



Northern  
Territory  
Government

## **COMMONWEALTH GRANTS COMMISSION 2015 METHODOLOGY REVIEW**

Northern Territory Response to Commission  
Position Paper CGC 2014-04 – Significant  
Changes Since The Draft Report

December 2014

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## Summary

- S.1 The Territory considers that the Commission should not make adjustments to its assessments in response to state revenue shocks, as this approach represents an unwarranted extension of the role of Horizontal Fiscal Equalisation (HFE) to include compensating states for budgetary deviations; would be susceptible to gaming by states; is inconsistent with the guiding principle of reflecting what states do; and is unlikely to be based on guidelines that are appropriate for all states.
- S.2 The Territory supports the Commission's proposals to introduce an assessment of expenditure related to the planning and regulation of investment projects and introduce an assessment of capital grants to local governments relating to community development and amenities and culture and recreation.
- S.3 The Territory supports the use of economic environment factors to assess the impact of the private sector on states' health expenses, but is concerned about the Commission's approach to standardisation, due to data deficiencies which likely understate the extent of Indigenous and low SES service use.
- S.4 The Territory does not support Commission staff's proposed rates of substitutability, as they do not reflect available fit-for-purpose data or the analysis of the consultants engaged by the Commission.
- S.5 The Territory does not support the Commission's proposal to adjust states' population shares of people in the lowest quartile of SEIFI by changes in the proportion of state populations with Health Care Cards between the 2006 and 2011 Censuses, which produces counter-intuitive results.
- S.6 The Territory accepts the Commission's decision to develop a general regional cost gradient calculated as the average of the Schools Education and Police gradients and considers that the Commission should reconsider its decision to apply a discount to the regional cost factors for categories in which the general gradient is used.
- S.7 The Territory has reservations about the Commission's proposal to use a simplified population based model to assess states' urban transport infrastructure investment needs, rather than the model proposed in the Draft Report, which was based on actual state data.
- S.8 The Territory supports the Commission's proposal to treat all Commonwealth payments for projects which affect the national road or rail networks consistently.

# 1

## Mining Revenue

The Territory considers that the Commission should not make adjustments to its assessments in response to state revenue shocks, as this approach:

- represents an unwarranted extension of the role of HFE to include compensating states for budgetary deviations;
- would be susceptible to gaming by states;
- is inconsistent with the guiding principle of reflecting what states do; and
- is unlikely to be based on guidelines that are appropriate for all states.

- 1.1 The Commission has invited state comments on the extent to which it should respond to sudden or large-scale shocks to states' revenue bases. While the Commission is seeking comments on a principles basis, the link between this issue and Western Australia's proposal for the Commission to implement HFE with no time lags cannot be ignored. The Territory's views on Western Australia's proposal were provided to the Commission in its November 2014 Supplementary Submission on Contemporaneity.
- 1.2 In principle, the Territory does not support the application of adjustments to the Commission's assessments as a means of reducing the impact of state revenue shocks.
- 1.3 The Territory has always been cautious about any measure that seeks to alter the form of HFE and its underlying principles. In this case, the Territory is concerned that the proposal to apply adjustments to the Commission's assessments in response to a revenue shock would unwarrantedly extend the role of HFE to include compensating states for differences between their forecast and actual revenue. The potential for states to game such a system through their budget forecasts is obvious.
- 1.4 Further, the Territory contends that adjusting the Commission's assessments in response to revenue shocks would be inconsistent with the guiding principle of reflecting what states do, as this approach would entail adjusting either the input

data used in the assessments or the resulting assessed revenue, to produce an outcome that is not reflective of HFE.

- 1.5 The Territory considers that if the Commission decided to adopt a policy of intervening to ameliorate revenue shocks, it would face considerable difficulties in developing guidelines that are acceptable to all states. States' economic structures are heterogeneous, and as such, guidelines developed on the basis of mining revenue concerns, for example, are unlikely to be relevant to states with small mining sectors, and may in fact disadvantage these states.
- 1.6 While the Territory recognises the fiscal impact on Western Australia of recent declines in iron ore prices, the Territory notes that all states face the risk that actual revenues will be significantly lower than forecast in their budgets. However, as the Commission's assessments are based on actual data (rather than forecasts), changes in states' fiscal circumstances are reflected in the GST distribution system over time. The Territory does not consider it necessary for the Commission to make any special adjustments in this regard.
- 1.7 As the Territory has noted previously, in the same way a state's GST relativity would not suddenly fall substantially at the onset of a revenue boom, its relativity will not suddenly increase in response to declines in revenue. The Territory considers that this stability in GST relativities is a strength, rather than a weakness of the HFE system.

