



TREASURER

Parliament House
State Square
Darwin NT 0800
minister.lawrie@nt.gov.au

GPO Box 3146
Darwin NT 0801
Telephone: 08 8901 4047
Facsimile: 08 8901 4169

Mr Nick Greiner, Mr John Brumby, Mr Bruce Carter
Review of GST Distribution Panel
GST Distribution Review
The Treasury
Langton Crescent
Parkes ACT 2600

Nick, John + Bruce
Dear Mr Greiner, Mr Brumby and Mr Carter

I am pleased to provide you with the Northern Territory Government's third submission to the Review of GST Distribution, which responds in detail to the Review Panel's Interim Reports released in March and June 2012.

The Northern Territory Government strongly supports a GST distribution system based on the principle of horizontal fiscal equalisation. Equalisation provides vital financial support to the small states. Without this support, Territorians would not enjoy the same access to and quality of services that are afforded other Australians.

The Territory strongly believes that the GST distribution process should not be used as a tool to achieve policy objectives other than equalisation. Expansion of the stated objectives of the GST distribution process would stretch it too far, to the detriment of equalisation outcomes.

The horizontal fiscal equalisation system is the only mechanism in Australia's system of federal financial relations that seeks to equalise states' fiscal capacities. Without it, there would be a great divide between the quality and scope of services provided across state borders.

I trust that you will give due consideration to the Territory's submission. I look forward to the Review Panel's Final Report.

Yours sincerely

DELIA LAWRIE

30.7.12



Northern
Territory
Government

REVIEW OF GST DISTRIBUTION

Northern Territory Government Submission to
the First and Second Interim Reports

July 2012

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Executive summary

1. The role and purpose of HFE

- 1.a. The stated objective of the distribution of goods and services tax (GST) revenue between states and territories (states), as outlined in the Intergovernmental Agreement on Federal Financial Relations (IGA), is Horizontal Fiscal Equalisation (HFE). No other objective is stated.
- 1.b. The Northern Territory (the Territory) strongly supports the view that the achievement of equity is the most important goal of the distribution of GST revenue between states.
- 1.c. Tasking the distribution of GST revenue between the states with the achievement of substantive, additional national policy objectives, some of which may be in conflict with HFE, is not practical given the limited size of the GST pool. Efficiency-enhancing national reforms can be more effectively pursued through other mechanisms.
- 1.d. The GST redistributed to the smallest states provides vital budgetary support for the provision of core government services and ensures that small state constituents have reasonable access to services available to other Australians.
- 1.e. The Territory contends that the current form of equalisation does not fully equalise states' fiscal capacities in practice. The Commonwealth Grants Commission's (the Commission's) use of materiality thresholds, discounting, the impact of the lag effect and the notion of average policy all dilute the achievement of full equalisation.

2. Predictability and stability of HFE outcomes

- 2.a. While stability and predictability of HFE outcomes are desirable features of a GST distribution system, they are not essential nor are they consistent with a dynamic system that responds to economic change.
- 2.b. The Territory's view is that the current form of equalisation provides an appropriate balance between responsiveness and stability through the three-year averaging process.

- 2.c. Options that provide greater predictability, stability and more contemporary assessments should only be considered if they are consistent with equalisation.

3. Simplicity

- 3a. Simplicity was a key objective and outcome of the Commonwealth Grants Commission's Report on GST Revenue Sharing Relativities – 2010 Review (2010 Review). Further simplification measures should only be implemented if there is no detriment to equalisation.
- 3b. The Territory believes that the number of categories and disabilities adopted in the 2010 Review provides an adequate balance between simplicity and the achievement of equalisation.
- 3c. The current adjustments to states' revenue bases are simple, intuitive, have a material impact on states' assessed revenues and reflect average state policies. Removing these adjustments would not result in significant simplicity gains.
- 3d. Currently, about 45 per cent of states' total own-source revenues are assessed on an equal per capita basis in the Other Revenue category, while about 20 per cent of states' total expenditure is largely assessed on an equal per capita basis in the Other Expenses category. The proportion of states' total revenue and expenditure captured in the 'other' categories suggests that the current materiality thresholds are already sufficient, if not too high.
- 3e. Broad indicators do not reflect what states do, are not reliable measures of relative differences in states' fiscal capacities and are subject to significant data revisions, which can lead to different assessments of states' fiscal capacities, depending on which iteration of the data is applied.
- 3f. A donor-recipient model would not only fail to achieve simplicity, because the Commission would still be required to calculate states' relative fiscal capacities, but, over time, would lead to significant disparities in states' fiscal capacities.
- 3g. Equalisation provides vital financial support to the small states. An equal per capita distribution would lead to a great divide between the quality and scope of services provided across state borders.

4. HFE and efficiency

- 4.a. The weighted average standard effectively has an implicit efficiency benchmark because the largest states, which, due to their size, are better able to achieve efficiencies and have the greatest influence on the current standard.
- 4.b. The Commission's assessments currently include significant discounting, which dilutes equalisation outcomes. For example, 45 per cent of states' total own-source revenue is assessed on an equal per capita basis in the Other Revenue category and about 20 per cent of states' total expenditure is assessed largely on an equal per capita basis in the Other Expenses category. This does not include the discounting the Commission applies in other categories.
- 4.c. Equalising to a standard below the current weighted average may appear, on the surface, to be an attractive and simple option to address perceived efficiency issues within the HFE system. However, in the Territory's view, adopting a standard lower than the current weighted average would only serve to further dilute equalisation outcomes and lead to increasingly different levels of services being provided to Australians in different states.

5. HFE and Commonwealth payments to the states

- 5.a. The Territory supports the Commission's default position to treat tied Commonwealth payments by inclusion in the equalisation process unless the payments meet the well established criteria for exclusion.
- 5.b. The Territory would support developing a set of criteria where capital payments aimed at improving Australia's national network infrastructure or supporting Australia's economic and productivity growth are excluded from the equalisation process.

6. HFE and the mining boom

- 6.a. The two-tiered mining assessment introduced in the 2010 Review is flawed. Consideration should be given to changing the method for assessing states' capacities to raise mining royalty revenue as soon as possible, by increasing the number of groupings – either by mineral type or royalty rate.
- 6.b. The Territory supports consideration of an economic development assessment for mining-related expenditure. There is a strong case for a differential assessment of mining-related economic development expenses to capture the material differences in the level of support required in each state.

- 6.c. The Territory's preference is for mining-related economic development expenses to be captured through an expenditure assessment rather than the alternative proxy approach of discounting the mining revenue assessment.

7. The Northern Territory and Indigenous influences

- 7.a. The Territory strongly supports the Review Panel's (Panel's) view that Indigeneity and the Territory should remain within the HFE system. This is fundamental in recognising Australia as a federation and treating all Australians as equals.
- 7.b. Excluding the Territory from the HFE system and having the Commonwealth fund it directly would: create additional complexity and bureaucracy in both levels of government; draw distinctions between Territorians and all other Australians; and impinge upon the Territory Government's autonomy and its ability to tailor policies and services to meet the needs and priorities of Territorians.
- 7.c. The Territory supports the Panel's view that closing the gap between Indigenous and non-Indigenous outcomes should be addressed outside the HFE system.
- 7.d. The Territory would support a proposal for all states to voluntarily undertake additional reporting on Indigenous-related revenue and expenditure in order to increase transparency and accountability and to provide better understanding of how GST funding is spent.

8. HFE and state tax reform

- 8.a. The Territory's view is that nationally significant reforms should be pursued outside of the equalisation process and that tasking equalisation with promoting reforms would be pushing the limits of what equalisation can achieve and would not be a successful means of achieving significant reforms of state taxes.
- 8.b. The Territory agrees with the Panel that state tax reform should be pursued multilaterally, through collaborative Commonwealth and state negotiations.
- 8.c. Adopting lower revenue category standards would not achieve the desired outcome of addressing perceived disincentives for states to undertake tax reform. Rather, it would lead to some states having significantly higher fiscal capacities than others.
- 8.d. The Territory reaffirms its opposition to using equalisation as a means of providing financial incentives or disincentives for states to reform their taxes.

- 8.e. There is no capacity available in the GST pool for funds to be set aside to support tax reform. Another source of revenue, or consideration of changes to the GST revenue base/rate, would be required to provide states with additional funding to support nationally consistent state tax reform.

9. State mineral royalties and Commonwealth resource tax reforms

- 9.a. Due to the profit threshold and the application of the Mineral Resource Rent Tax (MRRT) to iron ore and coal only, Territory mining operators are not currently affected by the Commonwealth's resource tax reforms. However, there is potential for this to change in the future and the Territory's view is that the issue of the interaction between Commonwealth and state resource taxation regimes should be resolved as soon as possible.
- 9.b. Notwithstanding that the MRRT and Petroleum Resource Rent Tax (PRRT) do not currently affect the Territory, it is opposed to changes in Commonwealth-state relations that exacerbate the level of vertical fiscal imbalance (VFI) in Australia and/or limit state governments' autonomy to determine appropriate taxation policy in their state.
- 9.c. The Territory would be strongly opposed to any option or suggestion that attempted to resolve the issue of the interaction between state mining royalties and Commonwealth resource tax reforms through changes to the equalisation process. The Territory's preference is for multilateral negotiation between the Commonwealth and the states on principles for levying mining royalties in Australia.

10. Governance and communication

- 10.a. The Commonwealth and state governments each have a role in determining the principles and objectives of equalisation in Australia.
- 10.b. The Territory supports the role of the Commission as an independent and impartial body responsible for recommending the distribution of GST revenue between states.
- 10.c. The Territory is proposing changes to the way equalisation outcomes are presented, to reduce the potential for misinterpretation. The presentation of states' GST revenue shares should clearly show that GST revenue is intended to fill the gap between states' expenditure needs and revenue from other sources.

1

The role and purpose of HFE

Key Points:

- 1.a. The stated objective of the distribution of GST revenue between states, as outlined in the IGA, is HFE. No other objective is stated.
- 1.b. The Territory strongly supports the view that the achievement of equity is the most important goal of the distribution of GST revenue between states.
- 1.c. Tasking the distribution of GST revenue between the states with the achievement of substantive, additional national policy objectives, some of which may be in conflict with HFE, is not practical given the limited size of the GST pool. Efficiency-enhancing national reforms can be more effectively pursued through other mechanisms.
- 1.d. The GST redistributed to the smallest states provides vital budgetary support for the provision of core government services and ensures that small state constituents have reasonable access to services available to other Australians.
- 1.e. The Territory contends that the current form of equalisation does not fully equalise states' fiscal capacities in practice. The Commission's use of materiality thresholds, discounting, the impact of the lag effect and the notion of average policy all dilute the achievement of full equalisation.

- 1.1. Australia's system of federal financial relations involves various transfers from the Commonwealth to the states. The transfer of GST revenue is only one of the many forms of Commonwealth payment to the states, yet the distribution of GST revenue between states is the one that is subject to continued criticism and public debate.
- 1.2. The stated objective of the distribution of GST revenue between states, as outlined in the IGA, is HFE. No other objective is stated. Despite this, there are expectations from various commentators that the GST distribution system can or should achieve other objectives, including:

- promoting national efficiency of government service delivery and resource allocation;
 - promoting state tax reform;
 - closing the gap between Indigenous and non-Indigenous outcomes;
 - providing states with a predictable and stable revenue source; and
 - providing a solution to the interaction between state mineral resource taxation and Commonwealth resource tax reforms.
- 1.3. Not only is equalisation being asked to achieve the substantive policy objectives listed above, critics of the current equalisation process are also calling for it to achieve these societal objectives in the simplest possible manner, under a methodology agreeable to all states.
 - 1.4. While the Territory would be supportive of a system that could achieve all of these objectives, the practical limits of what the distribution of GST revenue can achieve must be acknowledged. Further, neither the size of the GST pool nor the amount redistributed between states is currently significant enough to present an adequate means of achieving the above goals.
 - 1.5. GST revenue comprises only 17 per cent of total Commonwealth taxation revenue, less than half of total transfers from the Commonwealth to the states, and about 25 per cent of total state revenue. Further, while the total GST pool is used for equalisation, only 8.3 per cent, or \$4 billion is estimated to be redistributed between states in 2012-13 compared with an equal per capita distribution. This amount represents about 0.3 per cent of Australia's Gross Domestic Product (GDP).
 - 1.6. While the amount of GST revenue redistributed between states is small, it provides vital financial support to the smaller states. The combined GST pool shares of the four small states, estimated to be \$9.8 billion in 2012-13, equates to less than New South Wales' 2012-13 government schools education budget alone (\$10.2 billion).
 - 1.7. The GST revenue redistributed to the small states provides vital budgetary support for the provision of core government services, and ensures that small state constituents have reasonable access to services that other Australians enjoy.
 - 1.8. The amount of GST redistributed to the small states could not be replaced without these states significantly increasing the tax burden on their citizens or businesses, and/or reducing standards of services. Either of these approaches would have a deleterious economic impact on these states' and the national economy. As stated by former Commonwealth Treasury Secretary, Dr Ken Henry "shifting cash from rich parts of Australia to those that were struggling was vital

to the country's overall financial health...without fiscal equalisation, the Federation would not hang together.”¹

- 1.9. Without equalisation, the Territory would not be able to provide the range or quality of services afforded to all other Australians. The importance of fiscal equalisation to the small states cannot be overstated.
- 1.10. The distribution of GST revenue between states is the only mechanism in Australia's system of federal financial relations that seeks to equalise states' fiscal capacities. In other federal systems, a combination of transfers between sub-national governments and national tax bases are used to equalise states' fiscal capacities, but in Australia, the only available instrument of equalisation is GST revenue.
- 1.11. The zero-sum nature of the GST distribution means that states are unlikely to reach consensus agreement on any distribution of GST revenue, as each state seeks to maximise its own revenue share. In their submissions to the Panel's Issues Paper, large states argued that the current form of equalisation:
 - is too extreme – Western Australia stated that the current form of fiscal equalisation in Australia “is equivalent to a 100 per cent tax on any excess of one state's fiscal capacity over the average for all states”;
 - is over-reaching in its quest for equality – Victoria stated that “The goal of equity can be achieved without the provision of the same standards of service...”; and
 - has unclear aims – that is, that the Commonwealth's and the Commission's definitions of equalisation differ. Queensland stated that “the aim of the GST distribution process should be to provide the necessary budget support so that all states have the capacity to provide services at a comparable standard.”
- 1.12. The Territory strongly supports the current form of equalisation. While some critics of the current form of equalisation consider that it is too comprehensive, the Territory contends that significant movement away from the current form would lead to severe disparities in the quality and range of services provided between different states in Australia.
- 1.13. Australia's form of equalisation is often described as full equalisation, in that it encompasses all revenue available to states and all state expenditure responsibilities, and by doing so seeks to provide states with the fiscal capacity to deliver the same standards of services. The Panel is considering whether equalisation should be restricted such that states would be provided with the fiscal capacity to deliver comparable levels of services rather than the same levels

¹ The West Australian, *Rich States urged to help poor*, 25 May 2012

of services. The Territory's analysis of this approach is detailed in *Chapter 4 – HFE and efficiency*.

- 1.14. The Territory contends that the current form of equalisation does not fully equalise states' fiscal capacities in practice. The Commission's use of materiality thresholds, discounting, the impact of the lag effect and the notion of average policy all dilute the achievement of full equalisation. The practical outcome of the Commission's current processes is that states receive only the capacity to deliver comparable services rather than the same services.
- 1.15. Australia's form of equalisation is appropriate given the extent of VFI in the Australian Federation. It provides vital financial support to the smallest states, is contemporary and responsive to changes in state circumstances. Further, Australia's form of equalisation recognises that there are stark differences between states' revenue raising capacities and expenditure needs, and that the factors affecting state revenues and expenditure differ greatly.

2

Predictability and stability of HFE outcomes

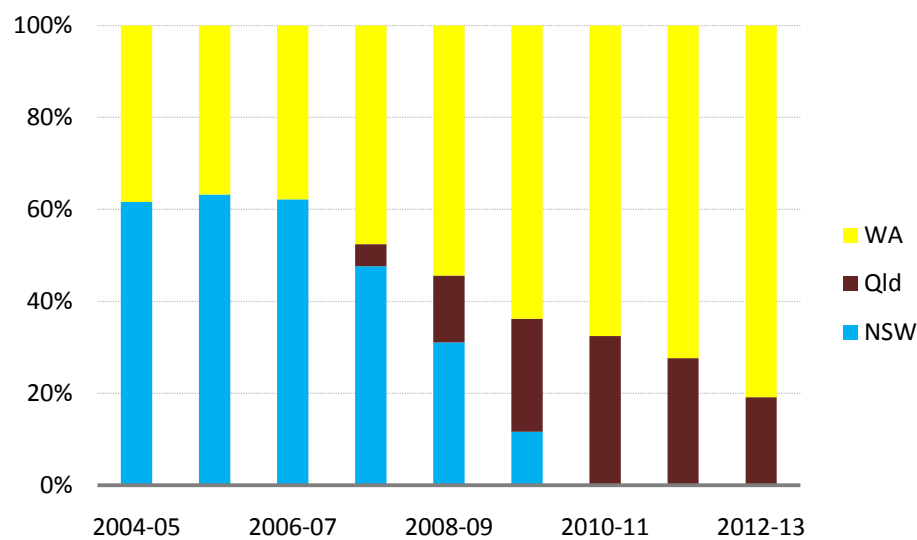
Key Points:

- 2.a. While stability and predictability of HFE outcomes are desirable features of a GST distribution system, they are not essential nor are they consistent with a dynamic system that responds to economic change.
- 2.b. The Territory's view is that the current form of equalisation provides an appropriate balance between responsiveness and stability through the three-year averaging process.
- 2.c. Options that provide greater predictability, stability and more contemporary assessments should only be considered if they are consistent with equalisation.

- 2.1. Predictable, stable and contemporaneous assessments are desirable features of a HFE system; however these are not essential nor are they consistent with a dynamic system that responds to changes in states' circumstances.
- 2.2. These objectives are not complementary and should not be first-order considerations in determining whether or not changes to the current form of equalisation are required. Options that provide greater predictability, stability and more contemporary assessments should only be considered if they are consistent with equalisation.
- 2.3. The GST is a tax on consumption. Consequently, the amount of total GST revenue collected is influenced by external economic factors. Fluctuations in the amount of total GST revenue collected in a period could be likened to other tax revenues, resulting from changes in the prevailing economic environment. It is unreasonable to suggest that GST is substantially less stable than other taxes.
- 2.4. While, at the aggregate level, the amount of GST revenue collected in a period is not substantially more volatile than any other broad-based tax, states' shares of GST revenue change from year to year. This is an essential feature of equalisation, whereby the distribution of GST revenue between the states changes in response to changes in states' fiscal capacities. More recently, the volatility in relativities has been driven by changes in states' revenue-raising capacities, primarily due to significant increases in some states' mining royalty revenue as a result of the

commodities boom. Figure 2.1 shows that Western Australia’s contribution to the redistribution of GST revenue from the revenue assessments has increased since 2006-07, reflecting its increasing capacity to raise mining royalties.

Figure 2.1: Contribution of revenue assessments to the redistribution of GST revenue



Source: Commonwealth Grants Commission reports (various)

- 2.5. If measures were in place to reduce the volatility in relativities over this period by limiting the responsiveness of equalisation to economic changes, states’ fiscal positions could be expected to diverge significantly.
- 2.6. The Territory contends that each state’s GST revenue would still be subject to volatility if mechanisms specifically aimed at limiting its effect on relativities were adopted. This is because changes to the GST pool and, to a lesser extent, state population shares, will continue to contribute to volatility. Indeed, when states agreed to replace the previous Financial Assistance Grants (which generally grew in real per capita terms) with GST revenue (which is influenced by changes in national and international economic conditions) states accepted a greater level of volatility in state revenue.
- 2.7. More recently, consistent downward revisions to the GST pool as a result of changes in consumption patterns and moderating consumption growth following the global financial crisis have been a significant impediment to states’ abilities to reliably forecast GST revenue, requiring governments to continually review their fiscal strategies and policies. This was evident when states were managing their 2011-12 Budgets.
- 2.8. Table 2.1 shows the changes to estimates of each state’s 2011-12 GST revenue between the Commonwealth’s 2011-12 and 2012-13 Budgets. In each of these reporting periods the 2011-12 GST relativities had already been determined. The

variation in each state's GST revenue is largely due to downward revisions to the GST pool estimates, and to a lesser extent revisions to population estimates. Table 2.1 shows that despite the GST relativities already being determined, states' GST revenue estimates decreased between 4.8 per cent for the Australian Capital Territory and 6.7 per cent for the Territory over a 12-month period.

Table 2.1: Commonwealth estimates of 2011-12 GST revenue entitlement

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
1) 2011-12 Budget (\$M)	14 950	10 889	9 139	3 598	4 493	1 743	867	2 672	48 350
2) 2011-12 MYEFO (\$M)	14 684	10 704	8 973	3 539	4 417	1 713	856	2 614	47 500
3) 2012-13 Budget (\$M)	14 105	10 274	8 601	3 420	4 239	1 643	825	2 494	45 600
<u>Change (3)-(1)</u>									
\$ million	- 845	- 615	- 538	- 179	- 253	- 100	- 41	- 179	- 2 750
Per cent	- 5.7%	- 5.6%	- 5.9%	- 5.0%	- 5.6%	- 5.7%	- 4.8%	- 6.7%	- 5.7%

Source: Commonwealth Budget Papers (various)

2.9. Table 2.1 shows the volatility of Commonwealth estimates of each state's GST revenue over a 12-month period, while Table 2.2 shows that volatility of estimates also exists over the forward estimates period. It shows Commonwealth estimates of the GST pool since its 2008-09 Budget. Between the Commonwealth's 2008-09 and 2012-13 Budgets, the estimates of the 2010-11 GST pool have been revised downwards by 15 per cent. Similarly, between the Commonwealth's 2010-11 and 2012-13 Budgets, estimates of the 2013-14 GST pool have been revised downwards by 11.5 per cent, or \$6.6 billion.

Table 2.2: Commonwealth estimates of GST pool, \$ million

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
2008-09 Budget	45 280	48 260	50 880	53 670	-	-	-	-
2009-10 Budget	41 189	41 330	43 580	46 460	49 410	-	-	-
2010-11 Budget	-	44 510	47 930	51 210	54 380	57 510	-	-
2011-12 Budget	-	-	45 450	48 350	51 750	54 700	57 400	-
2012-13 Budget	-	-	-	45 600	48 200	50 900	53 500	56 075

Source: Commonwealth Budget Papers (various)

2.10. Other taxes are similarly difficult to forecast. Table 2.3 shows changes in Western Australia's estimated mining royalty revenue between its 2008-09 and 2012-13 Budgets. It shows that Western Australia's 2012-13 Budget estimates of its mining royalty revenue for 2011-12 were 60 per cent or \$1.7 billion higher than at the time of its 2008-09 Budget.

Table 2.3: Western Australia's Budget estimates of mining royalty revenue, \$ million

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
2008-09 Budget	3 423	3 597	3 397	2 751	-	-	-	-
2009-10 Budget	2 675	2 577	2 684	2 758	2 873	-	-	-
2010-11 Budget	-	2 217	3 271	3 598	3 673	3 535	-	-
2011-12 Budget	-	-	4 159	4 794	4 998	5 447	5 336	-
2012-13 Budget	-	-	-	4 493	4 871	5 933	6 239	6 563

Source: Western Australian State Budgets (various)

- 2.11. While stability and predictability are desirable features of a fiscal equalisation system, they are not essential nor are they consistent with a dynamic system that responds to economic change. The Territory's view is that the current form of equalisation provides an appropriate balance between responsiveness and stability, achieved through the three-year averaging process.
- 2.12. The Territory's views on options raised in the Panel's Interim Report aimed at providing greater stability in GST revenue follow.

Changing the averaging period

- 2.13. In the 2010 Review, the Commission reduced the averaging process from five years to three years in order to provide a better balance between stable and contemporaneous relativities. The Commission had been increasingly concerned that the lack of contemporaneity as a result of the five-year averaging period was detracting from the achievement of equalisation. The Territory contends that the current three-year averaging process provides sufficient stability in relativities, while allowing equalisation to respond to changes in state circumstances in a timely manner.

Fixing annual relativities

- 2.14. The Territory's view is that advantages associated with fixing annual relativities by not adjusting, or backcasting, for data updates would be outweighed by the shortcomings of this option.
- 2.15. One disadvantage of fixing annual relativities is that known errors would remain in the Commission's assessments. The most recent assessment year is most likely to require revisions. For example, the Commission requires state-provided data for the most recent assessment year in order to calculate the standard budget, as Australian Bureau of Statistics (ABS) Government Finance Statistics data is not available in time for release of the Commission's updates. The Territory contends that the continued use of data that contains known errors would not be accepted in other forums.
- 2.16. Another disadvantage is that the assessments would be less contemporary. The Commission's assessments would be based on outdated data or data that has

been subsequently revised, for example population data. Over time, the continued use of outdated data would mean a greater departure from the achievement of equalisation.

- 2.17. The Panel has suggested that flexibility should be retained to allow data revisions to be made on a case-by-case basis. This would lead to threshold issues. Should data updates be limited to those that do not lead to material changes in GST revenue shares in order to provide stability? Alternatively, should data updates be limited to those that result in material changes to states' GST revenue shares in order to increase the reliability of the assessments? If only material data revisions were made, this would contradict the intent of this option, which is to provide greater stability of states' GST revenue.
- 2.18. The recent inclusion of updated wages data published by the ABS has led some states to question whether the Commission should have backcast this data update. The Commission includes the most recent data available in its assessments to ensure that its assessments are robust. However, this led to material revisions to states' GST revenue shares.
- 2.19. A case-by-case consideration would be unlikely to result in greater simplification as transparency would require all decisions about data updates to be explained.
- 2.20. The Territory's view is that backcasting data updates is appropriate. The impact on states' GST revenue shares of the wages data update is the result of the Commission under or overestimating wages growth in each jurisdiction. While backcasting updated wages data may be considered to be to the disadvantage of some states, this needs to be balanced against the fact that the GST revenue shares received by these states had been overstated because the use of the previous data had effectively overestimated their wages costs.

Limiting relativity changes

- 2.21. The Territory strongly supports the Panel's view that there is no compelling case to adopt a floor in relativities, and that this would cause major disparities in the fiscal positions of states. The Panel is considering the option of ensuring that a state does not receive a lower nominal amount of GST revenue than its share from the previous year (in years where the GST revenue pool grows).
- 2.22. This option is akin to a guaranteed minimum amount. This approach would be feasible if the Commonwealth provided top-up funding, external to the GST pool, in the event that a state's assessed GST revenue fell below its nominal GST revenue from the previous year. However, if no additional Commonwealth funding was available, the top-up funding would be provided through reductions in the GST revenue of the other states. This option is therefore tantamount to an implicit floor in relativities and would lead to disparities in states' fiscal positions.

3 Simplicity

Key Points:

- 3.a. Simplicity was a key objective and outcome of the 2010 Review. Further simplification measures should only be implemented if there is no detriment to equalisation.
- 3.b. The Territory believes that the number of categories and disabilities adopted in the 2010 Review provides an adequate balance between simplicity and achievement of equalisation.
- 3.c. The current adjustments to states' revenue bases are simple, intuitive, have a material impact on states' assessed revenues and reflect average state policies. Removing these adjustments would not result in significant simplicity gains.
- 3.d. Currently, about 45 per cent of states' total own-source revenues are assessed on an equal per capita basis in the Other Revenue category, while about 20 per cent of states' total expenditure is largely assessed on an equal per capita basis in the Other Expenses category. The proportion of states' total revenue and expenditure captured in the 'other' categories suggests that the current materiality thresholds are already sufficient, if not too high.
- 3.e. Broad indicators do not reflect what states do, are not reliable measures of relative differences in states' fiscal capacities and are subject to significant data revisions, which can lead to different assessments of states' fiscal capacities depending on which iteration of the data is applied.
- 3.f. A donor-recipient model would not only fail to achieve simplicity, because the Commission would still be required to calculate states' relative fiscal capacities, but, over time, would lead to significant disparities in states' fiscal capacities.
- 3.g. Equalisation provides vital financial support to the small states. An equal per capita distribution would lead to a great divide between the quality and scope of services provided across state borders.

- 3.1. The 2010 Review devoted considerable time and resources to pursuing greater simplicity in the achievement of HFE. For the most part, the increased simplicity of the equalisation process has contributed to greater understanding and transparency, although in some assessments, the pursuit of simplicity has resulted in unsatisfactory outcomes.
- 3.2. The Territory supports measures that lead to further simplification of the equalisation process provided that they do not compromise the robustness of assessments or equalisation outcomes. Simplification is only a desirable feature of equalisation if it leads to greater administrative efficiency, transparency, accountability, reduced scope for policy influence and enables the methodology to be more readily understood. If these outcomes are not achieved, simplification adds no value and should not be pursued.
- 3.3. There are numerous variables that influence the costs of and demand for government services and states' capacities to raise revenue, resulting in material differences in states' fiscal capacities to deliver services. Where these differences add materially to states' costs or demand for services, the Commission attempts to assess them. Assessing these material differences may give the Commission's methodology a veneer of complexity, but complexity should not be confused with detail or reliability.
- 3.4. The Territory's view is that the current level of detail in the Commission's assessments is necessary to capture the material cost and capacity differences of states' costs of delivering services or capacities to raise revenue. Without this level of detail, material disabilities could be understated or ignored to such an extent that equalisation outcomes would be compromised.
- 3.5. The Interim Report details a number of simplification options raised during the course of the GST Distribution Review. The Territory's views on each of the proposed options are discussed below.

Adopting higher materiality thresholds

- 3.6. Applying materiality thresholds is a rudimentary approach to simplifying the Commission's assessments. However, the Territory accepts that materiality thresholds provide a balance between detail and simplicity. In determining appropriate materiality thresholds it is important that equalisation objectives remain the priority.
- 3.7. Prior to consideration of whether a higher materiality threshold should be applied, it is important to understand and acknowledge the work undertaken by the Commission in this area in the 2010 Review.

