Northern Territory Government

COMMONWEALTH GRANTS COMMISSION 2015 METHODOLOGY REVIEW

Northern Territory Supplementary Submission to the Commonwealth Grants Commission – Additional Comments on Contemporaneity

January 2015

Department of Treasury and Finance

Introduction

I.1 Commission staff have invited state comments on the principle of improving contemporaneity in the Commission's assessments between the assessment and application years, following a request from the Commonwealth Treasurer for advice on this issue.

I.2 This submission provides further comments on the appropriate application of the Commission's contemporaneity supporting principle and builds on the views expressed by the Northern Territory in its November 2014 Supplementary Submission on Contemporaneity, the bilateral meeting between the Territory Under Treasurer and the Commission in November 2014, and the Territory's December 2014 response to Commission Position Paper CGC 2014-04.

I.3 This submission primarily addresses the Commission's query within the context of Western Australia's proposal for the Commission to base its assessments on projections of states' fiscal capacities in the grant year, as this is the only approach that has been proposed by a state in this regard so far in the 2015 Review.

Contemporaneity

The Territory is strongly opposed to any measures that seek to alter the impact of horizontal fiscal equalisation (HFE) on a particular state by changing the way in which the contemporaneity supporting principle is applied, for the following reasons:

- the Commission's current approach to contemporaneity achieves the right balance between responsiveness to changes in states' fiscal circumstances and stability of states' GST shares and should not be changed;
- the method change that has been proposed in this respect entails the use of projections of state circumstances in the grant year, which would increase the complexity of the GST distribution system and the volatility of states' GST shares, and require significant judgement by the Commission;
- basing the Commission's assessments on projections of the grant year would result in windfall gains for some states during the transition period, due to the non-assessment of some years and the partial assessment of others; and
- any adjustments aimed at reducing the impact of HFE are inconsistent with the Intergovernmental Agreement on Federal Financial Relations.

Use of Projections

1.1 The Territory is strongly opposed to Western Australia's proposal that the Commission base its assessments on estimates or projections of states' fiscal capacities in the grant year, rather than data for the three most recent years for which final data is available.

1.2 While the Territory accepts that basing the Commission's assessments on projections of state circumstances in the grant year would make the GST system slightly more contemporary, the drawbacks that would accompany such an approach far outweigh any contemporaneity gains.

1.3 As previously indicated by the Territory and a number of other states, Western Australia's proposed approach would increase the complexity and volatility of the GST distribution system, while the inherent need for subsequent adjustments when actual data becomes available mean the system would be less reliable and predictable.

1.4 The Territory notes that the Commission has also expressed reservations about the use of state or independent forecasts of revenues in the application year, on the basis of recent experience where there have been substantial errors in these forecasts.

1.5 The Commission would be required to use considerable judgement in determining the basis upon which state finances should be forecast to derive data for the application year. This would require consideration of the economic, political and social factors likely to affect a state's revenues in the coming year, in order to provide an unbiased assessment of a state's likely fiscal position, beyond what a state publishes in its budget.

1.6 Further, if the Commission was to rely on states' published forecasts, it is unclear how contemporary the estimates of the coming year's revenues would be. It is unlikely that the Commission could rely on the application year's budget forecasts, as states, particularly the smaller states, require prior knowledge of the GST relativity for the upcoming year prior to publishing budget estimates. If previous years' budget estimates were used, this would significantly reduce the contemporary gains of the proposal.

Windfall Gains

1.7 The Territory's view is that each dollar of government expenditure should be included in the equalisation process, but the proposal to achieve contemporaneity by using projections for the grant year would lead to the omission of at least two years from the Commission's methodology. For example, if applied from the 2015 Review onwards, this approach would mean state revenues and expenditures for 2013-14 and 2014-15 would never be assessed by the Commission, while revenues and expenditures for 2011-12 and 2012-13 would drop off the Commission's assessments without having fully flowed through the three-year assessment period.

1.8 The Territory is aware that a similar effect occurred in the 2010 Review, when the assessment period was reduced from five to three years. However, unlike in the 2010 Review, the contemporaneity gains that would be achieved through the use of projections in the 2015 Review are not sufficient to justify the potentially significant windfall gains that some states would receive from the partial assessment of some years and the non-assessment of others.

1.9 The Territory notes that in the first years of the commodities boom, Western Australia enjoyed the benefits of its increasing own-source revenues in the years when its assessed fiscal capacity was lower than its actual fiscal capacity, prior to its increasing mining royalty revenue being included in the assessment system. Further, the Territory notes that the reduction in Western Australia's actual own-source revenue will flow through the assessment system in due course. As such, the Territory considers that altering the form of fiscal equalisation in Australia to accommodate the temporary circumstances of one state is inappropriate.

1.10 The Territory notes that Western Australia's deteriorating fiscal position was a foreseeable consequence of the extraordinary growth in own source revenues it experienced as a result of the commodities boom. It is the responsibility of Western Australia, not the other states or the equalisation process, to manage changes in its fiscal position arising from fluctuations in its own-source revenues and the associated GST revenue impacts.

Inconsistency with the Intergovernmental Agreement on Federal Financial Relations

1.11 The only objective of GST distribution, as agreed by all states in the Intergovernmental Agreement on Federal Financial Relations (IGA), is to achieve HFE.[1] As such, the Territory's approach to any proposed change to the GST distribution mechanism is informed by the likely impact of the proposed change on this objective.

1.12 In this case, the Territory is of the view that the Commonwealth's request for an approach and alternative GST relativities that would reduce the impact of the Commission's HFE-based assessments on one state compromises the achievement of HFE and is, therefore, inconsistent with the IGA.

1.13 The Territory firmly considers that the Commission's current approach to ensuring the contemporaneity of its assessments is appropriate and should not be changed. The Territory's view is that this approach achieves a suitable balance between responsiveness to changes in states' fiscal circumstances over time and stability of states' GST shares. More importantly, the Commission's current approach achieves HFE over time.

1.14 Proposals for the Commission to make special adjustments to ameliorate the impacts of HFE on a particular state, such as Western Australia's proposal that the Commission's assessments should be based on forecast, rather than actual data, in order to cushion Western Australia's fiscal position in the transition out of the mining boom, imply the pursuit of objectives other than HFE and, as such, these proposals should not be applied.

1.15 Overall, the Territory's view of the GST distribution system is that it has always been intended to achieve HFE over time, rather than immediately, in recognition of the fact that concurrent equalisation is not achievable due to constraints on the availability of reliable data. The lagged implementation of HFE reflects the lagged availability of the most suitable data.

1.16 The Territory is hopeful that the Commission's advice to the Commonwealth will reflect this principle; that its current methodology is adequately equipped to address changes in states' fiscal circumstances over time.

[1] Clause 26 of the IGA states: "The Commonwealth will distribute GST payments among the states and territories in accordance with the principle of horizontal fiscal equalisation."