



**NORTHERN TERRITORY VIEWS ON  
2010 REVIEW DRAFT REPORT**

**OVERVIEW**

**September 2009**

## **Introduction**

This submission provides an overview of the key issues for the Northern Territory following the release of the Commission's 2010 Review Draft Report. These issues are dealt with in more detail in topic specific submissions.

As the Commission is aware, the Northern Territory has serious concerns about draft report outcomes. The outcome for the Northern Territory is around 10 times worse than next most affected state. If NSW had a similar loss, the loss would be around 80 per cent of their total GST revenue.

The Commission has undertaken reviews of Northern Territory's fiscal needs for the last 30 years, and on the same basis as the states' since 1985. Over that period, there has been minimal change in the Territory's relativity. The Commission's analysis in its 75<sup>th</sup> Anniversary Report<sup>1</sup> which uses data from the 2008 Update shows in Figure 5.4 that the relative cost of providing services in the Northern Territory has increased from around 2.3 times in 1994-95 to just under 2.4 times in 2006-07. Figure 5.8 from the same report shows that the Northern Territory's relative service level has fallen from 1.2 in 1994-95 to 0.93 in 2006-07.

The effect of the Draft Report on other jurisdictions ranges between +\$215 per capita for Queensland to -\$152 per capita for the ACT. However, for the Northern Territory, the loss is -\$1502 per capita which does not seem credible.

There can only be two explanations for such an outcome; the Commission's assessments over the past 30 years have seriously overstated the Territory's needs, or the methods adopted in the 2010 Draft Report are not sufficient to adequately measure the Territory's relative differences and consequent fiscal needs.

If, as implied by the Draft Report, the Territory's needs had been substantially overstated for many years, then the Territory's Budget position would have been far better than the states or standards of service in the Territory would have been superior to those elsewhere. However, there is no evidence to suggest that either situation

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<sup>1</sup> The Commonwealth Grants Commission, *The Last 25 Years*, 2008.

exists. In fact, the converse is true, as is shown by the Commission's own analysis described above.

There has been no dramatic change in circumstances or services that would warrant any material reduction in the Territory's disabilities. Rather, there has been significant service expansion in remote areas in health, education, police and child protection since 2004. As such, it would be reasonable to expect that the Territory's disabilities in 2010 would be higher than in 2004.

A more plausible conclusion is that the clean slate methodology used in the Draft Report is not sensitive enough to adequately reflect the very substantial differences in the Territory's needs as a result of its demography, geography and its service delivery requirements when compared to the national average. It is clear that further development of the methodology and use of better and more appropriate data is needed and would produce a materially different result more consistent with assessments in previous years.

The Territory has made final submissions on assessments where it has major concerns. This overview summarises the main issues the Territory wishes to bring to the Commission's attention, particularly in the assessment of *Location and Service Delivery Scale, Welfare and Housing, Community and Other Health, Services to Communities, Justice Services, Roads and Capital*, as well as comments relating to the principles and processes adopted in this review.

### **Assessment Guidelines and the Use of Data**

The Commission has adopted a clean slate approach to this review and has observed the requirement to achieve simplicity in the assessments. To support this approach, assessment guidelines have been revised and the Commission has attempted to adhere to them as closely as possible. The guidelines attach particular importance to the use of appropriate, nationally consistent and independently sourced data.

The Territory supports assessments being based on data which are fit for purpose, of a high quality, from a reputable source and which adequately reflect the circumstances of

all jurisdictions. However, realistically such data doesn't always exist. There are also some disabilities such as location which affect only some jurisdictions and for which national data is simply not available. The Territory's position is that where there is a strong conceptual case for a disability, the Commission should seek out as best data it can to assess the relative position of states.

It is therefore disappointing to find that the application of the assessment guidelines has precluded the use of some of this data (such as detailed unit record data outlining education employee costs) to enable disabilities to be recognised. In such circumstances the Commission has often used a factor of 1 on the basis that the data it has available is not sufficiently reliable or comprehensive to enable the assessment of a disability. The Territory strongly objects to this approach. A factor of 1 means that no disabilities exist. If there is a sufficient conceptual case, equalisation demands that the Commission assess a disability using the best information it has available. The Commission should also take into account that if the fall back position is an EPC assessment, there is a perverse incentive for some jurisdictions not to provide comparable data to enable assessments of disabilities.

It is similarly disappointing to find that application of this feature of the assessment guidelines has not been consistently applied, for example where single state data has formed the basis of the *Family and Child Services* component of the *Welfare and Housing* assessment.