- 3.8. In response to the 2010 Review Terms of Reference, the Commission included quantified materiality thresholds in its assessment guidelines. The thresholds relate to the size of:
- a category (average expenditure or revenue of at least \$50 per capita);
 - GST revenue redistributed by a category (\$30 per capita for at least one state);
 - GST revenue redistributed by a disability (\$10 per capita for at least one state); and
 - GST revenue redistributed by an adjustment for improving comparability of data (\$3 per capita for at least one state).
- 3.9. The Commission consulted with states on the size of the thresholds, stating “while some would have preferred higher thresholds and others lower ones, there was a consensus that they were a reasonable compromise and they should reduce the level of detail in the assessments while still recognising the important influences on state fiscal capacities...”²
- 3.10. The current number of categories and assessments is the result of the Commission adopting a clean slate, top-down approach to its assessments in the 2010 Review. The Commission began with only four expenditure and four revenue categories. The categories were disaggregated only if:
- the factors affecting states’ service delivery costs or revenue-raising capacities were different and that these differences could not be adequately captured in a single category; and
 - the disaggregated category exceeded the agreed materiality threshold criteria.
- 3.11. The implementation of the above thresholds resulted in a significant reduction in the number of:
- assessment categories from 29 to 13;
 - assessment components from 171 to 43; and
 - disabilities from 344 to 93.
- 3.12. Despite the simplification gains made in the 2010 Review, some states have suggested that the Commission did not go far enough and that higher thresholds should be adopted.
- 3.13. In effect, the average revenue or expenditure in categories adopted by the Commission in the 2010 Review far exceeded the minimum \$50 per capita threshold. In 2010-11, the smallest expenditure category was Post Secondary

² Commonwealth Grants Commission, *Report on GST Revenue Sharing Relativities – 2010 Review, Volume 1*, page 87

Education, with average per capita expenditure of \$257.92, and the smallest revenue category was Insurance Tax, with average per capita revenue of \$148.91.

- 3.14. As noted by the Panel, a significant increase to the threshold would be required in order to make any further simplification gains. For example, a six-fold increase in the materiality threshold for the size of a category (to \$300 per capita) would eliminate only two additional revenue categories (land tax and insurance tax) and two expenditure categories (post secondary education and roads). These areas are major government revenue sources/service functions, where capacity or needs differ markedly between states.
- 3.15. The arbitrary nature of increasing the materiality threshold could result in some categories oscillating between being included and being excluded from the Commission's assessments. For example, under a \$300 per capita category materiality threshold the Services to Communities category would meet the threshold in 2010-11, with an average per capita expenditure of \$300.31, but would have been ineligible in 2009-10, with average per capita expenditure of \$287.51.
- 3.16. The Other Revenue and Other Expenses categories are used to capture all remaining expenditure and revenue that has not met the Commission's materiality criteria. Currently, about 45 per cent of states' total own-source revenues are assessed on an equal per capita basis in the Other Revenue category, while about 20 per cent of states' total expenditure is largely assessed on an equal per capita basis in the Other Expenses category.
- 3.17. The proportion of states' total revenue and expenditure captured in the 'other' categories suggests that the current materiality thresholds are already sufficient, if not too high. For example, even though it has generally argued for equalisation to be limited through the application of a floor on relativities, in its submission to the Issues Paper, Western Australia recommended that "major gaps in the HFE expenditure assessments be addressed (e.g. facilitating economic development, servicing national parks, Indigenous socio-economic status indicator etc)..."³
- 3.18. Small increases in the materiality thresholds will result in negligible simplification gains, while larger increases in the materiality thresholds will have a significant adverse impact on equalisation outcomes.
- 3.19. The Territory believes that the current number of categories and disabilities adopted as part of the 2010 Review provides an adequate balance between simplification and achievement of equalisation outcomes. Increasing the thresholds would only serve to exclude categories or factors that are proven to have a material and differential impact on a state's costs of providing the average level of services; or capacities to raise revenue.

³ Western Australia, *GST Distribution Review WA Submission*, October 2011, page 54

Removing adjustments for tax differences

- 3.20. Some states have proposed that simplification gains can be made by reducing the detail in the Commission's revenue assessments.
- 3.21. The starting point for the Commission's revenue assessments is determining the base and then to make adjustments to the base to reflect 'what states collectively do'.
- 3.22. Examples of adjustments for tax differences include the adjustment/s to the:
- payroll tax revenue base to reflect average state policy to exempt small businesses and the general government sector;
 - land tax revenue base to reflect average state policy to exempt principal place of residence and land used for primary purposes, general government and charitable purposes; and
 - conveyance duty base to reflect average state policy to adopt progressive conveyance duty tax rates.
- 3.23. Each revenue base adjustment for tax differences met the materiality thresholds before being adopted in the 2010 Review. This means that not every difference is adopted but only material differences in states' capacities to raise revenue are captured. The importance and significance of including adjustments to reflect average state policies is demonstrated by the following worked example for payroll tax.
- 3.24. The revenue base for the payroll tax assessment is ABS compensation of employees' data, which is a broad measure of remuneration paid to employees in both the public and private sectors. However, this measure overstates capacities to raise payroll tax because the scope of the dataset is broader than what states actually tax or are able to tax. As a result, the Commission adjusts the data to reflect the average state policy to exempt small businesses, the general government sector (including Commonwealth), embassies and the defence force.
- 3.25. On the surface, it appears that simplification gains could be made by removing the detailed adjustments to the payroll tax revenue base. However, this would be a move away from the principle of 'what states do' and because there are material differences between states in the balance of small and large business or Commonwealth government employees, not taking these differences into account would result in an over or underestimation of a state's capacity to raise payroll tax relative to other jurisdictions, and hence a reduction in the reliability of the assessment.
- 3.26. Figure 3.1 shows each state's actual payroll tax revenue compared with assessed per capita revenue with and without the adjustments. It shows that if the adjustments to payroll tax revenue base were removed, the four small states'

assessed revenue raising capacities would increase relative to the four large states. This was an anticipated outcome because the small states have a higher proportion of small business or, in the cases of the Australian Capital Territory and the Territory, more Commonwealth employees that are exempt from payroll taxes in all states.

Figure 3.1: Actual and assessed payroll tax revenue, \$ per capita



Source: Commonwealth Grants Commission, *Report on GST Revenue Sharing Relativities – 2010 Review*, Northern Territory Treasury

- 3.27. Removing the payroll tax adjustments will primarily disadvantage the Australian Capital Territory (-\$576 per capita or -\$200 million in GST revenue) and the Northern Territory (-\$210 per capita or -\$47 million in GST revenue). Both these jurisdictions have relatively large general government and defence force sectors and small business sectors, which are exempt from payroll tax. Subsequently, removing the adjustments will result in an overestimation of the capacities of these jurisdictions to raise payroll tax revenue.
- 3.28. The Commission's approach to adjusting each state's revenue base is simple, intuitive, has a material impact on states' assessed revenue capacities and reflects average state policies. The Territory's view is that removing adjustments would not result in significant simplification gains. Rather, this would only serve to distort equalisation outcomes by over or underestimating a state's revenue-raising capacity relative to other states.

The use of broad indicators

- 3.29. Investigating the potential for greater application of broad indicators in the equalisation process is not a new concept. Indeed, the Commission has gone to great lengths on a number of occasions, most recently during the 2010 Review, to unearth broad measures that could reliably measure differences between states at either an aggregate revenue or expenditure level or for individual categories.

- 3.30. The Territory would not be averse to greater use of broad measures in the Commission's assessments if this did not result in the deterioration of equalisation. For broader indicators to be considered, the measure must satisfy a reality check and must accurately reflect differences between states' costs of delivering services or revenue raising capacities.
- 3.31. The Territory has examined the practicality of broad measures on both the revenue and expenditure side and findings are discussed below.

Broad indicators for revenue assessments

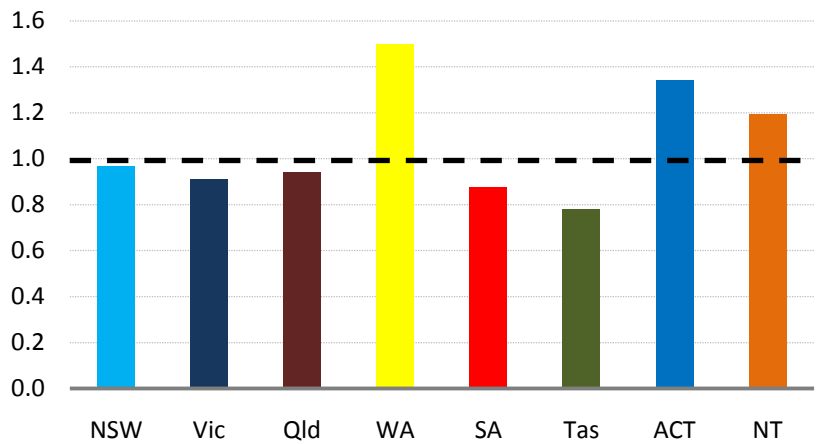
- 3.32. Despite the Commission's best efforts in past methodology reviews, broad indicators of states' revenue capacities were not identified as providing better or simpler outcomes. The Commission noted that adopting broad indicators rather than focusing on what states do would "measure [states'] revenue raising advantages and disadvantages on a theoretical basis, rather than in the context of the practical constraints states face in raising revenue and the tax instruments they use".⁴
- 3.33. The Commission identified the following conceptual problems with adopting broad measures as an indication of states' revenue capacity that do not occur under a tax by tax approach:
- industry structure was hidden in an aggregate measure but may be relevant to the capacity of an economy to pay taxes from production;
 - differences between states in the distribution of income among their residents did not show up in the aggregate measures but they were relevant to capacity to pay taxes because many taxes are progressive;
 - gross state product (GSP) and household disposable income (HDI) measured the annual value of production in each state or the annual income of residents of a state – they may not adequately reflect the effects of the stocks of wealth on capacity to pay;
 - non-residents paid taxes (for example gambling and property taxes) and some state taxes were paid by companies that passed them on to their consumers, some of whom may live in other states – a state-based global measure may not reflect this exporting of taxes; and
 - it may be difficult to remove the effects of other taxes, such as income tax and company tax from income measures and there was also the problem of how to deal with undistributed profits.⁵

⁴ Commonwealth Grants Commission, *Discussion paper CGC2002/04 Global Revenue Assessments*, 2002

⁵ Commonwealth Grants Commission, *Report on GST Revenue Sharing Relativities – 2010 Review*

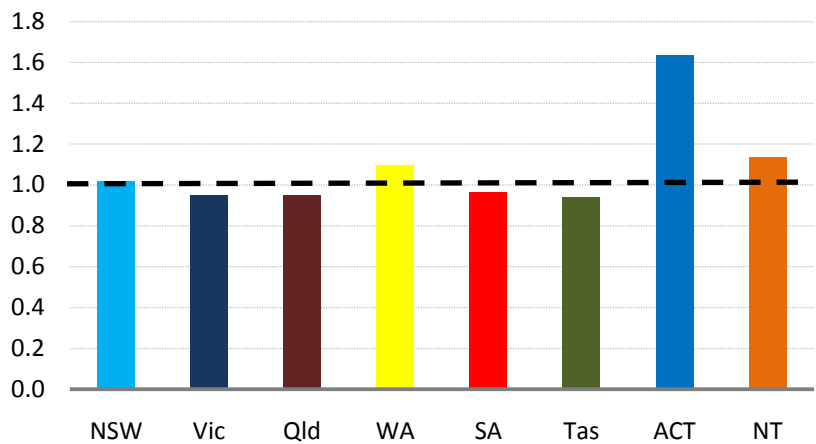
- 3.34. GSP and HDI are examples of broad measures that have been proposed for measuring differences in states’ revenue raising capacities at the aggregate revenue level.
- 3.35. Figures 3.2 and 3.3 show the relative revenue raising capacities of each jurisdiction using GSP or GHDI as a measure of total state revenue. Under a GSP or HDI measure, the Australian Capital Territory and the Territory would be assessed as having above average capacities to raise own-source revenue. This is counterintuitive given these states’ relatively small revenue bases and relatively large government sectors, which are exempt from state taxes. Further, the Australian Capital Territory does not have any capacity to raise mining royalty revenue. It is also counterintuitive that New South Wales, Victoria and Queensland would be assessed as having below average revenue raising capacities under a GSP or HDI measure.

Figure 3.2: Ratio of GSP per capita to the Australian average, 2010-11



Source: ABS, *Australian National Accounts: State Accounts, 2010-11*, Cat. No. 5220.0

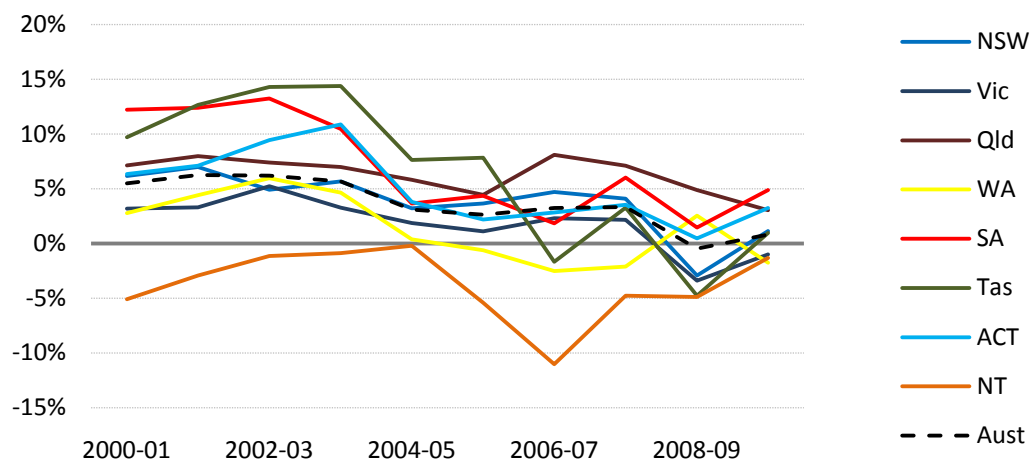
Figure 3.3: Ratio of HDI per capita to the Australian average, 2010-11



Source: ABS, *Australian National Accounts: State Accounts, 2010-11*, Cat. No. 5220.0

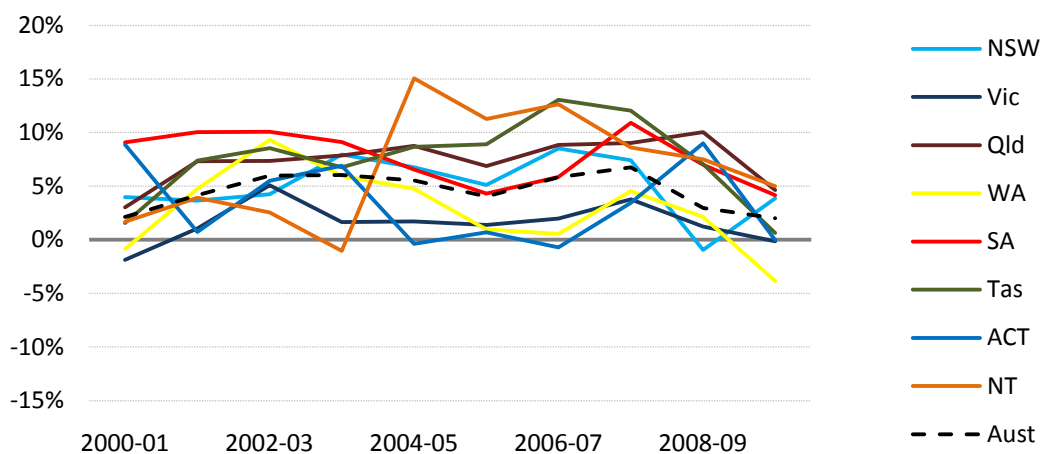
3.36. In addition to inaccurately reflecting differences in states' revenue raising capacities, GSP and HDI data are subject to significant and ongoing revisions. These revisions are not in the same direction for all states and are of differing magnitudes. Figures 3.4 and 3.5 show the change between the original and current estimates to GSP and HDI data, respectively for each state.

Figure 3.4: Percentage change between original and current estimates of GSP



Source: ABS, *Australian National Accounts: State Accounts*, Cat. No. 5220.0 (various)

Figure 3.5: Percentage change between original and current estimates of HDI



Source: ABS, *Australian National Accounts: State Accounts*, Cat. No. 5220.0 (various)

3.37. If these indicators were used to measure revenue needs, the ongoing revisions to this data would have significant impacts on each state's GST revenue shares. Table 3.1 shows estimates of each state's 2007-08 GSP and the subsequent annual revisions to this data. It shows that the revisions have been significant for all states, however the magnitude and direction of the revisions vary.

3.38. For example, Queensland's 2007-08 GSP has been revised upwards by 7.1 per cent, which means that its revenue-raising capacity would have been understated in the original estimate. Therefore, Queensland would have received

more GST revenue using the original data than using the current data as shown in Table 3.2.

Table 3.1: Revisions to 2007-08 GSP

Year Released	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc
2007-08 (original)	51 880	51 205	50 727	73 683	46 171	42 994	69 043	72 324	53 523
2008-09	54 972	53 494	52 666	72 706	48 262	44 938	71 862	73 031	55 650
2009-10	54 639	53 521	53 402	74 527	47 434	44 211	71 147	71 333	55 771
2010-11 (current)	54 004	52 323	54 329	72 138	48 962	44 408	71 492	68 880	55 311
% Change between original and current	4.1%	2.2%	7.1%	- 2.1%	6.0%	3.3%	3.5%	- 4.8%	3.3%

Source: ABS, *Australian National Accounts: State Accounts*, Cat. No. 5220.0 (various)

Table 3.2: Estimated GST impacts of revisions to 2007-08 GSP (as a broad measure of states' revenue needs), \$ million

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M
2007-08 original	12 885	8 555	10 483	2 143	4 185	1 744	101	2 234	42 330
2007-08 current	12 635	8 836	9 746	2 920	4 003	1 745	96	2 349	42 330
Difference	250	- 281	738	- 777	182	- 1	4	- 116	0

Source: ABS, *Australian National Accounts: State Accounts*, Cat. No. 5220.0 (various)

3.39. Similarly, Tables 3.3 and 3.4 show that revisions to 2007-08 HDI would also have had a material impact on states' GST revenue shares. Although all states' HDI were revised upwards, Victoria, Western Australia and the Australian Capital Territory's revenue-raising capacity were overstated using the original data because the upward revisions were less than the revision to the national average.

Table 3.3: Revisions to 2007-08 HDI

Year Released	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc
2007-08 (original)	33 456	33 546	30 276	34 091	30 404	29 216	52 389	34 952	32 898
2008-09	35 645	34 339	30 940	35 293	31 741	29 914	50 553	35 272	34 156
2009-10	35 310	35 391	31 454	35 471	32 199	31 141	54 794	36 248	34 569
2010-11 (current)	35 941	34 809	33 007	35 645	33 718	32 739	54 194	37 963	35 118
% Change between original and current	7.4%	3.8%	9.0%	4.6%	10.9%	12.1%	3.4%	8.6%	6.7%

Source: ABS, *Australian National Accounts: State Accounts*, Cat. No. 5220.0 (various)

Table 3.4: Estimated GST impacts of revisions to 2007-08 HDI (as a broad measure of states' revenue needs)

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M
2007-08 original	11 220	6 888	11 068	5 799	3 691	1 532	- 419	2 550	42 330
2007-08 current	10 993	7 641	10 650	6 027	3 402	1 422	- 334	2 530	42 330
Difference	227	- 753	418	- 228	289	111	- 85	21	0

Source: ABS, *Australian National Accounts: State Accounts*, Cat. No. 5220.0 (various), Northern Territory Treasury

3.40. The Table 3.4 analysis relates to revisions to estimates of 2007-08 GSP and HDI data that occurred three years after its original release. Revisions to data in the year following its original release can also have a significant impact on states' GST revenue shares, as shown in Table 3.5.

Table 3.5: Impact of revisions to 2009-10 GSP (as a broad measure of total revenue needs) on GST revenue

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
Original (\$pc)	56 591	54 793	54 559	81 159	49 152	46 185	78 164	71 279	57 965
Current (\$pc)	57 239	54 245	56 229	79 751	51 557	46 631	80 715	70 352	58 448
% change	1.1%	- 1.0%	3.1%	- 1.7%	4.9%	1.0%	3.3%	- 1.3%	0.8%
GST revenue (if GSP was used as a broad measure of total revenue needs)									
Original (\$M)	13 442	9 902	10 449	2 309	3 998	1 601	191	2 131	44 022
Current (\$M)	13 350	10 307	10 052	2 656	3 760	1 599	141	2 157	44 022
Difference (\$M)	91	- 405	397	- 347	238	2	49	- 26	0

Source: ABS, *Australian National Accounts: State Accounts*, Cat. No. 5220.0 (various), Northern Territory Treasury

3.41. Tables 3.6 and 3.7 show the GST revenue impact of adopting GSP or GHDI as measures of revenue needs for the 2012 Update. It should be noted that based on the GHDI measure, the Australian Capital Territory's relativity would be negative. That is, the amount of revenue it would be assessed as being able to raise would more than offset its assessed expenditure requirement. The Territory believes that this would not be an acceptable outcome of equalisation given the Australian Capital Territory's limited own-source revenue raising capacity.

Table 3.6: Impact of adopting GSP as a measure of states' revenue raising capacity

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
2012-13 relativities	0.95312	0.92106	0.98477	0.55105	1.28472	1.58088	1.19757	5.52818
2012-13 relativities – revised	0.93523	0.94277	1.14675	0.48218	1.22428	1.62378	0.22213	4.93702
Impact (\$M)	- 279	260	1 589	- 350	- 213	46	- 764	- 290

Source: ABS, *Australian National Accounts: State Accounts*, Cat. No. 5220.0 (various), Northern Territory Treasury

Table 3.7: Impact of adopting HDI as a measure of states' revenue raising capacity

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
2012-13 relativities	0.95312	0.92106	0.98477	0.55105	1.28472	1.58088	1.19757	5.52818
2012-13 relativities - revised	0.83040	0.85304	1.19212	1.24236	1.02508	1.26522	-0.40676	5.15771
Impact (\$M)	- 1 940	- 846	2 004	3 492	- 922	- 344	- 1 256	- 189

Source: ABS, *Australian National Accounts: State Accounts*, Cat. No. 5220.0 (various), Northern Territory Treasury

- 3.42. The above analysis highlights some of the flaws of using broad indicators of states' revenue needs. These flaws are also apparent when applying other broad measures because the drivers of change in states' tax bases differ from those of broad economic indicators. In addition, broad indicators do not reflect what states do and are subject to significant revisions, which can lead to different assessments of states' fiscal capacities depending on which iteration of the data is applied. The latter issue discredits the premise that broad indicators provide greater stability of states' GST revenue shares over time.
- 3.43. The Panel is also considering whether broad measures could be applied at the category level. The Territory's view is that the current measures of revenue bases are directly representative of states' actual tax bases and that it would be futile to adopt broad measures that would not result in simplification gains overall but would be inaccurate indicators of states' revenue needs. If broad measures were adopted the Territory contends that adjustments would still be necessary in order to better reflect what states do.

Broad indicators for expenditure assessments

- 3.44. Some states have proposed a more general approach to assessing states' expenditure needs. These options can be summarised as either:
- assessing expenditure disabilities at an aggregate level. This approach is currently used for the location and administrative scale factors and some states have suggested that this approach could be applied to other disabilities such as population characteristics; and
 - streamlining categories by introducing a single or a small number of indicators of expenditure needs.

Common factor approach

- 3.45. Common factors include administrative scale, location, service delivery scale, national capital, cross border and native title. Effectively, the Commission calculates these factors independently and then applies the factors to relevant categories. Queensland has proposed that other disabilities such as those relating to demographic influences could be assessed under a similar approach.

- 3.46. The Territory has interpreted Queensland's proposal as determining a single factor (for example) Indigeneity, which could then be applied to the relevant categories instead of having separate Indigenous factors for each category. The issue with this approach is that Indigenous use and costs differ depending on the service. For example, the additional costs associated with the provision of services to Indigenous people differ for justice, hospitals, education, welfare, community health and services to communities.
- 3.47. A single Indigenous factor would require the calculation of a weighted average across the relevant government services. While the assessed GST revenue needs for each state under a common factor approach should be the same as assessing Indigeneity within each category, the common factor approach would lead to a loss of transparency. For example, the common factor approach could overstate the impact of Indigeneity on costs of delivering education services while understating the impact on justice services.
- 3.48. The common Indigenous factor approach would not result in simplification gains because the Commission would still need to collect the data in order to calculate the weighted average Indigenous factor. This would also be true for other disabilities where the impact on costs differs by service function, for example, low socio-economic status and remoteness.
- 3.49. For these reasons the Territory does not support extending the common factor approach to assessing the impact of population characteristics on service delivery costs.

Assessing major disabilities only

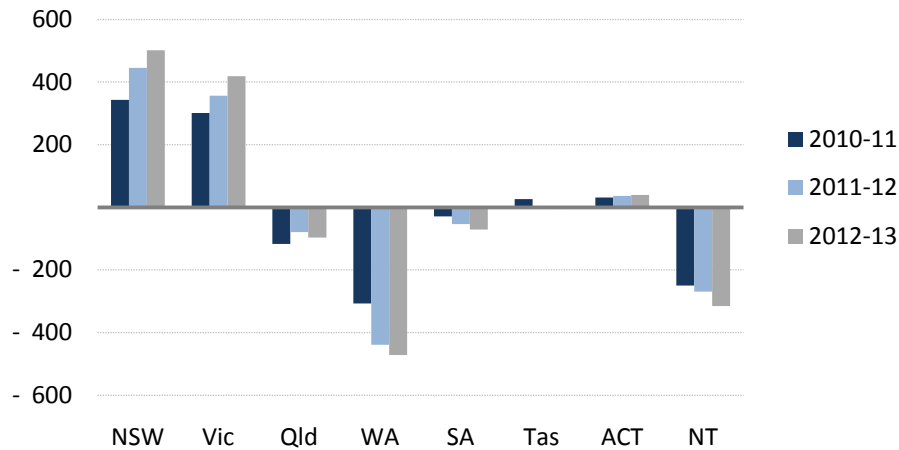
- 3.50. In their submissions to the Panel's Issues Paper, Victoria, Queensland, Western Australia and the Chamber of Commerce and Industry Western Australia have proposed using a single or a small number of high level indicators to capture differences in states' expenditure needs either at the aggregate or individual category level.
- 3.51. For example, the expenditure assessments would only capture differences in wages, Indigeneity, location, remoteness and scale. As detailed in the section on materiality thresholds earlier in this chapter (paragraphs 3.6 to 3.19), the Territory is strongly opposed to limiting the expenditure assessment to only high level disabilities as this would result in significant deterioration in equalisation outcomes, with material disabilities being ignored.

Equalising only for major revenue and expenditure items

- 3.52. New South Wales has proposed limiting the assessment of differences in states' expenditure needs to core categories.
- 3.53. The cost drivers that influence expenditure differ markedly between categories and for that reason assessments should be different in each category. While the Commission's assessments are comprehensive in that all state general government revenue and expenditure is included in the standard budget, a large proportion of this revenue and expenditure is assessed on an equal per capita basis (that is, needs are not assessed). This is not well understood.
- 3.54. Currently, about 45 per cent of states' total own-source revenues are assessed on an equal per capita basis in the Other Revenue category, while about 20 per cent of states' total expenditure is largely assessed on an equal per capita basis in the Other Expenses category.
- 3.55. Under its top-down, clean-slate approach to the 2010 Review, the Commission considered assessing states' fiscal capacities in just four expenditure and four revenue categories. However, the Commission concluded that such a limited number of assessment categories could not adequately capture differences in states' costs of delivering services or capacities to raise revenue. As such, the current range of assessment and revenue categories adopted by the Commission is considered to be the minimum scope of government services and revenue sources to achieve equalisation.
- 3.56. As noted by the Panel there are significant difficulties with equalising only for major items. The impact of equalising for major items only would vary depending on:
- the range of assessment categories;
 - the functions included in each category, for example assessing a combined health category or only assessing hospital costs; and
 - the disabilities applied in each category.
- 3.57. Further to the work undertaken by the Panel in its Interim Report, the Territory has modelled the GST revenue impacts of adopting a threshold to determine whether or not a revenue or expense category is assessed. This approach assesses all categories comprising less than 5 per cent of total expenditure or revenue on an equal per capita basis. The Territory has used the Commission's current grouping of revenue and expenses to highlight some of the problems with equalising only for major items.
- 3.58. The impact of this approach on states' GST revenue shares is shown in Figure 3.6. It shows that this approach would benefit New South Wales, Victoria, and the

Australian Capital Territory and would significantly disadvantage Western Australia, the Northern Territory and Queensland.

Figure 3.6: GST impact of equalising only for expenditure/revenue items that contribute over 5 per cent of total revenue/expenditure



Source: Commonwealth Grants Commission, *Report on GST Revenue Sharing Relativities – 2012 Update*, Northern Territory Treasury

- 3.59. States with above average GST revenue needs, or below average assessed revenue capacity in the excluded categories are worse off under this approach. The categories comprising less than 5 per cent of total revenue or expenses that have been treated on an equal per capita basis are; Post Secondary Education, Roads, Services to Industry, Transport Services, Depreciation and Insurance Tax.
- 3.60. As noted by the Panel in its interim report, equalising only for major items is highly problematic. The basis for grouping government expenses or revenues together would determine whether or not the expenditure or revenue is differentially assessed. For example, if roads and transport expenses are grouped together, needs would be assessed, however if they remain separate categories, both would be assessed on an equal per capita basis.
- 3.61. Further, adopting a threshold of five per cent of total revenue or expenses to determine whether or not expenses in a category are assessed would result in the Services to Communities category being differentially assessed in the 2010 Review, but not in the 2011 Update, when expenses fall below 5 per cent of total.⁶ Would the Commission continue to calculate the Services to Communities factor in the event that the category should be above the threshold in the future?
- 3.62. Similarly, while the mining royalties assessment represents more than 5 per cent of states' total revenue, it was not that long ago (2006-07) that mining revenue

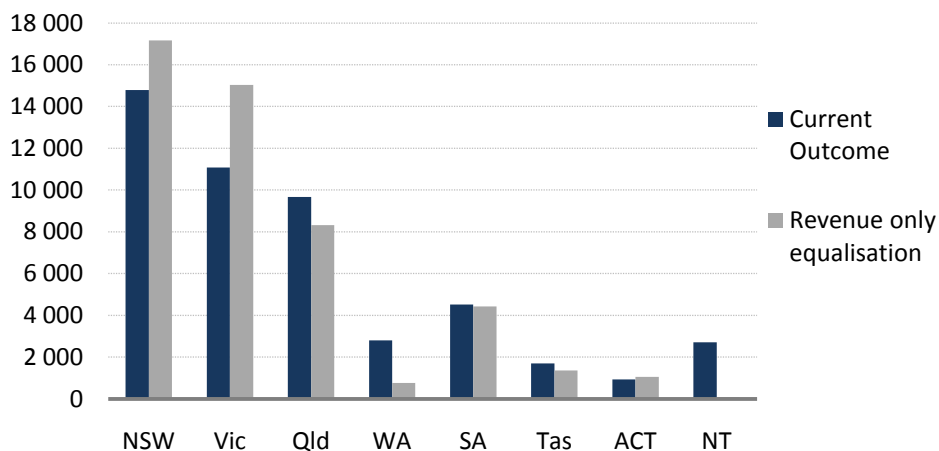
⁶ The Territory's modelling includes a differential assessment of the Services to Communities category, assuming that the Commission would not undertake an annual review of which costs should be included or excluded from assessment.

comprised less than 5 per cent. This highlights the limitations of equalising for major items only in that it would not respond to changes in states' expenditure policies or sources of revenue over time.

