Northern Territory Submission to the Commonwealth Grants Commission – New Issues for the 2021 Update

September 2020

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1. Introduction

This submission provides the Northern Territory's response to issues identified in *Commonwealth Grants Commission 2021 Update New Issues for the 2021 Update Staff Discussion Paper CGC 2020-01-S* (staff discussion paper), released in August 2020. The Northern Territory welcomes the early engagement and opportunity to respond to new issues likely to impact state and territory (state) GST relativities for 2021-22. It is noted that a second new issues paper focussed on the treatment of Commonwealth payments will be provided in October 2020 following release of the Commonwealth's final budget outcome.

This submission focusses primarily on proposals in the staff discussion paper relating to COVID-19 impacts and the assessment of expenditure on health services. Where no comment has been made on other issues or staff proposals, it can be considered that the Northern Territory either supports, has no significant objection to or no further information to offer on those matters at present.

2. Response to the COVID-19 pandemic

The staff discussion paper advises that staff propose to recommend to the Commonwealth Grants Commission (the Commission) that, unless otherwise guided through Terms of Reference (ToR), it:

- if material, adjust revenue datasets to ensure comparability by offsetting rebates against the relevant revenue category and assessing deferred revenue in the year in which the liability arose
- not remove JobKeeper payments from the payroll tax base on practicality grounds
- if material and reliable to do, assess National Partnership on COVID-19 Response expenses on an actual per capita (APC) basis
- in relation to the services to industry category, use state budget data to recalculate the split between regulation and business development expenditure for other industries and use the revised split if material
- not introduce a differential assessment of business development expenses due to the COVID-19 induced economic shock.

For the 2021 Update, COVID-19 related impacts are most likely to arise during the four month period from March to June 2020. Accordingly, any adjustments to account for differences between states in revenue capacity or expenditure needs may be immaterial for the 2021 Update. The need for adjustments may, however, need to be reconsidered in subsequent Updates where impacts could be broader and more sizeable.

Notwithstanding this, the Northern Territory considers that as a matter of principle, and regardless of materiality, where waivers to tax liabilities are processed as rebates (that is, they are captured as spending rather than a reduction in revenue), they should be removed from relevant expenses and offset against the appropriate revenue category. This will ensure policy neutrality as the same disabilities will be applied regardless of whether a waiver or a rebate is used to deliver tax relief to eligible parties.

2.1. Jobkeeper

The staff discussion paper advises that states have different policies regarding the exemption of JobKeeper payments from payroll tax. Some states are fully exempting payments while New South Wales and Victoria exempt only the top-up payment (the amount above an employee's standard salary). The Northern Territory notes that since New South Wales and Victoria jointly account for nearly two-thirds of JobKeeper payments, they effectively drive 'average policy'. Assuming 'average policy' is to only exempt top-up payments, these are likely to be small at a national level as only those from businesses that are above the average payroll tax threshold would be included in the payroll tax assessment (over a third of entities enrolled for JobKeeper are individuals or sole traders).

Furthermore, the staff discussion paper indicates that it is not possible to separate out JobKeeper payments from other wages and salaries in the Australian Bureau of Statistics (ABS) data used by the Commission in order to make an adjustment. Given these issues, the Northern Territory does not consider it necessary for the Commission to consider this issue further on both practicality and materiality grounds.

2.2. Services to Industry

States have increased spending to support businesses and industries during the COVID-19 pandemic. The additional spending will be captured in the Services to Industry category as business development expenses, primarily in the other industry component of the category. For the duration of the pandemic, the increased spending may mean that splits between regulation and business development expenses, which were determined and fixed in the 2020 Review, may not well reflect the actual split. The staff discussion paper advises that changing the split would constitute a method change and the ToR would need to provide the Commission with the ability to make such a change.

The Northern Territory notes that the ToR typically allow for changes to methods in response to data problems or a significant change in arrangements governing Commonwealth-State relations. The Northern Territory agrees with Commission staff that neither of these appear to provide a basis for allowing changes to the Services to Industry category to account for COVID-19 business development support. Accordingly, an additional provision may be needed in the ToR to enable changes to be made in relevant Updates, if needed. In each Update, the split between regulation and business development expenditure should remain as determined in the 2020 Review unless testing shows that changing the split will materially affect the distribution of GST.

Commission staff consider that while the scale of the COVID-19 response to the decline in economic activity is historically large, it does not have any unique features that warrant a differential assessment of business development expenses. The Northern Territory notes that despite states having different economic structures and different rates of growth, the Commission in the 2020 Review (or prior Reviews) could not determine a policy neutral driver of expenses. The Commission considers population to be the most appropriate driver and thus, a deliberative equal per capita (EPC) assessment of expenditure is made.

