

Occasional Paper: GST and the Commonwealth Grants Commission's assessment of health expenditure needs

June 2021

Summary

The methods and processes used by the Commonwealth Grants Commission (CGC) to distribute the revenue from the Goods and Services Tax (GST) in accordance with the principle of Horizontal Fiscal Equalisation (HFE) are complex and this has generated a degree of misunderstanding about the CGC's purpose, and how its methodology works in practice.

HFE and the methods used by the CGC in its assessments are discussed in more detail in the Department of Treasury and Finance's paper *Horizontal Fiscal Equalisation: an equitable approach to the GST distribution*, June 2017 published at <https://www.treasury.tas.gov.au/gst-distribution-to-tasmania>.

While HFE is extremely important to Tasmania in ensuring it has the fiscal capacity to provide services at the national average standard, the principle of HFE, and the choices that the Tasmanian Government makes as to where it spends its untied GST allocation, are two separate and distinct issues.

The expenditure assessments made by the CGC are not intended to be a measure of what States should spend on particular service areas. They are part of the complex mathematical model the CGC uses to achieve the overall objective of HFE.

The CGC itself recommends caution in making comparisons between its assessments of expenditure need and actual expenditure as these concepts are only intended for equalisation purposes to support the equalisation process.

Nevertheless, comparisons have been made between Tasmania's actual and assessed expenditures using unrelated data sources and, based on these comparisons, some commentators have erroneously argued that Tasmania is underspending in certain service delivery areas such as health.

Introduction

The focus of this paper is to address an issue that has been raised by some commentators who contend that Tasmania spends less on health than has been assessed by the CGC for GST purposes. It is then argued by these commentators that Tasmania therefore has the fiscal capacity to use this “additional” GST revenue to increase its funding of health services.

The paper outlines:

- the purpose of GST revenue to the States;
- what the CGC is attempting to measure;
- data sources used by the CGC;
- what Tasmania actually spends on health compared to the national average.

GST revenue and how it is spent

In accordance with the *Intergovernmental Agreement on Federal Financial Relations*, all GST revenue collected by the Australian Government is distributed amongst the states and territories (States). The purpose of the GST when it was introduced in July 2000 was to give the States access to a stable and growing source of revenue to fund important community services.

The GST is provided as untied revenue, that is, the States have discretion to spend their GST in accordance with their own spending priorities. This is in contrast to other conditional or tied Australian Government funding, such as Payments for Specific Purposes, which are only spent for purposes as agreed with the Australian Government. For example, payments to the States under the National Health Reform Agreement provide funding to be used for public hospital services, including services delivered through emergency departments, hospitals and community health settings in accordance with complex arrangements specified by the Australian Government.

As part of the introduction of the GST, it was agreed that the independent CGC would recommend the distribution of the GST in accordance with the principle of HFE. In broad terms, HFE ensures that all States have a similar fiscal capacity to deliver services and associated infrastructure to its citizens to the same standard as any other State.

It is noted that the Australian Government’s response to the Productivity Commission’s Inquiry into HFE in 2018 will result in a change to this equalisation standard. From 2027-28, the CGC will equalise the GST to the standard of the second strongest State, rather than the strongest State (currently Western Australia).

A separate paper will be published on the implications of these changes for Tasmania’s share of the GST.

As noted by the CGC on its website, it is not its role to determine how GST revenue should be spent by a State.

“The Commission’s role does not involve forming an opinion on how much a State should spend on any particular service it provides to its population, nor on how much tax it should raise under the revenue heads available to States. The Commission does not have a view on how a State should spend its GST revenue.”

“The GST revenue provided by the Commonwealth is general revenue assistance – that is, it is an established part of the federal financial agreements between the Commonwealth and the States that GST revenue is untied and each State can spend in accordance with its own spending priorities. States are accountable to their electorates and not to the Commission or the Commonwealth more generally, for how GST revenue is spent.”

Source: Commonwealth Grants Commission website, May 2021.