Revenue-only equalisation

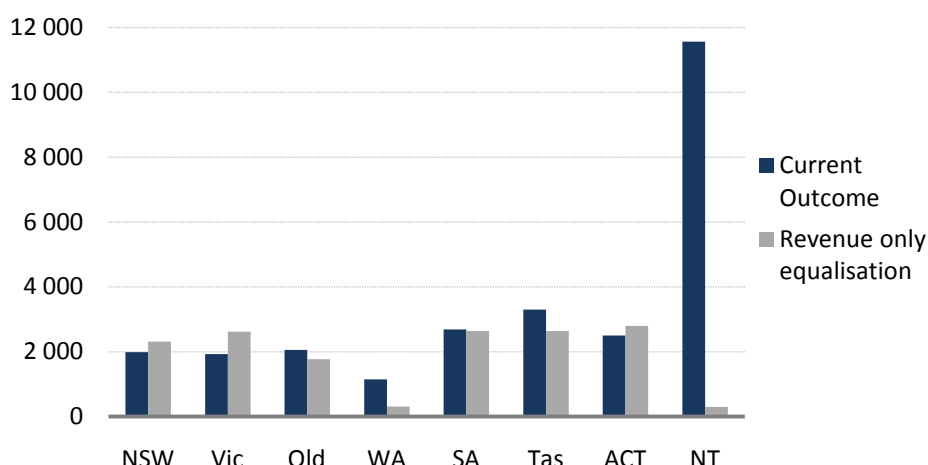
- 3.63. Victoria and the Chamber of Commerce and Industry Western Australia have argued for revenue-only equalisation. This approach would not take into account differences faced by states in the costs of delivering services but merely differences in states' capacities to raise revenue.
- 3.64. Figures 3.7 and 3.8 show the GST revenue impacts of a revenue-only assessment (including state own-source revenue and tied Commonwealth payments) if adopted in the 2012 Update. A revenue-only assessment would result in a significant shift in GST revenue between states, with the Territory and Western Australia the biggest losers. Under a revenue-only assessment, the Territory would only receive \$70 million or \$297 per capita of GST revenue, a decrease of \$2.6 billion.

Figure 3.7: Impact of revenue-only equalisation compared with current GST distribution, 2012-13, \$ million



Source: Commonwealth Grants Commission, *Report on GST Revenue Sharing Relativities – 2012 Update*, Northern Territory Treasury

Figure 3.8: Impact of revenue-only equalisation compared with current GST distribution, 2012-13, \$ per capita



Source: Commonwealth Grants Commission, *Report on GST Revenue Sharing Relativities – 2012 Update*, Northern Territory Treasury

3.65. Equalising only for differences in states' revenue capacities would only be appropriate if states were homogeneous. However, this is not the case. Equalisation on the expenditure side is also essential due to differences in population demographics, geography and economic circumstances between states.

Donor and recipient approach

3.66. The donor-recipient approach to distributing GST revenue has been suggested by some states as a means of improving the simplicity of the GST distribution. There are various ways to adopt such an approach, including:

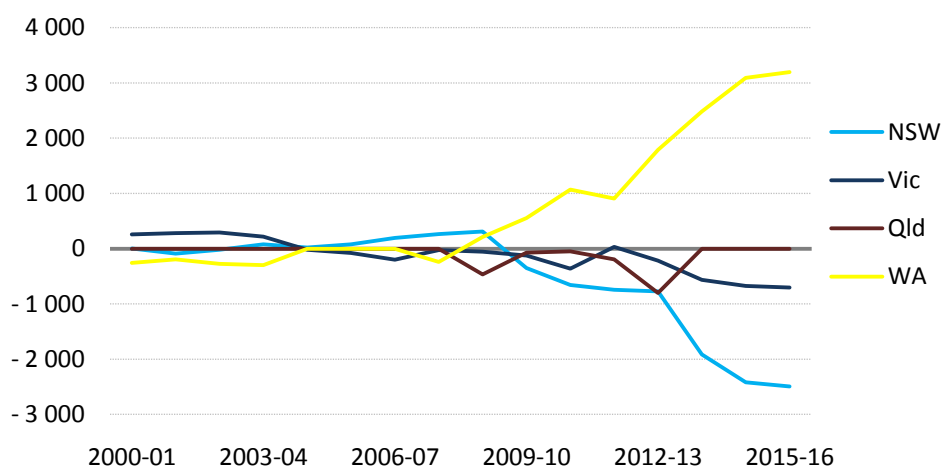
- option 1: continuing to distribute GST revenue to the recipient states based on the Commission's assessments and allowing the donor states to reach agreement on the distribution of the remaining GST pool;
- option 2: a variation of the donor-recipient model, which includes the Australian Capital Territory as a 'donor' state;
- option 3: a permanent split of the GST pool between the large and small states based on historical shares of the GST pool; and
- option 4: fixing a proportion of the GST pool for distribution on an equal per capita basis with the remaining proportion distributed on a needs basis.

3.67. On the surface the above options may appear attractive, however the apparent simplicity gains may not be realised and there are considerable complicating factors associated with each option.

Option 1: Continuing to distribute GST revenue to the recipient states based on the Commission's assessments and allowing the donor states to reach agreement on the distribution of the remaining GST pool

- 3.68. Under this option, the recipient states would receive needs-based shares of GST revenue as recommended by the Commission, while the donor states would reach agreement on the distribution of the remaining GST pool.
- 3.69. Western Australia states that “the fiscal equalisation system should allow a group of states, if they wish, to agree among themselves on matters that affect the allocation of GST grants among them.” While in theory this approach seems to have merit, it is unlikely that the donor states would agree or continue to agree on a revenue sharing arrangement because of the zero sum nature of the donor pool.
- 3.70. The obvious approach to the sharing arrangement of the donor state pool is on an equal per capita basis, which the large states have advocated as a fair and reasonable distribution in relation to the total GST pool. Figure 3.9 shows the GST implications if this approach for the donor states had been adopted since the introduction of the GST. Note that when Queensland and Western Australia's relativity was above one during this period, these states were treated as recipient states.

Figure 3.9: Annual GST revenue impact of donor states receiving an equal per capita share of the donor state pool, \$ million

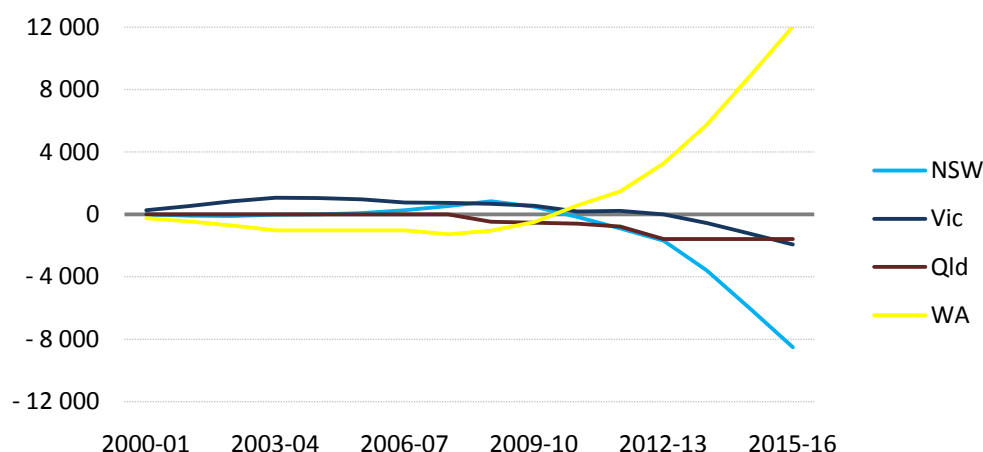


Source: Commonwealth Final Budget Outcome (various), Commonwealth 2012-13 Budget, Northern Territory Treasury

- 3.71. Figure 3.9 shows that an equal per capita distribution of the donor pool would lead to an increase in Western Australia's share of GST revenue from 2007-08 onwards, with an estimated increase in its GST revenue in 2015-16 of \$3.2 billion. This would be offset by a decline in GST revenue shares for New South Wales and Victoria.

3.72. Figure 3.10 shows the cumulative change in GST revenue if the donor pool was distributed on an equal per capita basis from 2000-01. It shows that Western Australia would have been a beneficiary under this approach, with a cumulative benefit of \$12.0 billion between 2000-01 to 2015-16, offset by cumulative losses of \$8.5 billion for New South Wales and \$1.6 billion for Victoria over the corresponding period.

Figure 3.10: Cumulative GST revenue impact of donor states receiving an equal per capita share of the donor state pool, \$ million



Source: Commonwealth Final Budget Outcomes (various), Commonwealth 2012-13 Budget, Northern Territory Treasury

- 3.73. Further complicating this donor-recipient model is when a state's GST revenue needs fluctuate between being a donor and a recipient. For example, in 2006-07 Western Australia's relativity was above one and it received \$3968 million in GST revenue. In 2007-08, Western Australia's relativity was below one. Under the donor-recipient model Western Australia's GST revenue would have been \$3746 million in 2008-09 compared to \$3984 million under the current approach. This highlights the financial risks of the donor-recipient model for states that oscillate between being a donor and recipient state.
- 3.74. Based on the Territory's modelling, it is difficult to see why New South Wales and Victoria would agree to an equal per capita distribution of the donor pool as this would result in these states receiving less GST revenue than under the current HFE system. This is particularly true over the forward estimates where Western Australia's relativity is expected to decline. As fiscal capacities can and do change over time, the concerns regarding the distribution of GST revenue would not be alleviated under a donor-recipient model even if initially donor states could agree on the appropriate shares of the donor portion of the GST pool.

Option 2 – A variation of the donor-recipient model, which includes the Australian Capital Territory as a ‘donor’ state

- 3.75. Victoria has suggested that under a donor-recipient model, the Australian Capital Territory should be included as a ‘donor’ state, on the basis that it has the highest per capita income, in a small compact area without issues of remoteness, diseconomies of scale or significantly disadvantaged population groups.
- 3.76. This approach highlights the inherent problems of all donor-recipient models. How would states be allocated between the groups over time? It appears arbitrary to include the Australian Capital Territory as a donor state when it is currently assessed as being a recipient state. Similarly, should Queensland be considered a donor state even though its relativity is forecast to be above one from 2013-14 onwards?
- 3.77. This approach would not result in significant simplification gains as the Commission would still be required to calculate the GST revenue shares of both the donor and recipient states unless seemingly arbitrary judgements of which states should be classified as donor or recipient are to apply.

Option 3 - A permanent split of the GST pool between the large and small states based on historical shares of the GST pool

- 3.78. A further variation on the donor-recipient model could be referred to as the large state-small state model. Where in option 1 the model is based on whether a state is a donor or recipient, that is whether a state’s relativity is below or above one, option 3 segregates states based on population.
- 3.79. This approach dedicates a portion of the GST pool to be distributed between the four large states, with the remaining portion allocated to the four small states. The split in the GST pool could be based on states’ historical shares.
- 3.80. The large state-small state approach would continue to recognise the above average needs of the small states, and could provide the facility for either the large (or small) states to reach agreement on sharing arrangements of their respective pools. It would also remove the potential for states to move between different GST pools as could be the case under the donor-recipient model.
- 3.81. Table 3.8 shows that historically the smallest states’ combined shares of the GST pool equate to about 20 per cent of the total pool while the large states historically share in about 80 per cent of the GST pool.

Table 3.8: States' historical shares of the national GST pool

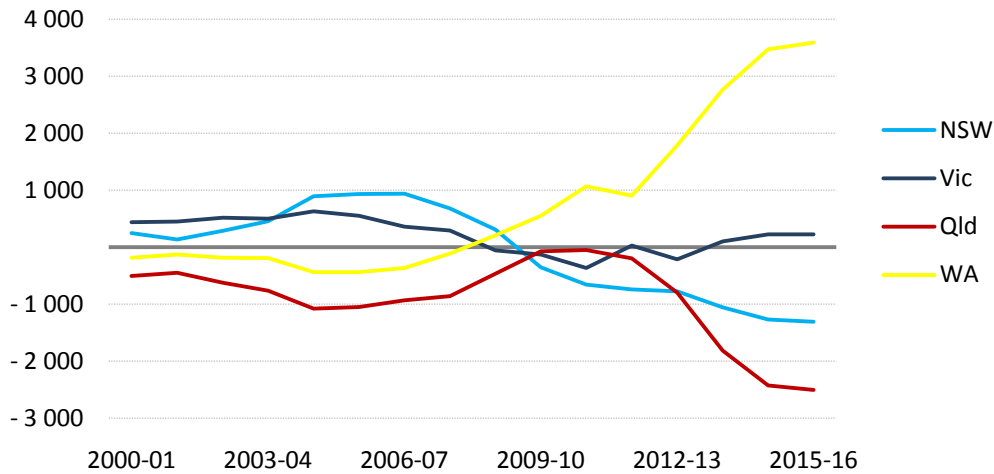
	NSW	Vic	Qld	WA	Large states' share	SA	Tas	ACT	NT	Small states' share
	%	%	%	%	%	%	%	%	%	%
2000-01	29.8	20.9	19.1	9.7	79.6	9.4	4.1	1.9	5.0	20.4
2001-02	30.5	21.0	18.8	9.5	79.8	9.3	4.0	2.0	4.8	20.2
2002-03	29.8	20.9	19.3	9.5	79.5	9.4	4.1	2.0	5.0	20.5
2003-04	29.1	21.0	19.7	9.5	79.3	9.5	4.2	2.0	5.1	20.7
2004-05	28.0	20.8	20.7	10.3	79.8	9.3	4.1	1.9	4.9	20.2
2005-06	27.9	21.1	20.7	10.2	79.8	9.3	4.0	1.9	4.9	20.2
2006-07	27.7	21.7	20.5	10.0	79.9	9.1	4.0	2.0	5.1	20.1
2007-08	28.1	21.8	20.2	9.4	79.6	9.2	3.9	2.0	5.2	20.4
2008-09	28.8	22.6	19.4	8.7	79.5	9.2	3.9	2.0	5.5	20.5
2009-10	30.3	22.8	18.5	8.1	79.7	9.2	3.7	2.0	5.4	20.3
2010-11	30.9	23.4	18.5	7.1	79.8	9.5	3.7	1.9	5.2	20.2
2011-12	30.9	22.5	18.9	7.5	79.8	9.3	3.6	1.8	5.5	20.2
2012-13 (e)	30.7	23.0	20.1	5.8	79.5	9.4	3.5	1.9	5.6	20.5
2013-14 (e)	31.1	22.4	22.0	4.1	79.6	9.4	3.4	1.9	5.7	20.4
2014-15 (e)	31.2	22.1	22.9	3.1	79.3	9.5	3.3	2.0	5.8	20.7
2015-16 (e)	31.1	22.2	23.0	3.3	79.5	9.5	3.3	2.0	5.7	20.5
Change										
2000-01 to 2012-13	0.9	2.0	0.9	- 3.9	- 0.1	0.0	- 0.5	0.0	0.6	0.1
2007-08 to 2012-13	1.9	0.4	0.7	- 2.9	0.1	0.2	- 0.3	- 0.1	0.2	- 0.1
2010-11 to 2015-16	0.3	- 1.2	4.4	- 3.8	- 0.3	0.0	- 0.4	0.1	0.5	0.3

Source: Commonwealth Final Budget Outcomes (various), Commonwealth 2012-13 Budget

- 3.82. The major complicating feature of the large state-small state model, as is also the case under the donor-recipient model, is determining how the large and small state GST pools are allocated.
- 3.83. The simple approach is to distribute based on needs as assessed by the Commission, however this will not result in any simplification gains. The alternative is to distribute the small state GST pool based on needs as assessed by the Commission and to distribute the large state pool on an equal per capita basis. However, this would result in a significant shift in GST revenue between the large states.
- 3.84. Figure 3.11 shows the GST revenue impact of distributing the large states' share of the GST pool (assumed to be 80 per cent of the total GST pool) on an equal per capita basis. It shows that Western Australia would be the main beneficiary under this approach, while Queensland and New South Wales would be the main losers. Consequently, it is hard to envisage that the large states would reach agreement on how the large state GST pool will be distributed that would result in

simplification gains compared with the current approach and does not have a material impact on large states' GST revenue shares.

Figure 3.11: GST revenue impact of large states receiving equal per capita shares of the large state pool, \$ million



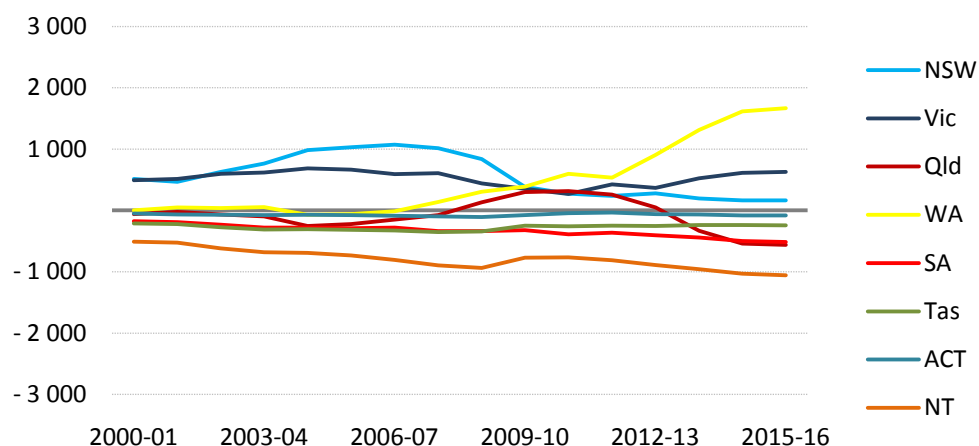
Source: Commonwealth Final Budget Outcomes (various), Commonwealth 2012-13 Budget, Northern Territory Treasury

- 3.85. The benefits of changing the form of equalisation to a large state-small state approach are minimal. While on the surface, this model could be viewed as providing more revenue certainty, this would not be the case if states' fiscal capacities change materially over time. This approach does not respond to changes in states' circumstances and would not provide greater simplicity because the Commission would still be required to calculate small states' needs-based shares of the GST pool.

Option 4 - Fixing a proportion of the GST pool on an equal per capita basis with the remaining proportion distributed on a needs basis

- 3.86. This approach is akin to applying a floor in relativities or providing states with a guaranteed minimum share of the GST revenue pool.
- 3.87. Similar to applying a floor in relativities, this approach would lead to significant variation in states' fiscal capacities. In its Interim Report the Panel stated that "it considers that there is no compelling case for adopting a floor at present." Moreover, a relative floor of 0.75 would cause a major disparity in the fiscal positions of the states in the very near future." Given the parallels between the two options, the Territory contends that the rationale for not adopting a floor in relativities extends to the option to dedicate a part of the GST pool to be distributed on a population basis.
- 3.88. The impact of this approach compared with the current methodology is shown in Figure 3.12. It shows that Western Australia would be the largest beneficiary under this model, and that the Territory would be the most disadvantaged.

Figure 3.12: GST revenue impact of all states receiving an equal per capita share of 40 per cent of the GST pool and a needs-based share of the remaining pool, \$ million



Source: Commonwealth Final Budget Outcomes (various), Commonwealth 2012-13 Budget, Northern Territory Treasury

- 3.89. The donor-recipient models would not only fail to achieve simplicity, because the Commission would still be required to calculate the relative fiscal capacities of, at a minimum, the small states, but would lead to material disparities in states' fiscal capacities. Further, under the donor-recipient or large state-small state models it has been suggested that the donor/large states determine amongst themselves the allocation of the donor/large state GST pool. It is unlikely that the donor/large states would agree, or continue to agree on a distribution other than their assessed needs-based shares.

Moving the GST distribution to an equal per capita basis

- 3.90. The Territory agrees with the Panel's view that an equal per capita distribution of GST revenue would not be achievable in the absence of a further funding source. If additional Commonwealth funds were available, a process similar to the current Commission methodology would be required in order to distribute the funds, and hence, there would be no simplicity gains.
- 3.91. The Territory notes that there is no tax in Australia where the proceeds are distributed entirely on an equal per capita basis and that it is not sensible for some states to continually propose this as a practical option for distributing GST revenue.
- 3.92. Equalisation provides vital financial support to the small states. An equal per capita distribution would lead to a great divide between the quality and scope of services provided across state borders.

4

HFE and efficiency

Key Points:

- 4.a. The weighted average standard effectively has an implicit efficiency benchmark because the largest states, which, due to their size, are better able to achieve efficiencies and have the greatest influence on the current standard.
- 4.b. The Commission's assessments currently include significant discounting, which dilutes equalisation outcomes. For example, 45 per cent of states' total own-source revenue is assessed on an equal per capita basis in the Other Revenue category and about 20 per cent of states' total expenditure is assessed largely on an equal per capita basis in the Other Expenses category. This does not include the discounting the Commission applies in other categories.
- 4.c. Equalising to a standard below the current weighted average may appear, on the surface, to be an attractive and simple option to address perceived efficiency issues within the HFE system. However, in the Territory's view, adopting a standard lower than the current weighted average would only serve to further dilute equalisation outcomes and lead to increasingly different levels of services being provided to Australians in different states.

- 4.1. The Territory re-affirms the view outlined in its submission to the Panel's Issues Paper, that the HFE system does not actively encourage or discourage states from pursuing productivity-enhancing reforms. The Territory's submission to the Panel's Issues Paper stated:
 - \$3.6 billion of the \$45 billion GST pool is redistributed between states, which equates to 0.3 per cent of Australia's \$1.3 trillion GDP. In this context, it is unlikely that the equalisation process has a material impact on allocative and dynamic efficiency in the Australian economy however, the redistribution is essential in underpinning the small states' capacities to provide the national average level of services.

- The national average cost of delivering services, as assessed by the Commission, is largely influenced by the level of efficiency in the largest states. Smaller states are unable to exert any significant influence on national average costs.
 - Equalisation provides incentives for states to pursue efficiencies in service delivery. If states can provide services at below the national average cost per service, they retain the difference between their actual costs and their assessed needs.
 - Over the last thirty years, all governments have actively participated in and implemented comprehensive and broad-ranging national reforms. This demonstrates that equalisation has not impeded states from pursuing efficiency-enhancing national reforms.
 - The supporting principles of policy neutrality and 'what states do' underpin the definition of equalisation in Australia and reduce the potential for incentives for states to vary, or game, policies in order to directly influence the GST distribution.
 - The current issues regarding population mobility should be addressed outside the equalisation process through direct and more targeted policies. The Territory contends that equalisation is not the root cause, or a major factor for the current labour shortage facing resource projects. Changing the method of GST redistribution is unlikely to have any meaningful effect on the attraction of labour to resource projects.
- 4.2. As noted by the Panel, the magnitude and significance of the effect of HFE on efficiency is disputed and unclear. While states continue to debate the merits of this argument, the Panel has rightly considered it appropriate that it examine alternative approaches to equalisation that may address the real or perceived efficiency issues. The options relate primarily to changing the standard to which states are equalised. The Territory's view on these approaches follow.

Equalising to a minimum (or lower than average) standard

- 4.3. The Panel is considering whether the HFE system should equalise states' fiscal capacities to provide comparable standards of services rather than the same standards of services. Supporters of this option argue that equalising to a lower standard would encourage reform, increase productivity and reduce the scope for individual state policies to affect the GST distribution.
- 4.4. As noted in *Chapter 1 – The role and purpose of HFE*, while the current definition of HFE is to provide states with the fiscal capacity to deliver the same level of services, in practice this does not occur. The Commission's methodology does not take into account all differences between states in the costs of delivering services

or raising revenue. A large proportion of state expenditure (about 20 per cent) and revenue (about 40 per cent) is assessed on an equal per capita basis, that is needs are not assessed. Similarly, the Commission applies large discounts and materiality thresholds that reduce (or disregard) the impact of some disabilities on states' assessed GST revenue needs.

- 4.5. Equalising to a standard below the current weighted average appears, on the surface, to be an attractive and simple option to address the perceived efficiency issues that some observers consider are a consequence of the HFE system. However, the following analysis undertaken by the Territory demonstrates that providing states with comparable capacities would not result in any meaningful reform or greater pursuit of efficiency outcomes. Rather, it would only serve to reduce equalisation outcomes by reducing the assessments of states with above average expenditure needs, and therefore result in increasingly different level of services being provided in each state.
- 4.6. Currently, the average or standard used in the Commission's assessments is calculated as the Australian weighted average, which is the total state expenditure or revenue for each category divided by the Australian population. In its 2012 Update report, the Commission stated that:

While this [weighted average of the per capita revenues and expenses] ensures the policies applicable to each person have the same weight in determining the average, the policies applied by the most populous states have a greater impact on it.⁷

- 4.7. The options that have been proposed for an alternative expenditure or revenue standard to the current weighted average approach include using:
- the lowest or second lowest state actual per capita expenditure or revenue;
 - the state actual per capita expenditure or revenue immediately below the average; or
 - an external standard.

Equalising to a state actual below the standard

- 4.8. Tables 4.1 and 4.2 show each state's actual per capita revenue and expenditure by category in 2010-11. For each category, the figures highlighted in red represent the state with the lowest actual per capita expenditure or revenue, while the figures highlighted in blue show the states with actual per capita expenditure or revenue immediately below the average.

⁷ Commonwealth Grants Commission, *Report on GST revenue Sharing Relativities - 2012 Update*, Volume 1, page 45

Table 4.1: Actual state revenue by category, 2010-11, \$ per capita (1)

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Weighted average	Simple average
	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc
Payroll tax	879	780	666	1 090	576	563	790	714	801	757
Land tax	315	273	230	257	237	147	303	0	268	220
Conveyance duty	556	674	426	536	471	290	752	446	547	519
Insurance taxes	126	163	120	202	225	97	125	143	149	150
Motor taxes	353	281	391	410	287	261	330	208	340	315
Mining revenue	171	10	594	2 249	94	96	0	691	426	488
Other revenue	2 030	2 072	2 475	1 449	2 367	1 643	4 057	1 754	2 116	2 231

1 Red = lowest state actual, Blue = State actual immediately below the average

Source: Commonwealth Grants Commission, *Report on GST revenue Sharing Relativities – 2012 Update*

Table 4.2: Actual state expenditure by category, 2010-11, \$ per capita (1)

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Weighted average	Simple average
	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc
School education	1 716	1 663	1 822	2 041	1 882	2 092	1 800	3 203	1 795	2 027
Post sec. education	224	374	149	234	284	277	289	625	258	307
Admitted patients	1 151	1 116	1 426	1 186	1 389	1 863	1 117	2 252	1 246	1 437
Com. other health	651	624	798	1 026	888	528	1 153	1 832	747	938
Welfare & housing	837	739	856	770	871	915	692	2 747	831	1 053
Services to comm.	183	257	234	789	352	207	221	1 404	300	456
Justice services	660	582	625	996	674	698	682	1 774	682	837
Roads	231	319	385	277	79	187	167	570	279	277
Transport services	428	184	441	282	244	107	194	211	328	261
Services to industry	282	197	428	498	290	360	261	922	321	405
Other expenses	1 440	1 743	1 888	1 050	1 772	1 762	3 271	3 189	1 645	2 015
Depreciation	387	360	523	387	406	413	796	818	421	511

1 Red = lowest state actual, Blue = State actual immediately below the average

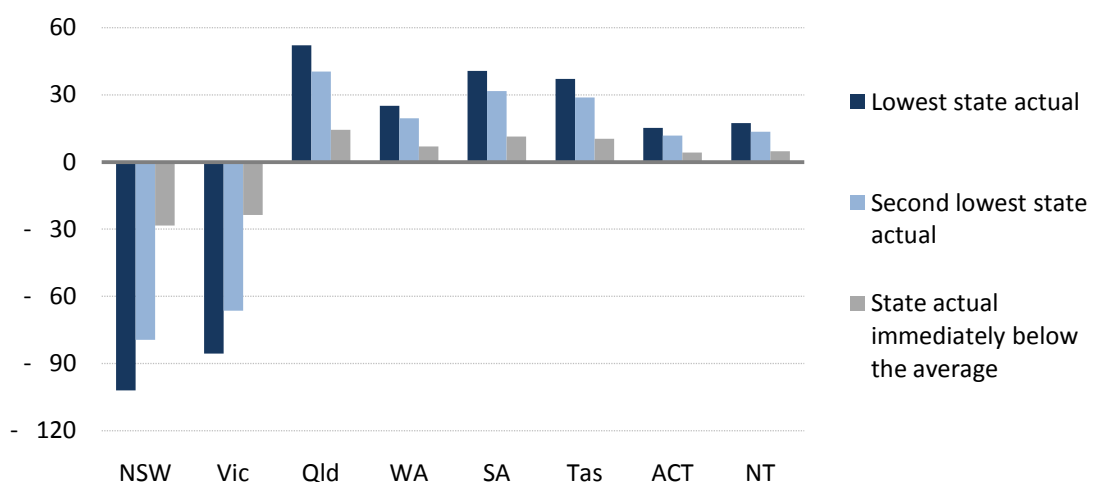
Source: Commonwealth Grants Commission, *Report on GST revenue Sharing Relativities – 2012 Update*

- 4.9. Table 4.1 shows that adopting a lower standard for revenue assessments would lead to small states being used as the benchmark for revenue policies. It is intuitive that small states' actual per capita revenue is generally lower than that of the large states because of the different sized revenue bases.
- 4.10. Table 4.2 shows that adopting a lower standard for expenditure assessments would increase the influence of large states' policies on the standard as evidenced by the clustering of the lower standard options around the large states. This is intuitive given that large states generally achieve greater economies of scale and scope in service delivery.
- 4.11. As stated earlier, the current approach uses a population-weighted average as opposed to a simple average (where each state's actual expenditure or revenue

receives an equal weighting in determining the average). The weighted average approach means that the more populous states determine the standard. This is evident in Table 4.2, which shows that in all expenditure categories (except Roads and Transport Services) the simple average of each state's actual per capita expenditure is higher than the weighted average.

- 4.12. The weighted average approach effectively has an implicit efficiency benchmark because the largest (and most efficient) states have the greatest influence on the current standard. The only category that is materially different is the Transport Services category where costs are higher in densely populated areas. Large states' higher per capita expenditure on transport services would have less influence under a simple average standard approach.
- 4.13. This outcome reflects the fact that states are different and face different cost pressures and revenue-raising capacities. For example, if, in the pursuit of efficiency, the lowest state actual per capita expenditure was adopted for the Transport Services category, Tasmania would set the standard. It would not be appropriate for Tasmania to be set as the standard for transport services in New South Wales or Victoria because the circumstances faced by Tasmania in the delivery of transport services differ vastly from those of the large states.
- 4.14. Figure 4.1 shows the impacts of adopting lower standards for the Transport Services category. Under these approaches, the assessed GST revenue needs of New South Wales and Victoria for the provision of transport services would be reduced.