Another major area of concern for the Territory is the Commission's use of Census data. While the Census provides the most comprehensive source of national data, its reliability between jurisdictions is variable with the Territory having the least reliable data. The ABS estimates that there is an undercount of around 16 per cent for Indigenous people living in the Territory, significantly higher than the Australian undercount of 11.5 per cent. While this has been rectified in the aggregate estimated resident population using imputations based on the data that were collected, the use of Census count data for small areas, as has been used in the *Location* assessment and other assessments, is demonstrably inadequate particularly when compared with the Territory's administrative data.

While Estimated Resident Population data corrects for the undercount, it does not correct the majority of missing persons' characteristics such as employment data which is used in the location assessment or socioeconomic data used in a variety of assessments. While the NT has provided comprehensive administrative data to the Commission, not all jurisdictions have done so and it is likely to be too late to obtain similar data from all jurisdictions. If that is the case, the Territory urges the Commission to use its judgement, based on available data including that from previous Reviews to ensure that the relativities adequately reflect the Territory's needs.

The Territory has been a willing and active participant in the 2010 Review process and has supplied considerable detailed data to the Commission to progress the methodology review. Additional data, as well as detailed commentary on methods adopted in the Draft Report, has been included in our final submissions and we urge the Commission to give careful consideration to our arguments in making its final judgements on methodology for the 2010 Review.

## **Discounting**

The Territory recognises the importance of judgement in the review process, and that discounting is one of the mechanisms that the Commission uses to apply its judgement.

However, by its nature, discounting always assumes that the more correct answer is less than the disability calculation would suggest. This is not statistically valid.

Indeed, analysis undertaken by the Territory and included in these final submissions shows that in some cases the factor as calculated is too low and any "adjustment" should be to increase the factor rather than discount or reduce it.

The Territory is of the view that discounting has been used too freely in the Draft Report and that rather than discounting a factor because of data concerns, the Commission should use its judgement to ensure that the result is consistent with the conceptual case for a given component of an assessment. For example, the Commission's estimate of an identical government employee housing (GEH) cost across all SARIA regions including no differences in rental subsidies is demonstrably inaccurate. However, the

Commission proceed to apply a “general” 15 per cent discount, further underestimating the impact GEH costs have on more remote jurisdictions such as the Territory.

### **Simplification and Equalisation**

The Territory agrees that simplification is an important component of the Terms of Reference (ToR) for this review. However, while the Territory has supported simplification of assessments throughout the review process, we have done so on the basis that equalisation is the paramount objective. The pursuit of simplification should not result in legitimate differences between states not being fully recognised. This is consistent with the ToR which spell out that the simplification of assessments should be consistent with the principle of horizontal fiscal equalisation.

The justification of several “simplified” assessments has also been linked with data availability. In some cases “simplified” methodology has been developed on the basis of data from nationally provided services. However, it is clear that in some instances, services that states provide do not directly correlate with the nationally provided services from which the data is drawn. It appears that “what states do” is subservient to an assessment that can be supported by a broad indicator instead of the other way around.

The inclusion of *Family and Child Services* into the *Welfare and Housing* category is a good example of where a “simplified methodology” does not adequately reflect state services. While national data is available to support the proposed Centrelink based assessment of Welfare and Housing services, the limited income and income support data available on clients of *Family and Child Services* does not provide as reliable a proxy for these services. The result is that including *Family and Child Services* into the same broad indicator framework as the other welfare services has led to an assessment which lacks the sensitivity to adequately differentiate between state differences.

The Draft Report indicates, at least for the Northern Territory, that equalisation has been diminished in the pursuit of simplification. In the Territory’s view, simplification can co-exist with equalisation when jurisdictions are relatively homogenous. While there are

some differences between the demographic and geographic features of the states, these are within reasonable bounds. However, the Northern Territory is an outlier in terms of these characteristics with the differences between the Northern Territory and the 'national' average being significant in most areas. For example, around 30.4 per cent of the Territory's population is Indigenous compared to the national average of around 2.5 per cent. As a result, disabilities that are not material for other jurisdictions are often significant for Northern Territory and are not being assessed in many parts of the proposed 2010 methodology.

For example, cost differences between urban and remote Indigenous services exist in most jurisdictions but because of the comparatively small remote population in other jurisdictions, this lack of identification is not material in the states but it is for the Territory. Similarly, the changes to the location methodology have had a profound effect on the Northern Territory's relativity but have had very little effect on other jurisdictions. In fact, when interaction effects are included, the loss as a result of the new methodology for location is greater than the Territory's overall loss in the Draft Report.

The Territory is concerned that the Commission's clean slate approach and the application of simplicity, materiality, assessment guidelines have not had an equal effect on the Northern Territory compared with other jurisdictions and the Territory asks that the Commission reconsider its approach to ensure a more equitable and credible outcome in the final report.

