Northern Territory Government

DEPARTMENT OF **TREASURY AND FINANCE** www.nt.gov.au

Under Treasurer
Cavenagh House, 38 Cavenagh Street DARWIN NT 0800
Postal Address GPO Box 1974 DARWIN NT 0801
Tel 08 8999 6033 **Fax** 08 8999 7150

Our Ref:
Your Ref:

Mr Greg Smith
Chairperson
Commonwealth Grants Commission
First Floor, Phoenix House
86-88 Northbourne Ave
Braddon ACT 2612

Dear Mr ~~Smith~~ Greg

RE: NORTHERN TERRITORY FIRST SUBMISSION TO THE 2015 METHODOLOGY REVIEW ON ARCHITECTURE OF HORIZONTAL FISCAL EQUALISATION

I am pleased to provide you with the Northern Territory's first submission to the Commission's 2015 Methodology Review. The submission addresses the principles and architecture of horizontal fiscal equalisation, priority issues as outlined in the 2015 Review Terms of Reference and other issues of priority for the Territory. It also includes an overarching Executive Summary as requested.

The Territory strongly supports a GST distribution system based on the current principle of horizontal fiscal equalisation, which gives states the capacity to deliver the same standard of services. In particular, the Territory considers the development of methods to appropriately capture the changing characteristics of the Indigenous population as a high priority and that without a method change, jurisdictions such as the Territory will be disadvantaged.

In terms of confidential detail included in the Territory's submission, I would like to advise that the Territory has made reference to the Pottinger Co Pty Ltd and AECOM report on the impact of the physical environment on State government expenditure.

I trust that you will give due consideration to the Territory's submission and look forward to discussing this with you at the bi-lateral meeting in mid-August.

Yours sincerely

Jodie Kirkman
Under Treasurer

1 August 2013

Northern Territory Government

COMMONWEALTH GRANTS COMMISSION 2015 METHODOLOGY REVIEW

Northern Territory Submission on Architecture of Horizontal Fiscal Equalisation: Principles and Interpretations; and Priority Issues for States

July 2013

Contents

Executive summary

The objectives of Horizontal Fiscal Equalisation

1.1. The only stated, and agreed, objective of the distribution of goods and services tax (GST) revenue between states and territories (states), as outlined in the Intergovernmental Agreement on Federal Financial Relations (IGA), is Horizontal Fiscal Equalisation (HFE).

1.2. The Northern Territory (the Territory) strongly supports the continuation of the current HFE system in Australia that aims to equalise the fiscal capacities of states in order for each state to provide the standard level of services.

1.3. Specifically, the Territory supports the view that achievement of equity is paramount to the objective of HFE, and that the current definition of HFE underpins the long standing tenet that all Australians regardless of where they live should have access to equivalent levels of government services.

1.4. Full equalisation is appropriate in the Australian context because of states' limited revenue bases and the diversity in states' population characteristics, natural endowments and economic circumstances that result in unavoidable and material differences between states' fiscal capacities to deliver the standard level of services.

1.5. The Territory contends that the current form of equalisation does not fully equalise states' fiscal capacities in practice. The Commonwealth Grants Commission's (the Commission's) use of materiality thresholds, discounting and the notion of average policy all dilute the achievement of full equalisation.

1.6. Partial equalisation is not supported as it would introduce further elements of subjectivity and uncertainty, and would require a higher degree of judgement by the Commission to determine the minimum or acceptable level that a state should be equalised to.

1.7. The Territory believes that the scope of equalisation should be as comprehensive as practically possible and include all revenue bases and general government services that states are responsible for delivering. This is consistent with what states do. Removing activities from the current scope of equalisation would diminish equalisation outcomes.

Supporting principles

1.8. The Territory believes that the current four supporting principles: what states do; policy neutrality; practicality; and contemporaneity, are sufficient and does not propose any additional principles. The current supporting principles work to appropriately reduce the level of judgement applied by the Commission, remove incentives to 'game', reduce complexity, maintain sovereignty and provide a balance between responsiveness and stability.

Treatment of Commonwealth payments to the States

1.9. In principle, the Territory supports the continuation of the 2010 guidelines for determining the treatment of Commonwealth payments. In general, the main circumstance where a Commonwealth payment should be excluded is where the payments are designed to address unmet need.

Methods to appropriately capture the changing characteristics of the Indigenous population

1.10. The Indigenous assessment is critically important to the Territory due to the large size and substantial needs of the Territory's Indigenous population. At 30 per cent of the population, Indigenous people significantly increase the demand for and cost of providing government services in the Territory compared with other jurisdictions.

1.11. Given the large increase in self-identification together with its disproportionate and highly significant impact on GST distribution, the Territory strongly supports the Terms of Reference for the 2015 Review, which directs the Commission to develop methods to appropriately capture the changing characteristics of the Indigenous population.

1.12. The Territory is of the view that the Commission's current assessment methodology, which is based on self identified Indigeneity, is not a reliable proxy and that there is a need for a method change which captures the multi dimensional aspect of Indigenous need.

1.13. The current Commission methodology accords growth in the Indigenous population with growth in expenditure needs. While this approach may be reasonable in circumstances where the Indigenous population grows due to births and/or migration of the existing population, it does not adequately account for the relative impact that newly identifying members of the Indigenous population may have on government service provision.

1.14. The Territory is of the view that the characteristics of the newly measured Indigenous population, as evidenced through the preliminary estimate of the Indigenous estimated resident population, may differ from previous populations with new members having characteristics more akin to those of the non-Indigenous population. As such, without a change to the Commission's assessment, jurisdictions such as the Territory, where growth in the Indigenous population more closely aligns with demographic factors, will be disadvantaged.

1.15. It is unlikely that a single variable could adequately capture the change in the characteristics of the Indigenous population. As such, it may be necessary for the Commission to develop a composite measure based on a number of key variables. In the Territory's view, this is a prime example of where the pursuit of simplicity would unduly compromise the achievement of HFE.

1.16. To assist the Commission, the Territory has outlined a range of variables that may be used to capture the characteristics of the Indigenous population. The Territory considers that each of the variables identified in this submission, that is the ratio of local Indigenous and non-Indigenous Populations, Education attainment, Housing occupancy and English proficiency, would usefully contribute towards a multi-variable composite measure.

Appropriateness of current materiality thresholds

1.17. The Territory considers that materiality thresholds, while providing a balance between detail and simplicity, should not undermine the objectives of equalisation. Therefore the Territory does not support an increase in thresholds.

Rounding relativities

1.18. The Territory considers the current level of rounding is appropriate and that any move to reduce the number of decimal points to which relativities are rounded would provide minimal gains, if any, in terms of simplicity and perceived views around accuracy.

Appropriateness of developing a new transport infrastructure assessment

1.19. The Territory sees there is merit in the consistent treatment of all transport infrastructure payments. However, any decision to apply or not apply a discount consistently to individual transport modes must be evidenced by no variation in assessed needs for each mode of transport.

1.20. Further, the Territory is of the view that discounting Commonwealth payments for nationally significant transport infrastructure projects would only be appropriate if it can be clearly demonstrated that needs are not being adequately addressed under the proposed new transport infrastructure assessment.

1.21. Any differential assessment for nationally significant transport infrastructure projects would require identification of such projects. In this regard, the Territory considers that a set of criteria be developed to assist in identifying nationally significant payments.

Appropriateness of data revisions

1.22. The Territory supports, in principle, the use of the most up-to-date data, subject to the data being reliable and fit for purpose. For this reason, data which is updated annually with a lag or updated less frequently than annually should not be disregarded or overlooked, particularly if the data is sound, reliable, of sufficient quality and provides an appropriate fit for purpose.

1.23. Further, the Territory contends that there may be some instances where the use of up-to-date data highlights a deficiency in the Commission’s current methodology and that such instances warrant consideration of a method change. For example, the Territory contends that the Commission’s current methodology is not designed to cope with large changes in states’ shares of the Indigenous population from increased self-identification, and as a result, the use of 2011 Census Indigenous estimated resident populations would be inconsistent with the principle of HFE.

1.24. The 2015 Review Terms of Reference supports this view through the inclusion of priority 1.d).

Simplified and integrated assessment framework

1.25. The context in which the Commission has been asked to consider the merits of adopting a simplified and integrated assessment framework is in relation to the capital assessment.

1.26. The Territory considers that any assessment of capital needs must take into account all relevant use and cost factors which impact on states' existing and new infrastructure needs. In this regard, the Territory encourages the Commission to re-examine the potential impact of physical environment on states' infrastructure needs.

1.27. The Territory supports the current direct approach to assessing each state's capital needs on the basis that this approach is relatively simple, contemporary and recognises the financial consequences of new infrastructure needs up front. The Territory would however be open to considering alternative approaches to assessing capital needs, as long as the above objectives are retained in the assessment.

Appropriateness of equalising interstate costs on a spend gradient basis

1.28. The Territory strongly opposes equalising interstate costs on a spend gradient basis as such an approach would be inconsistent with the objective of HFE, that is providing states with the fiscal capacity to deliver the same standard of services, and the principle of equity which is at the core of the GST distribution system and is embedded in the IGA agreed by all states.

1.29. The Territory considers that differences in the levels of services delivered by states are already reflected in the average of what states do and that interstate costs should continue to be fully equalised as there are material wage differentials between states due to factors that are not influenced by state policies.

1.30. The Territory contends that it faces substantially higher wage costs than other states due to a range of factors such as more competitive employment conditions, higher costs relating to Territory Government employees who are members of the Commonwealth Superannuation Scheme and a high rate of staff turnover.

Appropriateness of developing a new mining assessment

1.31. While the large redistribution arising from the mining revenue assessment is intuitive given the diverse distributions of natural endowments across states, the Territory considers that the two-tiered rate structure adopted in the 2010 Review in pursuit of greater simplicity has not necessarily achieved the desired policy neutral assessment.

1.32. The Territory sees merit in adjusting the mining assessment by increasing the number of groupings, either by mineral rate or mineral type, as a means to avoid spill over effects of state policy changes to the royalty rate for one mineral on other minerals.

Appropriate treatment of mining related expenditure

1.33. The Territory considers there is merit in developing a needs based assessment of mining related economic development expenditure given the differential influences on costs of state service provision in resource provinces.

1.34. The approach considered in the GST Distribution Review Final Report whereby a discount is applied to the mining revenue assessment as a proxy for expenditure needs would be less robust and overly subjective due to the level of judgement the Commission would have to employ, and is therefore not considered appropriate.

Treatment of National Education Reform Agreement (NERA) payments

1.35. The Territory considers that the simplest approach to giving effect to Clause 76 of the NERA, that is ensuring the GST distribution process does not unwind the recognised educational disadvantage embedded in the associated funding arrangements, is for the Commission's school assessment to mirror the disadvantage loadings in the Schooling Resource Standard (SRS), with some further adjustment to ensure drivers of differential costs are adequately captured.

1.36. Specifically, the Territory contends that the following disability factors should be retained in the Commission's assessment if the SRS loadings are to be adopted: administrative scale factor; interstate wage and non-wage components of the location factor; and student transport expenses factor.