Figure 4.1: GST impact of adopting a different approach to the Transport standard, 2012 Update, \$ million

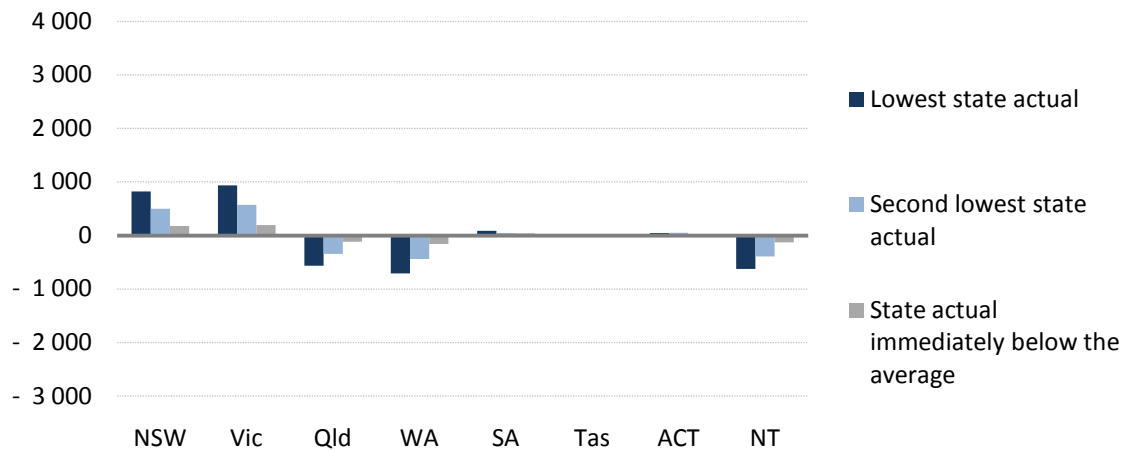


Source: Commonwealth Grants Commission, *Report on GST revenue Sharing Relativities – 2012 Update*, Northern Territory Treasury

- 4.15. Adopting a standard lower than the current weighted average would simply further dilute equalisation outcomes and would exacerbate the affect of the considerable discounting of revenue and expenditure assessments already applied by the Commission.
- 4.16. An equal per capita assessment (no disabilities being assessed) is akin to a discount of the revenue assessment. This would increase the already substantial amount of 45 per cent of total state own-source revenue, which is currently assessed on an equal per capita basis in the Other Revenue category. Similarly, in the Other Expenses category (which comprises about 20 per cent of total state expenditure), over 90 per cent of the category expenses are largely assessed on an equal per capita basis.
- 4.17. In addition to having no assessment of needs for almost half of total state own-source revenue and almost 20 per cent of total state expenditure, the Commission also applies discounts to many of the expenditure assessments, with some discounts as high as 50 per cent. For example the Commission applies a:
- 25 per cent discount to the police component of the socio-demographic influences factor in the Justice Services category;
 - a discount of either 12.5 per cent or 50 per cent to components of the location assessment;
 - 50 per cent discount to Commonwealth payments for national network roads;
 - 12.5 per cent discount to various non-state government expenditure in the Community and Other Health Services category;
 - 25 per cent to the water subsidies factor in the Services to Communities category; and
 - 12.5 per cent discount to the schools, police and general service delivery scale factors.
- 4.18. On the revenue side, the proposal to adopt a lower standard is intended to address perceived disincentives for states to undertake unilateral tax reform. A detailed discussion on whether adopting lower standards in the revenue assessments will encourage states to undertake tax reform is included in *Chapter 8 – HFE and state tax reform* (paragraphs 8.8 to 8.14).
- 4.19. In order to compare the GST revenue impacts of different approaches to the standard, on both the expenditure and revenue sides, figures 4.2 to 4.5 are presented on the same scale.
- 4.20. Figure 4.2 shows the GST revenue impacts of equalising to a lower expenditure standard than the current weighted average approach, with no change to the current revenue standards. It shows that under this approach, New South Wales

and Victoria would benefit through higher GST revenue shares. This is intuitive given that New South Wales and Victoria have below average expenditure needs. Reducing the standard would only serve to reduce equalisation outcomes and disadvantage states with above average expenditure needs.

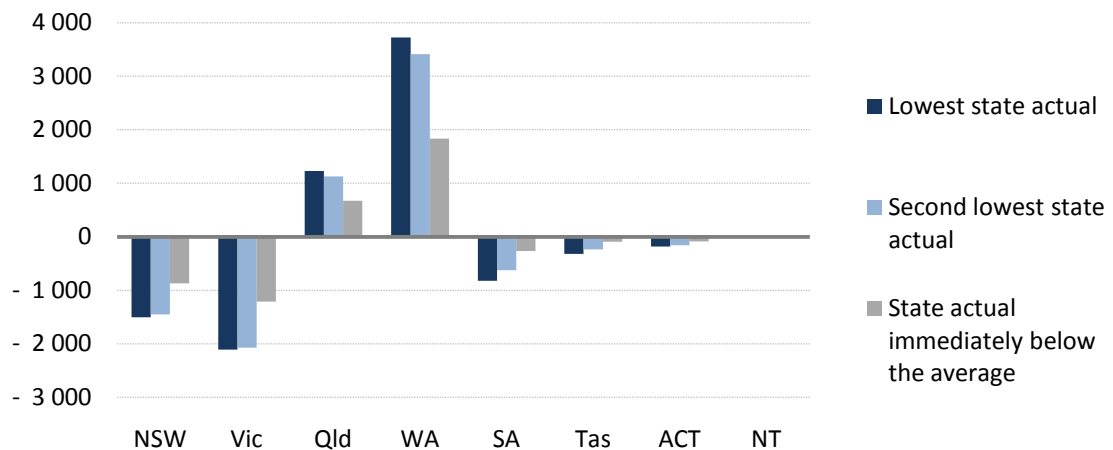
Figure 4.2: GST impact of adopting a different approach to the expenditure standards, 2012 Update, \$ million



Source: Commonwealth Grants Commission, *Report on GST revenue Sharing Relativities – 2012 Update*, Northern Territory Treasury

4.21. Figure 4.3 shows that adopting a lower revenue standard compared to the weighted average approach would significantly increase Western Australia's and Queensland's GST revenue shares. Under this approach, Western Australia's share of GST revenue would increase by between \$1.8 billion and \$3.7 billion, while Queensland would benefit by between \$675 million and \$1.2 billion. Again this result is not surprising as these states have the highest revenue raising capacity, primarily as a result of mining revenue.

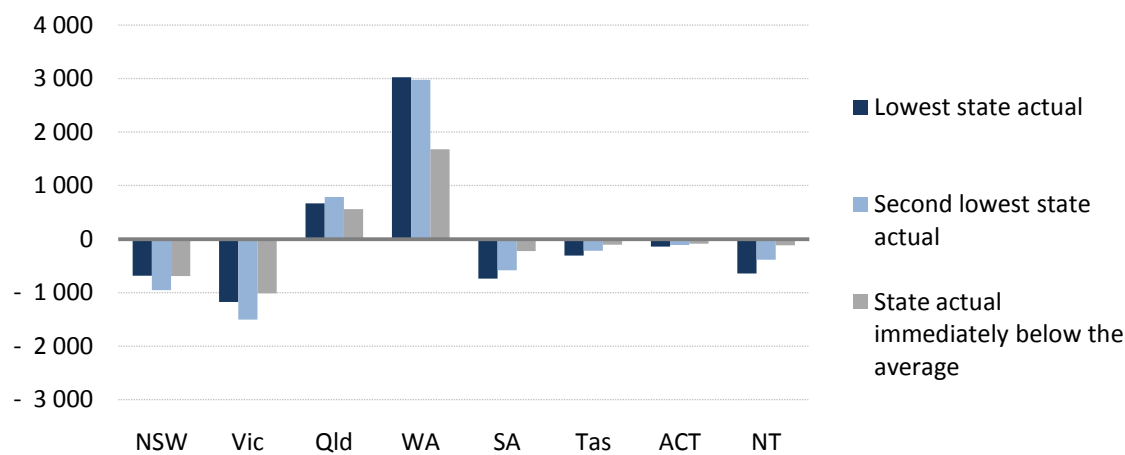
Figure 4.3: GST impact of adopting a different approach to the revenue standards, 2012 Update, \$ million



Source: Commonwealth Grants Commission, *Report on GST revenue Sharing Relativities – 2012 Update*, Northern Territory Treasury

4.22. Figure 4.4 shows the combined impact of adopting a lower standard on both revenue and expenditure assessments. It shows that changes to the revenue standard have more significant GST implications than changes to the expenditure standards, for all states except the Territory, which would be impacted more by changes to the expenditure standard due to its relatively high expenditure needs. Figure 4.4 shows that adopting a lower standard on both revenue and expenditure assessments would only benefit Western Australia and Queensland, offset by a decline in GST revenue shares for all other states.

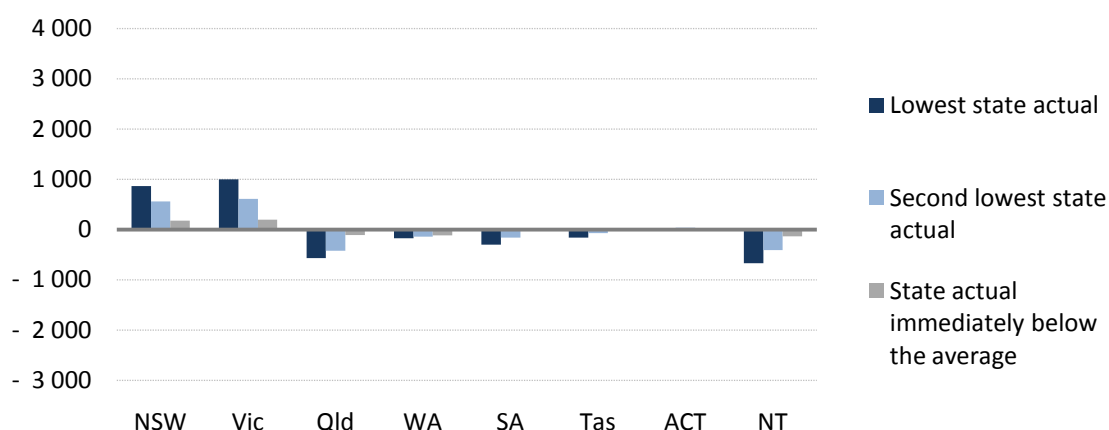
Figure 4.4: GST impact of adopting a different approach to revenue and expenditure standards, 2012 Update, \$ million



Source: Commonwealth Grants Commission, *Report on GST revenue Sharing Relativities – 2012 Update*, Northern Territory Treasury

4.23. Figure 4.5 is a slight variation to Figure 4.4, showing the impact of adopting lower standards for all expenditure and revenue categories except for mining where the current standard is retained. This was intended to isolate the impact of the mining assessment from adopting alternative approaches to the standard. It shows that the impact of adopting alternative approaches to the standard would be very different if mining is included or excluded. If mining is included, New South Wales and Victoria would be the biggest losers (in absolute terms), however if mining revenue assessment is excluded, New South Wales and Victoria would be the largest beneficiaries.

Figure 4.5: GST impact of adopting a different approach to revenue and expenditure standards, no change to the mining revenue standard, 2012 Update, \$ million



Source: Commonwealth Grants Commission, *Report on GST revenue Sharing Relativities – 2012 Update*, Northern Territory Treasury

Equalising to an external standard

- 4.24. The current form of equalisation provides states with the same capacity to deliver services, which is defined as the average of what states do. It does not specify a standard of services that states should provide, nor should it. The current form of equalisation, which has been in place since 1983, maintains state sovereignty, recognising the need for states to tailor services to their constituents, while having the capacity to provide the national average level of services.
- 4.25. The notion of an equalisation process that could drive a standard or set of outcomes sounds to be a well-intended proposition. However, there are a number of issues and challenges that prevent equalisation from being the appropriate mechanism to achieve this. Tasking equalisation to drive an external standard would:
- be inconsistent with the untied nature of GST revenue, as agreed by all governments under the IGA;
 - impede on state sovereignty;
 - create complexities surrounding how benchmarks would be determined, and whether there should be a national benchmark, or individual state standards;
 - require complex analysis and calculations to quantify the amount of funding that each state would require to achieve the benchmark; and
 - require consideration of the different baseline measures that are likely to exist between states, and whether states would be rewarded or penalised for the different starting points.

- 4.26. Expanding the role of equalisation to provide incentives for states to achieve specified outcomes is beyond its scope. Alternative arrangements outside of the equalisation process, which address specific government priorities and outcome objectives that can be tailored to local state populations, are preferable to the Commission or an alternative independent body specifying the standards.

5 HFE and Commonwealth payments to the states

Key Points:

- 5.a. The Territory supports the Commission's default position to treat tied Commonwealth payments by inclusion in the equalisation process unless the payments meet the well established criteria for exclusion.
- 5.b. The Territory would support developing a set of criteria where capital payments aimed at improving Australia's national network infrastructure or supporting Australia's economic and productivity growth are excluded from the equalisation process.

- 5.1. Commonwealth-state funding arrangements were reformed as part of the 2008 IGA. A key objective was to simplify and codify the arrangements for tied Commonwealth payments to the states and to clearly outline the treatment of these payments within the equalisation process.
- 5.2. The IGA provides for three broad types of tied Commonwealth payments: National Specific Purpose Payments; National Health Reform (NHR) payments; and National Partnership (NP) payments. NP payments can comprise a combination of: project payments; facilitation payments; and reward payments.
- 5.3. The IGA states that:

National SPPs, NHR funding and National Partnership project payments will be treated by 'inclusion', recognising that these payments provide the states and territories with budget support for providing standard state and territory services.
- 5.4. The Commonwealth Treasurer is able to direct the Commission to exclude particular payments when determining relativities. Such directions are done in limited circumstances when the purpose of the payment is not addressed in the equalisation process. In the absence of a direction in the Terms of Reference, the Commission treats most tied Commonwealth payments as a revenue source available to fund state services. Consequently, a state that receives an above

average share of tied Commonwealth payments requires less GST revenue to meet its expenditure needs, all other things being equal.

- 5.5. The Commission's default treatment by inclusion of tied Commonwealth payments enables Commonwealth and states to focus negotiations on the objectives of each agreement rather than be overly distracted by the distribution of tied Commonwealth funding between states.
- 5.6. The Commission uses its discretion to determine the treatment of Commonwealth payments on a case-by-case basis and has developed transparent guidelines to determine whether a payment should be included or excluded from its assessments. These guidelines ensure consistent treatment of Commonwealth payments and limit the scope for political gaming. For example, the Commission:
 - excluded payments relating to the National Agreement to Deliver a Seamless National Economy as these were considered to be Commonwealth purchases of nationally consistent regulations, which states would not have otherwise provided;
 - included a payment for pilot drought reform measures in Western Australia as it was considered average state policy to provide assistance to drought-affected farmers. Had the initiative not been replicated elsewhere it would not have been eligible for inclusion;
 - excluded reward payments made to non-government schools for improving student outcomes as these were made to third parties and did not impact on states' fiscal capacities; and
 - excluded payments relating to the local government reform fund because states' needs are not assessed in the equalisation process.
- 5.7. A less transparent approach would undermine the fairness of the system and greatly increase the administrative costs and complexity of tied funding distribution arrangements.
- 5.8. In addition to having transparent guidelines on the treatment of Commonwealth payments, the Commission consults with states on the treatment of new Commonwealth payments as the payments enter the assessment period. There is general agreement on the treatment of most payments with those in contention being one-off significant payments that have been negotiated bilaterally.
- 5.9. There have been considerable attempts by Commonwealth line agencies to diverge from the elements of the IGA that deal with tied payments, including a proliferation of NPs and expansion of the objectives of NPs to include programs that do not necessarily deliver on nationally significant reforms or projects. The treatment of tied payments has also been confused by the significant increase in

tied payments as a result of various fiscal stimulus and the growth in NPs since 2008-09.

- 5.10. An analysis of capital payments shows that each state's share of total capital payments does not change significantly over time. However, one-off payments do occur. When individual states receive significant funding for a particular capital project, there can be large and unintended impacts on that states' assessed GST revenue needs. This may not be appropriate to the extent that the payment delivers national economic benefits.
- 5.11. The Territory would support the development of an approach that reduces the one-off impact of large capital payments, for instance, developing a set of criteria where such payments are excluded from the equalisation process. Criteria could include:
 - payments provided to a state that are aimed at improving Australia's national network infrastructure; or
 - to support Australia's economic growth through nationally significant projects.
- 5.12. The Territory's preference is to exclude payments that meet the above criteria rather than isolating one area of expenditure, for example, transport or to a discrete function such as roads or rail.
- 5.13. The Panel has suggested that the Infrastructure Australia priority list could be used as a starting point for identifying nationally significant projects, while acknowledging that it cannot be regarded as a comprehensive list.
- 5.14. The Territory does not support using the priority list developed by Infrastructure Australia on the basis that the list is quite limited in scope, in line with Infrastructure Australia's generally restrictive assessment criteria, which focus only on economic infrastructure that achieve direct financial returns on investment. Moreover, many of the projects on that list have no status and are unlikely to receive funding from Infrastructure Australia. A more practical approach would be to continue to assess the treatment of funding for particular projects on a case-by-case basis with additional criteria developed for nationally significant projects.
- 5.15. The Panel raised concerns regarding the Commission's inconsistent treatment of tied Commonwealth infrastructure payments. For example, the Commission currently applies a 50 per cent discount to payments for National Network Roads on the basis that the current roads assessment may not capture all non-policy influences on state expenditure in this area. However, there are other nationally significant infrastructure payments where no discount is applied, such as rail. The Territory would support consideration of consistent treatment of all nationally

significant infrastructure payments in the HFE system but notes that in some cases this may require a modification to the Commission's category assessment.

- 5.16. As noted above, adopting a set of criteria that is based on payments that improve Australia's national network infrastructure or support Australia's economic growth should address the concerns regarding the inconsistent treatment of capital payments.
- 5.17. The Panel has suggested that capital payments be assessed over a longer period, say over 30 years, to better reflect the life span of the asset. The Territory does not support this approach as this would add to the complexity and data intensity of assessments. This approach would require:
- the Commission to develop a capital infrastructure assessment over (say) a 30-year period, which would require data on all capital payments to states over this period;
 - the Commission to examine all capital payments over the assessed period to identify which payments meet the criteria for inclusion or exclusion (for example nationally significant infrastructure projects);
 - the Commission to consider transitional arrangements to ensure that states are not disadvantaged by a secondary assessment of revenue from a payment that has already filtered through the equalisation process; and
 - consideration of whether states should be 'compensated' for previous losses of GST revenue as a result of payments that would have been treated by exclusion if the new arrangements applied and were backcast.
- 5.18. While spreading payments over a 30-year period is not considered practical, an alternative approach of spreading nationally significant payments over a shorter period of, say 10 years, may be an approach worth considering. Backcasting would also need to apply if such an approach was considered.

6

HFE and the mining boom

Key Points:

- 6.a. The two-tiered mining assessment introduced in the 2010 Review is flawed. Consideration should be given to changing the method for assessing states' capacities to raise mining royalty revenue as soon as possible, by increasing the number of groupings – either by mineral type or royalty rate.
- 6.b. The Territory supports consideration of an economic development assessment for mining-related expenditure. There is a strong case for a differential assessment of mining-related economic development expenses to capture the material differences in the level of support required in each state.
- 6.c. The Territory's preference is for mining-related economic development expenses to be captured through an expenditure assessment rather than the alternative proxy approach of discounting the mining revenue assessment.

- 6.1. Assessing each state's capacity to raise mining royalties in a policy-neutral way continues to be the most challenging task confronting the Commission. The difficulties of capturing states' mining royalty revenue-raising capacities stem from the distribution of fixed endowments of minerals across states, differences in the composition and quality of minerals in each state and different royalty rates applied to each mineral. These factors, combined with significant increases in recent years in international demand for Australia's mineral commodities, lead to stark differences in each state's capacity to raise mining royalties.
- 6.2. The resultant large redistribution arising from the mining revenue assessment is intuitive given the diverse distribution of natural endowments across states. More recently, this has increased as a result of the commodities boom, which has impacted states differently. The current method of GST revenue distribution ensures that states share in the benefits of investment and the economic growth of Australia, such as the revenues generated from the resources boom, as well as sharing the financial risks of Australia's exposure to external shocks.

- 6.3. The Territory agrees that the current mining revenue assessment is contributing to volatility and that due consideration should be given to removing anomalies in the assessment. Much attention has been given to the mining revenue assessment because of the increasing importance of mining revenue to some states' budgets in recent years, the importance of the mining sector to the Australian economy, the growing GST revenue redistribution arising from differences in states' capacities to raise mining royalties and the unintended interactions between the mining assessment and state policy decisions. However, the Territory does not accept that concerns regarding the mining assessment are evidence that the HFE system is broken. More correctly, the mining assessment needs to be fixed.
- 6.4. In its submission to the Issues Paper, Western Australia argued that the interaction of the mining revenue assessments with its decision to change the royalty rate for iron ore fines is evidence of a "fiscal equalisation system so broken the case for reform would not be ignored."
- 6.5. While the Territory agrees that the mining assessments need to be improved, this is an issue that should be addressed by the Commission within the current equalisation framework and does not warrant a fundamental change to the form of HFE in Australia.
- 6.6. The Territory agrees with the Panel that improving the assessment of the impact of mining on state budgets should consider both mining-related revenue and expenditure.

Mining revenue assessment

- 6.7. The Mining Revenue category has caused difficulties for the Commission for many years largely because of potential grant design effects that can arise due to the non-uniform distribution of minerals between jurisdictions and differences between royalty rates applied to those minerals.
- 6.8. The 2010 Review mining revenue assessment is an example of where simplification has gone too far and has led to unintended consequences. The current two-tiered rate structure was adopted in an effort to simplify and remove state policy influences on the average royalty rates for individual minerals. However, due to the distribution of resources across Australia, and differing costs associated with extraction such policy influences will always be present to some extent.
- 6.9. The particular problem of the two-tiered rate structure of the mining revenue assessment was made clear when Western Australia increased its royalty rate on iron ore fines, resulting in the average royalty rate increasing to above the low-royalty rate threshold. It should be noted that, as a short-term resolution to

this issue, the Commission was directed by the Commonwealth in the 2012 Update Terms of Reference to continue to assess iron ore fines in the low-royalty rate group. However, this should only be considered as an interim solution.

- 6.10. The Panel could consider recommending that the mining assessment be more granular, by increasing the number of groupings in the mining assessment, either by mineral rate or mineral type. This was the approach adopted in the 2004 Review where there were seven mineral groupings, based on mineral type rather than average royalty rate. A more detailed mining revenue assessment would negate the issues arising under the current two-tiered structure, where a policy change by a single state can lead to a significant change in GST distribution. The scope for state policies to influence average royalty rates would still exist, however, a more detailed assessment would avoid spill over effects of changes to the royalty rate for one mineral on other minerals.

Mining-related expenditure assessment

- 6.11. In addition to adopting a more detailed mining revenue assessment, consideration could be given to developing an assessment that captures states' expenditure, including infrastructure, aimed at supporting the mining industry or responding to the demand on services and costs of significant resource developments.
- 6.12. In previous reviews, the Commission had considered the feasibility of an economic development assessment to recognise the range of state expenses that contribute and/or relate to a state's revenue-raising capacity. For example, Western Australia argued that while the Commission equalises the revenue states raise from mining royalties, the Commission does not adequately recognise expenses incurred by states in developing these revenue sources.
- 6.13. The Commission recognised in previous reviews that it is standard policy for states to assist in economic development, and therefore there is an in-principle case for examining whether differential needs exist for economic development. However, the Commission decided not to assess states' economic development needs because there is no standard policy for providing economic development support. The Commission also considered that the forms of economic development assistance are subject to strong policy influences.
- 6.14. While states provide support to a range of industries, with the increasing influence of the resources boom and structural shift occurring in the Australian economy, there is a strong case that mining-related economic development expenses be differentially assessed. Reasons supporting the differential assessment include:
- the extent of resources-related expenditure;
 - the different levels of support required in each state;

- the influences on costs of state service provision in resource provinces; and
 - the quantum, location and timing of mining-related investment is primarily driven by external factors that are outside of states' control.
- 6.15. The Territory's preference is for a separate mining-related economic development assessment within the Services to Industry category. This is preferable to the alternative approach, which is to discount the mining revenue assessment as a proxy for expenditure needs. While discounting the mining revenue assessment may appear to be a simple, quick-fix solution, it would be less transparent, less robust than an expenditure assessment, would be unlikely to cope with changes in state circumstances and would rely too heavily on the Commission's judgement to determine the appropriate size of the discount.
- 6.16. An assessment of mining-related expenditure needs should encompass both recurrent and capital expenses. While the Commission does assess states' infrastructure needs, the capital assessment could be reviewed and improved to better capture mining-related expenditure disabilities. Mining-related infrastructure costs are borne by mining operators to the extent that they benefit directly. However, the establishment of mining projects also has spill-over implications in terms of increased need for public good infrastructure such as housing, schools and health facilities as mining communities expand. It is these costs that are not being adequately reflected in the current HFE system.
- 6.17. The Territory acknowledges that disaggregating additional expenditure incurred to support the mining industry from 'normal' expenditure may introduce additional complexity. For example, identifying the component of higher teacher wages resulting from location (which is currently assessed) and identifying the component of higher teacher wages paid as an incentive to attract and retain teachers in mining communities. However, this level of detail would be acceptable and the onus would be on the states to demonstrate that the costs involved were of sufficient materiality to require assessment.

7 The Northern Territory and Indigenous influences

Key Points:

- 7.a. The Territory strongly supports the Panel's view that Indigeneity and the Northern Territory should remain within the HFE system. This is fundamental in recognising Australia as a federation and treating all Australians as equals.
- 7.b. Excluding the Territory from the HFE system and having the Commonwealth fund it directly would: create additional complexity and bureaucracy in both levels of government; draw distinctions between Territorians and all other Australians; and impinge upon the Territory Government's autonomy and its ability to tailor policies and services to meet the needs and priorities of Territorians.
- 7.c. The Territory supports the Panel's view that closing the gap between Indigenous and non-Indigenous outcomes should be addressed outside of the HFE system.
- 7.d. The Territory would support a proposal for all states to voluntarily undertake additional reporting on Indigenous-related revenue and expenditure in order to increase transparency and accountability and to provide better understanding of how GST funding is spent.

Removing the Northern Territory from the HFE system

- 7.1. The Territory strongly supports the Panel's view that Australia's form of equalisation should encompass all states and territories. This is fundamental in recognising Australia as a federation and treating all Australians as equals.
- 7.2. Despite the Panel's position stated in its Interim Report, there are ongoing calls from some states for the Territory to be excluded from the HFE system on the basis that:
 - the Territory is an 'outlier' and that equalisation works best when all states are homogenous; and

- it may lead to simplification of the equalisation process as there would be fewer disabilities assessed.

Outlier status

- 7.3. It is sometimes suggested that because the Territory is an ‘outlier’, it should be treated differently from other jurisdictions. One reason for attributing the Territory with ‘outlier’ status is that its relativity is much higher than other states’. Based on this rationale, it could be argued that Western Australia should also be excluded from the HFE system. Western Australia’s relativity is much lower than other states’, reflecting its large capacity to raise own-source revenue. Indeed, determining whether Western Australia’s declining relativity is a fair and reasonable outcome is a key consideration of the GST Distribution Review.
- 7.4. Attributing outlier status could encompass a range of other characteristics. It could be argued that the Australian Capital Territory should be removed because it faces unique disabilities due to its status as the nation’s capital. Victoria has stated that the Australian Capital Territory should be treated differently because “it has the highest per capita income in Australia in a small compact area without issues of remoteness, diseconomies of scale or significant disadvantaged population groups.”⁸ The Territory notes that these are also characteristics of Victoria.
- 7.5. An alternative explanation is that Victoria is suggesting that equalisation should only apply when state characteristics include remoteness, diseconomies of scale or significant disadvantaged population groups, which would exclude Victoria from the equalisation process along with the Australian Capital Territory.
- 7.6. The Territory agrees with the Panel’s view that the exclusion of states from the equalisation process and funding them through separate arrangements would lead to duplication of effort and would only serve to shift the responsibility to another process or body. Another important consideration is: what level of difference is required before a jurisdiction should be removed from the equalisation process? Would Western Australia’s expenditure disabilities be assessed through a separate process because they are similar to the Territory’s expenditure disabilities?
- 7.7. Excluding a state from the HFE system and funding it through tied Commonwealth payments would reduce the state government’s autonomy and its ability to determine appropriate expenditure priorities in line with the needs and priorities of its constituents.

⁸ Victorian submission to the GST Distribution Review Issues Paper, October 2011.

- 7.8. Australia's form of equalisation is appropriate for its circumstances. Australia is a diverse federation with a high level of VFI and significant variation in states' socio-demographic structures and geographic sizes. HFE accommodates these differences effectively. It provides vital financial support to the smallest states, and is contemporary and responsive to changes in state circumstances.

Simplification gains from excluding the Territory?

- 7.9. The commentators that support the exclusion of the Territory from the HFE system argue that it would result in simplification gains, as there would be fewer disabilities assessed by the Commission. The Territory disagrees.
- 7.10. It is important to note that the disabilities faced by the Territory in the provision of services are shared by other states. There are no unique Territory disabilities. Rather, due to its size and population composition, the disabilities are exacerbated when applied to the Territory. For example:
- Indigeneity is an important factor assessed in the equalisation process. While Indigenous people represent between 0.7 and 3.9 per cent of other states' populations, Indigenous people comprise nearly one-third of the Territory's population. If the Territory was removed from the equalisation process, additional costs associated with Indigeneity would still require assessment for the remaining jurisdictions.
 - While all states, excluding the Australian Capital Territory, provide services to communities in regional and/or remote areas, nearly 40 per cent of the Territory's population resides in remote/very remote areas, compared to 6 per cent in Western Australia, the second highest jurisdiction. Again, if the Territory was excluded, the impact of remoteness on service delivery costs would still require assessment for the remaining jurisdictions.
 - All states incur a minimum fixed cost in the delivery of government services. However, on a per capita basis, the Territory faces the highest minimum fixed cost of delivering government services (over thirty times greater than New South Wales'), because of its small population.
- 7.11. Excluding the Territory from the HFE system would not result in meaningful reforms or simplification of the HFE system. There would need to be a parallel arrangement whereby the Territory's needs would continue to be assessed in order to determine the required amount of funding to the Territory from the Commonwealth. This would, presumably, echo the Commission's current assessments.
- 7.12. Excluding the Territory from the HFE system would also require Commonwealth ministers and agencies to play a greater role in determining the Territory's overall funding levels and policy priorities, reducing its autonomy and creating the

potential for a different form of HFE to apply to the Territory than in other jurisdictions. Further, this would:

- create additional complexity and bureaucracy in both levels of governments;
- draw distinctions between Territorians and all other Australians based purely on jurisdictional borders;
- impinge upon the Territory's autonomy and its ability to tailor policies and services to meet the needs and priorities of Territorians; and
- would require additional Commonwealth funding from alternative sources, when none is available. This would further erode the Territory's autonomy as funding decisions would be subject to Commonwealth fiscal and macroeconomic policy imperatives.