# 2

## Mining Related Expenditure

The Territory supports the Commission's proposals to:

- introduce an assessment of expenditure related to the planning and regulation of investment projects; and
- introduce an assessment of capital grants to local governments relating to community development and amenities and culture and recreation.

### Planning and regulation of investment projects

- 2.1 The Territory considers that the Commission's proposed approach to assessing the impact of planning and regulation of investment projects based on each state's share of total private non-dwelling construction expenditure, is appropriate.
- 2.2 While the assessment is not limited to mining-related expenditure, it appropriately captures the increased planning and regulation costs of states with large mining sectors, and is based on policy-neutral, nationally consistent data. The Territory considers that the proposed approach is the best option, given the limited data available and lack of alternate proposals.

### Capital grants to local government

- 2.3 The Territory considers that introducing a differential assessment of capital grants to local government based on differences in states' population growth rates is an appropriate means of capturing further costs to states of growth industries. The Territory accepts the Commission's decision that as the population growth disability is already material elsewhere, it is appropriate to include it in this assessment.

# 3

## Health

The Territory supports:

- the proposed direct approach to the health assessment; and
- the Commission staff's proposal for the Commission to assess the rate of substitutability of admitted patient services but considers that the 10 to 20 per cent proposed by Commission staff is too low.

The Territory does not support Commission staff's proposals that the Commission adopt:

- an estimated level of substitutability of between 10 and 20 per cent for emergency departments, as this estimate is inconsistent with fit-for-purpose data provided by the Australian Institute of Health and Welfare;
- a level of substitutability of between 40 and 45 per cent for non-admitted patients, as it is unclear how this estimate has been derived; and
- an estimated level of substitutability of between 60 and 75 per cent for community health, as there is no evidence to suggest that the level should be any lower than 75 per cent.

The Territory is concerned about:

- the Commission's approach to standardisation, due to data deficiencies which likely understate the extent of Indigenous and low SES service use.

This chapter addresses both the Commission Position Paper CGC 2014-04 and the Health Substitutability paper provided by Commission staff on 18 December 2014.

### The direct approach

3.1 The Territory strongly supports the Commission's proposal to adopt a direct approach to assessing health expenses, based on administrative data on state-provided services, with economic environment factors used to reflect the impact of private provision on states' expenses. The Territory's view is that this approach better captures the relative use and cost of providing services to population sub-groups than an indirect approach.

## Economic environment factors

- 3.2 While the Territory strongly supports the use of economic environment factors, the Territory has some reservations around the Commission's approach to standardising bulk-billed services by Indigeneity, remoteness, socioeconomic status (SES) and age in its calculation of the economic environment factors for each component of the Health assessment, due to data quality concerns, particularly surrounding Indigeneity and SES.
- 3.3 The Territory notes that there is a significant bias towards underreporting of Indigeneity in the Independent Hospital Pricing Authority data used in the calculation of economic environment factors.
- 3.4 As stated in the Territory's submission to the Draft Report, the Territory does not support the use of the Socio-Economic Index For Areas as a measure of SES, as it masks Indigenous disadvantage. The Territory's view is that the index of Indigenous Relative Socio-Economic Outcomes and Non-Indigenous Socio-Economic Index For Areas should be used instead. Further, due to the Territory's significantly above-average share of the Indigenous and low-SES population, these issues disproportionately impact on the Territory.
- 3.5 As part of the 2015 Review process, the Commission engaged two consultants, James Downie and Elizabeth Savage, to comment on the validity of the economic environment factors adopted in the Draft Report. Downie provided detailed analysis of the substitutability of admitted patient, emergency department, non-admitted patient and community health services, while Savage provided general comments on the Commission's proposed levels of substitutability.

## Admitted patients

- 3.6 The Territory supports Commission staff's proposal to recommend that the Commission develop a substitution factor for admitted patients but considers that the 10 to 20 per cent substitutability level proposed by Commission staff is too low.
- 3.7 In his report to the Commission, Downie argued that there is a strong case for assessing the substitutability of private and public hospital services for inpatient services, in recognition of the potential for patients who hold private insurance to utilise private hospitals. Downie estimated that the level of substitutability for admitted patients is about 28 per cent.
- 3.8 The Territory accepts that there are strong conceptual grounds for assessing substitutability for admitted patients, and is broadly supportive of the methodology and approach taken by Downie. On this basis, the Territory considers that the appropriate level of substitutability is closer to 20 per cent than to 10 per cent, consistent with Downie's findings.

