

As a result the Victorian Government provided a range of supports over 2020-21, generally at the commencement of significant lockdown periods to ensure businesses were in a financial position to operate post-lockdown, as well as programs to stimulate the economy and support a return to pre-COVID conditions. These support measures targeted industries that faced the most significant impacts from COVID-19 public health orders.

Figure 66 below shows the timing of key support packages and lockdowns in Victoria from March 2020 to July 2021.

Figure 6: Victorian major economic support packages, March 2020 to July 2021



Source 7: Scott et al

Over 2020-21, actual spending on initiatives in response to COVID-19 funded by the Victorian Government totalled over $13.257 billion[21]. Funding provided for business support, recovery and economic stimulus were rolled out over a number of departments, as summarised in the above section: Victorian service delivery response to the pandemic.

The Government's programs included a range of key supports for business, with many of them providing direct financial support to businesses directly impacted by lockdowns. These programs supplemented the Commonwealth's JobKeeper program, which provided direct support to employees. An overview of the types of programs that applied in 2020-21 can be found below.

- Programs that targeted particular types of businesses such as the Business Support Fund and its iterations, which supported small business operating in industries directly impacted by lockdowns.
- Programs that targeted specific industries, such as the Hospitality Business Grant Program, Licensed Hospitality Venue Fund and a range of other programs including supports for the arts.
- Programs that targeted industry and location specific business, such as the Alpine Resorts Support Program, and the Regional Tourism Accommodation Support Program. While these industries weren't required to close due to lockdown, a significant portion of their customer base was impacted by restrictions in metropolitan Melbourne.

Supports provided to business were implemented quickly, targeting industries that were not classified as essential, and often rolling over previous programs across sequential lockdowns. Reviewing a range of programs in Victoria in 2020-21, common eligibility criteria were:

- registered with an Australian Business Number (ABN);

[21] https://www.dtf.vic.gov.au/state-financial-data-sets/coronavirus-covid-19-reporting

- located within Victoria;
- registered for GST;
- operating in an industry or sector that has been subject to closure or highly impacted by shutdown restrictions; and
- trading solvently at the time of application.

Other eligibility criteria for a subset of programs included some turnover requirements, registration with industry bodies, and also receipt of JobKeeper payments. The programs were closely linked to ANZIC codes, with funding often tied to the ANZIC code linked to the business as per their ABN. Industries and types targeted by these programs included:

- sole traders;
- arts and creative industries;
- retail;
- hospitality venues such as restaurants, bars and cafes;
- small business;
- tourism including regional tourism; and
- accommodation providers.

A number of the most significant programs provided to Victorian business are summarised in **Error! Not a valid bookmark self-reference.**.

Table 1: Details of COVID-19 related industry support schemes in 2020-21

Program	**Business Support Fund**
Description	A grant of up to $10 000 for eligible business, to assist businesses that have been impacted by the shutdown restrictions. The grant funds may be used for meeting business costs, such as utilities, salaries and rent, seeking financial, legal or other advice to support business continuity planning, developing marketing strategies or other activities related to the operation of the business. Stream One targets small businesses that meet the standard eligibility criteria (refer to Section 1 below) and operate in industry sectors that have been subject to closure or highly impacted by COVID-19 shutdown restrictions announced by the Victorian Government. Stream Two provides support to small businesses in any other sectors that meet the standard eligibility criteria and are enrolled as eligible participants registered to receive support through the Commonwealth Government's JobKeeper Payment scheme.
Date announced	21 March 2020 with extensions announced on: 6 August 2020; and 13 September 2020.
Industry targeted	No specific industry, targets support small businesses that employ staff and have been highly impacted by COVID-19 restrictions.
Eligibility criteria	• Employ people; and • Have a turnover of more than $75 000; and • Have a payroll of less than $650 000; and • Hold an Australian Business Number (ABN) and have held that ABN at 16 March 2020 (date of the State of Emergency declaration); and