If a State Government were to align its expenditure commitments to the CGC’s assessments, then for some areas of expenditure it may need to spend more, and for others it would have to reduce expenditure, or alternatively raise more revenue.

Ultimately, State governments are accountable to their electorates on how they spend government revenue. Expenditure priorities are a matter of State policy and sovereignty, and should not be driven by the CGC’s modelling which is intended for an entirely different purpose.

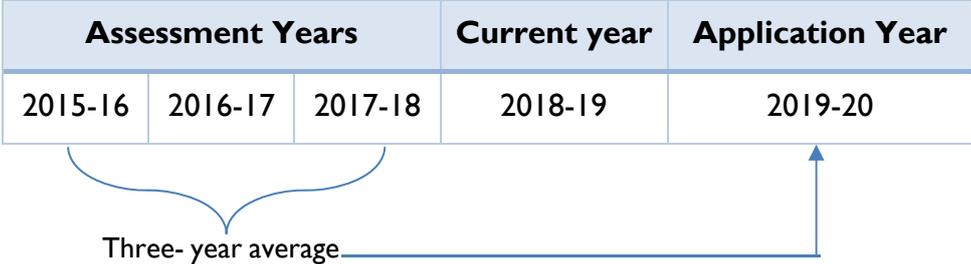
How the CGC determines each State’s share of GST

In order to distribute the GST in accordance with the principle of HFE, the CGC has developed a complex mathematical model to assess the amount of GST required by each State. While the purpose of this Paper is not to detail the CGC’s complex methodology, the sources of data used by the CGC in its methodology are relevant to the discussion.

The primary objective of the CGC is to produce GST relativities for each State which provide an indication of whether a State needs more or less than its per capita share of the GST pool. A GST relativity greater than one means a State requires more than its per capita share of the GST to deliver State services to its citizens to the same standard as any other State. Tasmania’s relativity in 2020-21 is 1.897.

The GST relativities recommended by the CGC each year are based on a one year lag and three-year average of each State’s overall assessment of fiscal capacity.

For example, Tasmania’s actual GST received in 2019-20 is based on the average of the 2015-16, 2016-17, and 2017-18 assessment years. This is illustrated in the following diagram.



As well as being driven by relativities, a State’s population share and the size of the GST pool will also impact the amount of GST distributed to a State in any year.

All of these factors will vary and can lead to volatile movements in the amount of GST received each year. Thus, to base State expenditure on the CGC’s annual assessments for each expenditure category as suggested by some, would mean that the funding of essential services and infrastructure becomes linked to potentially volatile GST revenue changes year on year.

Where does the CGC obtain its revenue and expenditure data?

The CGC collects information on expenditure and revenue from a variety of data sources including the Australian Bureau of Statistics (ABS), other national data sets, and information collected directly from the States.

The first step in the CGC’s assessment process is to use each State’s actual expenditure and revenue to determine national average levels of expenditure and revenue across a range of categories, including health, education and housing. The primary source of data used by the CGC is ABS Government Finance Statistics (GFS) data which is based on data provided by the States¹ to the ABS. The GFS data is a nationally consistent data set that includes the revenue and expenses by purpose for various levels of Governments in Australia.

The CGC makes some adjustments to the ABS GFS data to simplify its assessments, remove components that it does not assess, or move components to other categories to more closely align with its classifications. For example, the CGC deducts revenue received by the States from private patient hospital fees from total health expenditure so that the health assessment only applies to net actual health expenditure by the States.

This information is referred to by the CGC as the States’ Adjusted Budget (actual data) and can be found in the supporting data tables at: <https://www.cgc.gov.au/inquiries/2021-update>.

¹ The State Budget records expenditure based on Annual Financial Statements of State Governments prepared in accordance with the principles of Australian Accounting Standards, in particular, AASB 1049 Whole of Government and General Government Sector Financial Reporting.

The CGC urges caution in comparing this Adjusted Budget (actual data) with other State data.

The figures in these tables are for the Commission's calculations only. They are not necessarily the same as in State budget documents or in ABS publications as they have been adjusted for the Commission's calculation purposes.