### *Emergency departments*

- 3.9 The Territory does not support Commission staff's proposal to recommend a level of substitutability of between 10 and 20 per cent for emergency department services.
- 3.10 The proposed range is significantly lower than the 40 per cent used as a placeholder in the Draft Report, based on data from the Australian Bureau of Statistics' (ABS's) Patient Experience Survey and Australian Institute of Health and Welfare (AIHW) data on the number of GP-type presentations in emergency departments.
- 3.11 Both consultants' reports stated that the Commission's proposed level of substitutability for emergency departments in the Draft Report was too high. While a number of alternate studies and potential methods were canvassed, the consultants recognised that each has its shortfalls, particularly metropolitan bias.
- 3.12 The Territory's view is that Commission staff's proposed range of 10 to 20 per cent is too low and considers that the 40 per cent level of substitutability used as a placeholder in the Draft Report is more appropriate, as it aligns with the level of substitutability suggested by AIHW data, which is fit-for-purpose.
- 3.13 The Territory accepts that there is diversity in the data sources that can be used to estimate substitutability but notes that there are considerable data quality issues associated with the alternatives to the AIHW data, particularly the lack of applicability of alternative factors to non-urban areas.

### *Non-Admitted Patients*

- 3.14 The Territory does not support Commission staff's proposal to recommend a substitutability factor of between 40 and 45 per cent for non-admitted patient services.
- 3.15 The proposed substitutability factor is lower than the 55 per cent proposed by Downie, as Commission staff consider that Downie's analysis does not take into account the variable costs of each component of non-admitted patient services.
- 3.16 The Territory is concerned that Commission staff's proposed substitution factor may understate the substitutability of non-admitted patient services, as it is not clear how Commission staff have derived their estimates of the cost of each component of these services. In the absence of further information in this regard, the Territory supports Downie's estimate of substitutability for non-admitted patients.
- 3.17 Further, the Territory notes that Downie's approach aligns closely with how outpatient services are provided, as it uses robust AIHW Australian Hospital

Statistics data that provides a detailed breakdown of outpatient service delivery by provider.

### *Community Health*

- 3.18 The Territory does not support Commission staff's proposal to recommend a 60 to 75 per cent substitutability factor for community health.
- 3.19 In the Draft Report, the Commission proposed a community health substitutability factor of 75 per cent as a placeholder. Commission staff now propose to recommend that the Commission adopt a substitutability factor of between 60 and 75 per cent, based on the Commission's Draft Report estimate and Downie's analysis of the proposed level of substitutability for community health services. The proposed lower bound of 60 per cent appears to be based on some states' concerns that the 75 per cent estimate in the Draft Report is too high.
- 3.20 In the Territory's view, Downie's analysis clearly shows that the Commission's estimate of a level of substitutability of 75 per cent for community health services is appropriate and does not consider that there is any evidence to support concerns that this estimate is too high. Consequently, the substitutability factor applied to community health should be no lower than 75 per cent.

# 4

## Welfare

The Territory does not support the Commission's proposal to:

- adjust states' population shares of people in the lowest quartile of the Socio-Economic Index For Individuals (SEIFI) by changes in the proportion of state populations with Health Care Cards (HCCs) between the 2006 and 2011 Censuses, which produces counter-intuitive results.

- 4.1 The Territory's view is that the unadjusted 2006 SEIFI should be used as a placeholder for assessed needs in the general welfare component of the Welfare category, pending the release of the ABS's new socio-economic index for households. In the Territory's view, there has been little change in the underlying variables used in SEIFI between the 2006 and 2011 Censuses and therefore the proposed adjustment is not appropriate, as there is no reason to suppose that SEIFI has changed to the extent the Commission has suggested. The Territory also considers that an arbitrary adjustment of one index by the change in another unrelated data set is an unreliable and unfounded approach to addressing the Commission's contemporaneity concerns.
- 4.2 The Territory has consistently supported the use of the ABS's SEIFI as a proxy for need for general welfare services, because it is an individual measure of disadvantage and does not introduce the issues associated with area-based measures. However, the Commission noted in Discussion Paper CGC 2014-03 that it had decided against using SEIFI because the ABS had advised that it did not intend to update SEIFI using 2011 Census data.
- 4.3 In Commission Position Paper CGC 2014-04 the Commission has advised that the ABS will produce a household index using 2011 Census data in the near future and that it intended to use this as an alternative to SEIFI. In principle the Territory supports using a household measure for the same reasons it supports using SEIFI; because it is conceptually more appropriate than an area-based measure for assessing general welfare use.