	• Have been engaged in carrying out the operation of the business in the Australian State of Victoria on 16 March 2020; and • Operate in an industry sector that has been subject to closure or highly impacted by shutdown restrictions announced by the Victorian Government; OR • Be enrolled as eligible participants in the Commonwealth Government's JobKeeper Payment scheme.
Announced total spend in 2020-21	$822 million[22] under the 13 September 2020 announcement
Program	**Business Costs Assistance Program**
Description	The program seeks to assist eligible businesses that have incurred costs as a direct result of the circuit breaker action announced on 12 February 2021 which may include, but are not limited to: • the loss of perishable goods (e.g. food or flowers); • cancellation fees and charges (e.g. venue/performer/instructor); • booking cancellations; and • other costs and losses incurred due to the circuit breaker action that could not be reasonably avoided. The program provided support of $2 000 to business for the February roll-out, revised up to $7 000 in the May-June circuit breaker action.
Date announced	21 February 2021, with extensions and various supplements announced on: 27 May 2021 (round 2); 2 June 2021; 6 June 2021 (Tourism supplement); and 9 June 2021.
Industry targeted	Hospitality, food wholesaling, tourism, events and related services, selected retail.
Eligibility criteria	• Be located within Victoria; and • Be registered as operating in an eligible industry sector identified in the List of eligible ANZSIC classes (as defined by the industry classification (ANZSIC) linked to the business' ABN); and • Have incurred costs (as outlined in Section 5) as a direct result of the circuit breaker action announced on 12 February 2021; and • Have an annual Victorian payroll of up to $3 million, increased to $10 million in subsequent extensions, in 2019-20 on an ungrouped basis; and • Be registered for Goods and Services Tax (GST) on 12 February 2021; and • Hold an Australian Business Number (ABN) and have held that ABN at 12 February 2021.
Announced total spend in 2020-21	$92.06 million under the initial announcement $391.2 million under the 27 May 2021 announcement

[22] https://business.vic.gov.au/__data/assets/pdf_file/0007/1936294/Business-Support-Fund-3-guidelines.pdf

Program	**Licensed Hospitality Venue Fund**
Description	The program aims to help businesses survive the impacts of coronavirus (COVID-19) restrictions and to keep Victorians in jobs. Grant funds may be used to assist the business, for example on: • meeting business costs, including utilities, salaries or rent; • seeking financial, legal or other advice to support business continuity planning; • developing the business through marketing and communications activities; or • any other supporting activities related to the operation of the business. Eligible liquor licensees may apply for grants of between $10 000 and $30 000. The program is open to both metropolitan and regional based businesses across Victoria.
Date announced	13 September 2020, with further extension announced on: 30 May 2021.
Industry targeted	Licensed bars, restaurants, pubs, clubs, hotels, cafes or reception centres that serve food and alcohol
Eligibility criteria	Eligibility criteria for 13 September 2020 program: • Businesses must operate at licensed bars, restaurants, pubs, clubs, hotels, cafes or reception centres that serve food and alcohol (Premises) located in Victoria on 13 September 2020; and • Businesses must hold a general or late night (general), full club, restaurant and cafe, producer's or on-premises or late night (on-premises) liquor licence as at 13 September 2020; and • Businesses must have been operating prior to 13 September 2020 and intend to continue to operate under the Licensee's liquor licence; and • There must be a food business (which may be a third party or the Applicant) holding a Class 2 or 3 Service Sector Certificate of Registration under the *Food Act 1984* which serves food on the same Premises; and • Businesses must be registered for Goods and Services Tax (GST) on 13 September 2020; and • Businesses must hold an Australian Business Number (ABN) and have held that ABN at 13 September 2020; and • Businesses must be registered with the responsible Federal or State regulator.
Announced total spend in 2020-21	$251 million announced under the 13 September 2020 announcement $70 million announced under the 30 May 2021 announcement

For the 2020-21 period the Victorian Government provided additional supports for industry through a range of different departmental initiatives, with the Department of Education and Training leading programs such as the University Support and Contribution to Economic Recovery Program, and the Department of Transport providing rent relief for commercial tenants.

Further information regarding specific programs will be provided to the CGC as required.