Source: CGC Adjusted Budget Tables 2021 Update

The national average calculated from this adjusted GFS data becomes the starting point for the CGC's assessments of each jurisdiction's expenditure needs and revenue raising capacity.

In assessing expenditure need, the CGC applies cost disability factors to national average expenditure. These cost disability factors aim to capture the drivers that cause a State's delivery costs to vary from the average. States with greater than the national average cost disabilities will require more GST than those that have less.

These disability factors are calculated by the CGC annually using a range of data on the cost of providing services in each State. For example, in assessing health expenditure need, the CGC takes into account a range of cost factors to determine whether a State would need to spend more or less than the national average in order to have the capacity to deliver the national average service level. This can include demographic and socio-economic factors that result in a higher demand for services in Tasmania and a higher cost of service provision (such as a rapidly ageing population, poor population health and a highly dispersed population).

The CGC uses this to calculate major expenditure and revenue categories separately to develop an overall assessment of each states' fiscal capacity.

This information is referred to by the CGC as the States' Assessed Budget and can be found in the supporting data tables at: <https://www.cgc.gov.au/inquiries/2021-update>.

The CGC's individual expenditure and revenue category assessments are not intended to inform the States on how much they should be spending in each expenditure category, or how much revenue they should be raising. Rather, their primary function is to enable the CGC to determine a relativity for each State consistent with the principle of HFE.

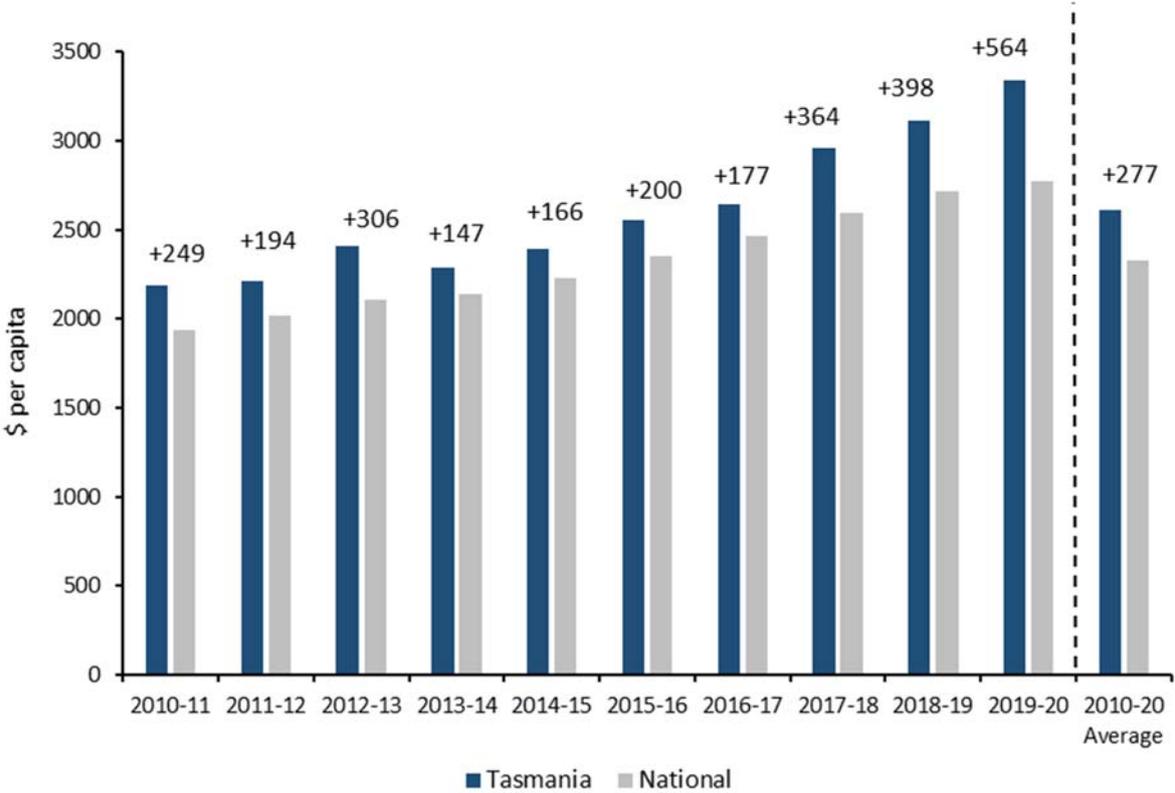
How does Tasmania’s actual health expenditure compare to the national average?

