

TRANSCRIPT

LEGISLATIVE ASSEMBLY ECONOMY AND INFRASTRUCTURE COMMITTEE

Inquiry into Commonwealth support for Victoria

Melbourne—Friday, 10 December 2021

MEMBERS

Mr John Eren—Chair

Mr Gary Blackwood—Deputy Chair

Ms Juliana Addison

Ms Christine Couzens

Ms Steph Ryan

Ms Kat Theophanous

Mr Nick Wakeling

WITNESSES (*via videoconference*)

Mr Mike Callaghan, Chairperson, and

Mr Jonathan Rollings, Secretary, Commonwealth Grants Commission.

The CHAIR: Thank you very much for attending. I want to start by acknowledging the traditional owners of the various lands on which we are all gathered today. I acknowledge that in this virtual environment we are gathering on many different lands and I pay my respects to elders past, present and emerging.

I want to welcome both of you and thank you very much for attending this very important hearing. Obviously the submission that you make is very important to us going forward in making a determination on recommendations, so I thank you very much for your attendance. You are attending the Economy and Infrastructure Committee's Inquiry into Commonwealth support for Victoria. All mobile telephones should be turned to silent.

All evidence taken by this Committee is protected by parliamentary privilege. Therefore you are protected against any action for what you say here today, but if you repeat the same things outside this hearing, including on social media, those comments may not be protected by this privilege.

All evidence given today is being recorded by Hansard. You will be provided with a proof version of the transcript for you to check. Transcripts will ultimately be made public and placed on the Committee's website. I remind members and witnesses to mute their microphones when not speaking, to minimise interference.

I invite you to make a brief 10-minute opening statement to the Committee, which will be followed by questions from the Committee. Thank you very much.

Mr CALLAGHAN: Thank you. My name is Mike Callaghan, and I am the Chair of the Commonwealth Grants Commission. I will make a brief opening statement. It is against the background of some of the submissions to the Inquiry that we thought it may be helpful to clarify at the outset the role of the Commonwealth Grants Commission. The Commission has a very specific role. To inform the Treasurer's decisions on the distribution of GST, the Commission provides its assessment of the relative fiscal capacity of the states and territories to provide services. The Commission does not advise the Commonwealth Government on GST policy, including the policy framework for the distribution of GST. As such it is not the place of the Commission to comment on the appropriateness of, for example, the 2018 legislation that introduced new equalisation benchmarks and a floor below which a state's GST distribution cannot fall.

Similarly, the submission makes no judgement or offers any comment on the spending and revenue policies of the states and territories. It does not express a normative view as to what states should do, it assesses the weighted average policy of what states actually do. As noted, the Commission provides the Treasurer with recommendations which feed into the decisions on the distribution of GST, and its recommendations are expressed in terms of relativities. A state's 'GST relativity' refers to the per capita GST distribution the state is assessed as requiring as a proportion of the per capita amount the state would receive if the GST pool were allocated on an equal per capita basis—that is, if it was based on population shares.

The framework for the Commission's advice is established by the Commonwealth legislation and the terms of reference that the Treasurer sets when the Commission reviews its methodology for assessing GST or when it updates its GST relativities every year. The objective for equalisation is set by legislation. Prior to the introduction of the new equalisation benchmark the objective for fiscal equalisation was to give each state and territory the same fiscal capacity to provide state services as that of the fiscally strongest state. Under the 2018 legislative changes the equalisation objective is to ensure that each state's GST relativity is at least as high as the relativity of the fiscally stronger of New South Wales and Victoria, which is referred to as the 'standard state'. This means no state will receive less GST per person than the standard state.

If a state is assessed as having a higher fiscal capacity than the standard state, its GST relativity will be below the standard state, so under the new arrangements the state's GST relativity would be lifted to equal to the standard state—it means it will receive a higher GST than it would have received under the previous arrangements and in turn the other states would receive a lower GST. Under the Commonwealth's no-worse-off guarantee, as part of the transition arrangements no state will receive a lower cumulative amount of GST than it would under the previous arrangements.

The 2018 legislation has introduced a different equalisation benchmark, but the Commission's role has not changed. It continues to assess the relative fiscal capacity of the states and territories to provide services, and in estimating fiscal capacity the Commission assesses each state's relative capacity to raise revenue and the relative cost of providing state services. The cost of providing services differs between states because their

characteristics differ. Where people live, Indigenous status and socio-economic status influence the cost of providing state services. For example, the cost of providing health services is relatively higher for older people, for Aboriginal and Torres Strait Islander people and for those of lower socio-economic status, so the cost of providing health services per person is relatively higher for states with a higher concentration of these groups within the state.