Suitability of the current approach

Firstly, it is important to point out that in the 2021 discussion paper, the CGC previously raised the treatment of industry support with States on adjusting the approach to business support in the context of COVID-19. The CGC has again included this in the discussion paper for the 2022 Update as it is clear the pandemic has had a significant impact with a sufficiently prolonged presence such that an alternative treatment is warranted.

The COVID-19 pandemic led to the largest global recession since the Great Depression, and the Victorian economy was not immune. Exogenous shocks such as global pandemics and natural disasters should not result in in a deterioration of the principle of HFE. If the instance of a global pandemic and related expenses are not considered significant enough to temporarily change adjust a component of the methodology to account for this, States may find it difficult to trust that the GST system will be able to support HFE under other force majeure situations.

The impact of COVID-19 in 2020-21 was unavoidable. Vaccines were not widely available in Australia and so the agreed method was to test, trace isolate and lockdown when case numbers became material.

Options realistically available for the treatment of industry support expenses are using the current EPC approach, or changing to an APC approach or a new differential assessment. These are discussed in more detail below.

The current approach for assessing services to industry was determined based on a single year of data from 2018-19. The ratio calculated in that particular year will remain in place until the next Review in 2025, unless flexibility is allowed for the Commission to properly address this issue in the forthcoming ToR for the 2022 Update. A ratio based on a single year of data does not reflect economic cycles that may occur across industries in both regulation and in business development.

Further, this ratio was based on a stable relationship between the two categories that no longer exists. The ratio is inflexible and is unable to respond to significant economic shocks, such as those presented from COVID-19.

It should be noted that in the 2020 Review, the total expenses for all states on services to industry for 2018-19 totalled $5.2 billion[23]. Excluding expenditure by the Department of Health, Victoria spent more than $9.695 billion on COVID-19 responses in 2020-21 which is almost double the total expenses used to develop and calibrate the ratio in the 2020 Review. It is clear that the determination made in the 2020 Review no longer holds in the current economic climate and will not satisfactorily deal with the necessary and unavoidable expenditure responding to the COVID-19 pandemic.

An EPC assessment relies on spending to be evenly distributed among the population. The data demonstrates that the impacts on the economy were not evenly distributed among the States nor among the population, meaning that an EPC assessment is not a reasonable approach to take.

Case numbers and lockdown days in a state generally drove the need for business support, with impacts felt in other States particularly in the tourism and accommodation sectors. Further discussion regarding the inappropriateness of EPC as a treatment option are also discussed in the Potential alternative treatments to COVID-19 health expenses section above.

[23] Table 22-1, Page 351, CGC 2020 Review Volume 2, Part B

Potential alternative treatments to COVID-19 economic support expenditure

Scott et al. conclude that economic responses to the pandemic by States were generally the same stating “economic support policies have also been similar in nature across states/territories”.

An APC approach would better assess States spending needs for the 2020-21 year, which is not currently reflected in the services to industry methodology. It will also simplify the approach for the CGC, given that the CGC is restricted by their access to quality and contemporaneous data to make a more detailed differential assessment. An APC approach would also be consistent with the approach proposed for health expenses.

However, economic supports did not have a national agency for agreement on COVID-19 responses, as was with the case for health responses with the NPCR and NHFB. As such, the CGC will have to go through a process to determine what expenses to consider as COVID-19 expenses for economic support. For Victoria this should be a clear process as Victoria already reports COVID-19 related expenditures through its 2021 Annual Financial Report, as quoted earlier in this submission.

CGC staff have indicated a preference for a differential approach to assessing economic supports. This will require investment and understanding of the economic landscape impacting States, as well as determining the appropriate disabilities, sourcing appropriate data and determining an appropriate method for the final calculation.

Victoria supports the CGC pursuing a differential approach, and is open to working with the CGC to help them understand the drivers of COVID-19 and industry support provided in Victoria.

A differential approach is considered appropriate as it would reflect the variance in the economic impacts of the pandemic between States, driving the need for different economic and community support measures. This variance does not reflect an equal per capita distribution.

