NT Department of Treasury and Finance Submission – 2022 Update New Issues

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NORTHERN TERRITORY GOVERNMENT

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Acronyms	Full form
AASB	Australian Accounting Standards Board
ABS	Australian Bureau of Statistics
DTF	Department of Treasury and Finance
GFS	Government Finance Statistics
GST	Goods and Services Tax
HFE	Horizontal Fiscal Equalisation
NHRA	National Health Reform Agreement
ToR	Terms of Reference

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1. Introduction

This submission provides the Northern Territory Department of Treasury and Finance (DTF) response to issues identified in the *Commonwealth Grants Commission 2022 Update New Issues Staff Discussion Paper CGC 2021-01-S* (discussion paper), released in October 2021.

DTF is appreciative of the opportunity to engage on the identified issues and the assistance provided prior to lodging this submission.

It is noted that this discussion paper is different compared to prior years, with many of the issues identified yet to crystallise, necessitating more conceptual responses, rather than providing specific data in support of submissions. DTF would welcome further opportunity to discuss emerging issues prior to the 2022 Update.

This submission is made in advance of the Terms of Reference (ToR) being available for the 2022 Update. DTF notes that the usual ToR for an Update year are limited and do not provide for methodology changes. Some additional commentary is provided for consideration in the event that the 2022 Update ToR are broadened to allow method changes for COVID-19.

2. Response to COVID-19

Revenue Assessments

The discussion paper proposes recommending the same approach for revenue assessments as the prior year, in respect of tax waivers, rebates and deferrals, and the impact of Jobkeeper payments on payroll tax data. DTF broadly agrees with the reasons and supports the proposed approach.

Expense Assessments

The discussion paper poses an open-ended invitation to "*…welcome state views on the impact of COVID-19 on state expenses and the drivers of these expenses.*"

The breadth of the question posed is challenging and a comprehensive reply on all of the impacts of COVID-19 on the Territory is not feasible in this submission. However, recent consultation and discussion with Commission staff identified that DTF's views would be encouraged in relation to:

- General commentary on a COVID-19 differential assessment
- COVID-19 related business support payments
- COVID-19 related health expenditure
- Other COVID-19 related expenditure.

General commentary on a COVID-19 differential assessment

DTF considers that the methodologies in the 2020 Review were not designed to accommodate the impacts of COVID-19 on state needs assessments and including actual COVID-19 expenditure in the ordinary health (and other) expense categories without adjustments could distort outcomes. As such, a specific disability for COVID-19 or differential assessment may be appropriate. However, it will be important in developing any adjustment for COVID-19 expenses that any assessment methodology remains policy-neutral.

DTF submits that an adjustment based on underlying state vulnerability to COVID-19, including transmissibility and severity, is more appropriate than an adjustment based on actual state cases or expenditures. In line with usual principles, if an appropriate policy-neutral measure of COVID-19 need cannot be determined, an equal-per-capita assessment may be appropriate. An equal-per-capita approach may also reflect the underlying vulnerability of all Australians to the virus. DTF would welcome discussion on options for, including impacts analysis of, any adjustment for specific comment.

DTF notes that a differential assessment for COVID-19 related expenses would be a methodology change and outside the usual ToR for an Update period. Should the ToR be expanded to allow a differential assessment, further consultation to allow consideration of the scope of the ToR would be appropriate. DTF reserves its position until that information can be provided, however provides general commentary to assist the Commission.

The Territory identified early in the pandemic that it faced a significant risk of severe health consequences should COVID-19 outbreaks occur. This is due to a combination of large cohorts of highly vulnerable persons and lower capacity in the existing health system, particularly in remote areas. Costs to the Territory following a COVID-19 outbreak may also be substantially higher, due to remoteness and staffing challenges.

In this context, the Territory's approach to COVID-19 was one of prevention and preparedness, with strict border controls and quarantine arrangements, coupled with rapid, widespread, and in most cases precautionary, lockdowns when a risk of COVID-19 transmission was detected. The Territory was quick to declare other jurisdictions as 'hotspots', with wide declarations in effect for much of 2020-21. Prevention was assisted in part due to the availability of a high-capacity, quality, quarantine facility in Darwin, discreet community boundaries and geographic remoteness.

An outcome of this prevention and preparedness regime was that there was no community transmission in the Territory in 2020-21, minimal COVID-19 case numbers, and relatively few, short (but strict), lockdowns. The experience in other states was different, reflecting unique circumstances and different policy responses employed. In making these observations, DTF appreciates the complexity and multifaceted drivers of policy and non-policy responses to COVID-19, including the randomness of the spread of the virus, and makes no comment on the appropriateness, successfulness, or net benefits of the responses in any state or territory.