The CGC’s assessments should not be used to make judgements about whether the Tasmanian Government is spending enough on health. Nevertheless, if a comparison is made on what the Tasmanian Government spends per capita on health compared to the national average, the data shows it consistently spends more, and this expenditure is growing at a faster rate than the national average.

Health accounted for 32.3 per cent of the State’s general government actual expenditure in 2019-20 and this share is projected to continue to grow.

Chart I shows that based on the CGC’s Adjusted Budget data from 2010-11 to 2019-20, Tasmania spent on average \$277 per capita more than the national average on health. The CGC’s Adjusted Budget data also demonstrates that the compound annual rate of growth in State Government health expenditure was 4.8 per cent compared to 4.1 per cent nationally.

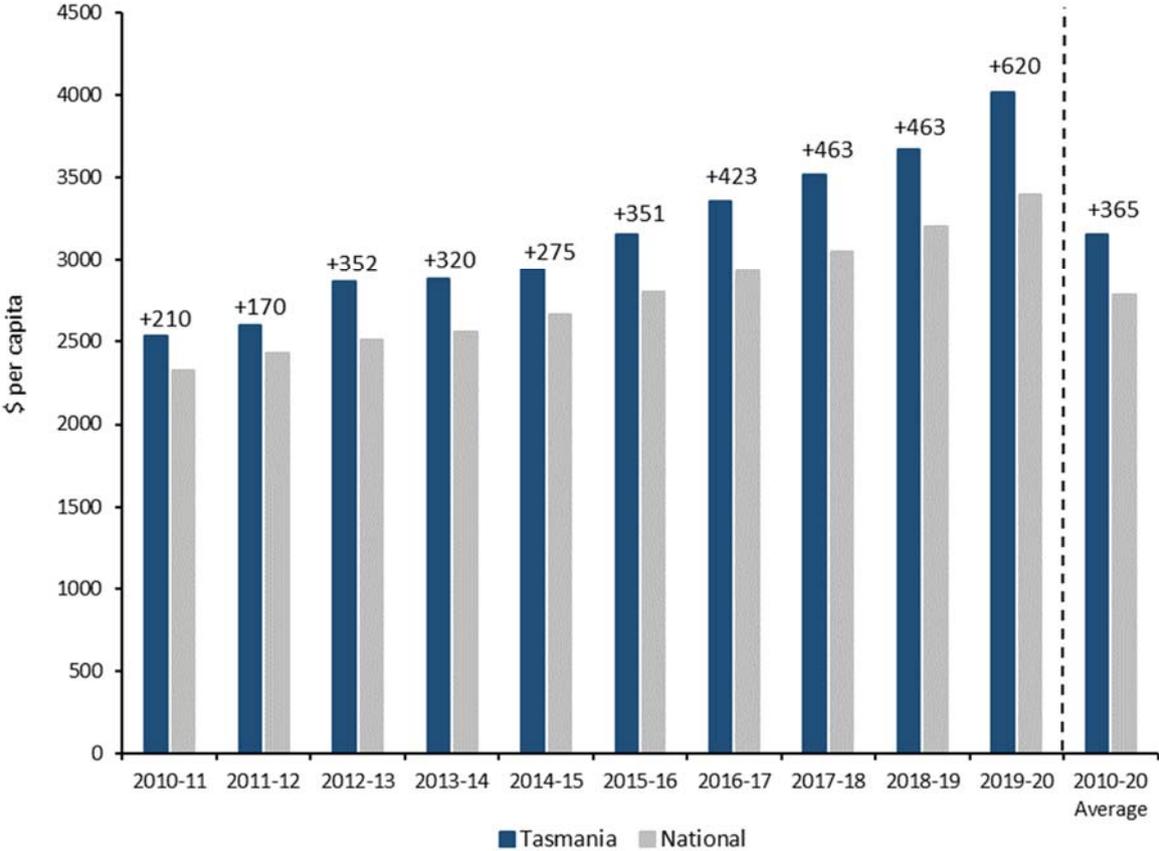
Chart I - Actual CGC Health Expense Category (CGC adjusted GFS data) - Tasmania versus National (average 2010-11 to 2019-20)