By way of context, Victoria's Indigenous population is below the national average, which works to reduce its relative cost of providing many state services. Geographic dispersion affects the relative cost of providing most state services. For example, it is more costly to provide school education to children living in remote areas than those living in cities. As such, the education cost per child will be higher for states with a higher proportion of children in remote areas than other states. Again by way of context, Victoria is geographically compact relative to most states and has relatively smaller outer regional and remote populations.

The Commission considers each state's capacity to raise revenue. It also considers the Commonwealth payments that are made to the states. If a state receives less Commonwealth payments than other states, this will work towards increasing that state's GST share. The major sources of state revenue are mining royalties, payroll tax, stamp duty and conveyances and land tax, and for each tax base the Commission calculates how much each state would raise if it adopted the average revenue-raising effort of all states—for example, applied the average tax rate across its tax base. And the sizes of the tax bases do vary, certainly across states, and they also vary over time.

The Commission brings all this analysis together to calculate how much GST each state would need to give it the same capacity as the other states to provide services and, as noted, it is expressed in relativities. The states and territories are consulted throughout the process of assessing fiscal capacities, and their views are outlined extensively in the Commission's reports, along with the Commission's response to the views of each state. There is invariably a difference in views across states on an issue and, not surprisingly, states normally advocate for a position that will increase their GST share. But in any given year the GST pool is fixed. If one state's share increases, other states' GST shares decrease. The Commission takes into account the views of the states, which are rarely unanimous, but it must make a decision. Not all states will be happy with the Commonwealth's decision. But the Commission always outlines the basis for its decision, and it is always open to the views from the states.

A focus of many of the submissions to the Inquiry is whether states will be worse off under the equalisation benchmark introduced in 2018 compared with the previous system when the Commonwealth's no-worse-off guarantee is scheduled to expire in 2026–27. The answer is that it depends. It depends on what happens to all the variables that influence the relative fiscal capacities of the states. It is not just what happens to one variable, such as iron ore prices, there are many moving parts. The Commission considers seven different revenue streams and 13 different expenditure functions. And it depends on relative movements in state revenue streams and costs of providing services. What happens in one state will influence the distribution of GST to other states. For example, a natural disaster in Queensland will increase its GST share but reduce that for all other states. Depending on what happens when the no-worse-off guarantee ends, all states but one may be worse off, all states may be better off or, alternatively, some may be worse off while others better off compared with the previous arrangements.

Part of the new arrangements involves an ongoing Commonwealth top-up to the GST pool. These top-ups grow to about \$850 million by 2024–25 and are indexed each year in line with the growth of the GST pool. If after the expiration of the no-worse-off guarantee no state is assessed as having a higher fiscal capacity than the standard state, there would be no need to boost the GST share of any state and all states would be better off compared with the previous arrangements because they would have a share in a bigger GST pool—that is, GST receipts plus the Commonwealth's top-up that is part of the new arrangements. However, if one state—say, Western Australia—is assessed at having a significantly higher fiscal capacity than the standard state, the size of the required boost in its GST distribution for it to have the same per capita GST as the standard state may be significantly more than the size of the top-up in the GST pool, and in this situation all states other than Western Australia would be worse off. Alternatively, the size of the top-up to the GST pool may be broadly sufficient to cover the required boost in GST distribution to a state that is fiscally stronger than the standard state. In this situation some states may be worse off while others, apart from WA, may be better off. A state will be worse off if the reduction in its GST share as a result of increasing the GST relativity of another state is more than its share of the top-up payments in the GST pool.

The Commission does not do projections of the factors influencing the relative fiscal capacity of states, and it does not base any assessments on forecasts. And before the no-worse-off guarantee expires, the legislation provides that the Productivity Commission has to assess whether the arrangements are operating as intended, and it has to examine the fiscal implications of the arrangements on the states. The Productivity Commission's report has to be before the end of 2026. Thank you.