Treatment of disability services during the transition to DisabilityCare Australia and operation of the full scheme

1.37. The Territory considers that the simplest approach to assessing state disability services during transition to DisabilityCare Australia is for the Commission to maintain its current assessment approach until such time as a majority of disability clients AND a majority of participating states have entered the scheme. Once this threshold has been met it is reasonable for the assessment to move to an equal per capita basis as DisabilityCare Australia would then represent the average state policy and state funding contributions will be based on an average package cost per client and population shares.

1.38. In considering an appropriate treatment to apply to disability services during transition and once the scheme is fully operational in participating states, the Commission should have regard to if/when back casting will be applied and also any issues that may arise as a result of proposed state funding contributions being reset every five years under the full scheme.

Priority Issues for the Territory

1.39. The Territory has identified the following priority issues for consideration as part of the 2015 Review:

- Indigenous influences;
- Discounting;
- School Education;
- Welfare and Housing;
- Physical environment; and
- Administrative Scale.

Further detail is provided in section 3 of this submission.

1 Architecture and principles of HFE

The objectives of Horizontal Fiscal Equalisation

1.1. The practice of HFE is not unique to Australia. However, the extent to which equalisation is applied varies between federations around the world. This reflects the different context and circumstances within the federation where HFE is being applied.

1.2. Australia's form of equalisation is appropriate due to the combined effects of the acute level of vertical fiscal imbalance between the Commonwealth and the states and importantly the differences in population demographics, geography, natural resource endowments and economic circumstances between states. Australia's form of equalisation recognises that the heterogeneity of states results in stark and unavoidable differences between states' revenue raising capacities and expenditure needs, and that the factors affecting state revenues and expenditure differ greatly.

1.3. The Territory strongly supports the continuation of the current HFE system in Australia that aims to equalise the fiscal capacities of states in order for each to provide the standard level of services.

1.4. The equalisation of fiscal capacities of states to deliver the average level of services supports two important objectives:

- Equity – that all Australians should have access to equivalent levels of government services no matter where they live. The Territory believes that the achievement of equity is the most important goal of the distribution of GST revenue between states. The amount of GST redistributed to the small states could not be replaced without these states significantly increasing the tax burden on their citizens or businesses, and/or reducing standards of services. Either of these approaches would have a deleterious economic impact on these states' and the national economy. As stated by former Commonwealth Treasury Secretary, Dr Ken Henry, "shifting cash from rich parts of Australia to those that were struggling was vital to the country's overall financial health…without fiscal equalisation, the Federation would not hang together."[1]; and
- Maintaining state autonomy – an important feature of the HFE system is the ability for each state to determine its policy priorities independently of other states and the Commonwealth. This is enshrined in the IGA which states that GST revenue "will be freely available for use by the states and territories for any purpose". Capacity equalisation allows states to provide the standard level of services without requiring an increased taxation burden and without impinging on states' sovereignty.

[1] The West Australian, Rich States urged to help poor, 25 May 2012

1.5. The only stated and agreed objective of HFE, as outlined in the terms of the IGA, is the equalisation of fiscal capacities between states and territories. Despite this, some states have argued for the objectives of equalisation to be broadened to achieve alternative or additional goals including: promoting economic efficiency; promoting state tax reform; and providing stability in GST revenue.

1.6. The GST Distribution Review considered the arguments made by some states that the current HFE system dulls incentives for states to deliver services efficiently. The GST Distribution Review Panel concluded that there was no evidence to support the claim that states with higher per capita expenditure needs are less efficient noting that a state's actual level of spending arise from both policy and non policy influences.

1.7. The Territory strongly disagrees with the argument that the HFE system provides disincentives for states to pursue efficiency gains in the delivery of services. The Commission uses an internal standard approach to assess the amount of GST each state would need to provide the national average level of services. The internal standard is calculated as the national average per capita expenditure for each government function. To the extent that the most populous states contribute to a greater share of total national expenditure, the cost at which these states deliver services drives the average. Therefore, assuming that the most populous states are able to achieve efficiencies in government services delivery through economies of scale, these efficiencies are built into the standard.

1.8. Further, there is an implicit efficiency mechanism built-in to the current equalisation process. Under the current definition of equalisation, it is assumed that states operate at the same level of efficiency. Consequently, states that are able to deliver services below the average unit cost are able to retain the benefits, while states that are unable to provide services at average cost are not compensated with additional GST revenue to fund the shortfall.

1.9. Some states have argued that the HFE system impedes state tax reform because it provides perverse incentives for states to structure their taxation policies to maximise their GST share. Accordingly, these states propose that the objective of HFE should include the promotion of state tax reform. The GST Distribution Review dismissed this line of argument stating that:

> *There is no clear evidence that the current system of HFE is impeding State tax reform. If it ever became apparent that possible changes in GST shares were impeding tax reforms, specific and temporary adjustments should be made to the GST distribution in that context, rather than changing HFE... the Panel has concluded that the GST distribution should not be used to compel or encourage States to change policies — HFE should be policy neutral and GST should remain untied and freely available.* [2]

1.10. Further, the GST Distribution Review stated that attempts to promote state tax reform cannot be achieved without "*significant reductions in equalisation outcomes*".

[2] The Australian Government, GST Distribution Review Final Report.

1.11. Following the extensive analysis undertaken by the GST Distribution Review, it could be concluded that is there no evidence to support the claim that HFE dulls incentives for states to deliver services more efficiently or that HFE is a barrier to state tax reform. Rather, the Territory believes that the objective of equity and providing states with the fiscal capacity to deliver standard levels of services delivers significant national benefits. Without equalisation, Australia's population would be more clustered on the eastern seaboard with potentially significant social and economic ramifications.

1.12. Equalisation provides capacity for the Territory to provide services and infrastructure at standards that are comparable to other jurisdictions, and this reduces the extent to which such factors influence investment decisions. For example, the availability of social infrastructure and human capital in the Territory, at levels approaching national averages, means that the major investment projects can proceed in accordance with economic imperatives.

1.13. As noted earlier, the only stated objective of the distribution of GST revenue between states is the equalisation of the fiscal capacities of states and territories. The Territory notes that if there was an impetus from governments to change the objectives of HFE or to fundamentally move away from the current full definition of HFE on a capacity basis, this would have been reflected through amendments to the IGA and guidance to the Commission in the 2015 Review terms of reference. As there was no direction for the Commission to change the objectives of HFE, the Territory contends that the Commission should continue to apply the current definition of HFE, which equalises states' fiscal capacities to deliver the average level of services.

Full or partial equalisation

1.14. Full equalisation is appropriate in the Australian context because of states' limited revenue bases and the diversity in states' population characteristics, natural endowments and economic circumstances that result in unavoidable and material differences between states' fiscal capacities to deliver the standard level of services.

1.15. The current form of equalisation provides states with the same capacity to deliver services, which is defined as the average of what states do. It does not specify a standard of services that states should provide, nor should it. The current form of equalisation, which has been in place since 1983, maintains state sovereignty, recognising the need for states to tailor services to their constituents, while having the capacity to provide the national average level of services.

1.16. Currently, the average or standard is calculated as the Australian weighted average. This approach is simple, policy neutral, removes uncertainty and limits grant design inefficiencies. Further, the weighted average approach effectively has an implicit efficiency benchmark because the largest (and most efficient) states have the greatest influence on the average.

1.17. Some states argue that equalisation should achieve an alternative standard, specifically equalising states fiscal capacity to a lower standard of services rather than the same. The Territory is strongly opposed to all forms of partial equalisation as it would lead to severe disparities in the quality and range of services provided throughout states in Australia.

1.18. Partial equalisation would introduce subjectivity and uncertainty, such as defining 'comparable' or 'not appreciably different', requiring a higher degree of judgement by the Commission to determine the minimum or acceptable level to which a state should be equalised. This goes well beyond the scope of the Commission's terms of reference.

1.19. The approach favoured by states that support partial equalisation is to discount the average by a predetermined amount. The Commission would be required to make a judgement on the level of services that states should be equalised to, without any basis for making such a subjective determination. Such a crude approach would simply dilute equalisation outcomes without any guarantees or evidence that this would result in efficiency gains or any other desired objectives. The Territory's view on discounting the average was supported by the findings of the GST Distribution Review, which concluded that discounting *"could only be considered minimal – perhaps even symbolic – from the large States' point of view, while having a significant impact on small states..., the Panel has decided, on balance, not to recommend adopting discounts to reflect minimum effort".*

1.20. Another form of partial equalisation that has been proposed is the use of broad indicators. The Territory would not be averse to greater use of broad measures in the Commission's assessments if this did not result in the deterioration of equalisation. For broad indicators to be considered, the measure must satisfy a reality check and accurately reflect differences between states' costs of delivering services or revenue raising capacities.

1.21. The Territory contends that there are limited applications of broad indicators without having a deleterious impact on equalisation outcomes. This view was affirmed by the GST Distribution Review which found that "*adopting broad cut-through' indicators that can produce closely comparable results to those under the present arrangements remains elusive*".

Scope of equalisation

1.22. The Territory believes that the scope of equalisation should be as comprehensive as practically possible. Consistent with the principle of what states do, the Commission's assessment should include all revenue bases and general government services that states are responsible for delivering. Activities of other levels of government and other sectors (including public trading enterprises) should be excluded with the exception of any impacts these activities have on a state's general government sector.

1.23. Some states have argued that the scope of equalisation should be limited to the assessment of differences in state expenditure on core functions. The Territory does not support this proposal. The removal, from the scope of HFE, of activities which are currently assessed would dilute equalisation. Exclusion would be inconsistent with the pillar of 'what states do' and would fail to provide all states with the capacity to provide the services they are responsible for.

1.24. Limiting the scope of equalisation to core functions would involve Commission judgement to rank the importance of services delivered by states. The 2010 Review introduced materiality thresholds to determine whether a revenue or expense category will be considered for a separate assessment. As such, the existing revenue and expenditure category structure reflects all state functions where there are material differences between states in providing these services. Reducing the scope of equalisation any further would only serve to ignore these substantial differences, thereby reducing equalisation outcomes.

1.25. It is important to note that while the Commission's assessments are comprehensive in that all state general government revenue and expenditure is included in the standard budget, a large proportion of this revenue and expenditure is assessed on an equal per capita basis (that is, needs are not assessed). Currently, about 45 per cent of states' total own-source revenues are assessed on an equal per capita basis in the Other Revenue category, while about 20 per cent of states' total expenditure is largely assessed on an equal per capita basis in the Other Expenses category.

1.26. Public trading enterprises should be excluded from the standard budget as these services are intended to be commercially based or not funded by tax revenues, except to the extent that community service obligations are provided. Rather, states provide subsidies to facilitate these services and may receive income such as dividends from the operation. The impact of any subsidies or income on states general government sectors should be accounted for in the equalisation process to enable equitable equalisation.

1.27. In the 2010 Review, the Commission expanded the definition of HFE to incorporate infrastructure needs of states. The Territory supports the continued recognition of differential capital needs. Factors such as population growth, service use (socio-demographic composition disabilities), physical environment and borrowing costs affect state expenditure on existing infrastructure and investment in new infrastructure.