## **Key points raised in the Territory's submissions responding to the 2010 Draft Report**

### ***Commonwealth Payments (Attachment 1)***

The Territory broadly supports the Commission's proposals regarding the treatment of Commonwealth payments and strongly supports use by the Commission of discretion regarding the treatment of individual payments is strongly supported.

### ***Other Revenue (Attachment 8)***

On the basis that it is material for four states, the Northern Territory considers that fire services levies should be assessed within the land tax category rather than on an equal per capita basis in Other Revenue.

### ***Schools Education (Attachment 9)***

The Territory is broadly supportive of the proposed schools education assessment but argues that the Commission should use actual rather than assessed post-compulsory enrolments. The methodology used in the Draft Report to determine the assessed post-compulsory enrolments delivers an implausible result whereby 20 per cent of the Territory's actual enrolments is being attributed to policy influences.

Cost weights should be adjusted for Census undercounts.

Adequate recognition of location and service delivery scale cost disabilities are critical in this assessment. The methodology to assess school transport expenses is supported.

### ***Admitted Patient Services (Attachment 11)***

The Territory argues that an interstate location factor should be included in the assessment to reflect that Darwin has the characteristics of an outer-regional town rather than those of a major city in terms of private sector provision and scope of specialist admitted patient treatment availability.

Private patient user charges should continue to be assessed using the current hospital patient fees assessment.

AIHW data understates non-hospital patient transport costs to the Territory. The most recent state data should be used to develop an adequate cost weight which better reflects patient transport expenses.

Both interstate and intrastate patient transport expenses should be differentially assessed to reflect the high proportion of expenses incurred by remote and very remote patients and by patients who require specialist treatment only available interstate.

### ***Community and Other Health (Attachment 12)***

The Territory continues to have strong reservations about the subtraction model, in particular the assumption that an extra dollar of Commonwealth funding reduces Territory expenditure needs by the same amount. Rather, increased Commonwealth investment often requires additional state investment.

Various iterations of the model through the Review period have highlighted the sensitivity of the model to its underlying assumptions. The resultant volatility is not consistent with the objective to achieve a reliable and sustained assessment of needs over time.

The Territory strongly contends that the Commission must improve contemporaneity of the Indigenous weightings in the assessment model given the substantial increase (recent and planned) in Indigenous health investment. Judgement will need to play a part in determining weightings that are not out of date and so achieve a reliable assessment.

The Territory considers there is a compelling case to treat by exclusion the Closing the Gap in Indigenous Health Outcomes National Partnership so as not to override the intent of the NP to substantially improve health services for Indigenous people.

The use of Medicare and National Health Survey data leads to an urban bias in the proposed age/sex weights.

The Territory disagrees with the model's assumption that any component of the extra cost of providing the same level of Medicare services (by non-state providers) is not transferred to state governments but is met in full by individuals or the private sector.

The Territory makes substantial top-up payments to both general practitioners and Aboriginal Controlled Community Health Organisations (ACCHOs) to compensate for

the higher costs involved in providing services and the limited capacity to receive out-of-pocket contributions, due to the disadvantaged socio-economic status of the Territory's population.

Given the above, the Territory considers that the Commission should review the model's assumptions of perfect substitutability and consider each state's circumstances individually.

### ***Welfare and Housing (Attachment 13)***

The Territory has a number of concerns with the assessment. A complex model has been developed around the use of Centrelink data on the basis that Centrelink clients are likely to be users of welfare and housing services. While that is likely to be so, the Centrelink data is not representative of the range of state services included in this category.

Victorian data has been used to assess the profile of users of Indigenous family and children's services (FACS). This data is not nationally representative and is inappropriate for to assess usage by remote Indigenous people.

The Territory is particularly concerned that the assessment overstates the use of FACS by people on Parenting Payment Single and understates use by those on other payments which have higher use in remote areas, such as Parenting Payment Partnered, thereby creating an urban bias in the assessment.

The proposed method and available data does not provide an adequate basis for assessment of the FACS element of this category. The Territory submits that the Commission should separately assess FACS within the welfare and housing assessment using a simplified 2004 Review methodology and AIHW data.

The proposed CDEP discount is based on unreliable data and reinforces the urban bias in the assessment. Assessing housing expenses on a net basis artificially dilutes the impact of expenditure disabilities. The Commission partially address this issue by

grossing-up some disabilities. However, the Territory considers that all expense disabilities, particularly location, should be similarly grossed-up.