Victoria also considers there are a range of potential disability factors the CGC may use to make this assessment and that there should be no issue with availability of data to make a differential assessment.

The disability measures used should reflect the need for economic responses to the pandemic. Factors could include measures of economic impacts, the presence of certain industries, the extent of health measures imposed, epidemiological measures of COVID-19 incidence, among others. There are many potential factors that may have merit and Victoria recommends the CGC explore these further.

Victoria’s recommendation

Victoria’s recommendation is that spending by States responding to the COVID-19 pandemic in relation to economic support for business and communities should be assessed separately to the current business development assessment.

Victoria requests further consultation from the CGC as to what form this may take, subject to approval in the ToR for the 2022 Update.

JobKeeper and wage costs

CGC recommendation

The discussion paper raises the issue that JobKeeper payments over 2020-21 will impact the wages data the CGC uses to make its wages costs assessment.

The wage cost assessment is used to adjust expenses to reflect differences in costs between States. It achieves this through an econometric analysis of different factors against a dependent variable of wages earnt including State, industry, occupation, education level and so on. Data used in the assessment is taken from the ABS Characteristics of Employment (CoE) Survey.

JobKeeper was a wage subsidy program implemented by the Commonwealth Government from March 2020 to March 2021. The rate and eligibility of JobKeeper payments changed through this period. However, for the period of the relevant ABS survey, August 2020, it was paid at $750 per fortnight for employees of eligible businesses.

The reference period for the forthcoming CoE survey is August 2020. Therefore, there will be respondents in the CoE sample who received JobKeeper.

As such, their remuneration, the amount paid under JobKeeper, would not relate directly to how much those employees would have earnt. This is because it was paid at a flat rate, regardless of State of residence, occupation, education level and so on. As such its inclusion would disrupt the relationships in the regression and potentially bias the results of the wages cost assessment (i.e. the coefficients on State variables in the regression).

To rectify this, CGC staff propose to recommend that the Commission remove employees earning $750 per week from the data used in the wage costs regression model.

CGC staff have indicated it has been in discussions with the ABS about this data from the CoE survey, and that its recommendation incorporates advice from the ABS that it is statistically appropriate.

Victoria's recommendation

Victoria considers generally that the Commission's proposal to address the impacts of JobKeeper in the CoS data for the wages assessment is appropriate. Victoria considers the inclusion of JobKeeper recipients would disrupt the relationships in the wages cost regression, and as such should be removed.

Removing all those paid exactly $750 will not capture those who were paid a top-up from their employer in addition to JobKeeper. However, Victoria considers this is acceptable as any amount paid above JobKeeper would reflect the underlying human capital factors impacting remuneration, which aligns with the purpose of the wages cost assessment.

Victoria supports this recommendation in-principle, subject to data becoming available in December after the ABS release of initial CoE data as indicated by the CGC at the meeting with jurisdictions on 2 September 2021.

However, Victoria reiterates its concerns with the wages cost assessment in general and with the specification of the underlying regression. Victoria notes, according to the results from the 2019-20 regression it has access to, the State variables are statistically insignificant. This suggests there is no difference in States' wage costs. The number and detail of industry and occupation variables used, in addition to interacting these with the gender variable, appear to be too great for strong statistical

relationships. In addition, it appears the residuals of the regression may be heteroskedastic, which may imply dependency on explanatory variables.

As such, in addition to making adjustments for JobKeeper, Victoria considers the CGC should revisit the specification of the wages assessment model generally for the 2022 Update.

New Western Australian Native title agreements

Western Australia commenced compensation payments in relation to the South-West Native Title Agreement and the Yamatji Nations Indigenous Land Use Agreement.

The expense is $1 billion to be paid over 15 years, with further costs that are not currently reliably measured. This amount is to be recorded on an emerging cost basis by the ABS (i.e. over the 15 years). However, Western Australian Treasury will accrue these settlement costs all to 2020-21.

CGC recommendation

Assess Western Australia's expenses relating to Native title agreements in the year they are paid.

