Please find below the Northern Territory’s response to Commission staff’s request for state comments regarding the three options presented by Commission staff for improving the contemporaneity of the Commission's assessments.

General comments

The Territory shares other states’ concerns that it is far too late in the 2015 Review for the Commission to be considering far-reaching changes to its methodology. Changes to fundamental aspects such as the guiding principles should be considered in a measured way, with ample time provided for consultation and examination of proposals. The Territory’s view is that there is insufficient time left in the 2015 Review for the states to conduct in-depth analysis of the changes that have been proposed in this regard. On this basis, the Territory considers that it would be more appropriate for this issue to be considered as part of the next methodology review.

The Territory notes that states have previously experienced significant variation in revenue sources, such as the significant decline in New South Wales’ stamp duty on conveyances revenue in 2008-09, with the effects taking time to flow through the Commission’s assessments, due to the inherent data lags under the current methodology. New South Wales was not afforded special treatment to smooth or lessen the impact on its fiscal capacity, and the Territory does not consider that it is appropriate to do so for Western Australia.

Western Australia enjoyed the impact of the lag effect in the early days of the mining boom, before the equalisation process reflected its significantly increased revenue capacity, and there was no movement to improve the contemporaneity of the assessment system at that time. Further, it is unlikely that should a similar situation arise in the future, that efforts will be made to reduce a state’s GST share when its capacity to raise own-source revenue is understated in the application year, rather than overstated, due to the inherent lag in the Commission’s methodology. As such, the proposed approaches are highly inequitable, and favour states with revenue sources subject to large fluctuations.

As stated in the Territory’s previous submissions, the Territory does not support any measures that seek to alter the impact of HFE on a particular state by changing the way in which the contemporaneity principle is applied. As the Commission and all states are aware, the only objective for GST distribution, as agreed by all states and the Commonwealth in the Intergovernmental Agreement on Federal Financial Relations, is the achievement of HFE.

Further to the above concerns, the Territory’s views on the Commission staff’s three options for improving contemporaneity are provided below, assuming that iron ore royalties would be the object of the proposed changes. The Territory's view is that none of the options presented by Commission staff would achieve HFE, and all would instead add unnecessary complexity to the Commission's assessments. However, the Territory's view is that extending the averaging period is the least inappropriate option, predominantly because it ensures that data for all years is still assessed, and represents the least change to the current methodology.

Option 1: Absorption approach

The Territory does not support the proposed absorption approach, which would remove the differential assessment of iron ore royalties from the assessment methodology, with the ensuing relativities applied to a combined pool of GST revenue and iron ore royalties. In the application year, 'actual' royalties, or an estimate of actual royalties, would be netted off states' assessed GST and iron ore royalty needs to give states' shares of GST revenue.

While it would lead to a more contemporaneous assessment of the impact of volatile revenue sources on states' fiscal capacities, the absorption approach would add a significant level of complexity to the assessment methodology, and would not result in an appropriate HFE outcome, due to the associated dilution of the impact of iron ore royalties on states' assessed relative fiscal capacities. Further, it fails to recognise that Western Australia has enjoyed the benefits of significant revenue growth due to its iron ore endowments.

The Territory is concerned that the absorption approach has been proposed in response to Western Australia's present fiscal position, and is therefore unlikely to be appropriately applied over the longer term. No guidance has been provided on the likely timeframe that it would apply, and the Territory notes that there will be winners and losers in the transition away from the proposed changes back to the current methodology, if this occurs, which will create further equity issues in the future.

If the absorption approach would be applied in response to volatility of revenue sources other than mining royalties, the Commission will also need to determine the level of volatility necessary for a revenue source to be considered for special treatment and the length of time that the special treatment should be applied, which would be extending the role of the Commission beyond its current ambit; that is, the Commission would be required to determine when 'full' HFE should apply, and when partial HFE is appropriate.

While the Territory acknowledges that the absorption approach was used to assess states' shares of Health Care Grants prior to the 2010 Review methodology, it notes that this was more appropriate given the nature of the Health Care Grants, which were provided to all states by the Commonwealth on a needs-basis. This is not the case for iron ore royalties, and it is not clear how an appropriate end-point to the absorption approach would be determined.

Option 2: Lagged five-year moving average

The Territory considers that the option of assessing 'large and significantly volatile' revenues based on a lagged five-year moving average is the simplest and least inappropriate of the three alternatives. However, this option is also counterintuitive, as it seeks to address contemporaneity concerns by incorporating into the Commission's assessments data that is older than that used in the current method.

Further, in addition to the obvious issue of inconsistent treatment of different state revenues in the Commission's assessments (as all other revenues would be assessed based on a three-year moving average), consistent with the issues associated with the absorption approach, this option presents the difficulty of appropriately determining what revenues are considered ‘large and significantly volatile’ and raises transition issues regarding the treatment of the ‘large and significantly volatile’ revenue once it ceases to be ‘significantly volatile’.

The Commission would no longer have a basis for using the five-year moving average approach and, as such, the appropriate action would be to revert to the three-year average to bring the revenue in line with other assessments. The Territory considers that this transition would result in windfall gains for some states at the expense of others. The Territory does not believe that these questions have been adequately addressed so far in the 2015 Review.

Option 3: An adjustment to GST outcomes

The Territory is strongly opposed to the option of adjusting the outcomes of the Commission's assessments to increase the GST revenue of states affected by large and volatile revenues, as this option is neither reliable nor practical.

Commission staff have suggested that the size of the adjustment would be determined either in advance of the application year (based on expected circumstances) or in the course of the application year (based on actual emerging circumstances). The Territory does not believe that these options are feasible.

Determining the size of the adjustment in advance of the application year would require the use of estimates of states’ fiscal circumstances in the application year, an approach that has already been rejected by most states and the Commission as it is not reliable. In addition, determining the size of the adjustment based on emerging circumstances implies updating states’ GST relativities during the application year. The Territory is strongly opposed to this approach, as it would add significant uncertainty to states’ budget processes.

The Territory notes that the adjustment would be funded by a reduction in other states’ GST revenue for the application year. In effect, this means that in attempting to reflect the likely circumstances of one state in the application year, the Commission would produce relativities that do not reflect the circumstances of up to seven other states, an outcome that is not equitable.

Finally, this option involves the subsequent reversal of the adjustment over a period of up to three years. This unprecedented arrangement represents a significant risk to the states whose GST revenue is reduced to finance the adjustment, particularly if the Commission adopts a method change before the reversal is fully implemented, potentially resulting in windfall gains to the state that benefits from the adjustment.

We trust that the Commission will give due consideration to the Territory's views and look forward to the Final Report of the 2015 Review next month.