### ***Services to Communities (Attachment 14)***

The Territory strongly contends that the assessment of water and electricity subsidy expenses should recognise Indigenous, dispersion and service delivery scale disabilities particularly as remote essential services expenses are now to be assessed in the respective water and electricity subsidy components of this category. The Territory will provide further comment on the assessment of water subsidy expenses in response to the Commission's next paper.

The use of the remote and very remote population to derive electricity subsidy expense factor is supported as this best reflects governments' policy in the provision of subsidies for utility services. The methodology used to assess community development expenses is supported as it appropriately reflects the additional costs of Indigenous community development.

### ***Justice Services (Attachment 15)***

The proportion of police expenses assessed equal per capita should be significantly less than 50 per cent, consistent with the level of community policing targeted to those most likely to commit crimes. The equal per capita attribution is unreasonable in the Territory's circumstances where there is high over-representation of Indigenous people as both offenders and victims of crime.

Discounting police custody data, particularly when applied in conjunction with the allocation of 50 per cent of police expenses equal per capita, diminishes the effect of the involvement of Indigenous people and other high users of police services in more serious crimes to the point where the additional needs that result are not properly recognised.

An Indigenous cost weight should be applied to all components of this assessment, reflecting the higher cost of providing Justice Services to Indigenous people.

### ***Roads (Attachment 16)***

The Territory broadly supports the way in which road length and use disabilities are assessed but does not support the methodology used to determine their relative influence.

The assumptions used by the Commission to cross-classify the NTC data produce such an unrealistic outcome that the resultant data is not fit for purpose. The Territory considers the Commission should instead derive the relative influence of use and length disabilities based on the Australian Road Research Board and National Road Transport Commission data used in the 2004 Review roads assessment.

The Territory considers the unsealed roads discount overstated as it:

- does not accord with the Territory's experience;
- inappropriately includes use related cost differences;
- is based on a sample which is not representative of the relevant roads; and
- does not acknowledge the explicit and implicit adjustments already incorporated in the National Transport Commission's cost allocation methodology.

The complete exclusion of National Transport Commission category F3 expenses is inappropriate as these expenses do not primarily relate to land acquisition.

### ***Services to Industry (Attachment 18)***

Population is a poor indicator of services to industry regulation expenses. The disability weights should be revised to better reflect the influence of business activity and the number of businesses on regulation expenses.

The rationale for not assessing intrastate location in the services to industries assessment is not consistent with equalisation and internally inconsistent as the Commission propose to use population as a proxy measure for regulation expenses

driven by the number of businesses. The Territory considers the Commission should apply the general regional costs factor to services to industries.

### ***Other Expenses (Attachment 19)***

The Territory does not support an equal per capita assessment of national parks and wildlife expenses. The category is material for the Territory and policy neutral measures exist to assess differential needs.

The Territory strongly supports an adjustment for locational disabilities for the service expenses in this category.

An actual per capita assessment of natural disaster, native title and national capital expenses is supported.

The fixed costs borne by small states for their central government services are not adequately recognised in this assessment and need to be increased if equalisation is to be achieved.

### ***Capital (Attachment 20)***

The Territory reiterates its support for the assessment of capital needs and its preference for a direct assessment of these needs on the basis of simplicity and contemporaneity.

The Territory considers a 50 per cent discount on capital stock disabilities excessive given:

- the strong link between socio-demographic composition use disabilities and capital needs;
- the Commission has adopted a very conservative approach in the development of expense use disabilities and to further dilute their influence in this assessment through additional discounting will understate relative needs;
- the Commission has not assessed capital specific disabilities; and

- the relationship between some expense use disabilities and capital use may be greater than 1.

In the interests of simplicity and to provide the most reliable assessment of relative needs the Territory urges the Commission to use unadjusted expense disabilities in the capital and depreciation assessments.

The Territory considers the use of a four state average inappropriate when determining the materiality of a cost of borrowing disability. The Territory considers a more jurisdiction specific rate would be material and should be assessed. The Territory is disappointed that the Commission continues to ignore the impact of the Territory's special circumstances on its capital needs.

### ***Location costs and Service Delivery Scale (Attachments 22 and 23)***

The proposed Location assessment represents a substantial change in methodology from the 2004 and prior Reviews. This assessment and associated interactions account for more than 100 per cent of the reduction in the Territory's relativities applied in the 2009 Update and the Draft Report. While at the conceptual level, the Territory accepts that the proposed approach has some merit, the data which is used in the model is clearly not fit for purpose and produces erroneous results. Often, national data simply does not reflect the Territory's circumstances. Unless the data is reliable and reflective of the actual situation, the model's output cannot be considered to be robust.