Supporting principles

1.28. The Commission's definition of HFE is underpinned by four supporting principles: what states do; policy neutrality; practicality; and contemporaneity.

What states do

1.29. The Territory supports the current approach which base standards on the averages of what states do. Internal standards ensure that the Commission is equalising on a relevant basis and assessing government services that are reflective of those provided to the Australian population. It removes any element of judgement required by the Commission if it had to estimate a standard based on an 'ideal' or a selection of government services which would be problematic. It also links with the principle of policy neutrality, in that the Commission's calculations are not affected by the specific policies of any one state therefore mitigating potential grant design inefficiencies. The absence of this standards approach may create perverse incentives to 'game' the system.

Policy neutrality

1.30. The Territory supports the policy neutrality principle. The policy choices of individual states should not directly influence the level of grants it receives. By adopting a standard approach, the Commission's processes are neutral to the specific policies each state follows and removes the incentive for a state to manipulate or game the system. A policy neutral approach also removes the influence of political and intangible precedents that shape state policy decisions. Without policy neutrality the Commission would be required to use judgement in defining average policies, which would be a complex and impractical exercise given the vast array of options open to state governments, and is beyond the role of the Commission to determine 'ideal' state policy. Policy neutrality therefore safeguards the system from what the Commission terms as 'grant design inefficiency' but also allows states to develop policy independently.

Practicality

1.31. The Territory supports the principle of practicality which ensures that assessments are based on sound and reliable data and methods are as simple as possible while still reflecting material differences between states.

Relativities are contemporary

1.32. The Territory supports the principle that relativities should be contemporary but recognising the data limitations that are inherent in the Commission's assessment. The current three year averaging approach provides an adequate balance between contemporaneity and stability in GST relativities.

1.33. In principle, the Territory believes that the Commission should use the most up-to-date data provided that it is fit for the Commission's purposes. Data that is updated annually with a lag, or updated or released less frequently than annually should not be discounted over concerns that is it not contemporary. This would significantly restrict the data that is available to the Commission for use in the assessment process. For example, data from the Census is an important dataset used in the Commission's assessment despite being collected every five years. The more important criteria for the Commission's assessment is whether the data is reliable and fit for purpose.

Additional principles

1.34. The Territory believes that the current four supporting principles of: what states do; policy neutrality; practicality; and contemporaneity provide a sound methodological framework to measure the fiscal capacities and relative advantage and disadvantage of states.

1.35. While additional pillars such as: efficiency, simplicity, robustness, transparency and stability and predictability have been proposed, the Territory believes that these are consequential to the implementation of equalisation and do not necessitate additional principles in their own right.

1.36. The Territory believes that the current four supporting principles are sufficient and does not propose any additional pillars.

Treatment of Commonwealth payments to the states

1.37. As part of the 2010 Review, the Commission established transparent guidelines for the treatment of Commonwealth payments. The Territory believes that the guidelines should continue to be applied in the 2015 Review.

1.38. In principle, the Territory supports all Commonwealth payments for a state service being treated by inclusion. The main circumstance where a Commonwealth payment should be excluded is where the payments are designed to address unmet need. For the Territory, this primarily relates to Commonwealth funding aimed at improving Indigenous outcomes.

2 Priority issues in the draft Terms of Reference

Methods to appropriately capture the changing characteristics of the Indigenous population

The following section provides an overview of the Territory's position regarding the changing characteristics of the Indigenous population and the need to differentially assess Indigenous need. This section is followed by a more detailed analysis of the issue and a discussion on variables that could be used to reflect the differential needs.

2.1 Between 2006 and 2011, preliminary 2011 Census data indicated substantial growth in the Australian Indigenous estimated resident population (ERP) in all jurisdictions except the Territory.

2.2 The Indigenous ERP in other jurisdictions increased by 24 per cent and higher, with the highest increases being 44 per cent in the ACT, 41.2 per cent in Victoria and 36.5 per cent in New South Wales. This compares to growth in the Territory of around 8 per cent.

2.3 The Territory is of the view that the growth rates experienced in other jurisdictions are much higher than would be recorded through demographic factors, that is the increased rate of growth is much faster than would be expected taking into account birth and death rates and mixed parentage, and are therefore due to increased recording of Indigenous self-identification in the 2011 Census. This situation contributed to a substantial redistribution of GST funding from the Territory toward other jurisdictions for the Commission's 2013 Update.

2.4 Further, the characteristics of the newly identified Indigenous people are likely to be very different from those that have identified as Indigenous in recent Censuses. The Territory is not aware of any supporting evidence that the newly identified Indigenous population has a comparable level of needs as the Indigenous people who had identified as Indigenous in previous Censuses.

2.5 On most socio-economic indicators, a much greater proportion of the Territory's Indigenous population is at the poorer end of the continuum and this remained the case in 2011. Consequently, there was no reduction in expenditure needs to meet the demand for and cost of providing services to the Territory's Indigenous population.

2.6 In other jurisdictions these indicators suggest that, despite the large growth in the Indigenous population, there has been a lessening in disadvantage among the Indigenous population. This can be explained by the newly identifying Indigenous people having characteristics more akin to the non-Indigenous population.

2.7 Unequal growth in jurisdictions' Indigenous populations is likely to occur in the future because of the greater extent of mixed parenting and identification change in other jurisdictions.

2.8 Given the large increase in self-identification together with its disproportionate and highly significant impact on GST distribution, the Territory strongly supports the Terms of Reference for the 2015 Review, which directs the Commission to develop methods to appropriately capture the changing characteristics of the Indigenous population.

2.9 The Indigenous assessment is critically important to the Territory due to the large size and substantial needs of the Territory's Indigenous population. At 30 per cent of the population, Indigenous people significantly increase the demand for and cost of providing government services in the Territory compared with other jurisdictions (Tasmania has the next highest proportion of Indigenous people at 4.7 per cent of its population).The Territory is of the view that the Commission's current assessment methodology, which is based on self identified Indigeneity, is not a reliable proxy and that there is a need for a method change which captures the multi dimensional aspect of indigenous need.

2.10 The current methodology accords growth in the Indigenous population with growth in expenditure needs without consideration of the relative impact that additional members of the Indigenous population may have on government service provision (compared with the previously identifying population). It is unlikely that a single variable could adequately capture the change in the characteristics of the Indigenous population. As such, it may be necessary for the Commission to develop a composite measure based on a number of key variables. In the Territory's view, this is a prime example of where the pursuit of simplicity would unduly compromise the achievement of HFE.

2.11 To assist the Commission, the Territory has outlined a range of variables that may be used to capture the characteristics of the Indigenous population. The Territory considers that each of the variables identified in this submission, that is the ratio of local Indigenous and non-Indigenous Populations, Education attainment, Housing occupancy and English proficiency, would usefully contribute towards a multi-variable composite measure.

Drivers of growth in the Indigenous population

2.12 In 2011, there was a 29.5 per cent increase in the Australian Indigenous estimated resident population (ERP), growing from 517 043 people in 2006 to 669 736 people in 2011. Growth was particularly high in the southern states of New South Wales (NSW), the Aust*ralian Capital Territory (ACT), Victoria and So*uth Australia (SA), where the Indigenous ERP increased by a third or more compared with growth of only 7.6 per cent in the Territory (Table 2.1).

Table 2.1: Indigenous Estimated Resident Population (ERP) by jurisdiction, 2006 and 2011

	ERP June 2006	ERP June 2011p	Intercensal change 2006-2011p
	no.	no.	%
New South Wales	152 685	208 364	36.5
Victoria	33 517	47 327	41.2
Queensland	144 885	188 892	30.4
Western Australia	*70 966*	*88 277*	*24.4*
South Australia	*28 055*	*37 392*	33.3
Tasmania	18 415	24 155	31.2
Australian Capital Territory	4 282	6 167	44.0
Northern Territory	**64 005**	**68 901**	**7.6**
Australia	517 043	669 736	29.5

Source: ABS, Cat no. 3101.0.
Note: p=preliminary estimate

2.13 In general, growth in the Indigenous population of jurisdictions other than the Territory increased at a rate much faster than expected considering birth and death rates. This phenomenon is not, however, isolated to 2011, but has occurred at many Censuses since estimates of the Australian Indigenous ERP commenced in 1991. It means that growth rates have generally been highest in south eastern jurisdictions and lowest in the Territory.

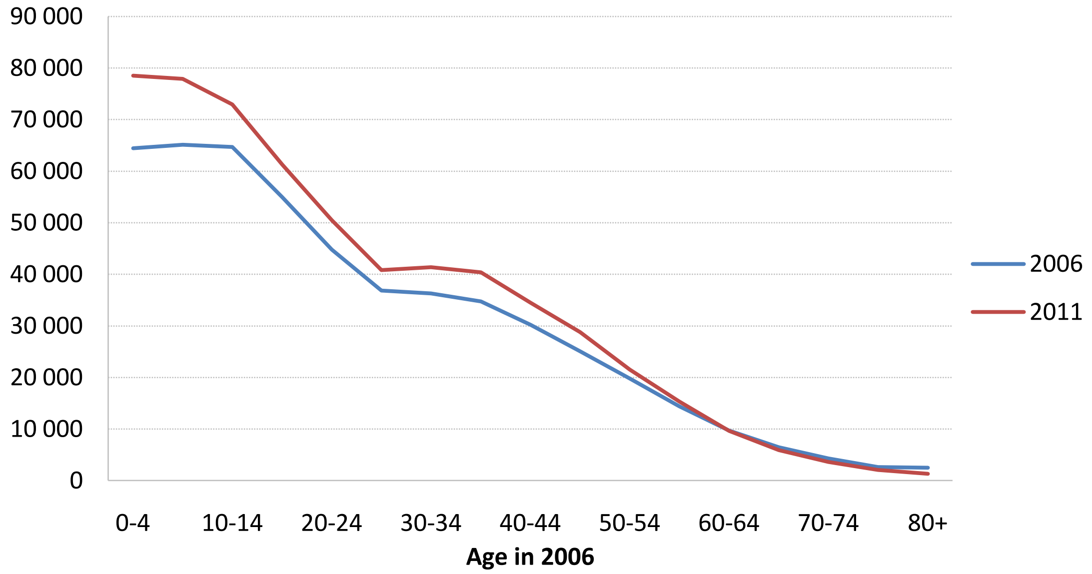
2.14 As the Indigenous ERP is based on the adjusted count of people self-identifying as Indigenous in each Census, it is not a 'closed' demographic population, even at the Australian level. Growth in the Indigenous population can occur not only through births of Indigenous children to Indigenous parents, but by an Indigenous adult parenting an Indigenous child with a non-Indigenous adult (mixed parenting). By definition, these births add individuals to the Indigenous population who are aged zero (aged 0-4 at each Census). The impact of mixed parenting on Indigenous population growth can be quite large in southern and eastern states, but tends to be smaller in the Territory. This difference in part reflects the small proportion of Indigenous people in southern and eastern states, which means there are few potential Indigenous partners, but a very large number of potential non-Indigenous partners for an Indigenous person. The magnitude of mixed parenting can be estimated from Census data using households with two adult (one Indigenous and one non-Indigenous) families with one or more young Indigenous children.