7.13. For these reasons, the Territory is strongly opposed to being excluded from the HFE system.

HFE and Indigeneity

7.14. The Territory welcomes the Panel's preliminary views in relation to Indigeneity and the HFE system, in particular that:

- the current form of equalisation does not provide states with additional fiscal capacity to address Indigenous disadvantage;
- the current form of equalisation does not provide an assessment of how much states would need to spend to improve Indigenous outcomes; and
- Indigenous influences should continue to be assessed within the scope of the HFE system.

7.15. In the 2012 Update, the Indigenous factor redistributed \$2.36 billion, or \$102 per capita between states compared with an equal per capita distribution. This was the second highest factor redistribution behind the mining assessment, which redistributed \$4.71 billion or \$204 per capita between states.

7.16. As noted in the Panel's Interim Report, the main driver of the redistribution of GST revenue arising from the Commission's assessment of the impact of Indigeneity on states' expenditure needs is the diverse distribution of Indigenous people across states. This is similar to the reason for the large redistribution of GST revenue arising from the Mining Revenue assessment, where the distribution of mineral resources across Australia leads to states having very different capacities to raise mining royalty revenue.

7.17. The relatively large redistribution from the Indigenous factor combined with the continued levels of disadvantage of Indigenous Australians compared with non-Indigenous Australians has led some states to suggest that equalisation cannot cope with addressing Indigenous disadvantage, and therefore, Indigeneity

should be removed from the equalisation process and funded separately. The Territory strenuously objects to this proposition.

- 7.18. There are inconsistencies in the arguments relating to Indigeneity and the HFE system. On the one hand, the Interim Report notes that: “some commentators have said that ‘excessive’ spending by the Northern Territory on services to Indigenous people acts to maintain the size of the Indigenous disability and ensures that the Northern Territory continues to receive a large GST distribution revenue.”
- 7.19. In contrast, it is sometimes alleged that the Territory misspends its nominal Indigenous-related GST revenue on services and infrastructure in Darwin. That is, it is claimed that the Territory underspends on its Indigenous population.
- 7.20. These statements are inaccurate and misguided and reflect a lack of understanding of what equalisation is trying to achieve and how services are delivered to Indigenous people in the Territory. These criticisms are thinly veiled attempts by some states to increase their GST revenue shares and to divest responsibility for service delivery to Indigenous people entirely to the Commonwealth.

Equalisation and Indigenous outcomes

- 7.21. As stated above, the equalisation process does not make any assessment of what a state would need to spend to improve Indigenous outcomes. In order to demonstrate this, the Territory refers to the Commission’s calculation of the socio-demographic composition factor in the Schools Education assessment.
- 7.22. Table 7.1 is a summary of the Commission’s calculation of the schools education socio-demographic composition factor. The base data for the assessment is actual enrolments reported in the ABS Schools Australia publication.
- 7.23. The Commission adjusts the enrolments data by applying a cost weight to Indigenous, low socio-economic status and non-government school students. These cost weights recognise the different costs of providing school education services to these population groups.
- 7.24. In relation to Indigenous students, the Commission applies a cost weight of 1.41. This weight reflects the average additional costs incurred by states for additional cultural and language services and lower student to staff ratios. The Commission has noted that when it was determining this cost weight, it adopted a conservative estimate of the additional cost data provided by all states.⁹ The Indigenous cost weight is not an assessment of the additional amount a state needs to spend to improve Indigenous outcomes but reflects the Commission’s conservative assessment on what states actually spend.

⁹ Commonwealth Grants Commission, *Report on GST Revenue Sharing Relativities – 2010 Review*, Volume 2, page 156.

7.25. After accounting for differences in costs of providing education services to certain high-needs students, the Commission derives a cost weighted enrolment number for each state. If a state's share of total weighted enrolments is higher than its population share, then that state will be assessed as having above average needs (a factor of above one). For example, Queensland has 21.3 per cent of total cost weighted students, but comprises 20.1 per cent of Australia's population, and therefore, it needs to spend more than the national average per student amount on schools education services.

Table 7.1: Calculation of schools' education socio-demographic composition factor

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
<u>Policy neutral enrolments ('000)</u>								
Government	737.0	532.1	481.8	233.6	159.2	58.8	33.2	29.0
Non-government	374.9	298.8	229.1	121.5	87.2	23.3	25.0	9.8
Total ¹	1 111.9	830.8	710.9	355.2	246.3	82.1	58.2	38.8
<u>Cost weighted enrolments ('000)</u>								
Government ²	775.1	546.9	509.8	246.1	167.6	63.2	33.7	35.7
Non-government ³	67.6	52.7	41.6	22.0	15.7	4.3	4.3	2.1
Total ¹	842.7	599.6	551.4	268.0	183.4	67.5	38.0	37.7
Share of total weighted students	32.6%	23.2%	21.3%	10.4%	7.1%	2.6%	1.5%	1.5%
Population share	32.6%	24.8%	20.1%	10.2%	7.4%	2.3%	1.6%	1.0%
Socio-demographic composition factor	1.0007	0.9345	1.0600	1.0168	0.9511	1.1279	0.9135	1.4235

1 Figures may not add due to rounding.

2 The Commission applies a cost weight of 1.41 for Indigenous students and 1.12 for low socio-economic status students.

3 The Commission applies a cost weight of 0.172 to non-government students.

Source: Commonwealth Grants Commission, *Report on GST revenue Sharing Relativities – 2010 Review*, Volume 2, pages 163-165

7.26. The Commission's calculation of the socio-demographic composition factor for schools education is consistent for other categories. It clearly shows that the Commission makes no allowances for the amount a state needs to spend in order to improve outcomes. Rather, a state's school education expenditure needs are based on numbers of enrolments, adjusted for a states' share of high-needs students relative to the Australian average. The Commission's assessment of states' school expenditure needs is simply derived from the number of students in each state. There is no consideration of how much a state would need to spend in order to improve school education outcomes for Indigenous students.

Service delivery to Indigenous people in the Northern Territory

7.27. There appears to be misconceptions surrounding how services to Indigenous people are delivered in the Territory – namely that Indigenous people only live

and access services outside of Darwin and that services to Indigenous people are delivered through Indigenous-specific targeted programs.

- 7.28. In all jurisdictions other than the Territory, Indigenous people represent a small share of the state population. This is not the case in the Territory where Indigenous people comprise 30 per cent of the population and, in many instances, are the majority of users of services. Due to the relative size of the Indigenous population in the Territory, the majority of government services for Indigenous people are delivered through mainstream services.
- 7.29. Table 7.2 shows the Territory's Department of Health expenditure by outputs/programs. These outputs are mainstream health services that are provided in Darwin, major centres or remote Indigenous communities. It shows that Indigenous people are the main users of these services.

Table 7.2: Northern Territory health-related expenditure, 2010-11

Output/Program	Expenditure	Description
Public hospitals	\$584M	The Territory's public hospitals are located in Darwin, Alice Springs, Katherine, Gove and Tennant Creek. About 70 per cent of patients in public hospitals are Indigenous.
Patient transport	\$63M	Aero medical services that provide emergency medical evacuations and return home flights for Territorians in remote communities. This ensures that all Territorians have access to an appropriate level of acute care. About 70 per cent of users of patient transport services are Indigenous.
Community health services	\$171M	There are 54 health clinics in remote communities across the Territory. These clinics provide a wide range of health and community support services including primary clinical care, 24-hour emergency care, immunisation, antenatal care, population health screening, growth assessment and action checks for children under five years, provision of essential medications and management of chronic illness. About 67 per cent of community health services expenditure can be attributed to the Indigenous population.
Public health services	\$35M	Public health services strengthen the capacity of individuals, families and communities to improve and protect their health through promotion and prevention strategies and appropriate interventions that minimise harm from disease, substance use and environmental factors. About 70 per cent of patients receiving public health services in the Territory are Indigenous.
Mental Health	\$41M	About 45 per cent of community mental health services are provided to Indigenous patients.
Pharmaceuticals, medical aids and appliances	\$28M	About 52 per cent of recipients of benefit-paid pharmaceuticals, medical aids and appliances in the Territory are Indigenous.
Health research	\$6M	
Total	\$929M	

Source: Northern Territory Department of Health, Australian Institute of Health and Welfare

- 7.30. It is clear that Indigenous people are the primary users of health services across the Territory. It has designed its services to cater to the needs of all Territorians, within tight budget constraints. Removing Indigenous influences from the HFE system would create complexity and duplication of service delivery across the Territory based on Indigenous status.

Addressing Indigenous disadvantage

- 7.31. Governments have agreed that closing the gap in Indigenous outcomes will not be achieved through existing programs alone and requires a considerably more targeted effort. The Territory agrees with the Panel's view that equalisation is not the appropriate vehicle to close the gap in outcomes between Indigenous and non-Indigenous Australians. Rather, improving Indigenous outcomes needs to be addressed through separate arrangements, such as through Council of Australian Governments (COAG) or agreements between the Commonwealth and the states.
- 7.32. The Territory and Commonwealth governments have been negotiating a 10-year, \$3.4 billion investment under the Stronger Futures Northern Territory National Partnership Agreement, (\$1.4 billion of which is expected to be provided to the Territory over 10 years). The Agreement will continue the essential effort to improve Indigenous outcomes in the Territory and maintain the continuity of service provision and project delivery initiated under the Closing the Gap in the Northern Territory National Partnership Agreement.
- 7.33. As part of the Territory Government's Working Future initiative, the Territory, in collaboration with the Commonwealth, local governments and the community are producing Local Implementation Plans (LIPs) for each of the twenty Territory Growth Towns. LIPs are agreements between individual communities and the three levels of government that outline initiatives in each community to improve service delivery standards, including setting out agreed community priorities, actions, responsibilities and timelines for delivery. LIPs are 'living' documents that will evolve over time as actions are completed and new priorities emerge to meet community needs and are available online at: www.workingfuture.nt.gov.au.

Accountability and transparency

- 7.34. The Territory is committed to accountable and transparent reporting. This is enshrined in the Territory's *Fiscal Integrity and Transparency Act 2001*, which states that:
- (3) *This [Fiscal integrity and transparency] Framework provides for this by:*
- (a) *requiring fiscal strategy to be based on principles of sound fiscal management;*
 - (b) *facilitating public scrutiny of fiscal policy and performance; and*

(c) strengthening accountability for the economic and financial projections underlying fiscal reporting and decision-making.

- 7.35. The Territory is an active and willing participant in various intergovernmental fora in this regard. The Territory continues to meet its accountability and performance reporting obligations to various external bodies, including the COAG Reform Council, the ABS, the Australian Institute of Health and Welfare and the Commonwealth as required under National Partnership Agreements.
- 7.36. The Territory has adopted open and transparent reporting of its Indigenous-related expenditure. It is important to note that the Territory has independently published two Indigenous Expenditure Reviews (IERs) in 2006 and 2008, which are provided at Appendix A and Appendix B to this submission. At the time of publication of the Territory's IERs, no other jurisdiction or independent body had undertaken a comprehensive review of Indigenous-related expenditure in Australia from a whole of government perspective. The impetus for the Territory's IERs was to improve accountability and transparency of Territory Government expenditure and to inform Indigenous-related policy in the Territory.
- 7.37. Since the release of the Territory's IERs, the Territory, all other states and the Commonwealth have worked collaboratively to produce the National IER in order to deliver on the COAG commitment to report transparently on all government expenditure on services for Indigenous Australians. The Territory continues to be an active contributor and promoter of the importance of the National IER.
- 7.38. Given the level of funds redistributed through the equalisation process associated with Indigeneity, it is not unreasonable that jurisdictions report on Indigenous-related expenditure and revenue. To this end, the Territory would agree to the development of a proposal for all governments to voluntarily report on Indigenous-related expenditure and revenue on a periodical basis, as an extension to the current National IER framework.
- 7.39. The Territory's IERs examined both revenue and expenditure attributable to the Territory's Indigenous population. The scope of National IER does not extend to consideration of Indigenous-related revenue.
- 7.40. The National IER could be expanded to encompass total general government revenue attributable to Indigeneity, including GST revenue, tied Commonwealth payments and states' own-source revenues.
- 7.41. The methodology and assumptions underpinning Indigenous-related revenue estimates could be developed in a similar way to expenditure estimates under the existing National IER.
- 7.42. Estimating Indigenous-related revenue to the participating states would allow for comparisons with Indigenous-related expenditure estimates reported in the

National IERs and would allow for more informed scrutiny on Indigenous-related revenue and expenditure in those states.

8

HFE and state tax reform

Key Points:

- 8.a. The Territory's view is that nationally significant reforms should be pursued outside of the equalisation process and that tasking equalisation with promoting reforms would be pushing the limits of what equalisation can achieve and would not be a successful means of achieving significant reforms of state taxes.
- 8.b. The Territory agrees with the Panel that state tax reform should be pursued multilaterally, through collaborative Commonwealth and state negotiations.
- 8.c. Adopting lower revenue category standards would not achieve the desired outcome of addressing perceived disincentives for states to undertake tax reform. Rather, it would lead to some states having significantly higher fiscal capacities than others.
- 8.d. The Territory reaffirms its opposition to using equalisation as a means of providing financial incentives or disincentives for states to reform their taxes.
- 8.e. There is no capacity available in the GST pool for funds to be set aside to support tax reform. Another source of revenue, or consideration of changes to the GST revenue base/rate, would be required to provide states with additional funding to support nationally consistent state tax reform.

- 8.1. States are committed to the reform of the state taxation system and have fully participated in efforts to undertake significant reforms to state taxes with abolition of inefficient state taxes and major legislative and administrative reforms. States have also acknowledged the need for further reforms to state taxes in order to deliver a more secure and stable revenue base to fund state expenditures in the future.¹⁰
- 8.2. At the state level there is agreement on the principles that should guide future reforms. In its submission to the Australia's Future Tax and Transfer System

¹⁰ Council for the Australian Federation, *Australia's Future Tax System – A state perspective*, 2009

review, the Council for Australia's Federation, which comprises all state governments, stated that the principles that should underpin state tax reforms are as follows:

- Reform should generate economic and financial benefits to be shared by all states. State governments should be better off financially from tax reform.
- Reforms should aim at improving the efficiency and equity of the taxation system.
- Reforms should improve the sustainability of own-source revenue in order to meet their service and infrastructure responsibilities.
- Ensure any future reform of states' taxes is offset by replacement revenue.

- 8.3. Ultimately, for a national agreement to be reached on state tax reform, states need to have assurances that they will at least be no worse off under the new arrangements. The state tax reforms agreed under the intergovernmental agreement in 1999 were successful because revenue lost from the abolition of inefficient state taxes was replaced with access to a broad-based consumption tax, the GST, supported by provisions for budget balancing assistance through a Guaranteed Minimum Amount, which the Commonwealth subsequently determined would be time limited.
- 8.4. The Territory agrees with the Panel that there is merit in further state tax reform as a means of advancing national economic growth and efficiency and that reform should be pursued multilaterally, through collaborative Commonwealth and state negotiations. The Territory's view is that nationally significant reforms should be pursued outside of the equalisation process and that tasking equalisation with promoting reforms would be pushing the limits of what equalisation can achieve, and would not be a successful means of achieving significant reforms of state taxes.

Promoting state tax reform

- 8.5. The Panel is exploring alternative forms of equalisation aimed at minimising the potential disincentives for states to pursue tax reform and whether the HFE system should provide incentives or reward states for good state tax policy decisions and how this could be implemented. The Territory's views on these issues are provided below.
- 8.6. The Territory's view is that HFE system is not a barrier to states deciding whether to undertake reform of their tax bases. Rather, states' taxation policies, including decisions to undertake tax reform, are not driven by GST revenue considerations but by a range of other factors including budgetary implications; the broader economic environment; implications for economic growth and living standards; and maintaining competitiveness with other states.

- 8.7. Nevertheless, the Panel is considering options to address the perceived or real disincentives for states to undertake unilateral tax reform and options to promote tax reform through the HFE system. The Panel's Interim Reports have raised potential methods to minimise GST revenue share effects of states abolishing inefficient taxes. The Territory has modelled the GST implications of the Panel's suggestions and the results are discussed in the following sections.

Equalising to a minimum (or lower than average) standard

- 8.8. The proposal to adopt a lower standard is intended to address perceived disincentives for states to undertake unilateral tax reform by minimising GST redistributions as a result of abolishing a tax.
- 8.9. In its submission to the Interim Report, Queensland stated that "one of the main benefits of this method [a minimum standard] is an increased level of policy neutrality, as an individual state's decision to provide a higher level of services or make a greater revenue effort does not impact on their GST revenue share unless they are the state with the lowest effort."
- 8.10. The options for equalising to a minimum (or lower than average) standard are adopting the state with the:
- lowest actual per capita revenue;
 - second lowest actual per capita revenue; or
 - actual per capita revenue immediately below the average.
- 8.11. It should be noted that the modelled outcomes of each approach to the standard shown in tables 8.1 to 8.4 and Figure 8.5 are based on the assumption that the alternate policy has been adopted prior to states' abolishing the taxes. This isolates the impact of a state abolishing a tax under an alternative approach, rather than using the current outcome as the baseline for comparison.
- 8.12. Tables 8.1 and 8.2 show that the GST revenue impacts are comparable under each approach to the standard. For example, if only New South Wales abolished conveyance duty, the direct revenue impact is a loss of \$4.0 billion in revenue, and the indirect GST revenue impacts under different approaches to the standard would be:
- +\$14.5 million under the current approach;
 - +\$14.4 million under the lowest state actual per capita approach;
 - +\$12.0 million under the second lowest actual per capita approach; and
 - +\$24.6 million under the state actual per capita immediately below the average approach.

Table 8.1: Revenue impact of individual state abolishing conveyance duty, \$ million

	Revenue Impact Net of GST Redistribution				
	Conveyance Duty Forgone	Weighted Average (current)	Lowest State Actual	Second Lowest State Actual	State Actual Immediately Below the Average
	\$M	\$M	\$M	\$M	\$M
NSW	- 4 037	- 4 022	- 4 022	- 4 025	- 4 012
Vic	- 3 763	- 3 711	- 3 675	- 3 720	- 3 685
Qld	- 1 933	- 1 921	- 1 887	- 1 931	- 1 911
WA	- 1 240	- 1 223	- 1 164	- 1 212	- 1 225
SA	- 776	- 795	- 948	- 840	- 818
Tas	- 148	- 149	- 215	- 148	- 148
ACT	- 272	- 271	- 251	- 264	- 271
NT	- 102	- 103	- 109	- 105	- 102

Source: Commonwealth Grants Commission, *Report on GST revenue Sharing Relativities – 2012 Update*, Northern Territory Treasury

Table 8.2: GST impact of one state abolishing conveyance duty, \$ million

	Weighted Average (current)	Lowest State Actual	Second Lowest State Actual	State Actual Immediately Below the Average
	\$M	\$M	\$M	\$M
NSW	14.5	14.4	12.0	24.6
Vic	51.6	87.6	42.5	77.4
Qld	11.5	46.0	1.7	21.5
WA	16.8	76.0	28.0	15.3
SA	- 18.7	- 171.2	- 64.1	- 41.7
Tas	- 1.5	- 67.5	0.0	0.0
ACT	0.8	20.9	8.1	1.5
NT	- 0.1	- 6.2	- 2.9	0.0

Source: Commonwealth Grants Commission, *Report on GST revenue Sharing Relativities – 2012 Update*, Northern Territory Treasury

- 8.13. Table 8.2 shows that the indirect GST revenue impacts of one state abolishing conveyance duty are not materially different from the current weighted average approach under any of the proposed lower standard approaches. This is because if a state abolishes a tax, the standard may change, however in most cases, the difference between the old and new standards are not significant.
- 8.14. Given that the GST revenue impacts are similar under the current average approach, adopting a lower standard is unlikely to address perceived disincentives for states to undertake unilateral tax reform. These results are similar if one state abolished insurance duty as shown in tables 8.3 and 8.4.

Table 8.3: Revenue impact of one state abolishing insurance duty, \$ million

	Revenue Impact Net of GST Redistribution				
	Insurance Duty Forgone	Weighted Average (current)	Lowest State Actual	Second Lowest State Actual	State Actual Immediately Below the Average
	\$M	\$M	\$M	\$M	\$M
NSW	- 918	- 881	- 832	- 898	- 882
Vic	- 912	- 924	- 939	- 918	- 924
Qld	- 546	- 552	- 570	- 552	- 556
WA	- 468	- 470	- 480	- 471	- 469
SA	- 371	- 372	- 374	- 372	- 371
Tas	- 49	- 50	- 61	- 49	- 49
ACT	- 45	- 45	- 48	- 46	- 45
NT	- 33	- 33	- 37	- 34	- 33

Source: Commonwealth Grants Commission, *Report on GST revenue Sharing Relativities – 2012 Update*, Northern Territory Treasury

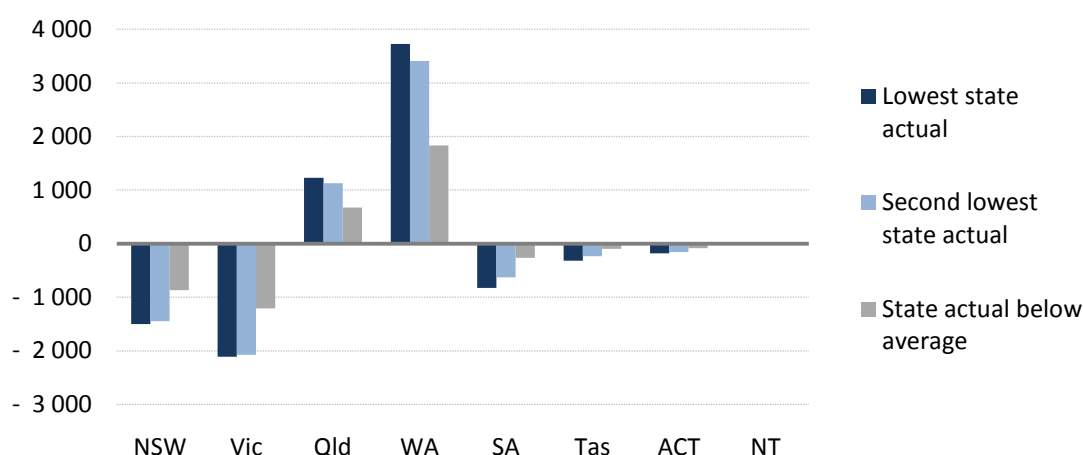
Table 8.4: GST impact of one state abolishing insurance duty, \$ million

	Weighted Average (current)	Lowest State Actual	Second Lowest State Actual	State Actual Immediately Below the Average
	\$M	\$M	\$M	\$M
NSW	37.3	86.0	20.1	35.7
Vic	- 11.6	- 27.6	- 6.4	- 11.6
Qld	- 6.2	- 24.3	- 5.7	- 10.0
WA	- 2.7	- 12.6	- 3.0	- 1.2
SA	- 0.5	- 3.0	- 0.7	- 0.1
Tas	- 0.3	- 11.3	0.0	0.0
ACT	- 0.1	- 3.1	- 0.7	0.0
NT	- 0.1	- 4.1	- 1.0	- 0.3

Source: Commonwealth Grants Commission, *Report on GST revenue Sharing Relativities – 2012 Update*, Northern Territory Treasury

8.15. Figure 8.1 shows the GST revenue impact of adopting lower revenue standards across all revenue categories. Under this scenario, Western Australia and Queensland would be better off under the lower standard approaches, primarily due to the reduced impact of the lower standard in the Mining Revenue assessment. The average for the Mining Revenue assessment in 2010-11 was \$426 per capita, compared to \$0 per capita under the lowest state actual approach, \$10 per capita under the second lowest state actual approach and \$171 per capita under the state actual immediately below the average approach.

Figure 8.1 GST revenue impact of adopting different revenue standards, 2012-13, \$ million



Source: Commonwealth Grants Commission, *Report on GST revenue Sharing Relativities – 2012 Update*, Northern Territory Treasury

8.16. The above analysis reinforces the Panel’s findings in its Second Interim Report, which shows that under the current HFE system, applying the weighted average as the standard, there is little to no correlation between GST revenue share change incentives and effort in different tax categories. Adopting lower revenue standards would not achieve the desired outcome of addressing perceived disincentives for states to undertake tax reform. Rather, it would result in a significant change in states’ GST revenue shares, which would lead to some states having significantly higher fiscal capacities than other states.

Alternative options to promote state tax reform

8.17. In addition to adopting a minimum or lower than average standard, the Panel is considering other options, including using broad indicators as a measure of states’ revenue raising capacities. A detailed analysis of these options is discussed in *Chapter 3 – Simplicity* (paragraphs 3.32 to 3.43).

Providing incentives or penalties for state tax reform

8.18. The Panel is considering options that would provide incentives or penalties to ensure that states adopt or implement the agreed reforms within the specified timeframes. The options are either within the GST distribution process or outside the GST distribution process. Proposed measures inside the equalisation process include modifying the current revenue assessments, delaying GST payments until milestones are met, or providing a small part of GST revenue or other Commonwealth funds intended for the states in the form of reward payments.

- 8.19. The Territory notes that there are existing federal financial relations arrangements to provide states with incentives to undertake economic and social reforms, set out in the IGA. It states that “The Commonwealth will provide National Partnership payments to the states and territories to support the delivery of specified outputs or projects, to facilitate reforms or to reward those jurisdictions that deliver on nationally significant reforms or service delivery improvements.”¹¹
- 8.20. In principle, the Territory contends that the HFE system should not be used as a policy tool of the Commonwealth to influence state tax reform or policies. In particular, the Territory reaffirms its opposition to proposals that provide financial incentives or disincentives to reform state taxes or adopt certain state tax policies by reducing or reallocating part of the GST pool for this purpose as it undermines states’ autonomy and would reduce state governments’ abilities to tailor tax policies according to the needs of state constituents and prevailing economic conditions of the state.
- 8.21. Such an approach is not dissimilar to the dissent in 2004-05 regarding the further removal of state taxes when the Commonwealth Treasurer’s view was that the growth in the GST pool was sufficient to enable states to remove additional taxes, whereas states argued that the additional revenue was required to support state services or to implement their own priority tax reforms. In 2012, after five years of GST revenue growth falling well short of estimates, there is no available capacity in the GST pool that can be set aside to support tax reform.

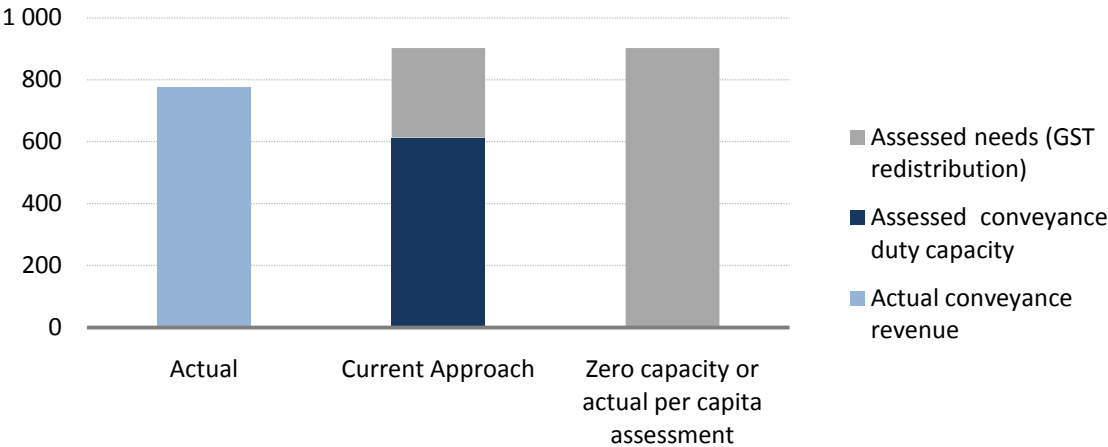
Modifying the revenue assessments

- 8.22. The Panel’s Second Interim Report suggests that options to modify the revenue assessments to provide incentives for states to meet their obligation under agreed reforms include assessing zero capacity or adopting an actual per capita approach. These approaches have been proposed to address circumstances whereby if a state chooses to abolish an agreed inefficient tax ahead of schedule it should not be penalised for this ‘good policy decision’.
- 8.23. While the proposed modifications to the revenue assessments seem to be well intentioned, analysis shows that the proposals to adopt zero capacity or an actual per capita approach would result in perverse outcomes and incentives.
- 8.24. Currently, if a state’s assessed per capita revenue-raising capacity is below the average, that state receives additional GST revenue equal to this difference. The opposite is true if a state’s assessed per capita revenue is above the average.
- 8.25. Under a zero capacity or actual per capita revenue approach, if a state chooses to implement reforms earlier than agreed, that state would effectively be funded for the total revenue loss through the equalisation process.

¹¹ Intergovernmental Agreement on Federal Financial Relations, 2008

- 8.26. Figure 8.2 shows the revenue impact of zero capacity or actual per capita assessment for South Australia if it abolished conveyance duty ahead of an agreed schedule. Under the current approach, South Australia is assessed as being able to raise \$613 million in conveyance duty in 2010-11, compared to an average capacity and policy of \$902 million. As a result, South Australia receives additional GST revenue of \$289 million (its assessed GST revenue needs) reflecting its below average capacity to raise conveyance duty.
- 8.27. Figure 8.2 shows that if a zero capacity or actual per capita assessment was adopted, South Australia would not only receive the \$289 million it was previously assessed as needing but would receive an additional \$613 million. Effectively, South Australia would be compensated for its policy choice to abolish conveyance duty at the expense of GST revenue of other states.