Source: CGC, 2015-2021 Reports, 2. Adjusted Budget, Table S 2-3-2

ABS GFS data² (before being adjusted by the CGC) also indicates that Tasmania consistently spends more than the national average on health. The GFS data show that from 2010-11 to 2019-20, the Tasmanian Government spent on average \$365 per capita more than the national average on health (Chart 2).

Chart 2 - GFS Total Health Expenditure - Tasmania versus National (average 2010-11 to 2019-20)

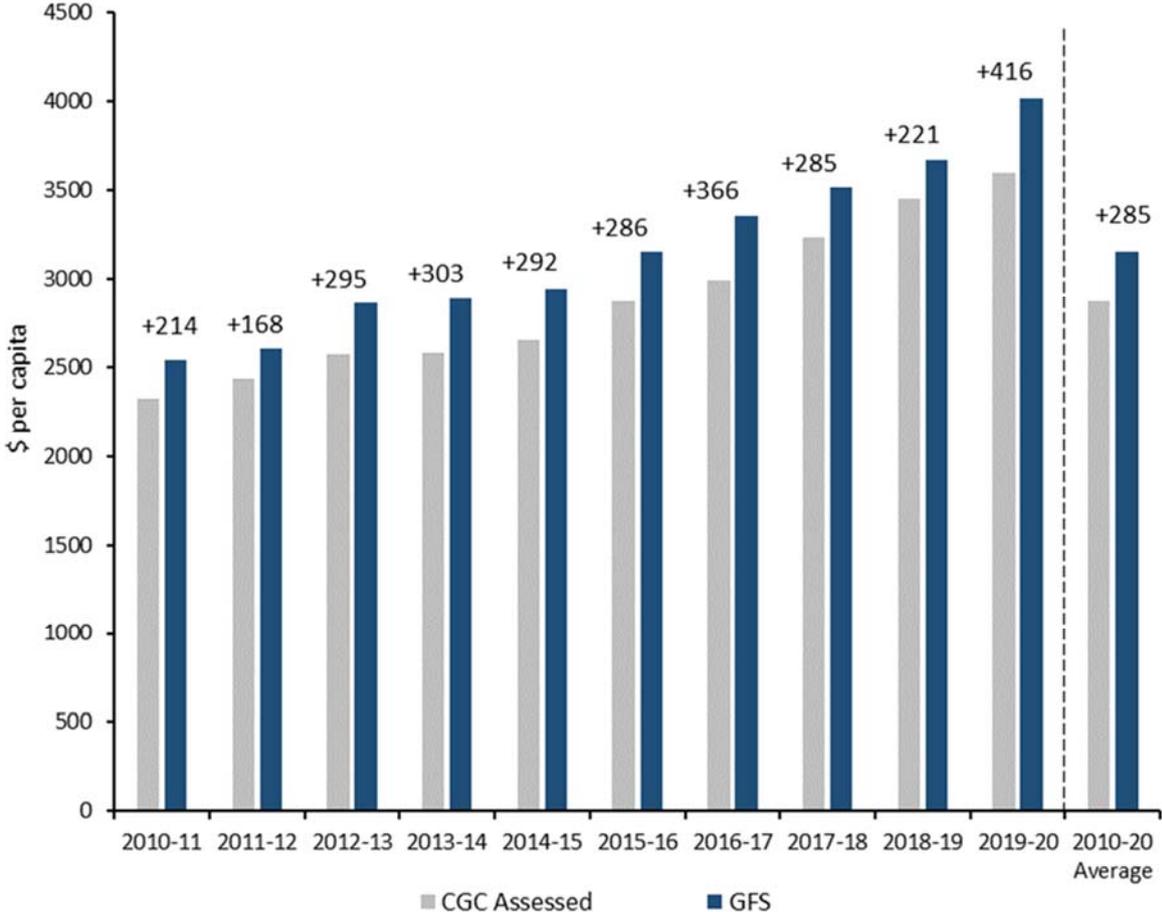


Source: ABS, Government Finance Statistics Australia 2019-20 (5512.0), April 2021.

² ABS catalogue number 5512.0 Government Finance Statistics Australia

In addition, the GFS data also demonstrates that Tasmania has consistently spent more per capita on health since 2010-11 than the CGC has assessed it needs to spend to provide the same standard of health services as any other State. The GFS data shows that from 2010-11 to 2019-20, the Tasmanian Government spent on average \$285 per capita more than the CGC assessed it would need to spend on health (Chart 3). In 2019-20 Tasmania spent \$416 per capita more than the CGC assessed.

Chart 3 - Assessed and GFS Actual Total Health Expenditure (average 2010-11 to 2019-20)



Source: ABS, Government Finance Statistics Australia 2019-20 (5512.0), April 2021.
CGC, 2015-2021 Reports, 3. Assessed Budget, Table S 3-3-2

Is it appropriate to use other data sources to assess health expenditure?

As noted, it is ultimately a policy choice for Governments as to how much of the Budget is allocated to different priorities and as consistently stated by the CGC, it is not its role to determine how GST revenue should be allocated by a State.

Notwithstanding this, some commentators persist in making judgements about whether the Tasmanian Government is spending enough on health. In addition, these commentators rely on data from the Australian Institute of Health and Welfare (AIHW) to argue that Tasmania has a health funding “shortfall” when compared to the CGC’s calculations, further misrepresenting the position.