The CHAIR: Thanks, Mike. We will go to questions now. I might kick it off. What information does the Commission seek from states and territories to inform its assessment of their fiscal capacities? And to what extent does the Commission discuss its assessments with the states and territories before reporting to the Treasurer? I just note, for example, that you mentioned our Indigenous population—various parts have more, some have less. I would imagine that rural and regional areas would be different to urban and populated areas and the complexities around living in a populated environment. How do you make a judgement for that of the needs of specific areas and demographics and what levels they are at compared to a maybe less populated area in Victoria but the needs may be a bit greater?

Mr CALLAGHAN: Yes, thank you. I will say a few words in response to that. It is a big question, and I think Jonathan will chip in also. In terms of, as I said, the whole process of doing the assessments, it is done in close consultation with the states—the nature of the way it goes through and so much of the information data comes from the states. But we do have a look from a whole variety of aspects to try and get a good handle on what may be the drivers of different cost pressures within the states. The data has to be robust. It has to be consistent and consistent across states, and that is always an ongoing issue. But throughout it all we do draw on the states to get their comments. For example, even doing the updates now in terms of the relativities, the Commission staff will put a paper out to the states saying, 'These are the issues that we think we need to address. These are some of the issues that we believe need to be handled. What do you think?'. And all states will give their submissions, and it can be the nature of data that was supplied, different sources coming in, how they view a variety of different issues, and that is all considered. It is considered by the Commission and decisions have to be taken, but when we take those decisions—and there can be an ongoing flow of exchange to try and get the best information from the states—the Commission will then let all the states know what was the basis for why we decided what we did.

As I say, we do want to get data that is consistent across states, and looking at some of these drivers, we do rely on a whole range of different indicators that will say what the cost pressures are, be it for remoteness, be it for socio-economic. It can come from such things as the Independent Hospital Pricing Authority, which provides a unit to try and assess what the cost of relative hospital services is, which takes into account such factors as Indigeneity, complexity of procedures, socio-economic status and also remoteness, and that can give an independent indication of what the different cost pressures are across states. The way the assessments are done is by looking at the total spending across all those areas weighted against those categories, be it geographic, be it remoteness, and then applying that to within each state what proportion of a population is in a particular socio-economic group or in a remote location to work out what would be the average cost of providing those services. The whole aim is to get an average cost. If a state provided the same level of service, what would be the average cost, which is not what they actually do provide. It is trying to assess the average policy.

The CHAIR: Thank you. Gary, Deputy Chair, do you have a question?

Mr BLACKWOOD: Yes. Thanks, Chair. Thanks, Mike and Jonathan, for your presentation. How common is it for the states and territories to raise issues and grievances with the Commission about how their fiscal capacities were calculated? And how often has the Commission amended its methods based on appeals from a state or territory?

Mr CALLAGHAN: As I said in the opening statement, the nature of it is that the states all give their views and nearly always the views differ. The views differ because they are generally consistent with what the position is that would be most beneficial for the state in terms of its GST share—the distribution it would get. As I said, in any given year it is a fixed sum of money, so one state's views which would give it a higher GST share mean other states would receive lower GST shares. At any time all states are not going to be happy, I suppose is the way you would say it. If you looked at our reports, that is ongoing throughout it all and it is in close consultation with the states. The states give all their views. They are quite often competing views. We have to take a decision, and the way it is done is being as transparent as possible. We publish and provide a good summary of what all the states are saying, and we have to balance it all, come to an opinion and explain

what our view is. As I said in the opening statement, we are always open. It is an ongoing dialogue. Quite often new evidence will come up in the sense of new data sources, things can change and different assessments can be done, which will result in different outcomes of GST distribution.

How often do we change our methods? The common approach over some time now is to do a thorough review of our methods, our methodology, every five years. That is quite an extensive process that takes several years work, and it is done in close consultation with the states. For example, the 2020 review started off with putting out a work program for the states to comment on, 'These are the methods that we're going to look at'. The states commented on it. Then the process was an extensive number of papers went out—they can be commission papers or staff papers—for the states to comment on. There were workshops involved. There was a very close involvement right throughout the process. A draft report was put out for the states to comment on—different views, different approaches—until a final report was done and released at the beginning of 2020. So the states have the opportunity to regularly—and ongoing—input their views. But as I say, because it is a fixed sum of money that is being distributed and changes in method will result in different distributions, states will always, you could say, be aggrieved at some stage or have different views. But it is an ongoing process of always considering it, and in some respects it is an evolutionary process.