Victoria's recommendation

Victoria supports the assessment of the compensation payments as they are paid. This will align with ABS GFS data recording the payments on an emerging cost basis. It will also avoid the issue of the expense affecting only three years of assessments.

This appears to be the most appropriate course of action as this will allow the effects of the payments to be distributed over 15 years.

Assessed revenue exceeding assessed expenditures

CGC recommendation

The discussion paper raises the possibility of a States' assessed revenues exceeding its assessed expenses. This would result in a negative GST relativity for that State.

CGC staff propose to recommend that the Commission lift the affected state's annual relativity to zero and share the cost of doing this among the other States on a population basis.

It is proposed to remove a negative relativity in the year that it arises in the same way used to transition a States' relativity to the relativity of the standard state. This would lift the affected States relativity to zero and lower the relativities of the other states on a population basis.

This issue is provided only a brief discussion in the paper, and Victoria considers there is no rationale presented for this approach or why the issue is raised for discussion by States outside of the five-year method review process.

Impact of proposed approach

The change suggested by the discussion paper is likely to have no impact once the system of HFE is fully transitioned to the new system, as legislated by the Commonwealth in the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018*. Under the new system States are already lifted to the relativity floor or the new equalisation standard which is above zero.

However, this will impact the no-worse-off payments States receive from the Commonwealth as compensation for being worse off under the new system of HFE. This is due to the transition to the new system, wherein the GST share is determined using blended portions of relativities under the previous and new arrangements.

The CGC's recommendation would have the effect of, where a negative relativity arises in an assessment year, artificially increasing the relativity of that jurisdiction under the former system. This would mean the redistribution required from other States to lift that jurisdiction to the new equalisation standard would be lower. As such, the impact of the new system compared to the former would be lower, decreasing no-worse-off payments.

Conceptually, it may be possible that a State's fiscal capacity is so strong and sustained that it experiences negative relativities over a number of assessment years, leading to its final three-year averaged relativity being negative.

In this case, on a theoretical level, the system suggests that State should pay into the GST pool to achieve HFE. States and the Commonwealth may need to consider the mechanism for managing this if it were to be expected to occur. However, this is not expected to eventuate in the short or medium term. As such changes should not be made to the system now that disrupt HFE for this unlikely event.

Victoria's recommendation

Victoria does not support the CGC's recommendation and considers there should be no adjustment made for negative relativities arising in an assessment year.

Victoria does not agree with this recommendation and suggests that negative relativities not be adjusted in the year they arise at this point and instead be allowed to flow through the system.

It is unclear why the CGC has raised this in the 2022 discussion paper. There is no conceptual or theoretical basis for making this adjustment in one assessment year. As noted in the discussion paper, a negative relativity is the natural result of the system when assessed revenues are greater than assessed expenditures. This represents a very strong fiscal position for a State, which should be reflected in an equally large contribution to HFE represented by a proportionately low relativity.

In addition, there is no operational reason for a relativity to be adjusted to zero in a single assessment year. Victoria's forecasts predict that this will only be an issue for Western Australia in the 2020-21 assessment year and will be managed through the current application of the relativity floor of 0.7. However, it will have ramifications for all other States through affecting their respective transitional payments.

This is unlikely to be an ongoing issue. The Productivity Commission Review in 2018 did not predict a negative relativity for any state at any point in the transition period. Furthermore, the discussion paper does not present any evidence as to why this issue detracts from HFE or causes issues for the calculation of GST relativities for the 2022 Update.

Forecasting by Victoria suggests it is unlikely that a negative relativity would persist for any State in the near future. As such the negative relativity would only be for a single assessment year and be minimised in the averaging of assessment year relativities for the actual recommended relativity.

In addition, once the new system is fully implemented by 2026-27, there will no longer be a possibility of a negative relativity due to the relativity floor and the new equalisation standard. As such, given there is no expectation this will cause any theoretical or practical issues with the GST distribution, Victoria does not support the proposal.

Further, Victoria considers that the change proposed by CGC staff represents a method change to the underlying GST distribution methodology set through the 2020 Review and as such would not be able to be made in an Update year without a changed to the ToR for the 2022 Update.