Figure 8.2: Impact of South Australia abolishing conveyance duty ahead of an agreed schedule under different revenue standards, 2010-11, \$ per capita



Source: Commonwealth Grants Commission, *Report on GST revenue Sharing Relativities – 2012 Update*, Northern Territory Treasury

- 8.28. As shown in Figure 8.2, adopting zero capacity or actual per capita approach would result in perverse outcomes. The Territory’s view is that it would be highly inappropriate for a state to be fully compensated for its policy decision to abolish a tax ahead of an agreed schedule.
- 8.29. Similarly, if a state chose to increase its revenue-raising effort (whether this is good policy or not) that state would be penalised through a reduced GST revenue share under an actual per capita approach. The application of actual per capita assessments is only appropriate where there are uniform policies across all states.

- 8.30. Notwithstanding the perverse incentives outlined above, once a schedule has been agreed for the abolition of taxes, the GST revenue effects on each jurisdiction can easily be calculated and are understood by all states. Thus, if a jurisdiction decides to vary from the schedule by removing a tax early, that decision would be informed by the known effect this would have on its assessed relativity. In such circumstances it is difficult to understand a conclusion that a state would be 'penalised' for such action.

Delaying GST payments or creating a reward pool

- 8.31. The Territory is strongly opposed to any change in Australia's form of equalisation that attempts to influence a state's policy decision by dedicating GST revenue, for the purpose of rewards payments, financial penalties or withholding GST revenue. These options are inconsistent with the provision of GST revenue on an untied basis as agreed by all states and the Commonwealth under the IGA. While there would not be expenditure restrictions on how the reward payments are used, payment of GST revenue would be contingent upon states adopting certain policies.
- 8.32. In addition to the Territory's in principle opposition to a dedicated GST reward pool or delaying GST revenue, there are significant issues with how such an approach would be implemented, including:
- how much of the GST pool should be dedicated as reward payment or withheld as a penalty for non-compliance?;
 - should the reward payment be a one-off or continuation and, if so, for how long should the arrangement continue?;
 - by whom and how should 'good' policies be determined?;
 - on what basis would the reward payments be distributed between states?;
 - and
 - if a state does not receive a reward payment, would this revenue be withheld and provided in subsequent years or would it be distributed to the other states?
- 8.33. Notwithstanding how the mechanics of such an approach would work, ultimately it would not result in states in aggregate being better-off for adopting the target policies as total revenue available to the states would be the same, if not less.
- 8.34. More broadly, this approach only penalises states for not adopting specific policies and does not address any of the other barriers to states undertaking reforms in general, including wider economic benefits, budgetary implications, priorities of state constituents and sharing of the economic benefits that generally accrue to the Commonwealth through higher Commonwealth tax receipts.

- 8.35. Also, as outlined in an earlier section, the significant reduction in GST revenue growth in the last five years, with little likelihood that previous growth rates will be achieved, indicates that there is no capacity available in the GST pool to be set aside to support tax reform. Another source of revenue would be required to support nationally consistent state tax reform.

9 State mineral royalties and Commonwealth resource tax reforms

Key Points:

- 9.a. Due to the profit threshold and the application of the MRRT to iron ore and coal only, Territory mining operators are not currently affected by the Commonwealth's resource tax reforms. However, there is potential for this to change in the future and the Territory's view is that the issue of the interaction between Commonwealth and state resource taxation regimes should be resolved as soon as possible.
- 9.b. Notwithstanding that the MRRT and PRRT do not currently affect the Territory, it is opposed to changes in Commonwealth-state relations that exacerbate the level of VFI in Australia and/or limit state governments' autonomy to determine appropriate taxation policy in their state.
- 9.c. The Territory would be strongly opposed to any option or suggestion that attempted to resolve the issue of the interaction between state mining royalties and Commonwealth resource tax reforms through changes to the equalisation process. The Territory's preference is for multilateral negotiation between the Commonwealth and the states on principles for levying mining royalties in Australia.

- 9.1. The Territory is the only jurisdiction that applies a general and harmonised proportional profit-based royalty regime. The Territory's profit-based regime was implemented to facilitate green field mines with low value minerals and where there are high start-up costs, to provide a standardised approach to assessing royalties on different mineral commodities. Further, the Territory's regime sets, for all minerals, a comparable share of mining returns between miners and government as owner of the extracted mineral. This royalty regime and rate ensures a fair contribution of the mining industry to the long-term welfare of Territorians while providing a flexible regime that contributes to a more viable mining industry in the Territory.
- 9.2. Due to the profit threshold and the limitation of the MRRT to iron ore and coal, Territory mining operators are not currently affected by the Commonwealth's

resource tax reforms. However, there is potential for this to change in the future and the Territory's view is that the issue of the interaction between Commonwealth and state resource taxation regimes should be resolved as a matter of priority, in order to provide investment certainty for potential future mining projects.

- 9.3. The Panel has not indicated that interaction between the Commonwealth's MRRT and PRRT and state royalties should be addressed through changes to the HFE system. The Territory would be strongly opposed to any option or suggestion that attempted to resolve this issue through changes to the equalisation process.
- 9.4. The Territory is opposed to changes in Commonwealth-state relations that exacerbate the level of VFI in Australia and/or limit state governments' autonomy to determine appropriate taxation policy in their state.
- 9.5. The Territory agrees with the Panel that the current situation in relation to state mining royalties and Commonwealth resource tax reforms is undesirable and unsustainable. The Territory's preference is for multilateral negotiation between the Commonwealth and the states on a way forward for levying mining royalties in Australia.
- 9.6. As outlined in *Chapter 8 – HFE and state tax reform*, the Territory and all other states are committed to improving the efficiency of state taxes, including mining royalties. The development of a multilateral agreement between the Commonwealth and the states will ensure that the taxes levied on the mining industry are more efficient and that the viability of the mining industry in Australia is maintained.
- 9.7. The Territory notes the present constrained revenue position of all states, which necessitates that any agreement reached will require sureties from the Commonwealth about the impact on states' revenues. Further, any agreement should include provisions ensuring that any change to the current roles and responsibilities of jurisdictions in the levying of mining royalties do not result in reduced budget certainty for states, or a diminution of states' powers to levy mineral royalties in the future.
- 9.8. This is particularly important given the fixed location and finite supply, of mineral and energy resources. Prevailing global economic conditions, including the price of and demand for Australian commodities, are sure to change in the future and states need assurances that they will be able to alter mineral and energy royalty policies in response to changes in market conditions.
- 9.9. The Territory agrees with the Panel that failing an agreement between states and the Commonwealth, the Commonwealth should be required to review its MRRT and PRRT legislation to remove any unintended consequences of its policy. The Territory strongly supports the continuation of states' autonomy to levy royalties

on resources that exist within their jurisdiction, and will not agree to any arrangement that reduces states' capacity to do so without due compensation.

- 9.10. Options that have been suggested as means of overcoming the unintended interaction between states' mineral royalty rates and Commonwealth MRRT and PRRT revenue are discussed below.

A reduction in the rate of ad valorem royalties with greater use made of resource rent taxes

- 9.11. The Panel has suggested that states consider reducing the ad valorem rate levied on relevant resources (iron ore, coal and petroleum) in order to increase the efficiency of mineral taxation in line with the recommendations of the Australia's Future Tax System Report, and to remove interactions between the MRRT and PRRT and state royalties.
- 9.12. While this proposal would not affect the Territory, as it already applies a profit-based mineral royalty regime, the Territory does not support it because it reduces state autonomy over state revenue policy and would increase the level of VFI in Australia, at a time when state revenues are heavily strained.
- 9.13. While the Panel has suggested that the arrangement would involve the Commonwealth providing compensation equal to the revenue forgone, it would result in greater reliance of the states on Commonwealth revenue and would reduce state autonomy to determine the scope and size of resource taxes within state boundaries.

Capping state royalty rates

- 9.14. The Commonwealth has suggested that states should impose a 'cap' on royalty rates equal to those at the time of the introduction of the Commonwealth's MRRT and PRRT. This would ensure that Commonwealth MRRT and PRRT revenues are maintained, however, it would result in states relinquishing power to set royalty rates according to the budgetary and industry priorities within their jurisdiction.
- 9.15. The proposal that there should be a cap on state royalty rates to avoid reducing Commonwealth MRRT or PRRT revenue is entirely inappropriate. This would place further constraints on states' revenue-raising capacities, exacerbating the increasing level of VFI in Australia.
- 9.16. The Territory notes that because the MRRT and PRRT only apply to particular resources, the impacts of adopting a royalty rate cap on affected resources would vary significantly between states, depending on their resource endowments. The proposal could result in reduced policy autonomy of states with large iron ore and/or coal endowments but not affect states with large endowments of other commodities. This is inherently unfair. The Territory strongly supports the

continued autonomy of state governments to determine state mineral royalty rates and that the Commonwealth should not penalise a state through the GST distribution for exercising this autonomy.

10

Governance and communication

Key Points:

- 10.a. The Commonwealth and state governments each have a role in determining the principles and objectives of equalisation in Australia.
- 10.b. The Territory supports the role of the Commission as an independent and impartial body responsible for recommending the distribution of GST revenue between states.
- 10.c. The Territory is proposing changes to the way equalisation outcomes are presented, to reduce the potential for misinterpretation. The presentation of states' GST revenue shares should clearly show that GST revenue is intended to fill the gap between states' expenditure needs and revenue from other sources.

Governance

- 10.1. The distribution of GST revenue and the prior arrangements for Financial Assistance Grants, have often been the subject of public criticism and debate. A recent monograph by Professor Ross Williams, which reviewed the distribution methodologies used over an extended period, indicates that public criticism is not a recent phenomenon.
- 10.2. While a laudable objective would be to achieve broad support for the method used to allocate GST revenue between the states, it is questionable whether such an outcome could realistically be achieved given the 'zero-sum game' that underlies GST revenue distribution. Much of the criticism levelled at the GST revenue distribution is based on a degree of self interest or misunderstanding.
- 10.3. The fundamental purpose of HFE is to provide states with the capacity to provide the same standards of schools, hospitals, roads and other essential government services. There is no indication that Australians would accept a situation where some states were no longer able to provide comparable services because of the diminution of equalisation.

- 10.4. The Panel has stated that “its Terms of Reference provide guidance that the longstanding practice of HFE has served Australia well... nevertheless, judging by the disparity of views contained in submissions from experienced jurisdictions and commentators, the present arrangements are complex, opaque and therefore not agreed, or not well understood.”¹² It is useful to examine each of these concerns in turn.
- 10.5. Reducing complexity has been a long standing aim of the HFE process, and a specific objective of the 2010 Review when the Commission and the states expended a great deal of effort to simplify the methodology used to calculate relativities. It is generally agreed that increasing simplicity reduces equalisation, as happened in the 2010 Review with the introduction of materiality thresholds, a significant increase in the use of equal per capita assessments and significant discounting of disability factors. Whether a further reduction in complexity or the achievement of greater simplicity can be achieved without an unacceptable reduction in equalisation is questionable.
- 10.6. The current HFE system is sometimes said to be opaque, but determining whether this is a fair criticism requires consideration. The Commission has developed a robust and reliable model, which, by its nature, must have a degree of complexity. The methods used by the Commission to assess each function are at least as understandable as other methods used to distribute funding, such as the regional funding model for universities, the case-mix hospital funding arrangements or the approach to schools funding recommended in the Review of School Funding Final Report. Each of these methods produces an absolute funding requirement. However, the additional requirement for the HFE assessment is that after assessing all state functions and revenues, the Commission has to bring all 21 separate assessments together in one formula, taking into account the level of tied Commonwealth revenue each jurisdiction receives, and calculate each state’s recommended share of the GST revenue pool. Variations in any of these elements can cause recommended relativities to change.
- 10.7. The Territory does not agree that opacity is an outcome of the Commission’s methodology. While it involves some complexity, this is no greater than in other funding distribution processes (such as those listed above).
- 10.8. The Panel has also suggested that the distribution method is not agreed. While this is correct, it is questionable whether an agreement by all states will ever be reached, given the zero sum nature of GST revenue distribution. As Professor Williams has recorded, there is a long history of criticism of the different distribution methods used to provide Commonwealth funding to the states. This criticism increases when states face reduced control over their own revenues, for

¹² The Australian Government, *GST Distribution Review Interim Report 2012*, page 22

example, when states lost the capacity to levy franchise fees in the late 1990s, which were significant state own-source revenue.

- 10.9. When the GST was introduced, it incorporated revenue replacement payments (paid in lieu of franchise fees) and also required states to give up other taxes, some of which contributed significantly to states' own-source revenue.
- 10.10. While there is no doubt that the introduction of the GST was appropriate and has led to many benefits to states and nationally, states forwent own-source revenues as part of the process, and this has, not surprisingly, resulted in a greater focus in the outcome of the HFE distribution arrangements. It seems unlikely to the Territory that agreement on the GST revenue distribution will be reached easily, while the GST is such a significant proportion of state revenue. There has been little effort of the Commonwealth to propose policy changes that could reduce the level of VFI in Australia, which means that a consensus agreement on the method for distributing GST revenue between states seems increasingly remote, particularly as state revenue capacities diverge.
- 10.11. While ideally, the Commonwealth and the states would agree on the definition of HFE and the way it should be achieved, the Panel needs to consider whether this is a realistic outcome. If the Panel concludes that it is unlikely, it should also consider the extent to which equalisation would need to be altered to satisfy all jurisdictions, and then how long would it be until the process comes under further attack.
- 10.12. This likely impasse means that the Panel may need to advise the Commonwealth on the implications for Australia and for each jurisdiction of moving away from the current equalisation arrangements. Gaining agreement of the majority of stakeholders is not a sufficient reason in itself to reduce or modify equalisation.
- 10.13. The Panel has stated that it sees merit in separating responsibility for determining the objectives of the GST distribution and the definition of HFE from the responsibility for interpreting and implementing HFE. The Territory agrees that separation of responsibilities is desirable, but that this is achieved under the current arrangements. As explained by Professor Williams:

Intergovernmental relations in a federation necessarily involve political decision-making. It is for this reason that the CGC [Commission] can only operate under a terms of reference which are given to it by the Commonwealth government after consultation with the states. It is also why the CGC [Commission] can only make recommendations. The CGC [Commission] has frequently in its reports mentioned that, in the end, it is up to government to make decisions on major issues, such as the trade-off between efficiency and equity, how recommendations

*should be implemented and the role of the CGC [Commission] in overall federal-state relations.*¹³

- 10.14. The Territory is opposed to an independent third party, such as the Productivity Commission, being responsible for determining the definition and objectives of equalisation. This approach would add an additional layer of bureaucracy to the HFE system and would not lead to greater confidence in the GST distribution process.
- 10.15. The Territory reaffirms its support of the Commission and its role as an independent and impartial body responsible for recommending the distribution of GST revenue between states. The Commission has the expertise and technical knowledge, accumulated since its establishment in the 1930s to provide impartial, transparent and independent advice to the Commonwealth on the distribution of GST revenue among the states.
- 10.16. The Commission has effectively balanced the conflicting views of states, particularly given the zero-sum nature of the GST distribution, and has provided an equitable distribution of GST revenue within the confines of its terms of reference.
- 10.17. The Panel has suggested that HFE outcomes should be subject to independent review from time to time. One approach is for the Standing Council on Federal Financial Relations (SCFFR) to undertake a periodical review of key aspects of the Commission's methodology as was done in 2004-05. The findings of SCFFR reviews could be incorporated into the Commission's terms of reference to provide guidance on methodological improvements.
- 10.18. This approach was used following the 2004 Review and resulted in additional terms of reference being provided to the Commission to simplify its assessments (including consideration of aggregating the number of assessments and applying materiality thresholds) and the development a work program to improve the quality and fitness for purpose of the data used in the assessments. It also resulted in the Commission adopting additional supporting principles of equalisation – that relativities are practical and contemporaneous.

Communication

- 10.19. Australia's form of equalisation encompasses differences between states':
- costs of delivering the average level of services;
 - capacities to raise own-source revenue; and
 - revenues from tied Commonwealth payments.

¹³ Professor Ross Williams, *History of Federal-State Fiscal Relations in Australia: A Review of the Methodologies Used*, The Australian Economic Review, vol. 45, no.2, 2012

10.20. These differences are aggregated and presented in the form of ‘per capita relativities’. A key reason for the misunderstanding and confusion of the HFE system is the presentation of the headline relativities and communication of how relativities are used to calculate each state’s GST revenue share.

10.21. Common misunderstandings surround relativities, for example:

- the Territory’s relativity – does it costs 5.52 times more to provide services in the Territory than in other states?
- the volatility of relativities – why do relativities fluctuate? Is this indicative of arbitrary outcomes?
- Western Australia’s declining relativity – why should Western Australia receive less GST revenue per capita than other states?

10.22. Irrespective of any changes to the equalisation process recommended by the Panel, it is essential that the outcomes of equalisation are better communicated.

10.23. Table 10.1 shows the current presentation of relativities and calculation of each state’s GST revenue share used in Commonwealth Budget Papers. To those unfamiliar with the equalisation process, the current presentation of relativities does not provide adequate information to easily interpret why states’ shares of GST revenue differ. Specifically, that GST revenue is intended to fill the gap between a state’s assessed expenditure needs and its other sources of revenue.

Table 10.1: Current presentation of 2012 Update GST relativities

	Estimated 31 December population	GST relativities	Adjusted population	Share of adjusted population	Share of GST pool
	No.		No.	%	\$M
NSW	7 424 410	0.95312	7 076 354	30.7	14 795.5
Vic	5 749 634	0.92106	5 295 758	23.0	11 072.6
Qld	4 694 804	0.98477	4 623 302	20.1	9 666.6
WA	2 427 901	0.55105	1 337 895	5.8	2 797.3
SA	1 679 657	1.28472	2 157 889	9.4	4 511.8
Tas	515 633	1.58088	815 154	3.5	1 704.4
ACT	374 663	1.19757	448 685	1.9	938.1
NT	234 782	5.52818	1 297 917	5.6	2 713.7
Total	23 101 484	n.a	23 052 954	100.0	48 200.0

Source: Commonwealth Government, *Commonwealth 2012-13 Budget*, Budget Paper No. 3, page 125

10.24. Public understanding of the equalisation process would be improved if states’ GST revenue shares were considered in the broader context of states’ aggregate revenue positions, consistent with how equalisation is applied.

10.25. Table 10.2 shows an alternative presentation of states’ GST revenue shares. It includes an expenditure ratio, which is simple to understand because it indicates

differences in the relative costs faced by each state in the provision of services. It also isolates states' expenditure needs from their revenue capacities. It shows that once an expenditure requirement has been calculated, the amount of revenue a state is assessed as being able to raise from its own sources and the revenue it receives from tied Commonwealth payments is deducted. The remaining amount equates to each state's GST revenue requirement.

Table 10.2: Alternative presentation of 2012 Update GST relativities

	Estimated 31 December population	Expenditure ratio	Expenditure requirement	State own- source and tied Cwlth revenues	Share of GST pool
	No.		\$M	\$M	\$M
NSW	7 424 410	0.97212	60 761	45 965	14 796
Vic	5 749 634	0.92320	44 687	33 614	11 073
Qld	4 694 804	1.02416	40 479	30 812	9 667
WA	2 427 901	1.05846	21 635	18 837	2 797
SA	1 679 657	1.02368	14 475	9 964	4 512
Tas	515 633	1.10366	4 791	3 087	1 704
ACT	374 663	0.96802	3 053	2 115	938
NT	234 782	2.32888	4 603	1 889	2 714
Total	23 101 484	n.a	194 484	146 284	48 200

Source: Northern Territory Treasury

10.26. Table 10.3 is a variant of Table 10.2. It separately identifies states' own source revenues and each state's share of tied Commonwealth payments.

Table 10.3: Alternative presentation of 2012 Update GST relativities

	Estimated 31 December population	Expenditure ratio	Expenditure requirement	State own-source revenue	Commonwealth Revenue	
	No.		\$M	\$M	Tied Cwlth payments	Share of GST pool
	No.		\$M	\$M	\$M	\$M
NSW	7 424 410	0.97212	60 761	30 080	15 886	14 796
Vic	5 749 634	0.92320	44 687	22 190	11 424	11 073
Qld	4 694 804	1.02416	40 479	20 344	10 468	9 667
WA	2 427 901	1.05846	21 635	13 691	5 147	2 797
SA	1 679 657	1.02368	14 475	6 026	3 938	4 512
Tas	515 633	1.10366	4 791	1 764	1 323	1 704
ACT	374 663	0.96802	3 053	1 394	721	938
NT	234 782	2.32888	4 603	946	944	2 714
Total	23 101 484	n.a	194 484	96 434	49 850	48 200

Source: Northern Territory Treasury

- 10.27. The alternative presentations are more intuitive and demystify the factors affecting a state's GST revenue share. For example, Western Australia has above average expenditure needs. This is intuitive given its geography and population characteristics. However, its large own-source revenue-raising capacity means it requires less GST revenue to meet its expenditure requirement.
- 10.28. The Territory acknowledges that changing the presentation of states' GST revenue shares will not on its own address some of the underlying concerns (whether real or perceived) regarding the equalisation process. However, the Territory believes that the proposed alternative presentations will contribute to a better public understanding of equalisation outcomes.



Indigenous Expenditure Review

September 2006



Foreword

Professor Kenneth Wiltshire AO
JD Story
Professor of Public Administration
University of Queensland
Business School
Former Member Commonwealth
Grants Commission
Founding Member Constitutional
Centenary Foundation

It is one of the paradoxes of our time that while we as Australians are discovering and acclaiming the uniqueness and richness of the cultural heritage of our Indigenous people, we are also recognising and acknowledging the magnitude of the difficulties which they face in so many aspects of their lives. Nowhere is this more evident than in the basics of health, education, and housing, but it applies in so many other areas as well.

Our State and Territory governments have long had the major responsibility for provision of services to Indigenous communities. Such was the arrangement (or lack thereof) in the constitutional design at the founding of the nation in 1901. This remains the case despite the referendum of 1967 which gave the Commonwealth a more direct role, though still a concurrent one. However, the provision of these services is well beyond the financial resources of the State and Territory governments, particularly given the severe vertical fiscal imbalance which exists in the Australian federation, whereby the Australian Government receives the lion's share of public revenue and the other levels of government are heavily dependent on transfers from the national level.

In the context of this *mélange* doubts are raised from time to time as to whether the needs of Indigenous communities are of the size and nature which is asserted, and whether State and Territory governments are justified in their claims for Australian Government funding for these purposes. This debate often occurs during the division of Australian Government funding amongst States and Territories which takes place under Australia's comprehensive Horizontal Fiscal Equalisation scheme which seeks to measure needs or "disabilities" faced by jurisdictions in their revenue raising and expenditure.

The Northern Territory is the quintessential jurisdiction in which to test these claims, with nearly 30 per cent of its population Indigenous, including a tapestry of mostly small and isolated Indigenous communities. It must be recognised that this is no easy task given the extreme difficulties of defining and measuring the physical and financial factors which drive this arena of public policy and its attendant funding regime. The contents of this paper represent a bold attempt to accomplish the difficult task of defining and measuring the cost of service provision of all Territory agencies to Indigenous people, and providing a comparison with the revenue which the Territory receives due to the size and circumstances of its Indigenous population. The methodology adopted here is rigorous, the assumptions soundly based, if somewhat conservative, and the whole exercise has been conducted in a transparent manner acknowledging the difficulties in quantification wherever they occur. In particular, the paper concludes Indigenous-related expenditure exceeds comparable revenue. In the process the paper also highlights the significant contribution which the Northern Territory Government has long made in this arena, an aspect not well known and appreciated in the rest of Australia. Indeed, every day Northern Territory public servants are the visible hand in matching resources to needs in Indigenous communities with a remarkable degree of professionalism and dedication.

The challenge of providing for the needs of, and opportunities for, Australia's Indigenous people is currently receiving welcome attention from all levels of government. This is encouraging because that challenge can only be addressed through a partnership in renewed federalism arrangements regarding finance and roles and responsibilities. This paper will be of significant assistance in this urgent task.



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Acknowledgments

Northern Territory Treasury is grateful for the constructive criticism and valuable input in the preparation of this report from:

- Professor Ken Wiltshire, JD Story Professor of Public Administration, University of Queensland Business School;
- Mr Saul Eslake, Chief Economist ANZ; and
- Chief Executives and senior officials of Northern Territory Government agencies.

Northern Territory Treasury held discussions with Commonwealth Grants Commission staff concerning the Commission assessments. The Commonwealth Grants Commission's methodology for determining state revenue sharing relativities can be found at: www.cgc.gov.au

Executive Summary

Key Points

- In 2004-05, an estimated 49.7 per cent of the Northern Territory Government's expenditure was related to its Indigenous population.
- An estimated 43.2 per cent of the Northern Territory Government's revenue was related to its Indigenous population over the same period.
- In 2004-05, Indigenous-related expenditure by the Northern Territory Government exceeded Indigenous-related revenue by 6.5 per cent or about \$175 million.
- Indigenous-related expenditure exceeded a per capita share by 73 per cent and represents 2.44 times the per capita expenditure related to non-Indigenous persons in the Northern Territory.
- Despite the high level of expenditure, outcomes for Indigenous Territorians against a wide range of indicators remain poor relative to those of non-Indigenous Territorians.
- There is clearly a need for additional funding streams to the Territory, so that the social wellbeing of the Indigenous population can be improved, economic participation and productivity be enhanced, and all Australians can benefit from improved economic activity and social cohesion.

The Northern Territory is a unique part of the Australian nation and cannot be easily compared to other Australian jurisdictions. It is not a state and was granted self-government less than thirty years ago. Its resident population of less than a quarter million occupies an area over one and a half times the size of New South Wales. About 29 per cent of the Territory's population is Indigenous, compared to 2.4 per cent of Australia's total population.

Given the significance of its Indigenous population, the level of the Territory's expenditure related to this group has come under intense public scrutiny. Until now there has not been a comprehensive estimate of the Territory's spending related to its Indigenous population. For this reason, the Northern Territory Government's Chief Executives' Taskforce on Indigenous Affairs has commissioned a review and analysis of Territory expenditure on Indigenous-related purposes. This analysis will be undertaken on a regular basis in the future.

Government service delivery needs of the Territory's Indigenous population are immense. Relative to non-Indigenous Territorians, Indigenous Territorians are more represented in remote or very remote areas, have a younger mean age and experience more socioeconomic disadvantage across a wide range of indicators. These include: higher mortality and morbidity rates; poorer educational attainment; lower school retention rates; higher rates of unemployment and income poverty; higher occupancy rates of overcrowded and poor quality housing; and higher rates of arrest and imprisonment. Correspondingly, usage of government services by Indigenous Territorians is disproportionately high, notwithstanding accessibility issues. Additionally, the multidimensional nature of Indigenous disadvantage often further complicates and adds to the cost of government service delivery. In many cases, other factors such as geographic location entail higher per unit costs to government of service provision than in other Australian jurisdictions.

These and other factors present difficult and pressing challenges for government service delivery that are unique to the Territory. In recognition of these challenges, the Northern Territory Government is, amongst other strategies, undertaking the initiative *Agenda for Action: A Whole of Government Approach to Indigenous Affairs in the Northern Territory 2005-2009*. The Territory has also been instrumental in developing strategies, now accepted by the Council of Australian Governments, in respect to a generational commitment to overcome Indigenous disadvantage. This report on expenditure and revenue related to the Indigenous population plays a role in this initiative by assisting in coordinating and better informing the Northern Territory Government's Indigenous policy.

Some of the Northern Territory Government's Indigenous-related expenditure is packaged in the form of Indigenous-specific programs and services. However, due to their relatively large share of the total population and above-average use of many government services, Indigenous Territorians in effect constitute the mainstream recipients of many Northern Territory Government services. In short, most of the 'mainstream' government services in the Territory are Indigenous-focused. For this reason, attempting to separate Indigenous-specific program funding from other program funding would be, in the case of the Northern Territory, not appropriate or relevant. Attempting to construct an estimate of Indigenous-related spending based solely on the identification of Indigenous-specific programs would therefore result in a significant underestimation of relevant expenditure.

The methodological approach adopted by this review to estimate Indigenous-related expenditure reflects this consideration, and takes into account both direct and indirect use and cost rates of all government services. Agencies were categorised in three distinct groups: service agencies that provide services directly to the Territory public (such as the Department of Health and Community Services); support agencies that provide services directly to other government agencies (such as the Department of Corporate and Information Services or NT Fleet); and central agencies that provide general, whole of government services to all agencies (such as the Department of the Chief Minister and Northern Territory Treasury).

Service agencies estimated their Indigenous-related expenditure by examining spending on Indigenous-specific programs, Indigenous usage rates for other programs and functions, and cost differentials between provision of services to the Indigenous and non-Indigenous populations. Where service agencies provide a service that generates broader economic and social benefits arising from government investment (for example, tourism promotion and industry development) but has limited direct beneficiaries, consideration was given to the indirect benefits accrued to the whole population. These indirect benefits may include availability of employment, access to the goods and services of production, and the advantages gained from taxation revenue raised from the relevant industry. Expenditure by these agencies was generally attributed to the Indigenous population on an equal per capita basis.

The estimation of Indigenous-related expenditure for support agencies is based on the premise that these agencies exist only to provide services to other agencies. Thus, support agencies' expenditure is treated as though it is a corporate cost for service agencies. The estimates for support agencies' shares of Indigenous-related spending are therefore based on the average Indigenous-

related expenditure for all service agencies. Where data was available, the support agencies' expenditure was apportioned to each service agency, and weighted accordingly.

Similar to support agencies, the estimates for central agencies are based on the average expenditure related to the Indigenous population of all service agencies, because central agencies predominantly provide functions that support service agencies. Exceptions were made for programs that are a direct service to the general population, such as those provided under Treasury's output group 'Gambling, Liquor and Other Regulation'.

Based on a detailed analysis of government expenditure at output and sub-output (or program) levels, this review has estimated that 49.7 per cent of the Northern Territory Government's total expenditure was related to the Indigenous population in 2004-05 (Table 1). This compares to a population share of 28.8 per cent. Thus Indigenous-related expenditure exceeds a per capita share by 73 per cent and represents 2.44 times the per capita expenditure related to non-Indigenous persons.

Table 1: Estimate of Northern Territory Government expenditure related to the Indigenous population 2004-05.

Agency type	% of total expenditure	Indigenous-related %
Service agency	77.3	50.9
Support agency	5.5	46.5
Central agency	17.2	45.6
All agencies	100.0	49.7

Source: Northern Territory Treasury

Territory revenue was also analysed to determine what proportion was Indigenous-related. The Territory, like other states, has three main revenue sources: own-source; specific purpose payments (SPPs); and goods and services tax (GST), which is untied. SPPs and GST are provided to states and territories (states) by the Australian Government.

Under Australia's federal system, states have limited capacity to raise own-source revenue, but are responsible for a wide range of government services. Conversely the Australian Government's revenue-raising capacity exceeds its limited responsibility for providing services. The mismatch of revenue powers and service delivery responsibilities of the Australian and state governments is described as vertical fiscal imbalance. It is the basis for the \$61 billion of funding the states received from the Australian Government in 2004-05 through distribution of GST revenue and SPPs.