Policy setting in response to COVID-19 continues to be in a state of constant revision. For example, decisions on the triggers, speed, extent and severity of future lockdowns are being reconsidered as vaccination programs continue. Domestic border controls and hotspot declaration policies are also within state control and subject to active revision.

Understanding the different policy and non-policy contexts in each state, and the impact on expenses, will be an important consideration when evaluating the utility of any particular dataset for a differential assessment.

DTF submits that most data sets are likely to be heavily influenced by policy decisions and any differential assessments should identify a policy-neutral driver of need to avoid future policy responses that could be influenced by GST distribution considerations. The application of policy neutrality principles to any differential assessment criteria becomes more important in an environment where policies are being actively adjusted. It is important that perverse financial incentives in response to COVID-19 are not created through a differential assessment.

To control for policy differences, a form of assessment on the level of COVID-19 expenditure if a state had employed national-average (rather than actual) preventative measures and responses may be suitable. An example of a possible adjustment may be to explore the inherent vulnerability of a state's population to COVID-19, including transmissibility and severity, rather than the actual experience of a state.

COVID-19 related business support payments

While the discussion paper is open-ended on this issue, DTF understands submissions on the type of COVID-19 supports provided to industry would inform how a differential assessment might be made to accommodate such payments.

Regulation and Business Development Expense Ratio

The discussion paper invited submissions on the continued use of the 2020 Review's ratio to split services to industry spending between regulation and business development. DTF notes informal advice from the Commission that amendments to the split are less likely to be material due to both categories having a similar impact on the overall assessment. In the absence of a clearer and more robust methodology and data to inform revisions to the ratio, DTF supports the proposed approach of maintaining the 2020 Review's ratio.

Should the Commission propose an amendment to the ratio, DTF considers it reasonable for states and territories to be provided with specific impact analysis, options for the revision and an opportunity to consider the amendment prior to the 2022 Update.

Differential Assessment of COVID-19 Business Support Payments

DTF submits it is important that any differential assessment relating to COVID-19 is policy-neutral and any proposed differential assessment take into account economic interdependence between state economies. Assessments of need for COVID-19 support based solely on individual state metrics (such as lockdown durations or actual state expenditure) in isolation may present an unbalanced view of states' needs.

For example, tourism in an important economic driver for the Territory and its contribution to the economy is captured in a range of industries. Tourism operators in the Northern Territory rely heavily on domestic markets in the populous states, with New South Wales, Queensland and Victoria being the three largest markets and when those states experienced COVID-19 cases, hotspot declarations and border controls negatively impacted Territory operators. This occurred independently of any Territory COVID-19 cases or lockdowns. In contrast, a lockdown in the Northern Territory would have a far lesser, possibly negligible, impact on tourism operators in New South Wales, Queensland or Victoria. For example, National Visitor Survey data from Tourism Research Australia indicates that in 2019, Victoria represented 27% of the Territory's overnight interstate visitor arrivals. In contrast, the Northern Territory accounted for 0.86% of Victoria's overnight interstate arrivals over the same time period.

Economic interdependence is not limited to tourism. Population flows, availability of skilled labour, and a range of other economic flow-on impacts were experienced in the Territory as a result of COVID-19 outbreaks in other jurisdictions. DTF disagrees with the discussion paper statement that "*…The decline in employment and hours worked in the Northern Territory may reflect effects not directly related to the COVID-19 pandemic…*" and submits that it is not supported by the evidence presented.

DTF also notes that there are an ongoing issues with the reliability of economic data, including labour market statistics that were exacerbated by the pandemic, and drawing inferences from high-level sources, may generate inaccurate results. In this context, it is reasonable to consider Territory business support schemes as legitimate forms of COVID-19 support, rather than as more general forms of economic stimulus.

DTF submits it is appropriate for any proposed adjustment to recognise that not all COVID-19 support payments were paid to businesses or conditioned only on intra-state lockdowns. In the Territory, significant support schemes were provided to customers rather than businesses.

An example of sectoral assistance provided due to border controls is the “Territory Tourism Voucher”, a scheme which provided three rounds of vouchers in 2020-21 (and further rounds in 2021-22) to Territory residents for spending on Territory tourism businesses, subject to various terms and conditions. This scheme did not specifically target businesses in lockdown or with turnover reductions, as there was an identified sector-wide need for support arising from interstate hotspot declarations and border controls.