New Accounting Standards

New accounting standards are expected to be reflected in State accounts and accounting data over the next few years. The CGC methodology has been based upon previous Accounting Standards and the changes affect calculations for assessments.

New Accounting Standards

AASB 16

Australian Accounting Standards Board (AASB) 16 *Leases* prescribes a change in the treatment for operating leases. An operating lease will be recorded as an asset (right-of-use) and a liability (lease liability). Over the course of the lease, the asset and liability will be run-down by the principal and interest payments for the lease liability and depreciation for the right-of-use asset.

AASB 1059

AASB 1059 *Service Concession Arrangements: Grantors* prescribes a change in the treatment of service concession arrangements so that the grantor recognises a service concession asset and a corresponding liability on the balance sheet.

AASB 15

AASB 15 *Revenue from Contracts with Customers* prescribes a change in when revenue is to be recognised. Revenue recognition is to occur when all performance obligations are met and the revenue/payment is certain.

Overview of CGC position

The CGC acknowledges that the application of a number of new accounting standards (AASB 15, 16, 1059) change the way that States will report their income, expenses, assets and liabilities. These items affect the current calculation of a number of items in the CGC assessment.

The CGC believes the changes will affect the data used in the Capital assessment. In particular, the value of physical assets and the value of investment.

- Value of physical assets data is sourced fully from State sourced data; whereas,
- Value of investment is sourced from ABS GFS data (for two years) with the third year of data sourced from the States.

Comparable data for the value of investment (and its sources) are used for the net borrowing assessment (net financial assets, net borrowing or net lending).

Additionally, the ABS proposes to prepare accounts without applying the new AASB standards to ensure that the GFS are consistent year on year. However, this results in the CGC receiving data from the States and ABS that is prepared on a different basis.

The ABS has advised that under AASB 16, investment is likely to be around $4 per capita higher. It appears unlikely that the adjustments will be material.

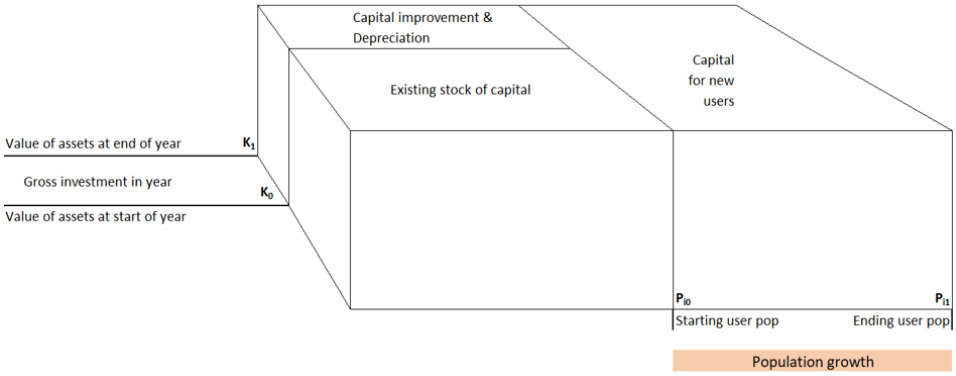
The CGC has stated that the effects of AASB 1059 is expected to smaller than AASB 16 and therefore immaterial.

The CGC has stated that the effects of AASB 15 are expected to be limited to when States may recognise certain grant revenue.

Current CGC calculations

The CGC has two capital assessments that would be affected: Investment and Net borrowing. Interest charges would be assessed in the Other Expense category and Interest income in the Other Revenue category.

Figure 7: Visualisation of the investment assessment



Source 8: CGC presentation to the States, Capital Assessments, 23 August 2021

Investment assessment includes the existing amount of capital and the drivers are recognised as: Growth in service user populations, differences in services user populations and the costs of construction.

Net borrowing assessment includes net financial wealth and the driver is recognised as population growth.

CGC recommendation

The CGC is proposing to use ABS GFS data adjusted to be consistent with the new accounting standards AASB 16 and AASB 1059 if doing so is materially different from using ABS GFS data as published.