2.15 A second way that the Indigenous population can increase, which is not available to closed populations, is for people who are enumerated in successive Censuses to be recorded with different Indigenous statuses in each of the two Censuses. For example, if a person is recorded as non-Indigenous in the first Census but Indigenous at the next, the Indigenous ERP will increase in a non-demographic way (hereafter called 'non-specific' change). A change in Indigenous status may occur for several reasons. For instance, a previously non-Indigenous identifying person genuinely discovers they have Indigenous ancestry and so change their (and possibly their off-springs') identity at the next Census or a person may choose to change their identity for other reasons. Unintended changes in the Census collection procedure could also have an impact on what Indigenous status is recorded for some people. Finally, the post Census undercount adjustment process might change in successive Censuses in a way that influences Indigenous ERPs. For example, improvements to the Post Enumeration Survey (PES) methodology and procedures and changes in the Empirical Bayesian method for estimating the Indigenous ERP in 2011.

2.16 These non-specific changes are reasonable to expect and to some extent will inevitably occur. Although it is not possible to directly estimate their magnitude, the collective impact of non-specific changes can be demonstrated by comparing the age profile of the Indigenous ERPs estimated from two successive Censuses.

2.17 Figure 2.1 compares the Australian Indigenous ERP for 2006 (in five year age groups between 0 to 80+) with the same age cohorts based on the preliminary Indigenous ERP for 2011 (i.e., five year age groups between 5 to 85+). If the Indigenous population behaved in a 'closed' way demographically and no deaths occurred in the five year interval then these age profiles would be identical. If the 2011 cohorts were 'survived' back to 2006 using Indigenous life tables (i.e., those that died are added back into the population), it is expected that although absolute growth would be highest in the younger age cohorts, the cohorts are expected to have increased in size by about 10 per cent at nearly all ages (over 50 000 people). Thus, of the 29.5 per cent increase in the Australian Indigenous ERP between 2006 and 2011 (a total of 152 693 people), about two thirds of it could be estimated and is due to normal closed population type growth combined with the effects of mixed parenting, and about one third is due to non-specific change.

Figure 2.1: Indigenous estimated resident population, Australia, 2006 cohort by age group in 2006 and 2011



Source: ABS, Cat. no. 3101.0.

2.18 Although non-specific change of about 10 per cent in the Indigenous population over five years may seem large, it is the consequence of identity differences (or their ERP adjustment equivalents) in a very small part of the non-Indigenous population. If just one non-Indigenous person in every 300 across Australia in 2006 were recorded as Indigenous in 2011 this would be sufficient to increase the Indigenous population by well over 10 per cent. This equates to an annual rate of change over the five year period between Censuses of as little as one non-Indigenous person in 1 500 from 2006 changing their identity from non-Indigenous to Indigenous.

2.19 Furthermore, if this same rate of change occurred among the non-Indigenous population of a state with just 1 or 2 per cent of the population identifying as Indigenous in 2006 (for example, Victoria, SA, ACT), the 2011 Indigenous population would be expected to expand by 15 to 30 per cent for these ‘non-specific’ reasons alone. Whereas, in jurisdictions with 2 to 4 per cent Indigenous population (e.g., NSW, Queensland, WA and Tasmania), the increase through non-specific means would contribute between 7 and 15 per cent growth. For the Territory, with 30 per cent of its population already identifying as Indigenous, this same rate of identity change would contribute no more than 1 per cent ‘non-specific’ growth to the Indigenous population by 2011. Changes of these magnitudes in the various jurisdictions combined with likely demographic and mix-parenting contributions (not estimated here) would result in increases consistent with the observed growth in the Indigenous population across jurisdictions shown in Table 2.1.

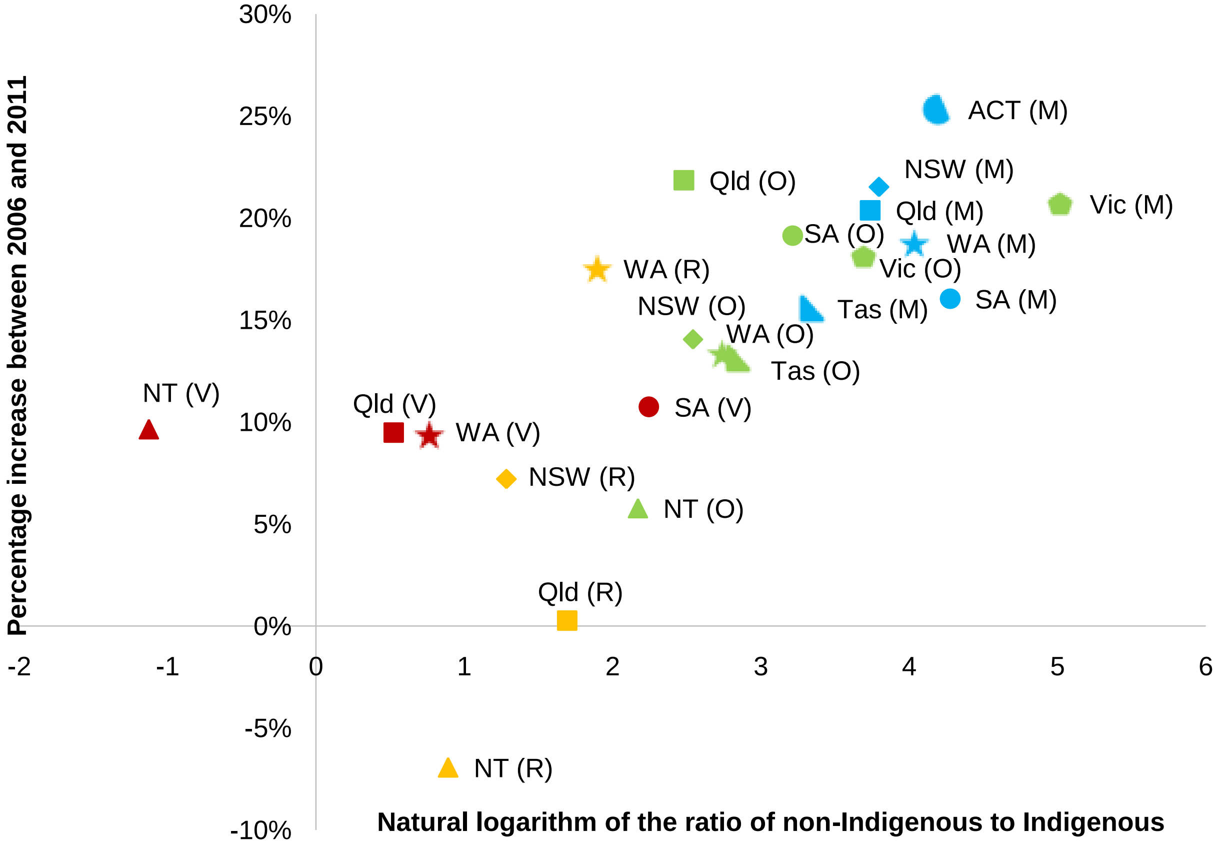
2.20 In summary, had the Indigenous population been a ‘closed’ population, the observed patterns of growth in the Indigenous ERPs between 2006 and 2011 for the various jurisdictions would be implausible. They are, however, plausible when the causes outlined above are considered, even though the extent of the effect may not be predictable in advance. Since the causes behind the current unequal increases in the jurisdictions’ Indigenous populations are highly likely to continue to be present in the future, it seems inevitable that similar patterns of unequal growth in jurisdictions’ Indigenous populations will be seen again at the next and/or subsequent Censuses. The Territory would again record much lower growth in its Indigenous population compared with other jurisdictions. Without any change in cost/use disabilities associated with this population, it will result in further funding redistribution away from the Territory to other jurisdictions.

2.21 The characteristics of the newly measured Indigenous population may be more likely to differ from previous populations with new members having characteristics more akin to those of the non-Indigenous population due to mixed parenting and other factors causing non-specific change. In the absence of an approach able to capture such dynamics, the current Commission methodology will disadvantage jurisdictions such as the Territory where growth more closely aligns with demographic factors, there is little change in the socio-economic characteristics of the Indigenous population and a much greater proportion of that population remain at the poorer end of the continuum in socio-economic indicators.

Variables which might record the changing characteristics of the Indigenous populations

2.22 As discussed previously, the relative size of the local Indigenous and non-Indigenous populations are likely to be key drivers of the magnitude of non-specific growth. Figure 2.2 plots the percentage increase in the Indigenous Census counts from 2006 to 2011 against the ratio of local non-Indigenous to Indigenous populations by remoteness classification and state/territory. It demonstrates a very strong relationship between Indigenous population growth (as represented by increases in Indigenous Census counts) and the relative scarcity of Indigenous people at the local population (as represented by the ratio of the Indigenous to non-Indigenous Census counts).

Figure 2.2: Increase in the Indigenous Census count (2006 to 2011) against the ratio of the Indigenous to non-Indigenous counts (2011) expressed as a natural logarithm



Key: M – Major Cities/Inner Regional; O- Outer Regional; R – Remote; V – Very Remote.
Note: Where remoteness classifications contain small numbers in a jurisdiction, they have been amalgamated with the adjoining classification.
Source: Northern Territory Department of Treasury and Finance calculation based on ABS 2011 Census data.

2.23 Figure 2.2 indicates that the Very Remote and Remote locations have little unexplained increase in their Indigenous populations so variables need to focus on measuring change in the characteristics of Indigenous people in Inner and Outer Regional areas and Major Cities. Accordingly, it may be appropriate to select variables that are relevant to and well measure the circumstances of people in those locations, even if they may be less relevant to or poorly measure circumstances in remote populations.

2.24 The theoretically ideal variable (a Type A variable) for displaying the change in characteristics that are solely associated with non-demographic change in the Indigenous population would be one which is (a) measured in the Census (because Indigenous ERP is derived from this data source); and (b) for a given person, is not expected to change between Censuses for any other reason. Very few variables would be expected to behave in this way, but a candidate is school education level for adults. The ratio of the

Indigenous to non-Indigenous population may also be a variable of this type, indicating where growth and change in characteristics is most likely to occur in the Indigenous population.

2.25 A type of variable almost as useful (a Type B variable) would be one which is measured in the Census but which could change due to measurable changes in social and or economic conditions. Possible candidates include (i) geographic region of residence, (ii) measures of overcrowding in dwellings, (iii) measures based on income, occupation etc. The potential value of these variables may be dependent on the complexity and magnitude of any changes that might occur from one Census time to another.

2.26 A further type of variable (Type C), which might be considered for this purpose is one that is not measured at Census time but is well recorded in another high quality dataset with reliable Indigenous status recording (or with a correction for under-recording being available). For example, potential variables might be selected from an administrative dataset such as hospitalisation data or a major national survey such as the National Aboriginal and Torres Strait Islander Social Survey (NATSISS) or the National Aboriginal and Torres Strait Islander Health Survey (NATSIHS). Indigenous status in Type C variables would, however, be measured by means of a different data collection mechanism to the Census. Possible variables could include (but are not restricted to) admissions for major trauma (a focus on major trauma ensures no confounding with issues of access to hospitals) and smoking prevalence from the NATSIHS.