Similar considerations arise on the timing of payments. Some Territory support programs were aimed at assisting businesses re-opening after a lockdown, rather than to support businesses during a lockdown. Support immediately afterwards was a practical approach to help businesses ‘catch-up’ for losses during a lockdown.

Consideration may also need to be given to the different payment channels used by jurisdictions. As an example, significant support was provided by various local councils with assistance from the Northern Territory Government. Clear definitions for any assessment, including the treatment of business support paid through intermediaries, will be important. A differential assessment may also need to take into account the differences in cost bases to businesses in each jurisdiction. For example, the Territory does not have a land tax, so no land tax assistance or offset grant measures were able to be provided.

It is also noted that the economic and fiscal position of states were different entering into 2020-21 and this may have influenced the level of support provided. Actual-per-capita assessments may favour the fiscally stronger states and distort assessments of GST need.

COVID-19 related health expenditure

The discussion paper articulates health-related expenditure issues relating to COVID-19, but does not propose specific amendments. As noted in the general COVID-19 commentary, DTF considers that the methodologies in the 2020 Review were not designed to accommodate the impacts of COVID-19 on state need. As such, a specific disability for COVID-19 or differential assessment may be appropriate. However, it will be important in developing any adjustment for COVID-19 expenses that any assessment methodology remains policy-neutral and do not create perverse outcomes.

Any differential assessment would need to consider how to separate COVID-19 from ordinary health-related expenses, noting that usual activities were disrupted sector-wide due to COVID-19 cases, and preventative and precautionary measures. Similar considerations would also arise for non-health related expenses, such as police and emergency services.

The largest impacts on the Northern Territory health system relate to preventative and preparedness measures, rather than responding to COVID-19 outbreaks. Examples include reductions in ward and surgical capacity due to COVID-19 precautionary measures, increases in patient complexity due to deferred elective surgery, and increases to length of stay due to COVID-19 testing requirements. Similar experiences were likely encountered in most states.

A particular Territory issue includes the impact of the Commonwealth Emergency Determinations under the *Biosecurity Act 2015 (Cth)*, which resulted in restrictions on travel to and from various areas of the Northern Territory. To accommodate this, it was necessary to appoint additional staff to remote areas above the usual clinical need in order to reduce personnel mobility. The result was an increase in average service delivery and health costs in remote areas.

These issues are articulated in *The Northern Territory’s submission to the Consultation Paper on the Pricing Framework for Australian Public Hospital Services 2021-22* (particularly, section 2). DTF refers the Commission to that paper for consideration.

Should the Commission endeavour to undertake a differential assessment for COVID-19 related health expenses, DTF does not consider it appropriate for the relevant expenditure to be limited to only responding to COVID-19 outbreaks. Health expenditure in relation to prevention and preparedness measures are also relevant.

Interaction between National Health Reform Agreement and National Partnership on COVID-19 Response

DTF notes the Commission's commentary on the distribution of Commonwealth funding under the National Partnership on COVID-19 Response (COVID NPA). If this data is to be used to inform the 2022 Update, DTF notes an interaction between the National Health Reform Agreement (NHRA) and the COVID NPA which may influence activity allocations between the two agreements, and thereby funding.

As NHRA funding is determined by a baseline expenditure plus capped annual growth, reallocation of activities from the NHRA to the COVID NPA impacts future NHRA funding. There may also be timing considerations, as final COVID NPA and NHRA outcomes are subject to reconciliations which may fall outside an Update period.

DTF submits that the use of NHRA or COVID NPA data for GST purposes may require additional consideration to ensure it does not distort financial outcomes.

Other COVID-19 related expenditure

DTF considers that a differential assessment for other COVID-19 expenditure would be a methodology change and outside the usual ToR for an Update period and reserves its position. The below is provided by way of general commentary to assist the Commission.

While most COVID-19 expenditure related to health, a significant amount of non-health expenditure was also incurred to support the Territory's response to COVID-19. Similar to the health expenditure, these costs were focussed on preventative and preparedness measures in the Territory, rather than responding to a particular COVID outbreak.

One such cost was for additional police services utilised to ensure compliance with the Chief Health Officer's directions. This entailed manning police at the Territory's border, including various biosecurity borders under the Commonwealth biosecurity determination, assessing border permits, and checking on people undergoing home quarantine. Anecdotally this resulted in increased overtime costs and increased consumables costs, including non-PPE costs, for police and emergency services. Additional COVID-19 expenditure was experienced in various other sectors and may also include formal and informal secondments of staff meet operational needs across government. Should any differential assessment be proposed, consideration would need to be given to the availability of data and the ability to differentiate COVID-19 costs from ordinary operating costs.