Funding arrangements for distribution of GST revenue among states are based on the principle of horizontal fiscal equalisation (HFE). This principle takes into account demographic, economic and geographic factors that affect the cost of and demand for government service delivery across different jurisdictions.

Untied Australian Government funding from GST revenue accounts for approximately two-thirds of the Northern Territory Government's budget, a share much higher than for all other states, due largely to the higher need for and costs of service delivery in the Northern Territory. One of the reasons behind this disproportionate redistribution is the influence of the Territory's Indigenous population. Tied funding such as SPPs and other Australian Government grants

comprises another 15 per cent of the Territory's total revenue. The remaining 20 per cent of the Territory Government's budget is own-source revenue.

For 2004-05, this review estimates that 43.2 per cent of the Northern Territory Government's total revenue was related to the Indigenous population (Table 2). This includes:

- the Commonwealth Grants Commission's estimates of the redistributive effect of Indigenous influences, native title, land rights and other relevant disabilities in determining GST relativities;
- SPP revenue targeted at Indigenous-specific purposes;
- the indirect impact on GST revenue of Indigenous SPP funding;
- estimates of the proportion of own-source taxes attributable to the Indigenous population; and
- an equal per capita (EPC) share of remaining revenue.

Table 2: Estimation of Northern Territory Government revenue related to the Indigenous population 2004-05

Source of revenue	Share of total revenue	Revenue	Indigenous-related share	Indigenous-related share
	%	\$M	\$M	%
Tied grants (including SPPs)	15.1	411.3	148.4	36.1
GST	64.1	1739.6	916.1	52.7
Own-source revenue	20.8	565.3	108.0	19.1
Total	100.0	2716.2	1172.5	43.2

Source: Northern Territory Treasury

Thus comparing revenue and expenditure shows that expenditure on government services that is directly or indirectly accessed by the Territory's Indigenous population exceeded revenue related to the Indigenous population by 6.5 per cent or about \$175 million.

Despite high levels of expenditure and recent improvements in life expectancy, infant mortality and educational outcomes, a strong case exists that current funding mechanisms are insufficient to: overcome the level of disadvantage faced by Indigenous Territorians; equalise outcomes and overcome the well-documented backlogs of infrastructure, such as essential services and housing; and provide the range of economic and social services available to most Australians.

There is clearly a need for funding streams to the Territory in addition to those delivered through HFE and the interrelated SPPs so that the social wellbeing of the Indigenous population can be improved, economic participation and productivity be enhanced, and all Australians can benefit from improved economic activity and social cohesion. Put simply, provision of average services will not reduce levels of disadvantage experienced by Indigenous Territorians and indeed other Indigenous Australians, particularly in remote locations.



Introduction

Recently, there has been considerable focus on Indigenous disadvantage and the response of all governments to this disadvantage. The Northern Territory in particular has been singled out for scrutiny in relation to its expenditure priorities in respect of its Indigenous residents.

It has been alleged that Indigenous-specific funds are not being used to improve socioeconomic outcomes for Indigenous Territorians, but instead some of these funds are used to support programs and infrastructure that are primarily accessed by the non-Indigenous population, particularly in Darwin. This in turn, it is argued, is perpetuating and exacerbating Indigenous disadvantage.¹

To date there have not been any robust, whole of government estimates that provide an assessment of the extent of revenue and expenditure related to the Territory's Indigenous population. As a result, the Northern Territory Government's Chief Executives' Taskforce on Indigenous Affairs has supported the preparation of this report, which seeks to provide an objective and comprehensive analysis to measure the deficit or surplus in funding to the Territory associated with indigeneity. It is intended that this analysis be carried out on a regular basis in the future.

The report is in two parts. Part A estimates the proportion of Territory expenditure that can be related to the Indigenous population. The report outlines the socio-demographic characteristics of the Territory, relative disadvantage of the Indigenous population, use and cost of services and then the methodology used to determine the estimate.

The methodology used to compile the estimates was based on a detailed analysis of output and sub-output groups (or programs) for all general government agencies.

Data on usage rates and relative costs of government service provision related to the Indigenous population was collated from available external sources, for example the Australian Bureau of Statistics (ABS), the Australian Institute of Health and Welfare (AIHW), the Australian Institute of Criminology (AIC), and internal Northern Territory Government agency sources. From this data, the proportions of Indigenous-related expenditure of the output/sub-output groups of each service agency were estimated. These proportions were then used as the basis to derive the Indigenous-related expenditure proportion for support and central agencies.

The report implicitly assumes that programs targeted to the Indigenous community or mainstream programs are expended at national average levels of

¹ For example, a draft report released in early 2005 by the ANU academics Taylor and Stanley pointed to underspending on education in the Thamarrurr region. Although the data initially presented was later revised, the immediate publicity given to the original findings lent them some unofficial status. See J. Taylor and O. Stanley (2005), *The Opportunity Costs of the Status Quo in the Thamarrurr Region: Working Paper no. 28*, Centre for Aboriginal Economic Policy Research, Australian National University, available at <http://www.anu.edu.au/caepr/Publications/WP/CAEPRWP28.pdf>. For selected media coverage of the reaction to Taylor and Stanley's draft report, see: F. Shiel (2005), "Aboriginal town considers legal push" in *The Age*, 17/06/2005; B. Briton (2005), "Special treatment: the case of Wadeye", in *The Guardian Unlimited*, 6/04/2005; National Indigenous Times (2005), "How to destroy a black community without even really trying", in *National Indigenous Times*, 30/03/2005; M. McLaughlin (2005), "Questions raised over Wadeye program" on *The 7:30 Report*, 28/04/2005, transcript at <http://www.abc.net.au/7.30/content/2005/s1355870.htm>.

efficiency. Likewise, judgements on measures of the expenditure's effectiveness or appropriateness are not made.

Part B estimates the proportion of Territory revenue that can be related to the Indigenous population. The report describes the Territory's sources of funding, outlines the system for fiscal transfers from the Australian Government and presents the methodology used to determine the estimates for each main revenue source.

Specific purpose payments (SPPs) represent tied funding and are used by the Australian Government to fund particular targeted programs. Generally, payments related to the Indigenous population can be readily identified. The payments provide a direct financial benefit to the states, however the distribution of SPP funding is interrelated with horizontal fiscal equalisation (HFE), and for the Territory the 'secondary' or 'indirect' effect of SPP funding generally results in a negative impact of Indigenous-related SPPs on the calculation of GST relativities.

Goods and services tax (GST) revenue is distributed on the basis of the Commonwealth Grants Commission's (the Commission's) definition of HFE. This definition allows for assessment of differential needs, including those of the Territory's Indigenous population, within the confines of provision of a national average level of services.

Own-source revenue capacity of the Territory is limited due to its small population, relatively undeveloped resource base and reduced taxing powers of states. No specific revenue capacity is related to population subgroups for revenue types such as interest or sale of goods and services. Own-source taxes can be attributed using proxies of demographic and economic indicators published by the ABS.



Part A: Estimation of Expenditure Related to the Territory's Indigenous Population

The process of accounting for expenditure that is related to Indigenous people is complex and open to interpretation. Difficulties arise when determining the range of spending that should be included. For example, should estimates account for direct spending on Indigenous-specific programs only, or include spending spread across mainstream services? How should government activities that do not directly provide a service to the public, such as the core functions of central agencies, be treated? There are also issues surrounding how attributed expenditure should be estimated: should it be based on client use or the total population share? How should cost differentials between servicing clients be treated? How should activities such as administrative services be attributed to specific population groups?

A significant share of the Territory Government's spending is on Indigenous-specific programs, however the majority of the services it provides for the Indigenous population are mainstream programs accessible to all Territorians. Even though these programs are not tailored to any particular population subgroup, in many cases the Territory's Indigenous population are disproportionate users of these services. This pattern of relatively high Indigenous patronage of services, reflecting widespread and multi-dimensional disadvantage, can be observed across all Territory Government services, but especially in the areas of health and community services, law and order and housing. As a result many mainstream programs are Indigenous-focused, if not explicitly Indigenous-specific, which leads to the delivery of these services in the Territory being fundamentally different to government service delivery in other jurisdictions in Australia.

Indicators of disadvantage include: higher mortality and morbidity rates; poorer educational attainment; poorer high school retention rates; higher rates of unemployment; lower average incomes; overcrowding in housing; and higher rates of arrest and imprisonment.

The multi-dimensional aspect is demonstrated through the complex and often long-term interplay of social, cultural and economic factors that entrench disadvantage for the Indigenous population. For example, low birth weight – itself often an indicator of poor maternal health – may have long-term consequences for the individual in terms of childhood development, health, educational achievement and employment prospects.² Similarly, evidence exists that seemingly disparate factors such as long-term health problems, unemployment status, alcohol use and poor education all positively influence the likelihood of arrest for an Indigenous person.

These factors all imply that the Indigenous population's usage of government services is likely to be higher than the non-Indigenous population, notwithstanding issues of accessibility. Unsurprisingly, statistical evidence from AIHW, ABS, AIC and the Productivity Commission largely corroborates this proposition. The Commission's *Report on Indigenous Funding 2001* stated:

"...[The] relative poverty of Indigenous people means they are reliant on government programs and services to meet basic needs to a far greater

² AIHW (2005a), *A Picture of Australia's Children*, Chapter 10.

extent than other groups. They do not have the resources to secure private access to services such as health and education, nor to be able to make a significant contribution towards their provision... Until such a time as Indigenous people have established a degree of economic and financial self-sufficiency comparable with other Australians, they will remain heavily dependent on government service provision.”³

A number of other matters further complicate and add to the cost of government service delivery to the Indigenous population, and inhibit Indigenous people from accessing government services. The multi-dimensional nature of Indigenous disadvantage poses distinct challenges for government in formulating policies to overcome poor outcomes. Short-term solutions based on the targeting of single issues may prove to be ineffective at promoting lasting change.

For many Indigenous Territorians, the language barrier is a significant factor that influences access to mainstream government services. A majority of Indigenous people in the Northern Territory speak a language other than English as their main language, which often necessitates the adoption of alternative service delivery models. Since 2000, an Aboriginal Interpreter Service (AIS) has been operating in the Territory, initially co-funded by the Australian Government, to reduce language barriers, and provides services to government and non-government clients including the Department of Health and Community Services (DHCS), Department of Justice (Justice), Northern Territory Police, Fire and Emergency Services (NTPFES), and Aboriginal Legal Aid Services.

Appendix 1 details a range of socio-demographic indicators of Indigenous wellbeing together with use rates and cost differentials applying to government services.

Appendix 2 details a number of Northern Territory Government strategic initiatives aimed specifically at the Territory's Indigenous population.


This review's estimates of expenditure have focused on the costs of service delivery. It is clear that service delivery in the Territory is different from other jurisdictions in Australia because of the presence of a large disadvantaged sub-group of its population. The four options that were considered are based on allocating service delivery cost by:

- EPC;
- use of services;
- use and cost of services; and
- modified use and cost of services.

EPC attribution of expenditure assumes that services are available to, and used equally by all Territorians regardless of indigeneity. However, this approach fails to consider Indigenous-specific programs or the non-average use and cost of services related to the Indigenous population.

Use of services (including mainstream and targeted program services) represents a reasonable basis for attribution of expenditure, provided the cost of service provision is similar across population subsets. However, in the case of the Territory, and as evidenced in the Commission's *Report on Indigenous Funding 2001* and its ongoing assessments of relativities, the cost of delivering

³ Commission (2001), [Report on Indigenous Funding 2001](#), p10.



services to the Indigenous population is generally higher than that of the non-Indigenous population. Incorporating a measure of cost of services would therefore serve to improve the accuracy of estimating expenditure related to the Indigenous population.

Costs of services include administration and overhead costs (for example, corporate and superannuation costs) that are fundamental to the provision of services but are not delivered directly to service users.

However, the use and cost of services framework is likely to understate expenditure related to population subgroups as it fails to take into account the broader economic benefits arising from government investment. These benefits reflect the function of government as an institutional nexus for the broader social, cultural and economic wellbeing of the wider community. This is most clearly seen in relation to the tourism and mining sectors where direct beneficiaries of expenditure may be industry participants or a relatively small number of persons, however the whole population indirectly benefits through availability of employment, produce and taxation revenue. For example, childless couples do not directly benefit from spending on schools, and urban populations may receive no direct benefits from government spending on primary industry. However, the whole community benefits from higher education standards, better health, increased economic development and the like.

As such, a modified use and cost methodology was developed to account for and attribute expenditure on activities that provide an indirect benefit to the community such as industry development or tourism. This expenditure is treated as EPC, unless it is specifically targeted at particular population subgroups.

Estimates of expenditure related directly and indirectly to the Indigenous population were collected through direct consultations with individual agencies, using the modified use and cost of services methodology as a guideline. Data was disaggregated to sub-output or program expenditure levels that reflect current agency structures. Government agencies were treated according to their classification under three categories:

- service agencies that provide services directly to the Territory public (such as DHCS and NTPFES);
- support agencies that directly provide services for other government agencies (such as the Department of Corporate and Information Services (DCIS) and NT Fleet); and
- central agencies that provide general, whole of government services to all agencies (such as the Department of the Chief Minister (DCM) and Northern Territory Treasury).

Service Agencies

For service agencies, the estimated proportion of expenditure related to the Indigenous population was based on usage and cost of services (including mainstream and targeted programs). Wherever possible, use rates and cost differentials have been sourced or cross-referenced to external publications and data. Where data on Indigenous usage was not available, attribution based on equal per capita or an appropriate population proportion as reported by the ABS or other external data sources was applied. Corporate and administrative costs

for each agency were apportioned based on the average expenditure share of all other output groups of the agency.

As an example, Table 3 shows the estimate of expenditure related to the Indigenous population for all programs under one of NTPFES' output groups titled 'Community Safety and Crime Prevention'. This output group accounts for just under a quarter of all NTPFES expenditure. For this output group, the base share for Indigenous-related expenditure was estimated at 52.0 per cent, and reflects the higher per capita usage rates of police services by the Indigenous population, and the cost differentials of servicing the Indigenous population compared to the non-Indigenous population. This figure was arrived at with reference to population data and data from AIC and the Productivity Commission's *Report on Government Services 2005*, and was confirmed by Commission staff.

For certain output and sub-output groups, NTPFES officials adjusted this base share to take account for factors such as stations and units that were identified as 100 per cent Indigenous, and all identified Aboriginal Community Police Officers (ACPOs) that are stationed at units other than those identified as 100 per cent Indigenous (such as the ACPOs at Darwin and Casuarina stations). Total estimated expenditure related to the Indigenous population for all NTPFES output groups was 57.3 per cent. NTPFES corporate costs were also therefore attributed to the Indigenous population at 57.3 per cent.

Table 3: Estimate for NTPFES expenditure related to the Indigenous population, output group 'Community Safety and Crime Prevention', 2004-05

Output and sub-output groups	Indigenous expenditure proportion	Share of NTPFES budget
	%	%
Community Safety and Crime Prevention		
Drug and Intelligence Division	52.9	0.1
Major/Organised Crime Division	52.0	0.1
Operations Support Division	52.0	0.0
Territory Support Division	52.0	0.9
Alice Springs Operational Service Division	56.2	3.4
Alice Springs Southern Operational Service Division	84.3	0.7
Alice Springs Operational Tennant Creek and Barkly	60.8	1.7
Crime Prevention and Reduction Division	52.0	1.2
Darwin and Suburbs Operational Service Division	52.8	3.4
Palmerston and Rural Operational Service Division	57.2	1.8
Juvenile Diversion	52.0	0.1
Katherine and Central Operational Service Division	60.4	1.8
Katherine Northern Operational Service Division	72.4	1.8
Road Safety Policy	52.0	0.0
Counter Terrorism	13.1	0.8
Training College	55.0	1.9
Forensics	52.0	1.0
Specialist Policing Support	52.0	3.1
Internal Corporate Costs	52.0	0.8

Source: Northern Territory Treasury



Support Agencies

The methodology used to estimate government support agencies' Indigenous-related expenditure is based on the premise that these agencies only exist to provide back office services to other agencies. Support agencies' expenditure is treated in the same way as corporate costs for service agencies and reflects the weighted average Indigenous-related expenditure for each service agency.

As an example, the estimate for DCIS of Indigenous-related expenditure was determined by apportioning DCIS's expenditure to each government agency and weighted to the proportion of Indigenous-related expenditure for that agency. This approach results in a proportion of 48.9 per cent of DCIS's expenditure related to the Indigenous population. Table 5 details Indigenous-related expenditure for each support agency.

Central Agencies

Like support agencies, the estimates for central agencies are based on the average expenditure related to the Indigenous population of all service agencies. This is because central agencies predominantly provide functions that support service agencies, and which in the absence of central agencies, would be undertaken by the service agencies themselves. The average Indigenous-related expenditure share for service agencies is 50.9 per cent. Where direct service delivery programs exist, usage data provides the basis of this allocation. Table 4 provides the example of DCM. Program levels such as 'Policy Advice and Public Sector Coordination' are treated as a support activity for service agencies, and therefore the average Indigenous-related expenditure share of service agencies is applied. For programs that provide a service specifically to the Indigenous population, such as 'Indigenous Policy', a 100 per cent weighting is given. For other programs that provide a service to the general population or a specific population group, such as 'Community Engagement', data on usage rates or appropriate population shares based on ABS data are applied.

An alternative analysis was carried out basing estimates for central agencies on the average Indigenous-related expenditure of both service and support agencies. Given the relatively minor contribution of support agencies to overall Territory expenditure, the sensitivity to this assumption is low. If this assumption was adopted the overall Indigenous-related expenditure share would decline to 49.5 per cent.

Table 4: Estimate for DCM expenditure related to the Indigenous population, 2004-05

Output and sub-output group	Indigenous expenditure proportion	Share of DCM budget
	%	%
Policy Advice and Public Sector Coordination		
Executive Support	50.9	5.4
Executive Support Southern Region	50.9	1.3
Whole of Government Policy Advice and Coordination	50.9	2.6
Whole of Government Risk Management Services	50.9	4.0
Whole of Government Communications and Marketing	28.8	3.3
Whole of Government Economic Policy	50.9	0.9
Whole of Government Indigenous Policy and Advice	100.0	3.0
Trade and Major Projects and NT Railway		
Asian Relations	28.8	1.1
Trade	28.8	3.1
Petroleum Developments	28.8	1.6
Investment Attraction/Special Projects including Railway	28.8	0.6
Territory Development Administrative Support	28.8	1.4
Government Business Support		
Support to Executive, Ministers and Leader of the Opposition		
Secretariat Support to Executive Council and Cabinet	28.8	1.8
Protocol Support and Advice, and Hospitality Services	28.8	4.7
Ministerial Offices and Leader of the Opposition	28.8	26.2
Legislation Drafting Services and Drafting of Bills for Acts	50.9	2.3
Support to Administrator and Government House	28.8	4.5
Community Engagement		
Women's Advancement	35.0	1.4
Community Engagement Support	28.8	3.0
Youth Advancement	35.0	1.3
Community Engagement Support	28.8	0.3
Multicultural Advancement	0.0	4.0
Community Engagement Support	0.0	0.3
Senior's Advancement	17.8	1.1
Community Engagement Support	28.8	0.2
Social Policy Advancement	50.9	2.0
Community Engagement Support	50.9	0.3
Support to Major Events	28.8	5.6
Support to Australia Day Council	28.8	0.2
Community Support	28.8	2.1
Corporate		
Corporate	34.6	13.2
Total	34.6	100.0

Source: Northern Territory Treasury

Estimate of Indigenous-related Expenditure

Table 5 summarises the proportion of expenditure related to the Indigenous population by agency, using the methodology outlined above. Based on this approach, it is estimated that 49.7 per cent of the Territory's expenditure is related directly or indirectly to the Indigenous population. If support and central agencies were removed from the analysis, the share of the Territory's total expenditure related to the Indigenous population increases to 50.9 per cent. This reflects an estimate of the proportion of expenditure related to services directly accessible by Indigenous Territorians rather than the indirect effect of expenditure related to administrative and corporate functions.

The approaches taken for the functions of each government agency are discussed in Appendix 3.

Table 5: Summary of estimated agencies' expenditure related to the Indigenous population, 2004-05

Agency	Indigenous expenditure proportion	Agency share of total expenditure
	%	%
Service agencies	50.9	77.3
Aboriginal Areas Protection Authority	100.0	0.1
Department of Business, Economic and Regional Development	40.1	0.7
Department of Employment, Education and Training	40.1	19.1
Department of Health and Community Services	59.4	23.5
Department of Justice	62.3	4.1
Department of Local Government, Housing and Sport	69.0	5.8
Department of the Legislative Assembly	28.8	0.6
Department of Natural Resources, Environment and the Arts	29.3	3.9
Department of Planning and Infrastructure	49.4	9.6
Department of Primary Industry, Fisheries and Mines	36.5	2.1
Northern Territory Electoral Commission	41.2	0.1
Northern Territory Police, Fire and Emergency Services	57.3	6.1
Tourism NT	28.8	1.2
Ombudsman's Office	28.8	0.1
Territory Discoveries	28.8	0.2
Territory Wildlife Park	28.8	0.3
Support agencies	46.5	5.5
Construction Division	28.8	0.3
Data Centre Services	49.9	0.5
Office of the Commissioner for Public Employment	28.8	0.2
Department of Corporate and Information Services	48.9	3.5
Government Printing Office	44.7	0.2
NT Fleet	48.7	0.7
Auditor-General's Office	28.8	0.1
Central agencies	45.6	17.2
Central Holding Authority (excluding appropriation)	50.9	11.7
Northern Territory Treasury	34.0	3.9
Department of the Chief Minister	34.6	1.5
Total all agencies	49.7	100.0

Source: Northern Territory Treasury

Part B: Estimation of Revenue Related to the Territory's Indigenous Population

The Territory's revenue comprises three main components:

- tied grants, the majority of which are from the Australian Government and are classified as SPPs;
- general purpose payments (untied), comprising GST revenue, national competition policy payments (final payment in 2005-06) and grants in lieu of uranium royalties; and
- own-source revenue.

The Northern Territory is much more reliant on Australian Government grants than other jurisdictions, with these grants contributing approximately 80 per cent of total Territory revenue. Territory own-source revenue, which includes taxation, sales of goods and services and interest earnings, contributes the remaining 20 per cent.

For each of these revenue sources, it was necessary to develop a methodology for determining the proportion that could be related or attributed to indigeneity.


Three options were considered for attributing revenue to the Indigenous and non-Indigenous population subgroups in the Territory:

- equal per capita (EPC);
- attribution according to collection source (e.g. taxpayer, service user); or
- modified EPC with allowance for the direct and indirect impact of targeted programs, the effect on the redistribution of untied grants as a result of the Commission's assessment of relativities, and attribution of Territory own-source revenue according to collection source.

An EPC attribution of revenue to population subgroups is not considered appropriate, as it does not allow for revenue that is targeted at particular subgroups, nor does it allow for any direct or indirect effects that arise from the Commission's assessment of relativities. Given the characteristics of the Territory's revenue, this methodology will understate the level of revenue that could legitimately be related to the Indigenous population in the Territory.

Similar to an EPC attribution of revenue, attribution of all components of the Territory Government's revenue according to collection source is a flawed approach that ignores the revenue redistribution mechanisms that are central to the Australian federal system. This would understate the level of revenue related to Indigenous people, as it would not allow any consideration of the revenue allocated by the Australian Government for Indigenous purposes. However, the approach of attributing revenue according to collection source can be applied to the Territory's own-source revenue.

For these reasons a modified EPC approach was preferred, as it specifically allows for the incorporation of programs targeting the Indigenous population, the Commission's assessment of needs arising from Indigenous influences including native title and land rights, as well as the indirect effect of inclusion of targeted funding programs in determining relativities. This modified approach also allows for a more refined consideration of own-source revenue, by enabling



an attribution of this revenue according to collection source through the use of proxy measures.

The allocative determination and treatment of each of the main sources of revenue, including untied GST revenue, SPPs and own-source revenue is detailed below. Unless otherwise stated, all figures presented here are from the most recent financial year, 2004-05.

Tied Grants Including Specific Purpose Payments

SPPs are grants from the Australian Government that are usually tied to some specific program or function against which they must be acquitted.

Funding levels for SPPs are a result of Australian Government policy priorities and the process of negotiation of SPP agreements between Australian and Territory Governments. As such, the methods used for distribution differs between grants.

There are two financial impacts related to SPPs and other tied grants. The direct impact is the payment received by the Territory from the Australian Government. In 2004-05, the direct budgetary impact of SPPs was \$411.3 million (Table 6). Of this amount, Indigenous-specific SPPs were \$42.3 million. Table 7 estimates the total SPPs attributed to the Indigenous population by allocating a proportion of the non-Indigenous-specific SPPs (\$369.0 million) to the Indigenous population on an EPC basis, amounting to \$106.1 million. This resulted in a total direct impact of SPP and other tied grants funding related to the Indigenous population of \$148.4 million.

Table 6: Indigenous and non-Indigenous SPPs

	\$M
Total SPP funding	411.3
Indigenous-specific SPPs	42.3
Non-Indigenous-specific SPPs	369.0

Source: Northern Territory Treasury

Table 7: SPPs attributable to Indigenous population

	\$M
Indigenous-specific SPPs	42.3
EPC share of other SPPs	106.1
Total Indigenous SPP revenue	148.4

Source: Northern Territory Treasury

The second financial impact of SPPs is their indirect effect on GST revenue distribution and is discussed in the next section.

Allocation of GST Revenue

GST revenue accounts for about two-thirds of Territory revenue. The basis of the GST distribution between the states is essential in order to understand the influence of Indigenous factors on revenues.

Under Australia's federal system, the states have limited capacity to raise own-source revenue, but are responsible for a wide range of government services. This mismatch of revenue powers and expenditure responsibilities between levels of government is termed 'vertical fiscal imbalance', and is the basis to the \$61 billion of funding the states received from the Australian Government in 2004-05.

States have become increasingly reliant on Australian Government funding over time. The latest round of taxation centralisation occurred in 2000 with the introduction of the tax reform package “A New Tax System” (ANTS), whereby the GST was established, states agreed to abolish and review a range of state taxes, and states were given full access to the proceeds of the GST under the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations (IGA)*. In 2004-05, total GST revenue was \$35.3 billion, or 58 per cent of total Australian Government funding to states.⁴ Other major Australian Government payments to states were national competition payments and a wide range of SPPs, including health care grants, schools assistance and various housing programs (discussed above).

GST revenue is distributed to states according to the principles of HFE in order to provide average or standard services. These principles effectively act as the fiscal bond of the Australian federal system, and underpin the goals of providing all Australians with equitable access to services. Under this system, an individual state's share of GST is based on its population share and modified by the Commission's recommended ‘relativities’, or distribution ratios that embody per capita financial needs. The definition of HFE used by the Commission is:

“...state governments should receive funding from the pool of goods and services tax revenue such that, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the capacity to provide services at the same standard.”⁵

The Commission quantifies differences between states in the cost of, and demand for, delivering services and revenue-raising capacity. It takes into account factors such as socio-demographic composition influences, wage levels, scale, dispersion, economic environment and physical environment.⁶

Whereas an equalisation-based distributive process should achieve improvements in outcomes to the extent that standard services produce such improvements, the definition of HFE does not imply equalisation in outcomes. To the extent that above-average services are required to overcome severe disadvantage, or a backlog in needs, supplementation over and above HFE is required.

Table 8 shows the ‘relativities’ recommended by the Commission for 2004-05.⁷ States with a relativity less than one are sometimes referred to as ‘donor’ states, while those with a relativity greater than one are referred to as ‘recipient’ states. New South Wales and Victoria are the only two donor states at the current time based on the five year averaging approach used by the Commission, although if only the last year of the 5-year period is considered, Western Australia is also a donor state. The Northern Territory, on a per capita basis, has the highest relativity, which results in the receipt of over four times the average per capita share of GST revenue.

⁴ Australian Government (2005), *Commonwealth Final Budget Outcome 2004-05*, p59.

⁵ Commission (2004a), *Report on Revenue Sharing Relativities: 2004 Review*, px.

⁶ Commission (2006), *Report on State Revenue Sharing Relativities: 2006 Update*, p30.

⁷ The term ‘relativities’, as applied by the Commission, denotes the per capita distribution ratio of GST revenue between all states. The Australian average relativity is 1.0. A state assessed as having a relativity of 2.0 would require twice as much per capita from the GST pool than the Australian average to achieve horizontal fiscal equalisation.

The Northern Territory's overall disability is around 2.6. This means that after taking account of revenue and expenditure differences, it costs 2.6 times to deliver standard services in the Territory. However the additional capacity to provide standard services is derived from the GST pool, which represents only 55 per cent of state revenue. Thus the Territory needs over four times per capita from the GST pool to meet its overall disability factor of 2.6.

Table 8: Per capita GST relativities, 2004-05

State	Relativities
New South Wales	0.86750
Victoria	0.86534
Queensland	1.05504
Western Australia	1.03054
South Australia	1.20407
Tasmania	1.55939
Australian Capital Territory	1.12930
Northern Territory	4.26538

Source: Commission (2004a), Report on State Revenue Sharing Relativities: 2004 Review

Table 9 illustrates the distribution by state of GST revenue based on the above relativities. This shows that in 2004-05, 92 per cent was distributed on a EPC basis and less than 8 per cent (\$3.2 billion) of the combined GST and health care grants pools (\$41.6 billion) was redistributed on the basis of needs to achieve equalisation.

Table 9: Commission's 2004 recommendation of GST and health care grants (HCG) revenue distribution, 2004-05

State	GST and HCG revenue received	Difference from EPC
	\$M	\$M
New South Wales	12 128.0	-1 835.1
Victoria	8 920.3	-1 378.4
Queensland	8 460.4	449.4
Western Australia	4 232.6	131.4
South Australia	3 806.2	649.2
Tasmania	1 525.4	548.0
Australian Capital Territory	760.1	86.3
Northern Territory	1 761.2	1 349.4
Total	41 594.2	0.0

Source: Commission (2004a), Report on State Revenue Sharing Relativities: 2004 Review

The comparatively high share of grants for the Territory is primarily due to the more acute needs of its population for government services, significantly higher costs of providing services and also below-average revenue-raising capacities. This in turn is a reflection of the unique history, geography and socio-demographic composition of the Northern Territory. With 1.35 million square kilometres of land area, the Territory occupies over one-sixth of Australia's land mass, is two-thirds larger than New South Wales and almost six times larger than Victoria. Conversely, only one per cent of Australia's population resides in the Northern Territory, and half of its population lives in Darwin. All areas of the Territory are distant from Australia's major urban centres.