Mr BLACKWOOD: Thanks, Mike.

The CHAIR: Thank you. Chris Couzens.

Ms COUZENS: Thank you both for your time today. It is appreciated. What impact do you see foresee the COVID-19 pandemic having on data used to calculate the GST relativities in the future?

Mr CALLAGHAN: Thank you. Yes, in some respects that is what we are looking at right now as we are working on the update for the distribution of GST for 2022–23. We will be publishing an update of our relativities in February 2022, and the issue of the impact of COVID is a very live issue. But it does pick up many of the things that we have been talking right now, such that the first thing is having the data to know what might be the impact of it. We know it has had a very significant impact on the Australian economy. But there is always a lag in getting data, and our assessments are an average of three years prior. For example, when we did the update last year, when COVID was still impacting, it only impacted on the data we had for four months, a short period. The data we were looking at there was up to 2019–20, so it was only impacting a small amount. This year when we do it, it will be 16 months we will see the impact of COVID on it.

We know that it certainly has had an impact on general economic activity, but that is variable coming through. There has been an impact on aspects of revenue. It has had an impact on health expenditure, on the main drivers of health expenditure. As I was saying before, Indigeneity, remoteness and age, for example, are not the drivers of impacting on COVID. There is a lag in getting available data to know what those drivers are. We rely a lot on the information that comes from the Independent Hospital Pricing Authority, and they will not have updated data to know what are the main factors that are driving the nature of expense from COVID. Also, when we do an update on this, it depends on what our terms of reference are as to whether we apply the methods that came out of the last review of methodology or there is liberty to take into account that if some things have changed, would we apply different methods? We still do not know whether we are going to have that. We have already done the consultation process with the states not knowing what flexibility we will have in our methods, but we have done the consultation with the states.

As I say, it is a very extensive approach we always take, asking them what they think has been some of the impact going in. And, not surprisingly, there is a very different view within the states. Some say, 'We think that the impact we are seeing on it'—of COVID, for example, on hospitals, let us say—some states would say, 'This really has changed things. The approach that we were applying in the past we can't apply now'. It should be treated like a natural disaster approach, shall we say, and we need to assess it like that. Other states have a very different view and say that we are seeing a differential impact of COVID across states and we think that that is a result of the policy that those states have applied and so we should not be changing our assessment methods, because it is policy influenced—again, very different views. The different approaches each state is taking will have very different implications for GST distribution.

We are in the process of still considering all this. We have not received from the Treasurer what the terms of reference are for next year's update, the update we will be publishing early next year, but all these issues are those that we are considering now. As I say, it is a snapshot of the overall process how we do these assessments—consultation, looking for the right data. There are lags in getting the available data, and we have to make judgement calls throughout it all. But also there are very different views amongst the states as to what will be the impact, but we have to make a decision and make some recommendations to the Treasurer early next year.

Ms COUZENS: Can I just ask what your view is on the impact of wage levels on GST distribution?

Mr CALLAGHAN: Wages have an impact, certainly. Public sector wages impact on the cost of providing services, and there are different wage levels across the various states. We take that into account, and we use a proxy. We use private sector wages as a proxy of what might be the wage pressures in different states to try and assess that. So higher wages can lead to higher cost of services. But it also affects revenue, because a state with a higher wage level will be getting a higher level from payroll tax. So wages certainly come into impacting on the distribution of GST, but they impact on both the expense side and the revenue side. A state might have higher than average wages. It can result in higher costs of services, but with higher than average wages it will be getting higher revenue from payroll tax.

Ms COUZENS: Thank you.

The CHAIR: Nick, did you have a question?

Mr WAKELING: Thank you, Chair. Just quickly, if I may ask: what are the key drivers that affect the states' fiscal capacity—in just the very brief time that we have left?

Mr CALLAGHAN: Sure. Look, we have put out a paper trying to improve people's understanding. We just put out a research paper on why states get different shares of GST, and it is really all those factors I spoke about. But to quickly give a snapshot, drawing from the paper, if we look at a summary of what might be some of those—for example, mining resources—they provide a state with the ability to raise revenue from royalties, but mining is distributed very differently, resources are distributed very differently across the states. In addition, that value of mining is very volatile. So what is happening in mining can certainly impact on the distribution of GST. Property prices affect the states' ability to raise revenue from stamp duty on conveyances and land tax, and we see that different states have different property cycles and that can certainly be influencing their GST distribution. Where people live, as I say, is very important. Indigenous and socio-economic status are very important. And the states have different proportions of these populations, so that drives differences in the GST distribution.