States' policy responses to COVID within their borders (e.g., lockdowns) and interstate (e.g., lockouts) will have substantial implications for local economic activity and thus, the amount of business support that may be needed. The Northern Territory considers that, with the nature and duration of state policy responses diverging over time, it will be difficult for the Commission to find a policy neutral driver of business development expenses. Accordingly, the Northern Territory supports the proposal to maintain the deliberative EPC approach (that is, population remains the most appropriate driver of expenses).

While not raised in the staff discussion paper, the Northern Territory notes that COVID-19 has impacted on freight networks and operations. This may have implications for non-wage costs and while not anticipated to have a material impact in the 2021 Update, this matter may require further examination in subsequent Updates.

3. Health category assessment

3.1. Data for non-admitted patient (NAP) services

The Northern Territory is extremely concerned that Commission staff propose recommending to the Commission that it use the Independent Hospital Pricing Authority's (IHPA's) national weighted activity unit (NWAU) data for 2018-19 for the assessment of NAP services in the 2021 Update. IHPA data for NAP services is only available for 2018-19 and Commission staff propose that the same data be used for all assessment years, replacing data based on a current proxy measure using admitted patient (AP) separations (as a measure of service use) adjusted for regional costs (using adjustments for emergency department [ED] services] and service delivery scale (SDS).

As shown in Table 3 of the staff discussion paper, the 2018-19 NAP NWAU are not adjusted for price differences due to patient address remoteness or hospital address remoteness. As a result, Table 4 on page 19 of the paper shows use of the 2018-19 NAP NWAU will have a disproportionate impact redistributing $172 per capita ($42 million) away from the Northern Territory compared with the next most affected state, Tasmania, with a loss of $31 per capita ($17 million). The sizeable impact reflects the fact that 40.1 per cent of the Northern Territory's population lives in remote or very remote areas, far higher than any other state and the national average of 1.9 per cent and all but one of its hospitals are located in remote areas. This emphasises the importance of the need for the Commission's assessments to adequately capture the impact of remoteness on the cost of service provision.[1]

In the 2020 Review, the Commission accepted the conceptual case that remoteness impacts the use and cost of delivering NAP services (regional cost and SDS). The regional cost impact is clearly evidenced by IHPA in its 2019-20 data and the extent is greater than allowed for in the NAP proxy measure. For example, the ED patient and hospital address adjustments in 2019-20 are a weight of 24 and 5, respectively for both remote and very remote areas (no adjustment for outer regional areas). The NAP data shows patient address adjustments ranging from a weight of 8 for outer regional areas (where all of the Northern Territory's non-remote population resides) to 29 for very remote areas. The hospital address adjustment for very remote areas for NAP services is twice that for ED services.

The absence of adjustments in the 2018-19 IHPA data does not equate to the absence of remoteness disabilities. It means that the comparison in Figures 1 and 2 of the staff discussion paper of spending per capita between a measure based on the 2018-19 NAP NWAU data (which the Northern Territory understands includes an adjustment for SDS) and the NAP proxy is not valid. The 2018-19 data is not capturing the full impact of remoteness and some of the shortfall is evidenced in IHPA's 2019-20 pricing model.

[1] ABS. 3218.0 – Regional Population Growth, Australia, 2018-19. Accessed on 8 September 2020 at https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/3218.02018-19?OpenDocument

Despite there being a strong conceptual case over time, it is only relatively recently that IHPA has more fully quantified remoteness disabilities for hospital services. This reflects improvements in the knowledge and sophistication of costing and pricing systems and IHPA's calculations over time. Improvements will continue to be made in the future, for example, the development of the new Australian non-admitted care classification system, which will ultimately replace the Tier 2 classification currently being used for NAP services, and better accounts for differences in patient characteristics and the complexity of care.

IHPA's expertise is in developing national cost and pricing systems and calculating a national efficient price in order to determine the level of Commonwealth funding for public hospital services. IHPA's role is not to achieve horizontal fiscal equalisation (HFE).

If IHPA does not adjust its pricing for remoteness in a particular year, this results in a lower Commonwealth payment to hospitals, leaving the Northern Territory Government to fund a greater proportion of their cost. While undesirable, provided the Commission appropriately recognises remoteness disabilities in its methods and data, the redistribution of GST will adjust for shortcomings in IHPA's determinations. If the Commission uncritically uses IHPA data and does not make additional adjustments to adequately recognise known disabilities, which are not sufficiently captured in the IHPA data, then its methods will not be achieving HFE. If both IHPA and the Commission are appropriately capturing the additional costs of remoteness then the net level (assessed expenditure needs less Commonwealth payments) of GST distribution will be lower.