2.27 The following analysis provides examples of the changing characteristics of the Indigenous population using these types of variables. Selected variables capture characteristics of the changed population and have implications for the demand for and/or the cost of service provision. The analysis is preliminary and aims to show the application of the variables rather than provide definitive results. Further analysis is needed including refinement to focus the evaluation on the characteristics of the non-remote Indigenous population.

Type A Variable - Ratio of local Indigenous and non-Indigenous populations

2.28 This variable, defined as the number of Indigenous people in an area divided by the number of non-Indigenous people in the same area, is a property of the geographical area in which a person lives; however, it may be a useful indicator of personal characteristics of Indigenous people living in the area. To reflect age-related patterns of non-specific and mixed parenting change, it may be appropriate for the population ratio variable to be based on a restricted subset of the population, for example all adults or women of child-bearing age.

2.29 This variable is expected to be highly correlated with the two contributors to growth, which exceed demographic expectations, that is, the ‘non-specific’ growth associated with changed identification of people, and mixed parenting, which gives rise to greater population birth rates per Indigenous person compared with parenting by two Indigenous people. Analysis of data from previous Censuses where large unexplained growth in the Indigenous population has occurred (e.g., Kate Ross, 1999[3] and Boyd Hunter, 1998[4]) have suggested that the relative importance of mixed to non-mixed parenting of Indigenous children has generally been and will probably continue to be highest in areas where Indigenous people reside in predominantly non-Indigenous communities facilitating greater social mixing of Indigenous and non-Indigenous people. The reverse has also been observed. That is, non-mixed parenting will be a much more common mode of parenting in locations with predominantly Indigenous populations.

2.30 It is suggested that analysis of the percentage growth rates of Indigenous populations from different areas/regions will demonstrate that growth is highly positively correlated with this population ratio variable. Contributions to growth will tend to be largest in locations where the ratio variable is also highest (i.e. few Indigenous people to non-Indigenous people) and least where the ratio variable is lowest.

Type A Variable – Education attainment

2.31 The Census variable Highest Level of School Education Completed (HSCP) informs on the highest year of schooling. For adults outside of schooling age in 2006, for example, older than age 20, this variable should be stable with few people likely to return to complete schooling at an older age. Restricting the analysis by excluding people older than age 60 focuses the analysis on the age cohorts where most non-demographic change has occurred and avoids problems associated with accurate memory recall and different historical schooling systems in older age groups.

2.32 If the population is stable and change only occurs due to deaths among the 20-59 year cohort from 2006, then there should be less Indigenous people in this cohort at the 2011 Census. With the exception of the Territory, however, state and territories were estimated to have a greater number (‘excess’) of people in the 2011 Indigenous Census count for the 25-64 year age range than was recorded in the 2006 Indigenous Census count for the 20-59 year age group (Table 2.2). The excess ranged from 6762 people in NSW to 282 people in the ACT. In contrast, the Territory had a deficit of 1659 people between the two counts, which can mostly be accounted for by the number of deaths expected among the cohort between 2006 and 2011 [there were 2200 Indigenous deaths (all ages) during the five year period]. Consequently, the Territory is excluded from the remainder of this analysis because there are no characteristics of the ‘excess’ population to be evaluated. Excluding the Territory, the total Australia Indigenous ‘excess’ was 15 197 people. This would be higher if adjustment was made for expected deaths in the five years between 2006 and 2011.

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[3] Ross K. Occasional paper: Population issues, Indigenous Australians, 1996. Cat. No. 4708.0, 1996. Canberra: Australian Bureau of Statistics, 1999.

[4] Hunter B. Assessing the utility of 1996 Census data on Indigenous Australians. Centre of Aboriginal Economic Policy Research Discussion Paper no. 154/1998. Canberra

Table 2.2: Census counts by Indigenous status, selected age groups, 2006 and 2011

	2006 Census age 20-59	2011 Census age 25-64	Excess 2011 count
	no.	no.	no.
NSW	62 571	69 333	6 762
Vic	13 995	15 584	1 589
Qld	58 382	62 418	4 036
WA	27 809	29 351	1 542
SA	12 026	12 729	703
Tas	7 769	8 057	288
ACT	1 938	2 220	282
NT	26 707	25 048	- 1 659
Total	211 197	224 740	13 543
Total excluding NT	184 490	199 692	15 202

Source: ABS, 2006 and 2011 Census, Usual Place of Residence Population. Accessed through TableBuilder Pro, NTG licence, on 10 July 2013.

2.33 When the schooling outcomes of the cohort are considered, the proportion of Indigenous people with Year 9 or less as the highest level of educational attainment decreased between 2006 and 2011 for the six states, but increased in the ACT (Table 2.3). Overall, the proportion of Indigenous people completing Year 9 or less decreased from 23.7 per cent in 2006 to 22.5 per cent in 2011.

Table 2.3: Proportion of people who completed Year 9 or less aged 20-59 in 2006 by Indigenous status and state/territory, 2006 and 2011

	Indigenous		Non-Indigenous	
	2006	2011	2006	2011
	%	%	%	%
NSW	27.7	26.3	9.8	9.5
Vic	23.5	22.6	9.9	9.5
Qld	21.1	20.2	8.4	8.0
WA	21.8	19.7	6.2	6.0
SA	23.7	22.9	8.1	8.0
Tas	19.3	18.5	10.7	10.3
ACT	14.8	16.4	4.3	4.2
Total (excludes NT)	23.6	22.5	9.0	8.6

Source: ABS, 2006 and 2011 Census, Usual Place of Residence Population. Accessed through TableBuilder Pro, NTG licence, on 10 July 2013.

2.34 The 'excess' number of people among the Indigenous cohort who had a highest attainment of Year 9 or less was estimated as the difference between the counts of the corresponding numbers in 2011 and 2006 (i.e., in the same manner as for the cohort as a whole). While there was considerable variation between jurisdictions, the estimate of the proportion of the excess population that had a highest attainment of Year 9 or less was

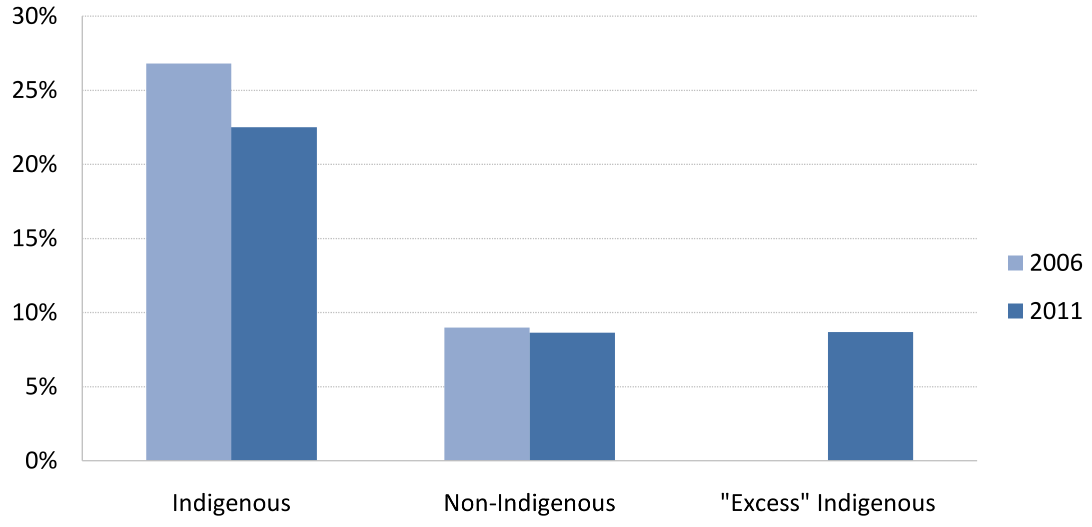
8.6 per cent (Table 2.4). This figure is closer to the corresponding figure for the non-Indigenous population than the 2006 Indigenous population (Figure 2.3) and suggests that newly identifying Indigenous people in the 2011 Census exhibit educational attainment characteristics more like the non-Indigenous population than the 2006 Indigenous population. To have exhibited the same characteristics as the 2006 population, a further 2268 people (a total of 3588) would have had to complete Year 9 or less among the excess Indigenous population.

Table 2.4: Proportion completing Year 9 or less by Indigenous status by state/territory, 2006 and 2011

	Estimated 'excess' Indigenous population	Estimated no. of 'excess' Indigenous population completing Year 9 or less	Estimated % of 'excess' Indigenous population completing Year 9 or less
	no.	no.	%
NSW	6 762	879	13.0
Vic	1 589	229	14.4
Qld	4 036	336	8.3
WA	1 542	-264	-17.1
SA	703	71	10.1
Tas	288	-9	-3.1
ACT	282	78	27.7
Total (excludes NT)	15 202	1320	8.7

Source: ABS, 2006 and 2011 Census, Usual Place of Residence Population. Accessed through TableBuilder Pro, NTG licence, on 10 July 2013.

Figure 2.3: Proportion of people completing Year 9 or less by Indigenous status, 2006 and 2011



Source: Northern Territory Department of Treasury and Finance calculation based on ABS data.

Type B Variable – Housing occupancy

2.35 The Census variables Number of Bedrooms in Private Dwelling (BEDD) in conjunction with Number of Persons Usually Resident in Dwelling (NPRD) can be used to assess changes in overcrowding. The proportion of three bedroom dwellings which had more than six usual residents, where at least one resident was Indigenous, was used as a proxy for overcrowding. This is consistent with the Canadian National Occupancy Standard (CNOS), which defines a dwelling as being overcrowded if there are more than two usual residents per bedroom. For brevity, the analysis has been restricted to dwellings with three bedrooms, as a significant proportion of Indigenous households (not less than 45 per cent across all states for the 2006 and 2011 Censuses) resided in dwellings of this size. These choices also reflect constraints on the availability of comparable data between the two Censuses.

2.36 Table 2.5 shows the number of three bedroom dwellings where at least one resident was Indigenous and the proportion of these dwellings where there were seven or more usual residents. Overcrowding decreased in all jurisdictions except the ACT and Tasmania where the number of overcrowded dwellings was very low in 2006 (three and 45 dwellings in ACT and Tasmania, respectively). In general, however, those states which had the largest increases in the Indigenous population between 2006 and 2011 (refer Table 2.1) tend to show a larger decrease in Indigenous overcrowding, which indicates that newly identifying Indigenous people are residing in dwellings that are not overcrowded.

Table 2.5: Proportion of three bedroom dwellings with seven or more usual residents by state/territory, 2006 and 2011

	2006		2011		2006-2011
	No. of three bedroom households	Proportion overcrowded	No. of three bedroom households	Proportion overcrowded	Proportionate change
	no.	%	no.	%	%
NSW	27 505	1.8	33 806	1.7	-2.8
Vic	7 248	1.4	9 049	1.2	-15.2
Qld	21 890	4.4	25 859	3.8	-13.2
WA	8 715	6.7	9 908	6.2	-7.2
SA	5 817	3.7	7 141	2.7	-28.3
Tas	4 590	1.0	5 361	1.1	10.4
ACT	944	0.3	1 170	1.1	249.6
NT	5 712	24.4	5 877	23.8	-2.6
Total	82 421	4.6	98 171	4.0	-12.6
Total *less* NT	76 709	3.1	92 294	2.8	-11.5

Source: ABS, 2006 and 2011 Census, Counting Dwellings - Place of Enumeration. Accessed through TableBuilder Pro, NTG licence, on 10 July 2013.