3. Impact of JobKeeper Payments on Wages Costs

The discussion paper proposal to remove all $750 per week observations from wages data, could have distortionary impacts on the regression analysis, as JobKeeper was paid more heavily to certain states, sectors, and income groups. The result of simply removing the data may be to under-observe and bias the residual data.

DTF is unable to comment on the appropriate statistical approach due to a lack of information on the modelling conducted or the impacts of the data manipulation on outcomes.

While it is recognised that there is limited time between the release of wages data and the 2022 Update, DTF submits that it is appropriate that more than one option for adjusting the wages data is considered i.e. options to 'back-fill' the removed observations, including potentially using prior year data if necessary. DTF would welcome further consultation on the proposed change for the assessment, as well as options and information on the impacts on GST relativities.

4. New Western Australian Native Title Arrangements

DTF would appreciate advice on the impact and materiality of the proposed adjustment over time. DTF's preference is that differences between Government Financial Standards and Australian Accounting Standards be resolved on a long-term basis rather than on a one-off adjustment in response to individual cases. See also commentary at section 6, below.

5. Negative Relativity

The discussion paper proposes to recommend to the Commission that if there is a negative relativity in any assessment year, it is removed in the year it arises, with the removal being distributed on an equal-per-capita basis between the other jurisdictions.

For the purposes of this submission, DTF refers to relativities and horizontal equalisation principles as understood prior to the enactment of the *Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Act 2018* (Amending Act). This reflects section 5(3) of the *Federal Financial Relations Act 2009* (Cth), which provides for a 'no worse off guarantee' under the transitional period from 2021-22 to 2026-27. It is also noted that headline relativities calculated post the enactment of the amending Act cannot be negative from 2022-23 due to the introduction of a relativity floor.

DTF submits that adjusting a negative relativity to zero is not consistent with horizontal fiscal equalisation principles and where a states' assessed revenue exceeds its expenditure needs, full horizontal equalisation principles require that excess revenue to be taken into account to determine the appropriate level of support provided to other states and territories. This implies a negative relativity may occur.

A negative relativity is not an unintended or anomalous result under equalisation principles, but rather the expected outcome arising from the application of ordinary principles and calculations. As such, an adjustment reflects a departure from established principles, and will fail to account for the full fiscal position of a state over time.

Further, as GST entitlements are based on a three-year average relativity and not a single-year assessment relativity, adjusting a single-year negative relativity when the three-year relativity is otherwise positive is unnecessary and may overstate the adjusted state's GST entitlement, to the detriment of other jurisdictions.

If an adjustment is required, DTF submits that the principle in support of the adjustment should first be identified. Once identified, the adjustment should be contained to the minimum adjustment that is necessary to achieve that principle, and supports it occurring through an equal-per-capita adjustment.

DTF also submits that any adjustment should be followed by a corresponding unwinding/balancing adjustment in future years. This is to prevent GST windfalls arising over time. Conceptually, an unwinding adjustment would be similar to recognising that raising a state's negative relativity to nil has a similar effect in-principle to providing additional revenue to a state, or excluding a portion of that state's assessable revenue. An adjustment to recognise this excess revenue in future periods is appropriate.

6. New Accounting Standards

DTF notes the discussion paper advice that changes to the Australian Accounting Standards relating to AASB 15 (*Revenue from Contracts with Customers*), AASB 16 (*Leases*) and AASB 1059 (*Service Concession Arrangements*) impact the recognition of state revenues, expenditure and investment.

DTF's position is that the issues may represent an ongoing data problem and will require a permanent resolution noting the discussion paper's proposed solution is unlikely to resolve the underlying issues. Options for resolution will likely require the input of all states, territories, and bodies such as the Australia Bureau of Statistics (ABS).

Lease and Service Concessions

DTF observes that the ABS Government Financial Statistics (GFS) data is no longer consistent with state and territory leases and service concessions data as required under the Australian Accounting Standards. DTF currently reports leases data as 'out of scope' for GFS purposes, in line with the GFS manual.

While the ABS may be able to quantify the difference between state accounts and GFS treatment of leases through an adjustment, it is understood that this would reflect the difference at the time the AASB changes occurred, i.e. at 2019-20. An ABS adjustment to GFS data to subtract the value of leases taken up on the initial recognition of the new standard from ongoing data would not be an accurate estimate for future periods, and would increase in inaccuracy over time, as it does not reflect the value of new leases that are entered into. It is understood that the ABS adjustment is also subject to an assumed growth rate, which represents additional uncertainty and may not reflect actual investment.