AIHW data is not strictly based on official data sources such as State government budgets and expenditure reports. It also appears not to cover the same range of health expenditure activity as covered by the ABS GFS statistics. The AIHW methodology has been developed to enable national and international expenditure comparisons, rather than State comparisons and commonly does not correspond to official data sources, such as State government financial reports and expenditure reports.

It is unclear why this data has been used, particularly given it is not directly comparable with the ABS GFS data which most closely reflects jurisdictional budget information. As noted previously, the ABS GFS data is the primary source of data used by the CGC as the basis of its calculations of actual and adjusted budgets.

Conclusion

It is an established part of the federal financial framework between the Commonwealth and the States that GST revenue is untied and each State can spend GST in accordance with its own spending priorities.

There is no requirement or expectation that the GST funds must be allocated in accordance with the CGC’s distribution formula. The CGC’s role is to recommend relativities to enable GST revenue to be distributed consistent with the principle of HFE.

The CGC’s assessments are not intended to be the benchmark for government spending priorities and to do so misrepresents the purpose and intent of the GST distribution process.

It is also misleading to focus on one expenditure assessment area in isolation of the CGC’s overall distribution model.

There are a number of technical reasons arising from the CGC’s methodology that explain why comparisons between actual and assessed expenditure can vary. Therefore, drawing any conclusions, without proper consideration, could misrepresent the CGC’s assessments.

The CGC's assessments therefore should not be used to make judgements about whether Tasmania is spending enough on health or in any other services area.

Nevertheless, if a comparison is made between Tasmania's actual expenditure and assessed expenditures, it is not appropriate to use AIHW data. This is because AIHW data is not comparable across jurisdictions, does not capture the full extent of health expenditure in a State, and is not a source of data used by the CGC in its assessments.

The ABS GFS data demonstrates that the Tasmanian Government has consistently spent more per capita on health than the national average and more than what the CGC has assessed it needs to spend on health.