If the Commission uses the 2018-19 NAP data, which does not fully recognise remoteness disabilities, it will have failed to ensure that the Northern Territory has sufficient fiscal capacity to deliver the average level of NAP services (this is also the case for other components of the Health category as discussed in section 3.3). To rectify this, the Northern Territory considers the following options are available to the Commission for the 2018-19 and 2019-20 assessment years:

1. Continue use of the NAP proxy measure for years where IHPA data does not include patient address and hospital address adjustments (and progressively incorporate IHPA data in subsequent Updates when the data is available that includes all the adjustments)
2. Use the 2018-19 IHPA data, but apply the 2019-20 weights to expenditure in relevant parts of the Commission's socio-demographic composition matrix.
3. Obtain a backcast from IHPA of 2018-19 data applying the 2019-20 weights.

The Northern Territory considers that Option 1 is the simplest approach and consistent with that used in the 2020 Review. It also captures variation in usage between years (rather than using the same data for all years) and while there will not be a perfect correlation between AP and NAP utilisation, a relationship would be expected with AP patients likely to be key users of NAP services.

Other options could be more difficult to implement and Commission staff have indicated that there are issues with the timeliness of 2019-20 IHPA data, which could affect the viability of Option 3.

For 2017-18, the Northern Territory considers the NAP proxy to be best choice of measure for that year and ensures a consistent measure is used for each time it is used in the Commission's assessments. IHPA NAP data from other years should not be used for 2017-18.

3.2. Utilisation of NAP services

The staff discussion paper notes that the proportion of aggregate activity level data reported at the patient level is lower for NAP services than ED services (86 per cent compared with 97 per cent), but considers this acceptable. Where there is no patient level data (primarily block funded hospitals), staff will allocate the user profile of hospitals in the same remoteness region and with the same funding type to the data (as it does for ED data). The Northern Territory has no objection to the adjustment approach, but remains concerned by the much lower coverage of the NAP data.

3.3. AP and ED services

In the 2020 Review, the Northern Territory was highly critical in its submissions and state visits of the Commission's use of IHPA data during the 2015 Review as it only incorporated patient address adjustments. The data did not sufficiently capture the full impact of regional costs and SDS. While IHPA had evidenced the impact of SDS through its National Efficient Cost for block funded hospitals, this had not been captured in the Commission's 2015 Review assessment methods. 'Omitted' regional costs were subsequently evidenced by IHPA when hospital address adjustments for AP services were incorporated into the National Efficient Price framework in 2018-19 and similar adjustment for ED services was introduced in 2019-20.

The Northern Territory expected that when these omissions were recognised in the 2020 Review that the methods would ensure that the regional cost and SDS disabilities would be fully accounted for in each of the assessment years. Table 3 and associated commentary in the staff discussion paper indicates to the Northern Territory that this is not the case. While it understands SDS disabilities are applied to all assessment years, for AP and ED services, regional costs are only fully assessed if the IHPA data for the assessment year includes patient and hospital address adjustments. For years where these have not been calculated by IHPA, no adjustment or backcasting of data has occurred to account for the omitted regional costs. As a result, the 2020 Review understated the Northern Territory's health expenditure needs and this could continue to occur through until the 2023 Update, when IHPA data for all years in the assessment period for all hospital services will finally include patient and hospital address adjustments, if the Commission uncritically uses the IHPA data.

The Northern Territory considers this to be unprecedented and inconsistent with the objective of HFE. There is a conceptual case for the regional cost disabilities and supporting evidence that quantifies their impact. Furthermore, the need to quantify the disability for each specific assessment year has not previously been a requirement in order for the Commission to make an adjustment, for example, the regional costs disability for Prisons is set for the entire 2020 Review period as are cost weights for Policing (which incorporate the impact of remoteness).

The IHPA data are not fit for purpose where they do not include adjustments to account for all evidenced regional cost disabilities. Northern Territory is of the view that this is a data problem that necessitates changes in relevant years of the assessment period. This is typically permissible under the ToR for an Update and the Northern Territory expects that the ToR for the 2021 Update will allow the Commission to take appropriate steps to rectify this issue.

4. Revisions to stamp duty on conveyances and land tax data

In the 2020 Review, the Commission determined that duties from future major asset sales would be assessed EPC, consistent with past treatment of these duties and that they reflect state policy choices about which assets to hold and for how long. The staff discussion paper proposes to recommend to the Commission that it cease deducting duties from the sale of major state assets from GFS conveyance revenue as a state has advised that duties relating to the sale of equity in publicly owned corporations would be classified to GFS tax code 465 (Other stamp duties on financial and capital transactions) rather than tax code 463 (stamp duties on conveyances). Tax code 465 is assessed EPC under the Other Revenue category.

While the Northern Territory has few major state asset sales, it notes that the sale of the Territory Insurance Office in 2014-15 was classified to tax code 463 (not 465) as it was duty payable on the transfer (sale) of a commercial business (not stamped documents evidencing financial and capital transactions). The Northern Territory believes that the Commission will need to continue to check, and if necessary, deduct duties from the sale of major state assets from the stamp duty category as it can not be assumed that they will be classified to tax code 465.