Type C Variable – English proficiency

2.37 The Census variable Proficiency in Spoken English/Language (ENGLP), where another language is spoken at home indicates communication difficulties, an issue that impacts on the cost and effective delivery of services. This analysis was constrained to people aged 20 to 59 years in 2006 (25-64 in 2011) to be consistent with the cohort where most growth occurred. It may also be difficult to interpret change in schooling age cohorts where these skills are still being developed.

2.38 Table 2.6 shows the English language proficiency of Indigenous people aged between 20 and 59 in 2006 who reported speaking a language other than English at home. Jurisdictions which had the largest increases in their Indigenous population tended to have the largest declines in the proportion of Indigenous people who spoke English "not at all/not well". While some of the declines could be explained through people improving their English skills (or perceiving that their skills have improved over the five year period), the greater decline in high growth states suggests that newly identifying Indigenous people are more likely to have good proficiency in English than the previously identifying population.

Table 2.6: English language proficiency of Indigenous people who spoke a language other than English at home by state/territory, 2006 and 2011

	2006		2011		2006-2011 Proportionate change
	Not at all/ Not well	Very well/ Well	Not at all/ Not well	Very well/ Well	Not at all/ Not well
	%	%	%	%	%
NSW	11.5	88.5	7.0	93.0	-38.5
Vic	17.7	82.3	9.6	90.4	-45.7
Qld	7.4	92.6	6.3	93.7	-15.2
WA	12.7	87.3	7.7	92.3	-39.9
SA	12.4	87.6	8.1	91.9	-35.0
Tas	7.9	92.1	2.6	97.4	-66.6
ACT	5.4	94.6	3.9	96.1	-27.8
NT	12.5	87.5	10.3	89.7	-17.5
Total	10.7	89.3	8.7	91.3	-19.3

Source: ABS, 2006 and 2011 Census, Usual Place of Residence Population. Accessed through TableBuilder Pro, NTG licence, on 10 July 2013.

2.39 The above examples show that while there has been growth in jurisdictions' Indigenous populations, the characteristics of their Indigenous population have changed with the newly identifying population tending to be less disadvantaged than the previously identifying population. These people would be expected to have a more moderate impact on government expenditure than if they had characteristics the same as the previously identifying population.

2.40 The Commission's methods should appropriately capture this change in the characteristics of the Indigenous population and key to the development of methods for this purpose will be identifying characteristics where change is appropriately recorded and quantified. The Territory has outlined the type of variables that may be used in these methods; however, any variables used will need to operate in the same way as the characteristic that they represent (e.g. an improvement in outcomes represents a lessening of need for services or the cost of service provision). Furthermore, consideration will need to be given to factors that may influence variables, for example, the use of health indicators would require consideration of the impact of access to hospitals and other health services; and financial variables would require consideration of purchasing power, particularly in remote areas where the cost of living is higher.

2.41 Finally, it is unlikely that a single variable could adequately capture the change in the characteristics of the Indigenous population, particularly given the multi-dimensional nature of disadvantage among Indigenous people. Accordingly, it may be necessary for the Commission to develop a multivariate measure based on a number of key variables to capture change in the Indigenous population and its implications for fiscal equalisation.

2.42 A multivariate measure is likely to draw on similar variables to those used in the Socio-Economic Indexes for Individuals (SEIFI) developed by the ACT Government.[5] SEIFI uses a set of Census variables representing disadvantage (or advantage), ascertained through principal components analysis, to measure an individual's relative access to material and social resources. While the Territory supports the Commission investigating use of SEIFI within its assessments to better distinguish relative demand and cost pressures within the population, it is not clear that this measure will suitably measure change in the characteristics of the Indigenous population, particularly that associated with newly identifying members of the population, and the associated implications for expenditure need.

Appropriateness of current materiality thresholds

2.43 In its final report, the GST Distribution Review Panel recommended the quadrupling of the materiality thresholds for assessing disabilities to ensure the GST distribution system is not driven to become 'falsely precise'.

2.44 Table 2.7 shows the current materiality thresholds and those recommended by the Review Panel.

Table 2.7: Current and recommended materiality thresholds

Type of materiality	Current threshold	Recommended threshold
Category total (ave. expense/revenue per capita)	$50	$200
Category redistribution for any state (per capita)	$30	$120
Disability for any state	$10	$40
Data adjustment (per capita)	$3	$12

Source: GST Distribution Review Final Report

[5] ACT Government. Detecting Disadvantage in the ACT. Report on the comparative analysis of the SEIF and SEIFA indexes of relative socio-economic disadvantage in the Australian Capital Territory. Canberra: Data and Research Division of ACT Commmunity Services Directorate, 2012.

2.45 Materiality thresholds provide a balance between detail and simplicity. The Territory considers that in determining appropriate materiality thresholds, it is important that equalisation objectives remain the priority.

2.46 The Territory considers that increasing materiality thresholds may result in the exclusion of categories or factors that have been proven to have a material and differential impact on a state's costs of providing the average level of services, or capacity to raise revenue. Small increases in materiality thresholds would result in negligible simplification gains, while larger increases would have a significant adverse impact on equalisation outcomes.

2.47 Any increase in materiality thresholds would need to be significant to achieve tangible simplicity gains. For example, the recommended quadrupling of the materiality threshold for category totals to $200 would remove only one assessment category (insurance tax) from the Commission's assessment.

2.48 However, arbitrarily increasing materiality thresholds would likely result in some categories oscillating between being included and being excluded from the Commission's assessments in successive years.

Rounding relativities

2.49 The Terms of Reference direct the Commission to consider the appropriateness of continuing to round relativities to five decimal places. This reflects a recommendation by the GST Distribution Review Panel that GST relativities be rounded to two decimal places to ensure that the GST distribution system "does not appear to be falsely precise."

2.50 The issue of rounding state relativities, and to what extent, was considered by the Commission as part of its 1995 Research Report which informed the 1999 Review.

2.51 In addressing this issue, the Commission considered that rounding of relativities was a necessary way of achieving a balance between precision and stability of the system for distributing grants between states. The Commission noted that relativities rounded to fewer decimal places would achieve stability in the grant distribution system but at the expense of the system's responsiveness to changes in state fiscal circumstances. Conversely, relativities rounded to more decimal places would potentially give the impression of false precision.

2.52 The Commission concluded that the appropriate level of rounding to achieve the balance between precision and credibility was five decimal places. As such, the Territory considers that the current level of rounding of relativities is appropriate and should be maintained. Rounding to fewer decimal places, if pursued, should be done for presentational purposes only.

2.53 The Territory notes that merely rounding relativities to fewer decimal places will not aid simplicity nor will it enhance public understanding of the GST distribution system. Further, this approach will not streamline the overall assessment process, as the Commission would still need to collect data and apply the current methodology in assessing states' fiscal capacities.

Appropriateness of developing a new transport infrastructure assessment

2.54 The Commission is asked to consider developing a new transport infrastructure assessment as well as a framework for the treatment of Commonwealth payments for nationally significant road and rail infrastructure projects. The Territory believes that these issues are intertwined and must be considered concurrently.

2.55 The treatment of payments for nationally significant transport infrastructure, including whether this should be consistent across all infrastructure types, should be based on whether needs are being adequately addressed under the new transport infrastructure assessment.

2.56 The Territory understands that the Commission discounted payments for national network roads because this is an area of dual national/state responsibility and due to concerns that the current investment assessment did not adequately capture all relevant disabilities relating to expenditure on national network roads. These issues do not apply to rail infrastructure payments. Specifically, there is likely to be greater Commonwealth policy influence on national roads compared to rail because of the greater extent to which national roads transcend state borders.

2.57 While the Territory considers that there is merit in the argument for the consistent treatment of all transport infrastructure payments, the Territory is strongly opposed to the discounting approach. The Territory's preference is for the Commission to develop a new assessment that captures all relevant needs relating to national transport infrastructure expenditure.

2.58 A critical issue will be the identification of what constitutes a nationally significant project. The GST Distribution Review suggested that Infrastructure Australia's list of priority projects could be used as a starting point for identifying nationally significant projects, while acknowledging that it cannot be regarded as a comprehensive list.

2.59 The Territory does not support using the Infrastructure Australia priority list on the basis that the list is quite limited in scope, in line with Infrastructure Australia's generally restrictive assessment criteria, which focus only on economic infrastructure that achieve direct financial returns on investment. Moreover, many of the projects on that list have no status and are unlikely to receive Commonwealth funding.

2.60 A more practical approach would be to continue to assess the treatment of funding for particular projects on a case-by-case basis with additional criteria developed for nationally significant projects. These should include projects that: transcend states borders; are designed to support Australia's international trade; and generate material fiscal benefits for the Commonwealth.

Appropriateness of data revisions

2.61 In principle, the Territory believes that the Commission should use the most up-to-date data provided that it is fit for the Commission's purposes.

2.62 Data that is updated annually with a lag, or updated or released less frequently than annually should not be discounted over concerns that is it not contemporary. This would significantly restrict the data that is available to the Commission for use in the assessment process. For example, data from the Census is an important dataset used in the Commission's assessment despite being collected every five years. The more important criterion for the Commission's assessment is whether the data is reliable and fit for the Commission's purposes.

2.63 Further, the Territory contends that there may be some instances where the use of up-to-date data highlights a deficiency in the Commission's current methodology and that such instances warrant consideration of a method change. For example, the Commission's current methodology is not designed to cope with large changes in states' shares of the Indigenous population from increased self-identification, and as a result, the use of 2011 Census Indigenous estimated resident populations would be inconsistent with the principle of HFE.

2.64 The 2015 Review Terms of Reference supports this view through the inclusion of priority 1.d).

Simplified and integrated assessment framework

2.65 The context in which the Commission has been asked to consider the merits of adopting a simplified and integrated assessment framework is in relation to the capital assessment.

2.66 In the 2010 Review, the Commission changed its method for assessing capital needs from equalising on an operating statement basis to a direct approach which incorporates the assessment of net investment and net lending. The Commission's decision was based on the premise that the direct approach:

- is consistent with what states do to fund new infrastructure;
- accounts for differences between states in the cost of investing in new infrastructure such as socio-demographic characteristics and population growth;
- is contemporary because it provides states with the capacity to fund investment in new infrastructure when the need arises; and
- is simple to implement, uses reliable data and is less data intensive.

2.67 The Territory supports the direct approach to assessing each state's capital needs. The direct approach is simple, contemporary and recognises the financial consequences of new infrastructure needs as they arise.

2.68 The Territory believes that the current net lending method is a relatively straightforward calculation. It examines the difference between a state's opening and closing stock of infrastructure after taking into account population growth and a stock factor, which accounts for the different use and costs of infrastructure in each state.