As we just talked about, levels of wages are another factor both in terms of the cost of services and your revenue-raising capacity through payroll tax. And again, wages do differ significantly across states, and that is why you have different relative fiscal capacities. States with a growing population have a bigger demand for infrastructure, so they will require more services and demand higher GST based on that population growth. And again, the geographic remoteness is an important driver of the cost of many services. As we say, those states with higher geographic areas have a higher per unit cost of providing services than other states, and that is a significant driver of states' GST distribution. And again, natural disasters—a big natural disaster will result in a higher GST to the state experiencing the natural disaster, and that will have an impact on the other states. As I say, it is all relative. What is happening in one state has an impact on the other states.

The CHAIR: Thank you. Kat Theophanous, do you have a question?

Ms THEOPHANOUS: I do. Thank you, Chair. I was just looking at your submission, and I guess it grows on what you just said in terms of how you assess revenue-raising capacity. But your submission also says that it calculates how much each jurisdiction could raise if it adopted the average revenue-raising effort of all jurisdictions, and I am just interested to know: how is revenue-raising effort defined and calculated?

Mr CALLAGHAN: In many respects it is the average tax rate. For example, if we talk about stamp duties on property turnover, states have different levels of stamp duties. So what we do is have a look at your tax base—the turnover of your property—and we apply the average stamp duty. One state may have a very low stamp duty. Others have higher stamp duties. If you apply the average stamp duty to your turnover of property,

that is your average revenue-raising capacity. So it is not the stamp duty you apply but if everyone applied the same one to try and equalise it to get to some average.

Ms THEOPHANOUS: Thank you.

Mr ROLLINGS: A key part of our task is to find policy-neutral assessments of revenue and service costs. So, for example, if a state decided to lower its taxes, that should not flow through to a higher GST share. We are trying to find a policy-neutral assessment of its capacity to raise taxes. Equally, if it decided to spend more money on services or pay its public servants more wages, we do not want that to flow through to a higher GST share. We are trying to find a policy-neutral assessment of taxes and of spending costs.

Ms THEOPHANOUS: That is helpful. Thank you.

The CHAIR: Juliana?

Ms ADDISON: Yes, thank you very much, Chair. I just welcome the opportunity to try and get an understanding. In its submission, the WA Government says that the Commission uses the last three years of available data to assess state fiscal capacity. They have argued or put forward that this makes budget management difficult because it does not reflect the volatility of iron ore royalty revenue. How valid is this point made by WA?

Mr CALLAGHAN: Like all things there is a trade-off there that—

The CHAIR: Sorry, something has happened to your mic.

Mr CALLAGHAN: Is that better now?

The CHAIR: It is muffled. We had some other questions for you, Mike and Jonathan. Is it okay if we write to you with some of the questions?

Mr CALLAGHAN: Sorry about this at our end. Any better now?

The CHAIR: Yes, but you might have to speak up.

Mr CALLAGHAN: Okay, we will shout.

The CHAIR: Okay, go ahead.

Mr CALLAGHAN: It is just going back to the issue of the lag that Western Australia said. As I said, there are trade-offs. We do have to wait to get the most recent data, and also data that will not be subject—hopefully not subject—to too many revisions, and we also average it over three years. Now, that does mean, in the case of Western Australia, if iron ore prices are coming down there is a lag in terms of when that decline would be impacting on their assessment and their fiscal capacity for GST. It also works the other way of course. If iron ore prices are rising, there is a lag before that increase in revenue capacity would result in them receiving less GST. The reason for doing that average is to try and provide a bit more stability against the volatility in the factors that are influencing the GST. Most states say they would prefer to have—

The CHAIR: I am sorry, Mike. Our Hansard are having difficulties in hearing you. So I think we had better cut it off at this point. If it is okay, can we put some questions in writing and get a written response, please?

Mr CALLAGHAN: Yes, we would be happy to. I am so sorry about the technical problems at our end.

The CHAIR: It happens. Thank you for being with us today. Your evidence is very important to us, so we will write to you in relation to other questions that we have, and if we could get a response as quickly as possible, that would be great. Thank you very much for attending today. We really appreciate it.

Witnesses withdrew.