Impact of the proposed approach

There appear to be two issues that are raised by the application of the new accounting standards.

Data Mismatch

There is a mismatch between the data that the ABS GFS and the data that the States will provide. This is due to the accounts being produced based off different reporting frameworks. Value of physical assets is sourced from State data, while value of investment is a mix of ABS GFS data (first two years) and state data (final year) of the assessment period.

For assessment items where state data is only a third of the assessment, it is unclear whether the effect of this will be material.

Effect of the new accounting standards

The new accounting standards will increase the amount of capital stock that is recorded by each state and thus increase the expected Assessed Investment. However, this effect will be limited to the cost of the lease as the standard will increase both opening and closing stock.

This difference is weighted by the drivers before resulting in a GST redistribution. The drivers of the investment assessment are population growth and differences in service user populations, and the costs of construction. This contrasts with the net borrowing assessment in which the only driver is population growth.

Victoria's recommendation

Victoria supports in-principle CGC staff's proposal to align the data provided by States and the ABS to the same accounting standard. Under this proposal, Victoria would like the opportunity to review the data provided by the ABS to ensure that the accounting standard treatment is aligned with Victorian expectations.

Victoria would not support States being required to provide additional data to match the ABS GFS treatments.

Victoria supports the CGC working further on this issue with the ABS and requests the CGC consult States once the impact on GST distributions and materiality are clear.

Health assessment – non-admitted patient data

The health assessment relies on cost weighted activity data provided by the IHPA to determine the cost of providing health services to different groups. This is combined with expenditure data from States, through ABS GFS to form an assessment of the need for health expenditure.

In the 2020 Review, the Commission decided to move from a proxy indicator of non-admitted patient activity costs to IHPA national weighted activity unit data. It was agreed this would take place once the IHPA non-admitted patient data were 'sufficiently robust'.

Overview of CGC position

The CGC raises an issue in the discussion paper on the alignment of expenses data and the new IHPA activity data for non-admitted patients. Expenses data is provided by States through ABS GFS. These include funding for 'General Practice (GP) type' services. However, the proposed new activity data from IHPA on non-admitted patients does not include these types of activities.

'GP-type' services include primary care, family planning and general counselling. Primary care often refers to medical care provided by general practitioners, but it can also refer to care provided by nurses, dentists, pharmacists, allied health and mental health providers, and Aboriginal and Torres Strait Islander health practitioners[24].

Therefore, if the CGC were to use the new IHPA activity data on non-admitted patient services, the expenses and activity data would not algin.

CGC staff propose to recommend that the Commission use an imputed measure of activity unit data for GP-type services in the non-admitted patient assessment. This involves estimating what activity data for GP-type services might look like, based on the data for medical consultations and allied health. This effectively assumes the patterns of use of GP-type services are the same between medical consultants and allied health.

Victoria's recommendation

Victoria supports the CGC continuing to seek out and use the most recent and accurate data for its assessments.

Victoria encourages the CGC to continue working with the IHPA to develop a more appropriate dataset on this issue. Given the importance of the GST distribution, access to the most accurate data for its assessments is essential.

Victoria has concerns with the accuracy of the imputation method suggested by the CGC. It is unclear to what extent the cost profiles of consultations and allied health match those of the GP-type services. It will be difficult to gain confidence on this given IHPA data are unavailable. Victoria would like to see further evidence of the appropriateness of this approximation, and that it is more accurate than the previous proxy, before agreeing to this approach.

The aim of moving from the previous proxy indicator of non-admitted patient data agreed in the 2020 Review was to use a more accurate dataset. As the discussion paper notes this was intended once

[24] https://www.health.vic.gov.au/primary-and-community-health/primary-care

the IHPA data on non-admitted patients were ‘sufficiently robust’. It would appear that the data is still not sufficiently robust.

Victoria notes data used in the health assessment already do not match exactly between expenses and activity, due to the lag in activity data provided from IHPA.

New commonwealth payments

The CGC has provided a list of proposed treatments for a range of Commonwealth payments to States and at this stage Victoria has not identified any concerns with this list.