2.69 The perceived complexities of the capital assessment as a whole appears to stem from the understanding of concepts used to measure capital needs in each of the various approaches, timing of recognition of net investment needs and the impact of population growth on states' new capital needs. Greater understanding of these issues would improve confidence in the Commission's capital assessment.

2.70 The Territory believes that recognising upfront the financial consequences of new infrastructure is simpler and better reflects what states do compared to the alternative holding cost or debt charges approaches. The upfront direct approach does result in volatility, which can be an undesirable feature. However, in the case of the capital assessment, volatility is expected and a sensible outcome given the 'lumpy' nature and timing of states' capital investments.

2.71 More importantly, for the Territory, is that any assessment of capital needs must take into account factors that impact on states' existing and new infrastructure needs such as population growth and socio demographic composition, which affect the use and cost of infrastructure. In addition, the Territory believes that the Commission should examine whether a needs assessment should be made to capture the impact of:

- physical environment on timing of state investment in new infrastructure. This was supported by the Pottinger consultancy report, which found that physical environment has a material and differential impact on states' construction and maintenance costs for roads, schools and housing;
- scale; and
- different borrowing costs between states. The liquidity factor as well as the Territory's weaker credit rating position results in a higher premium being placed on holding Territory debt. These are factors outside the influence of Territory Government policy that result in higher borrowing costs and greater volatility relative to other states.

Appropriateness of equalising interstate costs on a spend gradient basis

2.72 The Terms of Reference direct the Commission to investigate whether it is appropriate and feasible to equalise interstate costs on a 'spend gradient' basis. This reflects a recommendation by the GST Distribution Review Panel, based on the findings of an Independent Economics research paper commissioned by the South Australian Government.

2.73 In the 2010 Review, the Commission assessed intrastate costs on a 'cost gradient' that reflected the additional cost of providing services in less accessible areas relative to highly accessible areas. As this assessment was based on actual state expenditure, the determined 'cost gradient' was effectively a 'spend gradient' as well.

2.74 The Commission also found that the main driver of interstate differences in service provision costs is the difference in wages. In assessing interstate wage costs, the Commission used private sector wage differentials between states as a broad indicator of interstate differences in public sector wages; while the assessment of interstate non-wage differences was based on each state's share of assessed interstate freight and airfare expenses. In both instances, costs were fully equalised.

2.75 The impetus of the Review Panel's recommendation appears to be achievement of greater consistency between the interstate and intrastate cost assessments through the application of the spend gradient approach to interstate costs.

2.76 The Review Panel's recommendation was premised on research cited in the Independent Economics paper, which suggested that the level of services provided by state governments in 'high cost' locations within a state is generally lower than the level of services provided in 'low cost' locations in that state. According to the Review Panel, this is evidence that state governments tend to pursue economic efficiencies through lower expenditure in high cost areas.

2.77 The Review Panel therefore concluded that interstate wage costs should be only partially equalised to recognise the intrinsically lower service standards in high cost states, noting:

> *"On the face of it, high cost states should be treated the same way – that is, high cost states should have needs recognised, but not so much as to provide the same services as low cost states without an additional local contribution."*[6]

2.78 The Territory strongly opposes the proposed approach on the basis that it is inconsistent with the principle of equity, which is at the core of the GST distribution system and is embedded in the IGA agreed by all states.

2.79 The current form of equalisation provides states with the capacity to deliver the same standard of services, which is defined as the average of what states do. The Territory considers that if high cost states do provide a lower level of services than low cost states, this would be reflected in the 'average' and, as such, it would not be appropriate for a further discount to be applied to recognise the differences already reflected in the average.

2.80 Further, it appears that the proposed approach would effectively be based on a perceived level of service delivery in some states, rather than the actual level of services delivered. This would require substantial judgement to be applied by the Commission. The Territory strongly contends that the purpose of HFE is not to prescribe standards of services provided by states.

2.81 The Territory notes that the Independent Economics paper appears to mistakenly assume that full equalisation of interstate wage costs (the cost gradient) is akin to assessing the cost of providing the same level of services in every region of every state. That is, it seeks to recognise the level of spending that would be needed to provide residents of remote and very remote areas with the same services provided to residents in metropolitan areas. However, this is not the case, as HFE aims to provide the capacity for equal services in comparable regions in each state but different levels of services between those regions.

2.82 Consequently, the Territory considers that interstate wages should continue to be fully equalised, as there are material wage differentials between states due to factors that are not influenced by state policies. In particular, the Territory faces substantially higher wage costs than other states due to a range of factors including:

- more competitive employment conditions including staff accommodation and additional leave entitlements to attract and retain staff;
- higher costs relating to Territory Government employees who are members of the Commonwealth Superannuation Scheme, which is generally more generous than comparable state schemes; and
- a high rate of staff turnover, which increases the Territory's recruitment costs.

[6] The Australian Government, GST Distribution Review Final Report.

2.83 Partial equalisation would not adequately recognise the material impact of these factors on the cost of providing services in the Territory compared to other states. As such, the Territory is of the view that, should the Commission decide to modify its assessment of interstate cost differences between states; this should be done in a manner that enhances or at least maintains equity. In addition, the Commission should consider the potential of any change to the assessment to add unnecessary complexity to the location assessment.

Appropriateness of developing a new mining revenue assessment

2.84 The terms of reference directs the Commission to develop a new mining revenue assessment as part of the 2015 Review. This follows concerns raised in the GST Distribution Review Final Report that the current two-tier mining revenue assessment can produce large GST revenue redistribution changes when a commodity moves between groups.

2.85 Developing a mining revenue assessment that is consistent with the supporting principles of what states do and policy neutrality has consistently been a challenge for the Commission. This is exemplified due to the uneven distribution of mineral wealth across Australia, differences in the composition and quality of minerals in each state and different royalty regimes applied to each mineral.

2.86 The resultant large redistribution arising from the mining revenue assessment is intuitive, given the diverse distribution of natural endowments across states. More recently, this has increased as a result of the commodities boom, which has impacted states differently. This should not be perceived as a flaw in the HFE system. Rather, the current method of GST revenue distribution ensures that states share in the benefits of investment and the economic growth of Australia, such as the revenues generated from the resources boom, as well as sharing the financial risks of Australia’s exposure to external shocks.

2.87 The Territory believes that the current two-tiered rate structure adopted in the mining revenue assessment for the 2010 Review is an example of where simplification went too far and has resulted in unintended consequences. While intending to simplify and remove state policy influences on the average royalty rates for individual minerals, policy influences will continue to be present to some degree due to the distribution of resources across Australia and the differing costs associated with mineral extraction.

2.88 The Territory sees merit in adjusting the mining assessment by increasing the number of groupings, either by mineral rate or mineral type. A more detailed mining revenue assessment would counteract the issues arising under the current two-tiered structure, where a policy change by a single state can result in a significant change in GST distribution. While the scope for state policies to influence average royalty rates would still exist, a more detailed assessment would avoid spill over effects that changes to the royalty rate for one mineral have on other minerals.

2.89 An option that could be considered is to base the groupings of minerals on the Australian Bureau of Statistics’ Australian Industry report (catalogue number 8155.0). Based on this approach, minerals would be classed into four categories: fuel minerals; metallic minerals; industrial minerals; and construction materials. Each of these categories would be weighted accordingly and may include separate assessments for the main minerals, as shown below.

- Fuel minerals
  - Coal
  - Oil and gas
  - Other
- Metallic minerals
  - Iron ore
  - Uranium
  - Other
- Industrial minerals
- Construction materials

Appropriate treatment of mining related expenditure

2.90 In past reviews, the Commission considered the treatment of assistance for economic development. It is the Territory's understanding that the Commission decided not to adopt a needs based assessment for costs incurred by states in assisting economic development on the basis that:

- there was no common policy on how states provide assistance for economic development;
- drivers of differences between states in the level of assistance provided for economic development could not be identified;
- differences in costs incurred by states for economic development may be primarily due to state policies; and
- the Commission was unable to identify and measure the strength of links between state investment and development expenses and new revenue producing activities.

2.91 Notwithstanding the reasons given by the Commission to assess expenditure related to economic development on an equal per capita basis for the 2010 Review, the Territory believes there is merit in developing a needs based assessment of mining-related economic development expenditure for the 2015 Review due to:

- the extent of resources-related expenditure;
- the different levels of support required in each state;
- the influences on costs of state service provision in resource provinces; and
- the quantum, location and timing of mining-related investment, which is primarily driven by external factors that are outside of states' control.

2.92 The Territory's preference is for mining-related economic development to be captured through an expenditure assessment. This is preferable to the alternative approach of discounting the mining revenue assessment as a proxy for expenditure needs, as proposed by the GST Distribution Review Final Report. Discounting is less robust and transparent than an expenditure assessment. Further, the discounting approach would require the Commission to make a significant level of judgement on the level of discount and whether the discount should be floating or fixed over the review period and would not reflect changes in state circumstances.

2.93 An assessment of mining-related expenditure needs should encompass both recurrent and capital expenses. While the Commission does assess states' infrastructure needs, the capital assessment could be reviewed and improved to better capture mining-related expenditure disabilities. Mining-related infrastructure costs are borne by mining operators to the extent that they benefit directly. However, the establishment of mining projects also has spill-over implications in terms of increased need for public good infrastructure such as roads, housing, schools and health facilities as mining communities expand. It is these costs that are not being adequately reflected in the current HFE system.

2.94 The Territory acknowledges that disaggregating additional expenditure incurred to support the mining industry from 'normal' expenditure may introduce additional complexity. For example, identifying the component of higher teacher wages resulting from location (which is currently assessed) and identifying the component of higher teacher wages paid as an incentive to attract and retain teachers in mining communities. However, this level of detail would be acceptable and the onus would be on the states to demonstrate that the costs involved were of sufficient materiality to require assessment.

2.95 In considering an appropriate assessment framework the Commission will need to have regard for how mining related expenditure is currently captured and assessed. In terms of identifying the types of expenditure to be included, consideration could be given to using an avoidable cost approach which identifies expenditure on government services and infrastructure that would not have been incurred in the absence of private investment in mining and energy projects/activities.

2.96 Further, the Territory is of the view that the assessment of mining related needs should take into account the stage of development, particularly in terms of capital expenditure. The majority of capital support to meet increased demand by the mining industry is likely to be required at the early stages of mine development rather than when the mine is well developed. Examples of relevant mining related expenditure incurred by the Territory include road works/upgrades to address increased heavy vehicle traffic use associated with projects such as McArthur River Mine (Carpenteria Highway) and Ichthys Darwin LNG projects (Stuart and Arnhem Highways and arterial roads). Other examples of relevant expenditure could include telecommunication towers, borefields/water supply and electricity generation plants.

2.97 Factors that ensure needs are appropriately assessed would include location and service delivery scale which particularly reflect the higher costs and demand for public services associated with supporting the mining industry.

Treatment of National Education Reform Agreement (NERA) payments

2.98 Clause 76 of the National Education Reform Agreement (NERA) states:

The Commonwealth Treasurer will ensure that the GST distribution process will not have the effect of unwinding the recognition of educational disadvantage embedded in the NERA funding arrangements.