- 4.4 In the meantime, the Commission has proposed to use SEIFI as a placeholder, adjusted by the changes in the proportion of state populations with HCCs. The Territory supports the use of SEIFI as a placeholder but has significant reservations about the proposed adjustment.
- 4.5 The Territory notes that SEIFI is comprised of a significant number of variables such as income, educational attainment, family composition and use of public housing. The explanatory value of these variables is tested through a complex statistical process which tests for significance, with the results presented as a standardised score. The Commission's proposed approach would apply an adjustment for changes in the number of HCC-holders between the 2006 and 2011 Censuses in order to 'update' SEIFI, which is based on 2006 Census data. In the Territory's view this adjustment is entirely inappropriate. There is no evidence that the HCC-holder variable has any explanatory power over SEIFI, and the chosen adjustment methodology is overly simplistic given the multi-faceted nature of SEIFI.
- 4.6 In the Territory's view, the proposed adjustment to SEIFI is not just methodologically flawed but also produces flawed outcomes. It results in the Territory moving from being assessed as the state with the highest general welfare needs in 2006 to the third highest in 2011. This implies that there has been a significant reduction in the implied extent of individual disadvantage in the Northern Territory between the 2006 and 2011 Censuses. The Territory is not aware of any evidence for this having occurred.
- 4.7 The proposed adjustment to SEIFI also implies that there has been a significant reduction in the relative proportion of Western Australia's population that uses general welfare services.
- 4.8 The Territory has conducted analysis which compares the variables used in SEIFI between the 2006 and 2011 Censuses by state. Table 1 shows that the variables used in the computation of SEIFI for Western Australia and the Northern Territory have not varied to the extent that the Commission's proposed methodology would suggest. This strongly supports the Territory's view that there has not been a significant reduction in implied individual disadvantage over the intercensal period.

**Table 1: Comparison of SEIFI variables for the Northern Territory, Western Australia and the Rest of Australia, 2006 and 2011**

	Northern Territory			Western Australia			Rest of Australia		
	2006	2011	Change	2006	2011	Change	2006	2011	Change
	%	%	ppts	%	%	ppts	%	%	ppts
Does not speak English well	20.9	18.1	-2.8	15.3	14.3	-1.0	17.9	16.9	-1.1
Indigenous	30.4	29.2	-1.2	3.2	3.3	0.1	2.0	2.3	0.3
Annual family Income less than \$15,600	4.3	5.9	1.6	3.0	3.3	0.2	3.4	3.5	0.1
Lives in private dwelling with two or more families	9.4	10.8	1.4	2.1	2.8	0.7	2.6	3.3	0.7
Lives in dwelling with no car	14.5	12.6	-2.0	7.2	6.4	-0.8	10.3	9.2	-1.0
No qualifications	69.4	64.6	-4.7	64.7	60.0	-4.6	64.6	60.2	-4.4
Part of one-parent family with dependent offspring	10.8	10.4	-0.4	9.5	9.3	-0.1	10.3	10.4	0.1
Household rents from Government authority	7.0	12.7	5.8	3.9	3.9	0.0	4.1	3.9	-0.2
Separated or divorced	12.3	11.5	-0.7	11.6	11.4	-0.3	11.3	11.5	0.2
Unemployed	3.1	3.8	0.7	2.5	3.2	0.7	3.5	3.7	0.2
Left school at year 10 or lower	46.0	40.9	-5.2	40.2	35.3	-4.9	42.2	37.7	-4.6

Ppts: percentage points

Source: ABS, 2006 and 2011 Census, accessed through TableBuilder Pro

- 4.9 The Territory understands the Commission’s concerns regarding the contemporaneity of the assessment, however the Territory’s view is that the proposed adjustment, which creates a ‘new’ index using a method which has clear flaws, to produce an outcome that is counter-intuitive and does not align with the change between the 2006 and 2011 Census variables which underpin SEIFI, is not an appropriate means of addressing contemporaneity concerns.
- 4.10 The Territory strongly urges the Commission to continue to use unadjusted SEIFI as the measure of states’ general welfare services use, until an updated household measure of disadvantage becomes available.