The Territory and other states have provided alternative, state based data that would produce more credible outcomes than those in the Draft Report. Getting the location assessment right is critical across all assessments as location is a common factor that is highly relevant in all areas of service delivery in the Territory. The effect of not getting it right has a significant and disproportionate effect on the Territory's relativity. As a consequence, the Territory considers that materiality tests of alternate methodologies must apply to the full redistributive impact across all assessments including interactions rather than be limited to components within the location assessment.

### ***Interstate Location***

The Territory offers a range of additional non-wage conditions of service as a result of Commonwealth policies at self-government and is unable to remove them at no cost due to both market conditions and rulings on the issue.

These costs are not reflected in SET as it does not include Government wages, does not recognise the importance of the public sector as an employer in the Territory, does not include similar non-wage incentives offered by the private sector and does not reflect the ongoing costs of grandfathered entitlements.

The costs are conceptually identical to those associated with the Commonwealth Superannuation Scheme (CSS) which are assessed by the Commission. Not recognising the Territory's non-wage conditions of service produces an internally inconsistent methodology. The Territory also notes that the Commission recognise the impact of the Commonwealth on wage costs in the Australian Capital Territory and submits that the Commonwealth also has a distorting influence on costs in the Northern Territory.

The proposed freight methodology does not adequately capture embedded freight costs of goods purchased locally but originating interstate nor does it capture all relevant freight margins.

The distribution of airfare and related costs between jurisdictions does not reflect the concentration of meetings in the south-eastern capitals, the differences in fares or the additional costs associated with interstate travel such as travelling allowance and accommodation which states do not incur proportionately.

*To address the interstate location issues the Commission should:*

- Increase the Territory's interstate wages factor to recognise its unavoidably higher conditions of service.

- Revise the freight methodology to incorporate embedded costs of locally purchased goods which are sourced interstate and include freight margins from courier and postal services industries.
- Adjust the distribution of airfares expenses to recognise the dominance of the southern capitals as meeting venues and also incorporate the disproportionate impact of travel allowance and accommodation costs on jurisdictions such as Western Australia and the Territory which often require overnight stays due to distance and flight schedules.
- Recognise the impact of high population turnover on recruitment expenses.

### *Intrastate Location*

There are a number of elements in the regional costs and service delivery scale (SDS) assessments that require significant adjustment to ensure the methodology accurately reflects the full impact of location on service delivery. In particular, the Territory is concerned with the way in which data, particularly Census data, has been used in the regional costs and SDS assessments.

The Territory is also concerned that:

- the asymmetric treatment of cost weighted clients between the socio-demographic composition (SDC) and regional costs assessments understates the Territory's regional costs factors;
- the government employee housing (GEH) assessment fails to adequately account for significant non-policy differences between states;
- the schools SDS factor is derived using population in SDS areas rather than the student population in SDS areas, which overlooks significant differences between states in student population proportions;

- the methodology used to combine the regional costs and SDS disabilities results in an assessment that does not appropriately reflect the impact of intrastate location disabilities, particularly in relation to non-wage and GEH costs; and
- the definition of SDS areas does not adequately recognise the increasing influence of SDS as client populations decrease and does not recognise differences in accessibility.

*To address the intrastate location issues the Commission should:*

- Adjust Census data to correct the impact of the undercount on student and schools staff data.
- Treat cost weighted clients symmetrically between the SDC and each component of the location assessments.
- Revise the assessment of GEH costs to reflect:
  - a credible GEH base cost;
  - differences in the base GEH cost between jurisdiction; and
  - differences in rental subsidy between SARIA regions.
- Apply judgement to ensure the GEH assessment reflects the impact of differences in costs of construction (acknowledging that construction is subject to public tender), conditions of employment, availability of employees, availability of dwellings, rental and purchase markets and land tenure between states.
- Base the schools SDS factor on the student population in SDS areas rather than total population in SDS areas to better reflect the actual impact of SDS on schools costs.
- Adjust the SDS weights for schools and police to recognise that a weight based on simple differences in staff ratios does not reflect the full impact of SDS on costs.

- Change the definition of SDS areas to recognise that the impact of SDS increases as the relevant client population decreases. The Territory considers an SDS weight of 1.4 for students living more than 50 but less than 200 kilometres from a Class D town and a weight of 1.64 for students living more than 200 kilometres from a Class D town appropriate. For police, the Territory considers a weight of 1.25 for the population living more than 50 but less than 350 kilometres from a Class D town and 2.75 for the population living more than 350 kilometres from a Class D town appropriate.
- The Commission should adjust the distance threshold to recognise the accessibility differences associated with travelling on unsealed roads.