2.99 The intention of the above clause is to ensure that the disadvantage loadings in the Schooling Resource Standard (SRS) will not be overridden through the Commission's assessment of GST per capita relativities. This occurs because the types and size of the factors in the Commission's assessment are very different from those adopted in the SRS, as shown in Table 2.8.

Table 2.8: Comparison of disabilities/loadings assessed in the CGC 2010 Review School education category and in the National Education Reform Agreement

CGC 2010 Review School Assessment	National Education Reform Agreement
Indigenous students – weighting 1.41	Indigenous students – weighting based on proportion of Indigenous students in each school. Weightings vary from 20% to 120%.
Low SES – weighting 1.12	Low SES – Based on proportion of students in Quartile 1 and Quartile 2 of ICSEA[1] values in each school. Students in Quartile 1 receive weightings varying from 15% to 50%. Students in Quartile 2 receive weightings varying between 7.5% and 37.5%.
Location – recognises differences in the cost of providing labour and non-labour resources between states and to different areas within a state.	Location – Recognises different costs of schools within a state based on MCEETYA[2] location categories. Does not capture differences in costs of providing school services between states. For example, a school in Darwin is classified as the same as a school in Sydney for the purpose of location loadings.
Students with a disability – No needs assessment.	Students with a disability – Loadings applied to recognise higher costs of providing education services to students with a disability.
Students with limited English proficiency – No needs assessed.	Students with limited English proficiency – Weighting of 10% for students with 'language background other than English'.
Size of school – No needs assessment.	Size of school – Recognises the diseconomies of scale experienced by small schools. Loadings of up to \$150 000 for primary schools and \$240 000 for secondary schools, based on enrolments.
Non-government students – weighting of 17.15%	Non-government students – Recognises the capacity of the school community to contribute to the school's funding needs. Weighting of between 20% and 90% based on the school's SES score.
Student transport – recognises the differences between states in the cost of providing transport services to school education.	Student transport – Expenditure on student transport is outside the scope of school expenditure captured in MySchool.
Administrative scale – recognises the unavoidable costs each state incurs to provide the policy and administrative infrastructure necessary to provide the minimum unavoidable services, regardless of	Administrative scale – No disabilities assessed.

the size of the task.	
Service delivery scale – recognises the cost of providing school education in small population centres	Service delivery scale – Partly captured through loadings for small schools.

[1] ICSEA – Index of Community Socio-Educational Advantage

[2] MCEETYA – Ministerial Council on Education, Employment, Training and Youth Affairs

2.100 The Territory believes that the simplest approach to giving effect to Clause 76 is for the Commission's school education assessment to mirror the disadvantage loadings in the SRS, with some adjustment.

2.101 The SRS funding model is intended to recognise the different service provision costs between schools as a result of different demographic characteristics of students and the size and location of each school. The SRS is not designed to reflect the different costs of school education between states (outside of socio-demographic factors), which is the aim of the Commission's assessment.

2.102 For this reason, a school education assessment that merely mirrors the SRS model would not achieve horizontal fiscal equalisation. As such, the Territory contends that the Commission would need to make the following adjustments:

- Retain the administrative scale factor. There are material differences between states in the per capita costs of providing the minimum level of administration, which is not recognised in the SRS.
- Retain the interstate wage and interstate non-wage components of the location factor. The SRS provides for loadings to reflect that costs increase with remoteness within a state. However, there is no differential treatment for schools with similar location classification between states. For example, schools in Darwin receive the same location loading as schools in other capital cities, regardless of the higher costs of providing services in Darwin.
- Retain student transport expenses factor. Expenses related to student transport are outside the scope of the SRS but included in the Commission's assessment.

2.103 The Territory acknowledges that a potential flaw in the adoption of the SRS loadings in the Commission's schools education assessment is that it may not be consistent with the supporting principle of what states do, as there is no requirement for states to fund schools on the same basis as the SRS model. This reinforces the Territory's argument for the Commission to retain the administrative scale and interstate location assessments.

2.104 An alternative proposal is for the Commission to assess school education expenses in four components: Commonwealth revenue; service expenses; transport expenses; and other expenses. The Commonwealth revenue component would be assessed based on the SRS loadings.

2.105 The reforms to school education funding will require the Commission to expand the current number of factors assessed in the services expenses component in the school education category. While states are not required to fund schools on the same basis as the SRS, the NERA stipulates that states should adopt a funding model that aligns with the SRS. Specifically, that states adopt a needs-based funding model that takes into account specific circumstances of students and individual schools including, but not limited to, school location, school size, low socio economic status students, Indigenous students, students with limited English language proficiency and students with disability.

2.106 The factors used in the Commission's assessment to recognise differences in state expenditure on school education are different in terms of type and size than those applied in the SRS, as shown in Table 2.8.

2.107 The Territory's preference is for Commonwealth funding needs to be assessed based on the SRS loadings rather than on an actual per capita basis. The actual level of Commonwealth National Education Reform funding will be influenced by each state's level of school funding or effort prior to the implementation of the NERA. That is, a state that has a higher level of school funding/effort prior to the introduction of the NERA will receive relatively less Commonwealth funding than a state that has a lower level of effort.

2.108 Therefore, assessing Commonwealth funding needs on an actual per capita basis would be inconsistent with the definition of HFE, which assumes all states make the same level of effort.

2.109 Clause 77 of the NERA states:

> *The Commonwealth Treasurer will instruct the Commonwealth Grants Commission to ensure that no state or territory will receive a windfall gain through the GST distribution from non-participation in NERA funding arrangements.*

The Commission is seeking state input into options to give effect to the above clause.

2.110 The Territory considers that while the intention of Clause 77 of the NERA is to ensure that non-participating states are not advantaged through the GST distribution process, it is also important to note that these states should not be penalised for not participating in the NERA. This is consistent with the equalisation supporting principle of policy neutrality and the policy objective of the IGA that GST revenue is provided to states on an untied basis.

2.111 A key consideration will be the treatment of future National Partnerships (NPs) related to school education. Under the proposed Commonwealth funding arrangements, some existing school education-related payments will be rolled into the National Schools Specific Purpose Payment and named National Education Reform funding. These include NPs for: students with disabilities; empowering local schools; rewards for great teachers; rewards for school improvement; literacy and numeracy; and low socio-economic status schools.

2.112 The Territory contends that future school education-related NPs are outside the scope of the NERA. Therefore, these payments should not be treated in the same way as NERA-related payments. A state that is not participating in the NERA and chooses not to sign a future school-related NP should not be assessed as though it did sign the NP for the purpose of the Commission's assessment.

Treatment of disability services during the transition to DisabilityCare Australia and operation of the full scheme

2.113 The Commission is asked to consider the most appropriate treatment of disability services during the transition to DisabilityCare Australia (the National Disability Insurance Scheme) and once the full scheme is operating nationally.

2.114 With the exception of Western Australia, all states have signed up to DisabilityCare Australia which will be progressively rolled out from July 2013, starting with specific location/cohort launches.

2.115 The transition phase for the majority of states will commence from 2016-17, with the scheme expected to be operating in full across all participating states by July 2019. Funding contributions for disability services under the DisabilityCare Australia full scheme will be made based on an average package cost per client.

2.116 During the launch phase, the average state policy in relation to the delivery of disability services by jurisdictions will remain unchanged. As such, the Territory would not support any change to the Commission's assessment of disability services during this period.

2.117 The Territory considers that the simplest approach to assessing state disability services as the delivery of these services transition to DisabilityCare Australia is for the Commission to maintain its current assessment approach until such time as a majority of disability clients across a majority of participating states have entered the scheme.

2.118 Once this threshold has been met it is reasonable for the assessment to move to an equal per capita basis as DisabilityCare Australia will now represent the average state policy.

2.119 In considering an appropriate treatment to apply to disability services during transition and once the scheme is fully operational in participating states, the Commission should have regard to if/when back casting will be applied and also any issues that may arise as a result of proposed state funding contributions being reset every five years under the full scheme.

3 Other issues of priority for states

3.1 The following is a list of the priority issues identified by the Territory for consideration as part of the 2015 Review. The Territory does not propose reviewing any assessments other than those listed below or discussed above.

Indigenous influences	The Territory contends that the significant increase in the Indigenous population in some states in the 2011 Census was primarily attributable to increased Indigenous self-identification. The current methodology for assessing Indigenous needs is not designed to cope with large changes in states' shares of the Indigenous population from increased self-identification. For this reason, the Territory supports the Commission's view that priority consideration should be given to capture the changing characteristics of the Indigenous population, and the different impact this has on each state's expenditure needs on Indigenous people, in the 2015 Review.
Discounting	Discounting across various expenditure and revenue assessments should be reviewed with a view to abolishing its use. The Territory believes that discounting requires a significant amount of Commission judgement, particularly in terms of determining the size of the discount. Further, the Territory believes that discounting is biased because, by its nature, it is always applied in one direction. Discounting is generally applied to lessen the GST impact of data for which the Commission has concerns regarding quality and fitness for purpose. However, in applying the discount the Commission makes the assumption that the data overestimates the impact of the disability being assessed. This is not always the case. For example, there is no evidence to suggest that the Survey of Education and Training data supporting the existing interstate wage assessment overestimates the differences in wage costs between states. Despite this, and that there is a strong conceptual case that differences in wages exist, the Commission applies a discount to the assessment. Where there are data deficiencies in the Commission's methodology, the priority should be to address the data quality rather than ignore or discount unavoidable disabilities because of data limitations.
Schools education	A review of the schools education assessment is considered to be a priority issue for the 2015 Review due to the likely changes to the way the Commonwealth and states will fund school education as a result of the National Education Reform Agreement. This should include consideration of: the treatment of Commonwealth National Education Reform funding; the

	treatment of non-participating states; and increasing the number of factors affecting the costs of services to reflect the loadings for disadvantaged students and schools applied in the Schooling Resource Standard.
Welfare and housing	The Territory believes that the Welfare and Housing assessment should be reviewed to determine whether alternative (more comprehensive) data is available to replace the existing child protection assessment which is based on data from Victoria and South Australian only. Further, consideration should be given to whether the current cost factors that impact on welfare and housing costs are sufficient and whether this should be broadened to include cultural and linguistic diversity and remote Indigenous populations.
Physical Environment	There is a strong conceptual case for assessing the impact of the physical environment on capital expenditure needs. It has been a long held view by the Territory and other states that certain environmental characteristics attach a premium to the construction and maintenance of assets. Higher costs associated with harsh environmental conditions are unavoidable and as such should be captured by a disability factor. The Territory supports further investigation of environmental characteristics that have a material impact on state expenditure needs and the appropriate treatment of the differential costs incurred.
Administrative Scale	The scope of expenses captured in administrative scale has not been adjusted since the 1999 Review. Since the 1999 Review, all states have experienced significant costs associated with increases in regulation and legislation, intergovernmental workloads, a wider scope of government service provision and increased use and costs associated with information and communication technology. The Territory believes that the scope of expenses captured in administrative scale should be reviewed and increased to reflect these changes in state circumstances and provide for a more contemporary assessment. The Territory is willing to provide data to the Commission to support the administrative scale assessment. The Territory would require guidance from the Commission on the framework of such a data request to ensure that the Territory's data is fit for the Commission's purposes.