# 5

## Regional Cost Gradient

### The Territory:

- accepts the Commission’s decision to develop a general regional cost gradient calculated as the average of the Schools Education and Police gradients; and
- considers that the Commission should reconsider its decision to apply a discount to the regional cost factors for categories in which the general gradient is used.

- 5.1 The Territory accepts the Commission’s decision to develop a general regional cost gradient calculated as the average of the schools and police gradients; however it is unclear why the Commission has changed its position on the most appropriate regional costs gradient for categories other than schools and police since the Draft Report.
- 5.2 In the Draft Report, the Commission proposed to apply:
- a police regional costs gradient based on state-provided data from 2008-09 to the Justice category; and
  - a schools regional cost gradient derived from regression analysis of Australian Curriculum, Assessment and Reporting Authority (ACARA) data to the Schools Education category and other categories for which regional costs are assessed.
- 5.3 This was a departure from the Commission’s approach in the 2010 Review, where it applied a general regional costs gradient derived from the simple average of the schools and police gradients to all categories other than police and schools. The Commission considered that applying the schools gradient to other categories (apart from Justice) was appropriate, as it was based on more recent and more comprehensive data compared to the police or general gradients.
- 5.4 The Commission now proposes to revert to the 2010 Review approach of applying a general regional costs gradient calculated as the average of the schools and police gradients, as this approach draws on two different service delivery models,

creates a smoother gradient, and assists in reducing the sensitivity of the gradient to changes in ACARA data over time.

- 5.5 In its response to the Draft Report, the Territory accepted the Commission's proposal to apply the schools gradient to other categories for which regional costs are assessed, in the absence of more contemporaneous data on regional costs for other categories. The Territory strongly supports the use of the most recently available data that is fit-for purpose.

### Discounting

- 5.6 The Territory considers that as the Commission is now proposing to adopt a general gradient, it should review its decision to apply a 12.5 per cent discount to the categories to which the general gradient will apply, as the concerns it raised in the Draft Report regarding stability and reliance on schools-only data have been addressed through adopting a gradient based on the average of schools and police data, rather than schools-only data, which produced more variation over time.
- 5.7 In the 2010 Review, the Commission found that the average of the schools and police gradients produced a gradient that best reflected the gradient observed for other categories in states that were able to provide regional cost data. The Territory's view is that in the absence of proof that this is no longer the case, and considering the higher quality of the schools data in the 2015 Review compared to the 2010 Review, the Commission should reconsider its decision to apply a discount to the categories to which the general gradient will apply.
- 5.8 As the Territory has stated previously, it is fundamentally opposed to discounting, as it inherently assumes that the disability being discounted is overstated in the assessment, which is not always the case. In addition, discounting requires the Commission to apply significant judgement on the appropriate level of the discount.

# 6

## Urban Transport Infrastructure Assessment

The Territory has reservations about the Commission's proposal to use a simplified population based model to assess states' urban transport infrastructure investment needs, rather than the model proposed in the Draft Report, which was based on actual state data.

- 6.1 The Commission has proposed to move away from a regression analysis which used actual state expenditure data on urban transport infrastructure, towards a simplified model which assumes that there is a simple linear relationship between population size and state need for urban transport infrastructure.
- 6.2 The Territory is concerned that the Commission has not provided sufficient rationale for why it has abandoned its earlier approach. Given the significant variation for assessed investment in 2012-13 compared with the results in the Draft Report, which are based on actual state data, it is not clear why the Commission's confidence in the results of the model has significantly increased.
- 6.3 While the Commission claims that the current approach is simpler the Territory is not convinced that the gains from simplification are sufficient to justify moving towards a model that is not based on actual state data.

# 7

## Nationally significant infrastructure projects

The Territory supports the Commission's proposal to treat all Commonwealth payments for projects which affect the national road or rail networks consistently.

- 7.1 The Commission has proposed that 50 per cent of Commonwealth payments to the states which affect the national road and rail networks will impact on the relativities, on the basis of their distribution among states.
- 7.2 The Territory supports this approach, which harmonises the treatment of payments for national network roads with those for national network rail, as payments to states for national transport infrastructure are akin to purchases of services by the Commonwealth.