Moving forward, DTF will not be able to distinguish (and therefore quantify) the value of out-of-scope leases, and doing so would require recording data that is inconsistent with AASB or GFS requirements, which would not be appropriate from a financial reporting perspective.

On this basis, DTF submits that the materiality assessment in the discussion paper (of $4 per capita) is unlikely to reflect the true impact.

DTF submits that investigation of long-term options to resolve this issue is required.

Revenue Recognition

DTF recognises that the underlying issue for revenue recognition arises due to accounting standards which require grants paid using Commonwealth Final Budget Outcome data to be recorded at payment date (cash accounting), while revenue recognised by states and territories is based on when it is earned (accrual accounting).

DTF submits that the differences between Commonwealth payments and Territory recognised revenues can, at times, be significantly different. For example, infrastructure payments may be made in full and close to the end of a financial year by the Commonwealth, but expensed by the Territory over time as the project is completed. For many Commonwealth payments, the timing differences are not material as milestone reporting in most Commonwealth payment arrangements have the effect of aligning revenues and expenses, however a small number of outlier payments can have a significant impact on the Territory's overall revenue assessments.

DTF observes it is uniquely exposed to this issue due to a proportionately higher share of Commonwealth payments as a portion of total revenue, and due to the small revenue and population base implying small changes in total grant payments can have a large per capita impact on revenues.

While it is expected that any Commission adjustment will not have a net impact over time, DTF is concerned that any adjustment may increase the volatility of the Territory's relativity assessments. DTF recognises that the issue may be partly beyond the Commission's ability to resolve, but would welcome the Commission's views on the materiality of the impacts, including over time, and to explore any potential options beyond those posed in the discussion paper.

7. Health Assessment – Non-Admitted Patient Data

DTF notes the 2020 Review decision to move away from a proxy indicator for non-admitted patient data once national weighted activity unit (NWAU) data becomes sufficiently robust.

DTF seeks clarification on how the Commission has evaluated whether the data is fit-for-purpose for use in a relativity assessment, the quality of weighted activity data, and the impacts on state assessments of moving away from the proxy indicator, including materiality.

DTF advises, as noted in prior submissions, that use of NWAU data will require a decision that the data is fit-for-purpose for use in GST distribution assessments. The basis for the determination that the data is now fit-for-purpose is not clear from the discussion paper, and DTF would welcome the opportunity to review the evidence for this.

It is observed that the Australian Institute of Health and Welfare data provided by the Commission to DTF indicates that over 80% of national GP-type non-admitted patient service events were in New South Wales, while the rate of GP-type non-admitted patient service events to total allied health and medical consultations was close to nil in four jurisdictions. It is not clear whether these trends are driven by true differences in the level and rate of service events between jurisdictions, or due to possible data quality issues.

As raised in previous submissions by the Territory, the Commission accepted that remoteness has an impact on the use and cost of delivering non-admitted patient services, and noted that the Independent Hospital Pricing Authority provides remoteness loadings for non-admitted patients from the 2019-20 financial year. DTF submits that it is important for any proposed adjustment to ensure that the assumed costs continue to reflect the true costs of service delivery. DTF would benefit from additional information on how the proposed average cost weight incorporates and reflects all appropriate loadings.

8. New Commonwealth Payments

DTF broadly agrees with the proposed treatment of new Commonwealth payments, other than as set out below.

For the Project Agreement - Darwin City Deal: Education and Community Precinct, the Commission proposes a "split" assessment, apportioning funding between the university complex and state government library services. DTF submits that the whole agreement should be assessed as "no impact" on the basis that the whole of the agreement is for the construction of university buildings.

The purpose of the agreement is to build a higher education precinct which will be owned by Charles Darwin University. While the Implementation Plan to the Darwin City Deal includes the future co-location of part of the Northern Territory State library to the site, this will be subject to commercial leasing arrangements between the Territory and Charles Darwin University, and funded by the Territory. No funding under the Project Agreement is allocated to support the state library. Should the Commission remain of the view that a "split" assessment is appropriate, DTF would welcome the opportunity to comment on the proposed apportionment basis.

Additionally, Commonwealth funding received under the National Partnership on Northern Territory Remote Aboriginal Investment (NTRAI) is treated on an exclusion basis. While the *Children and Family Schedule* under NTRAI expired before the expiry of the overarching NTRAI, the Commonwealth has agreed to continue funding of the same initiatives through Commonwealth Own-Purpose Expense (COPE) payments. As these COPEs continue NTRAI programs, DTF requests confirmation that the COPE payments are treated consistently with NTRAI funding. DTF has engaged with Commission staff to identify the relevant payments and is able to provide additional information if necessary.