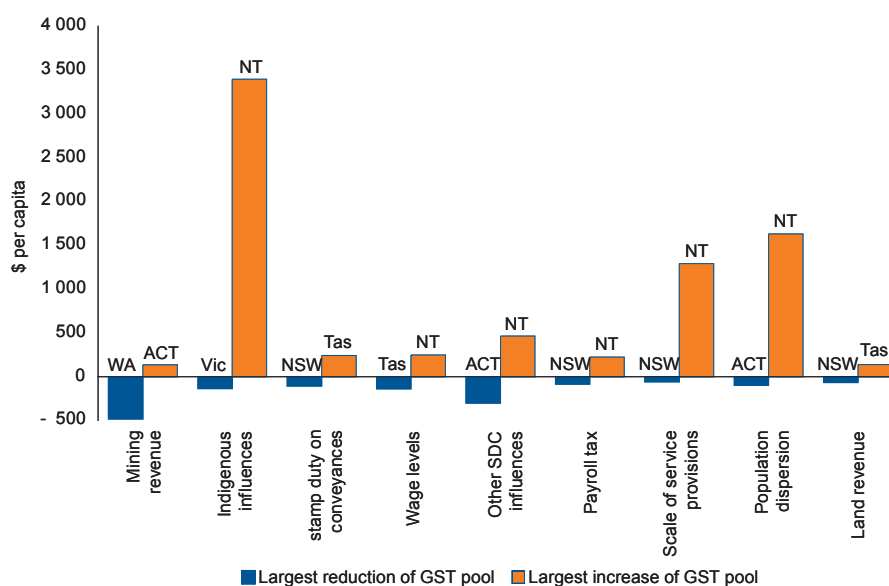
Another unique feature of the Northern Territory is its proportionately large Indigenous population, which comprises approximately 29 per cent of the total

population, many of whom live in remote or very remote areas.⁸ The majority of Indigenous Territorians speak a language other than English at home. More than anywhere else in Australia, measures of relative poverty and outcomes related to health, education and other social indicators point to widespread and long-term inequality between Indigenous and non-Indigenous Territorians.

The distinct nature and disproportionate level of disadvantage displayed across wide portions of the Indigenous population has led the Commission to conclude that there exists a strong rationale to treat indigeneity as a factor distinct from other socio-demographic composition influences, such as age, sex, socioeconomic status and English-speaking ability. Importantly, the Commission has also acknowledged there exists a strong conceptual case that provision of services to Indigenous people costs more per unit of service than for non-Indigenous people. The Commission has concluded that higher unit costs are a result of a number of multidimensional influences such as poor health status, lack of access to employment opportunities, low educational attainment, low fluency in English, and differences in culture and lifestyle.⁹

Graph 1 details the key drivers of the redistribution of GST revenue compared with an equal per capita distribution. This shows that the most significant influence on redistribution across all states is Indigenous influences.

Graph 1: Largest GST revenue redistribution drivers, by state, 2006-07




Source: Commission (2006), Report on State Revenue Sharing Relativities: 2006 Update

The Commission has also acknowledged evidence from many sources of higher unit costs of service delivery arising from specific practical difficulties service providers encounter in Indigenous communities.¹⁰ Complicating factors include: cultural and socioeconomic reasons that impinge upon participation in education; inadequate housing and household management skills; limited awareness or limited choice in respect of nutritional issues; limited employment skills or opportunities; alcohol and drug abuse; and violence affecting communities and service provision staff. Likewise, it has accepted the conceptual basis for

⁸ According to the Australian Bureau of Statistics' (ABS) 2001 Census of Population and Housing, there were 56 875 Indigenous people living in the Territory, or about 28.76 per cent of the total population. Approximately three-quarters were living in remote or very remote areas.

⁹ Commission (2004b), 2004 Review: Working Papers, vol. 7, p190.

¹⁰ Ibid, p187.



recognising additional costs associated with providing services to Indigenous people who follow a traditional lifestyle, speak Indigenous languages and live in remote communities. For these reasons, the Commission applies usage and cost weights to assess relative expenditure need due to Indigenous influences.

Since the 1999 Review, the Commission has used remoteness as a proxy to differentiate between the cost of providing services to 'traditional' lifestyle Indigenous people and 'non-traditional' Indigenous people, in recognition that indicators of relative need in relation to health, education and employment are more acute amongst Indigenous people in remote areas, irrespective of income levels.¹¹ Care is taken by the Commission to ensure remoteness cost weights related to indigeneity do not include dispersion costs, such as for freight and travel, which are captured in other parts of its relative needs assessments.¹²

This report does not attempt to develop its own methodology for quantifying needs and translating them into resource allocation, and instead acknowledges and accepts the Commission's methodological approach. This approach has been developed over many years, and has been informed and influenced by a wide range of quantitative and qualitative research from sources such as the ABS and the AIHW. In 2001, the Australian Government commissioned the Commission to conduct a comprehensive inquiry into its methodology for allocating funds for Indigenous purposes, and subsequently published the *Report on Indigenous Funding 2001*. The Commission also consults with states and conducts a major review of its approach to Indigenous funding during the course of each of its quinquennial reviews of state revenue sharing relativities. The last major review occurred in 2004.

In the cases where the Commission is required to exercise some judgement to determine an appropriate cost differential to use in its assessments, effort is made to verify the soundness of the decision through empirical checks.

In 2004-05 the Territory received \$1739.6 million in GST revenue, about 64 per cent of total revenue of \$2716.2 million. The distribution reflects the Commission's assessment of the Territory's relative needs in providing standard service. These needs relate to a wide range of factors including socio-demographic composition, wage levels, Indigenous influences, administrative scale, population dispersion and physical environment.¹³

The Commission has identified \$640.4 million of the Territory's redistribution as specifically related to Indigenous influences, native title and land rights. This amount is attributed wholly to the Indigenous population.

From a technical viewpoint, the remaining expense disabilities that contribute to above EPC distribution of GST are dependent on factors other than the Indigenous status of the population. Hence it could be argued that an EPC distribution for remaining disabilities is appropriate. For instance, the calculation of the dispersion factor by the Commission is dependent on the distance of population groups from the capital city or regional centre(s) rather than the population's indigeneity. This can be illustrated by a number of scenarios. If the Territory's remote population was non-Indigenous, the Territory's dispersion factor would not change. Conversely if the Indigenous population currently residing in remote areas moved

¹¹ Ibid, pp190-191.

¹² Ibid, p194.

¹³ Commission (2004a), op cit, pp16-17.

to urban areas, the dispersion disability would reduce because less people were living in rural and remote areas, not because Indigenous influences had changed.

Similarly the “other socio-demographic factors” disability includes age, sex and income level but not indigeneity.

While it is possible to separate the indigeneity factor from other factors when assessing its effect on GST revenue shares, it is difficult to identify the separate effects of such influences when estimating expenditure related to Indigenous Territorians. As set out in Part A the Territory has estimated the expenditure of all agencies (classified into service, support and central agencies). The expenditure recorded reflects the combined influences of the relevant factors identified by the Commission (for example, indigeneity, socio-demographic characteristics, dispersion and scale).

To ensure consistency with the approach taken to estimate expenditure, the estimation of revenue takes into account factors in addition to indigeneity (such as other socio-demographic characteristics, dispersion and scale) that are characteristics of the Indigenous population.

Table 10 summarises the treatment of expense disabilities contributing to above EPC distribution of GST. This shows that \$640.4 million has been estimated by the Commission as being attributed to the Indigenous influences, land rights and native title factors and a further \$226.1 million can be attributed to the Indigenous population as a result of other disability factors. A total of \$866.5 million or 65.5 per cent of all factors taken into account by the Commission can be attributed to its Indigenous population.

Table 10: Treatment of expense disabilities

Disability	Redistribution amount	Indigenous-related share	Indigenous-related share	Comment
	\$M	%	\$M	
Indigenous influences	624.6	100.0	624.6	
Land rights and native title	15.8	100.0	15.8	
Other socio-demographic influences	51.7	39.7	20.5	Weighted by relevant population shares of major contributing factors e.g. primary schools
Input costs	241.9	28.8	69.6	EPC
Scale of service population	242.2	40.1	97.1	Includes allowance for separate Indigenous policy functions and proportion of remote communities
Urban influences	-28.3	56.6	-16.0	Weighted by Indigenous proportion of remote and very remote population
Population dispersion	282.6	56.6	159.9	Weighted by Indigenous proportion of remote and very remote population
Economic environment	35.6	28.8	10.3	EPC
Physical environment	56.2	28.8	16.2	EPC
Other factors	-200.5	65.5	-131.4	Scaled proportionately across other identified disabilities
Total	1321.9	65.5	866.5	

Source: Northern Territory Treasury, Commission (2004) Report on Revenue Sharing Relativities: 2004 Review; and unpublished material

In addition to the effect of disability factors on grant shares, the Commission also takes into account the effect of SPPs in estimating the financial capacity required to achieve equalisation. Generally, a higher level of SPPs will result in a lower level of GST and vice versa. In 2004-05 the Territory was assessed as receiving about \$70.5 million more than its share of Indigenous-related SPPs. Consequently, this negative adjustment offsets the Commission's assessed Indigenous needs (\$624.6 million).¹⁴ This effect is accounted for in Table 11.

Table 11: Indigenous-specific
GST funding

	\$M
Total disabilities	1321.9
Indigenous-specific GST funding (from Table 10)	866.5
<i>less</i> Indirect effects of Indigenous-specific SPPs	-70.5
Net Indigenous-specific GST funding	796.0

Source: Northern Territory Treasury

Table 12 estimates the share of GST revenue attributed to the Territory's Indigenous population.

Table 12: Indigenous-related
GST funding

	\$M
Remainder of GST revenue	418.1
Indigenous EPC share of remainder	120.2
<i>plus</i> Net Indigenous-specific funding (from Table 11)	796.0
Total Indigenous share of GST revenue	916.2

Source: Northern Territory Treasury

Own-source Revenue

Own-source revenue includes state taxes, interest received and sales of goods and services. Own-source revenue other than state taxes has been treated on an equal per capita basis. For state taxes, proxies have been used to estimate the proportion of revenue that is contributed by the Indigenous population as shown in the Table 13.

¹⁴ The indirect SPP adjustment of \$70.5 million is higher than the \$42.3 million of direct Indigenous-related SPPs received in 2004-05. This anomaly reflects a combination of the five-year averaging effect in the Commission's assessments and the provision of a housing-related SPP directly to the Indigenous Housing Authority of the Northern Territory, which is outside the general government sector.

Table 13: Estimated proportion of own-source taxes that is contributed by the Indigenous population

Tax type	Revenue \$M	Indigenous- related share	Indigenous- related share	Proxy
		%	\$M	
Payroll tax	110.6	7.5	8.2	Indigenous employment share less CDEP employment
Stamp duty on conveyances	73.5	4.5	3.3	Proportion of Indigenous persons aged 18 years or older living in homes where a resident owned, or was purchasing, the home
Financial transaction taxes, includes hiring duty, leases duty, electronic debits tax	7.9	18.2	1.4	Proportion of Indigenous persons living in main urban centres or EPC (debits tax)
Stamp duties on shares and marketable securities	0.5	13.4	0.1	Proportion of Indigenous persons living in main urban centres
Gambling taxation	47.9	13.4	6.4	Proportion of Indigenous persons living in main urban centres
Insurance taxation	21.5	13.4	2.9	Proportion of Indigenous persons living in main urban centres
Heavy vehicle registration fees and taxes	9.9	27.9	2.7	Indigenous proportion of population weighted by heavy vehicle ownership by statistical division
Light vehicle registration fees and taxes	12.0	23.9	2.9	Indigenous proportion of population weighted by passenger and light vehicle ownership by statistical division
Stamp duty on motor vehicle registrations and transfers	17.4	23.9	4.2	Indigenous proportion of population weighted by all vehicle ownership by statistical division
Other	0.2	28.8	0.1	EPC
Total	301.4	10.7	32.1	

Source: Northern Territory Treasury, ABS various publications

Table 14 summarises the overall treatment of own-source revenue.

Table 14: Summary of overall treatment of own-source revenue

	Share of own-source revenue	Revenue	Indigenous- related share	Indigenous- related share
	%	\$M	\$M	%
Own-source taxes	53.3	301.4	32.1	10.7
Other revenue	46.7	263.9	75.9	28.8
Total	100.0	565.3	108.0	19.1

Source: Northern Territory Treasury

Estimate of Indigenous-related Revenue

Table 15 shows the components of revenue and the derivation of the proportion of revenue related to the Indigenous population. Indigenous-related revenue is \$1172.5 million, which represents 43.2 per cent of total revenue for 2004-05.

Table 15: Estimation of Northern Territory Government revenue related to the Indigenous population 2004-05

Source of revenue	Share of total revenue	Revenue	Indigenous- related share	Indigenous- related share
	%	\$M	\$M	%
Tied grants (including SPPs)	15.1	411.3	148.4	36.1
GST	64.1	1739.6	916.1	52.7
Own-source revenue	20.8	565.3	108.0	19.1
Total	100.0	2716.2	1172.5	43.2

Source: Northern Territory Treasury

Conclusion

This report has sought to quantify the proportion of the Northern Territory Government's expenditure that is related to its Indigenous population and how this compares to revenue for that population, particularly given a context of disadvantage.

Government service delivery needs of the Territory's Indigenous population are immense. Relative to the non-Indigenous Territorians, Indigenous Territorians are more represented in remote or very remote areas, have a younger mean age and experience more socioeconomic disadvantage across a wide range of indicators. These include: higher mortality and morbidity rates; poorer educational attainment; lower school retention rates; higher rates of unemployment and income poverty; higher occupancy rates of overcrowded and poor quality housing; and higher rates of arrest and imprisonment (see Appendix 1). Correspondingly, usage of government services by Indigenous Territorians is disproportionately high, notwithstanding accessibility issues. In most cases, the per unit costs to government of providing these services are higher than elsewhere in Australia.

These and other factors present difficult and pressing challenges for government service delivery that are unique to the Territory. In recognition of these challenges, the Territory Government is, amongst other strategies, undertaking the initiative *Agenda for Action: A Whole of Government Approach to Indigenous Affairs in the Northern Territory 2005-2009*. The Territory has also been instrumental in developing strategies, now accepted by the Council of Australian Governments, in respect of a generational commitment to overcome Indigenous disadvantage.

This report on expenditure and revenue related to the Indigenous population plays a role in this initiative by assisting in coordinating and better informing the Territory Government's Indigenous policy.

Based on a detailed analysis of Government expenditure at output and sub-output (or program) levels, this review has estimated that 49.7 per cent of the Territory Government's total expenditure is related to the Indigenous population (Table 16). This compares to a population share of 28.8 per cent. Thus Indigenous-related expenditure exceeds a per capita share by 73 per cent and represents 2.44 times per capita expenditure related to non-Indigenous persons.

Table 16: Estimate of Northern Territory Government expenditure related to the Indigenous population 2004-05

Agency type	% of total expenditure	Indigenous-related %
Service agency	77.3	50.9
Support agency	5.5	46.5
Central agency	17.2	45.6
All agencies	100.0	49.7

Source: Northern Territory Treasury

Under current funding mechanisms, the Territory Government has three main sources of revenue: specific purpose payments, GST and own-source revenue. Untied Australian Government funding from GST revenue is distributed according to the principle of HFE, which takes into account demographic, economic and geographic factors that affect the cost of and demand for government service delivery across different jurisdictions. GST revenue accounts

for approximately two-thirds of the Territory's budget, a share that is much higher than for other states. A key reason why Australian Government grants are distributed disproportionately to the Territory is because of the influence of its Indigenous population. Tied funding such as SPPs and other Australian Government grants comprises another fifteen per cent of the Territory's revenue. The remaining 20 per cent of the Northern Territory Government's budget is own-source revenue.

Based on the methodology adopted in this review, it is estimated that 43.2 per cent of the Territory's revenue is related to its Indigenous population (Table 17). This includes:

- the Commonwealth Grants Commission's estimates of the redistributive effect of Indigenous influences, native title, land rights and other disabilities in determining GST relativities;
- SPP revenue targeted at Indigenous-specific purposes;
- the indirect impact on GST revenue of Indigenous SPP funding;
- estimates of the proportion of own-source taxes attributable to the Indigenous population; and
- an equal per capita (EPC) share of remaining revenue.

Table 17: Estimation of Northern Territory Government revenue related to the Indigenous population 2004-05

Source of revenue	Share of total revenue	Revenue	Indigenous-related share	Indigenous-related share
	%	\$M	\$M	%
Tied grants (including SPPs)	15.1	411.3	148.4	36.1
GST	64.1	1739.6	916.1	52.7
Own-source revenue	20.8	565.3	108.0	19.1
Total	100.0	2716.2	1172.5	43.2

Source: Northern Territory Treasury

Thus comparing revenue and expenditure shows that expenditure on government services that are directly or indirectly accessed by the Territory's Indigenous population exceeds revenue related to the Indigenous population by 6.5 per cent or about \$175 million.

Despite high levels of expenditure and recent improvements in life expectancy, infant mortality and educational outcomes, a strong case exists that current funding mechanisms are insufficient to overcome the level of disadvantage faced by Indigenous Territorians, equalise outcomes and address the well-documented backlogs of infrastructure such as essential services and housing, as well as provision of the range of social services available to most Australians.

There is clearly a need for funding streams to the Territory additional to those delivered through HFE and the interrelated SPPs, so that the social wellbeing of the Indigenous population can be improved, economic participation and productivity can be enhanced, and all Australians can benefit from improved economic activity and social cohesion. Put simply, provision of average services will not reduce levels of disadvantage experienced by Indigenous Territorians and indeed other Indigenous Australians, particularly in remote locations.

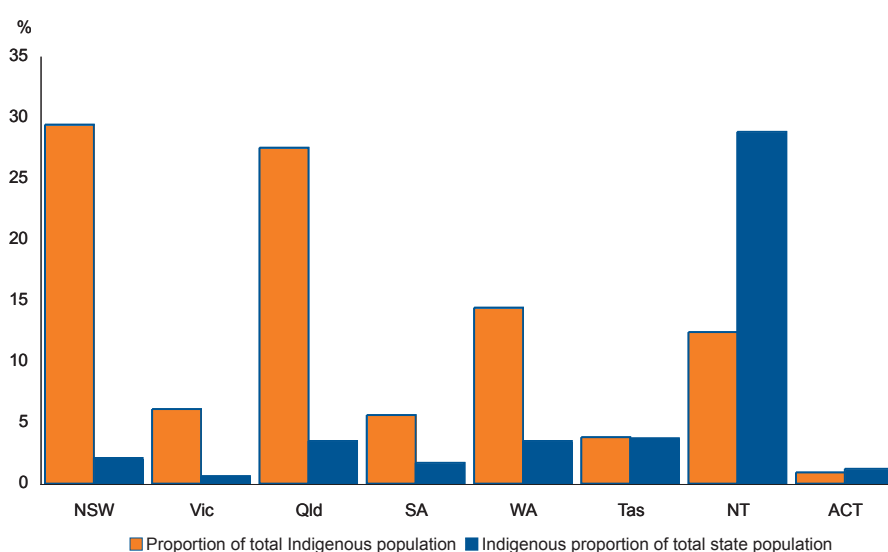
Appendix 1: Socio-demographic Indicators, Usage and Cost of Services Related to the Indigenous Population

Empirical evidence of relative wellbeing and government service usage differentials between the Indigenous and non-Indigenous populations is readily available for most states. Data on unit cost differentials, on the other hand, is generally less comprehensive, with the exception of health-related services. In the following subsections, selected available data on these indicators will be presented in the areas of population, health, education, law and order, and housing and welfare. These indicators are not intended to be an exhaustive representation of the circumstances of Indigenous people living in the Territory or of their use of government services. Instead, they aim to convey broad indicators of Indigenous wellbeing and relative disadvantage, and the likely additional costs incurred through service provision. The presentation of this data is accompanied by a discussion of the Commission's approaches to use and cost weighting for the Indigenous population in its assessments. For most indicators, the Territory is an outlier among Australian jurisdictions.

Population

Indigenous people comprised about 29 per cent of the total Northern Territory population in 2001, the highest proportion of all state populations (Graph A1.1). The Territory's Indigenous population accounted for about 12.4 per cent of the total Indigenous population of Australia. Indigenous people comprised 2.4 per cent of Australia's total population.

Graph A1.1: Estimated resident Indigenous populations, by state, 2001



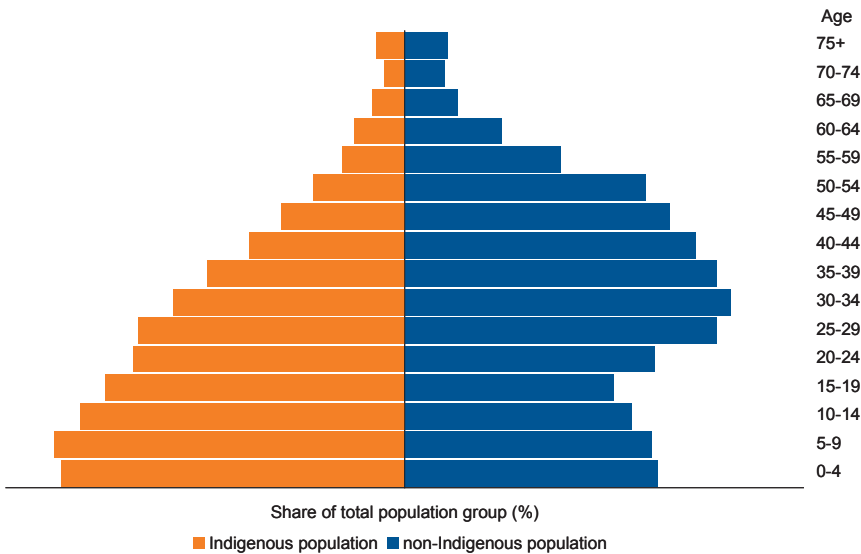
Source: ABS (2004a), Experimental Estimates and Projections, Aboriginal and Torres Strait Islander Australians: 1991-2009, Cat No. 3238.0

As a whole, the Indigenous population in the Northern Territory is younger than the non-Indigenous population (Graph A1.2). For example, 44.6 per cent of the Indigenous population is aged between 0 and 19 years, whereas 28.5 per cent of the non-Indigenous population is aged between 0 and 19 years.

A relatively high proportion of the Northern Territory's Indigenous population lives in remote or very remote areas. Using data from the 2001 Census and the

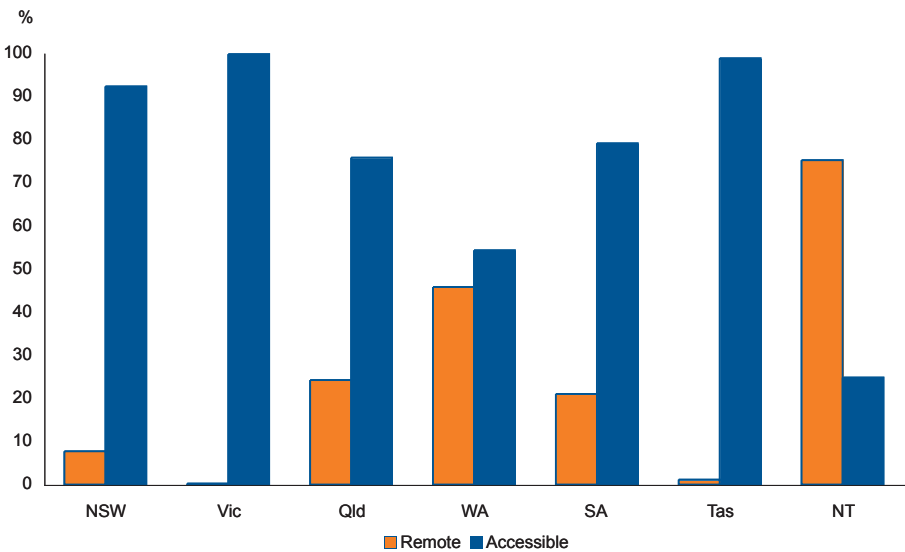
state-based version of the Accessibility/Remoteness Index of Australia (SARIA), 19.9 per cent and 55.3 per cent of the Territory's total Indigenous population are shown to be living in remote or very remote areas respectively (Graph A1.3).

Graph A1.2: Age distributions of Indigenous and non-Indigenous populations in the Northern Territory, 2001



Source: ABS (2004a), Experimental Estimates and Projections, Aboriginal and Torres Strait Islander Australians: 1991-2009, Cat No. 3238.0; ABS (2001b), Population Characteristics, Aboriginal and Torres Strait Islander Australians, Cat No. 4713.0

Graph A1.3: Indigenous population by accessibility/remoteness, by state, 2001



Source: Commission (2006), Relative Fiscal Capacities of the states 2006

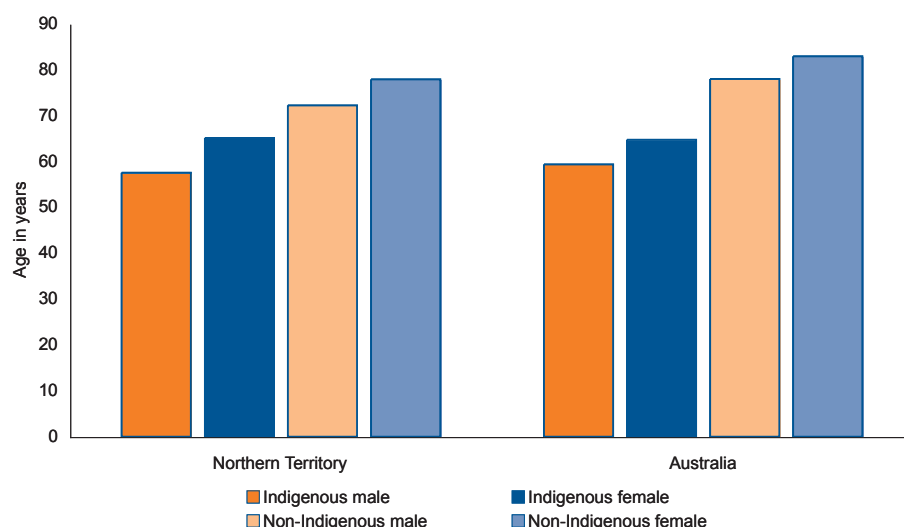
Health

A broad range of health services data indicates that Indigenous people die younger and experience poorer health outcomes compared to the non-Indigenous population. For example, life expectancies in the Territory for Indigenous people are about 20 years less than the total population (Graph A1.4), and data collected by the Australian Institute of Health and Welfare (AIHW) shows that public hospital separation rates for the Territory's Indigenous population were 2.9 times higher than for the non-Indigenous population in 2002-03. The AIHW also recorded that the separation rates for Indigenous males were significantly higher than for all males over a range of causes, including

assault (6.7 times higher), diabetes (6.0 times higher), and infectious pneumonia (4.1 times higher).¹⁵

The leading cause of death between 1999 and 2003 for Indigenous males and females aged between 35 and 54 years was ischaemic heart disease, which occurred at a rate almost ten times higher than for non-Indigenous males and females of the same age. The second leading cause of death for Indigenous people in this age group was diabetes, at a rate around 25 times higher than for the non-Indigenous male and female populations (Table A1.1).

Graph A1.4: Life expectancy at birth, Indigenous population 1996-2001, total population 2004



Source: ABS (2004b) Deaths, Australia, Cat. No. 3302.0; ABS (2004a) Experimental Estimates and Projections, Aboriginal and Torres Strait Islander Australians: 1991 to 2009, Cat. No. 3238.0

Table A1.1: Death rates by major causes per 100 000 population – persons 35-54 years, 1999-2003

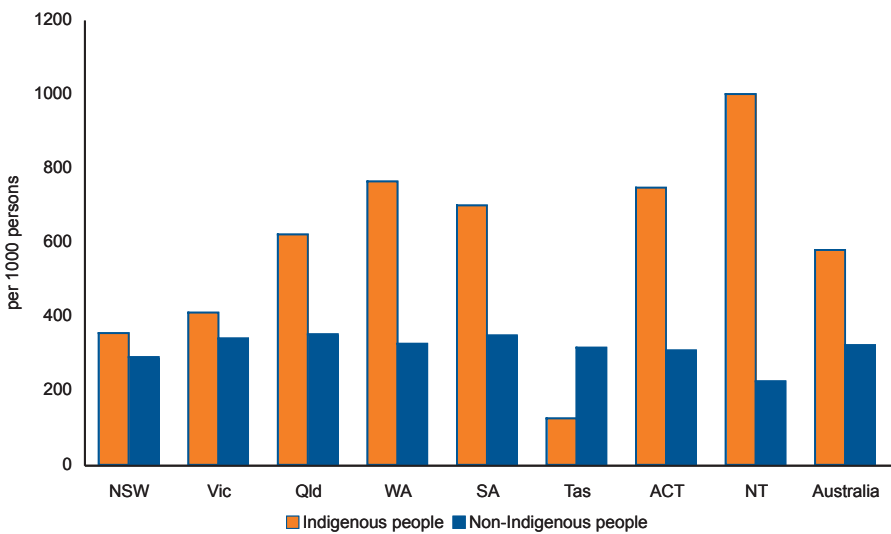
Cause	Indigenous		Non-Indigenous	
	Males	Females	Males	Females
Ischaemic heart disease	237.5	102.7	33.1	6.2
Diabetes	73.6	56.7	3.5	1.5
Disease of liver	69.0	45.3	8.3	3.1
Other forms of heart disease	45.2	18.4	5.4	2.3
Intentional self harm	45.2	7.8	27.6	7.9
Mental and behavioural disorders due to psychoactive substance use	40.6	7.8	3.0	0.7
Malignant neoplasm of digestive organs	36.8	15.6	19.2	12.5
Chronic lower respiratory disease	35.2	26.2	2.5	2.7
Influenza and pneumonia	32.2	12.0	1.6	0.7
Assault	31.4	12.7	1.9	1.0
Cerebrovascular disease	30.6	27.6	5.8	5.1
Malignant neoplasm of respiratory and intrathoracic organs	30.6	19.1	13.1	8.6
Ill-defined and unknown causes of mortality	26.1	10.6	3.1	1.2
Car occupant injured in transport accident	25.3	11.3	5.9	3.3
Pedestrian injured in transport accident	20.7	12.0	1.6	0.3

Source: AIHW (2005b), The Health and Welfare of Australia's Aboriginals and Torres Strait Islander Peoples 2005

¹⁵ Steering Committee for the Review of Government Service Provision (SCRGSP) (2005a), [Report on Government Services 2005](#), pp9.12-9.13.

Across Australia, except in Tasmania, the Indigenous population is much more likely to use hospital services. In the Northern Territory, the hospital separation rate per 1000 persons for the Indigenous population is 999, the highest for all states. This figure indicates that every Indigenous Territorian is on average separated once from hospital every year (Graph A1.5).

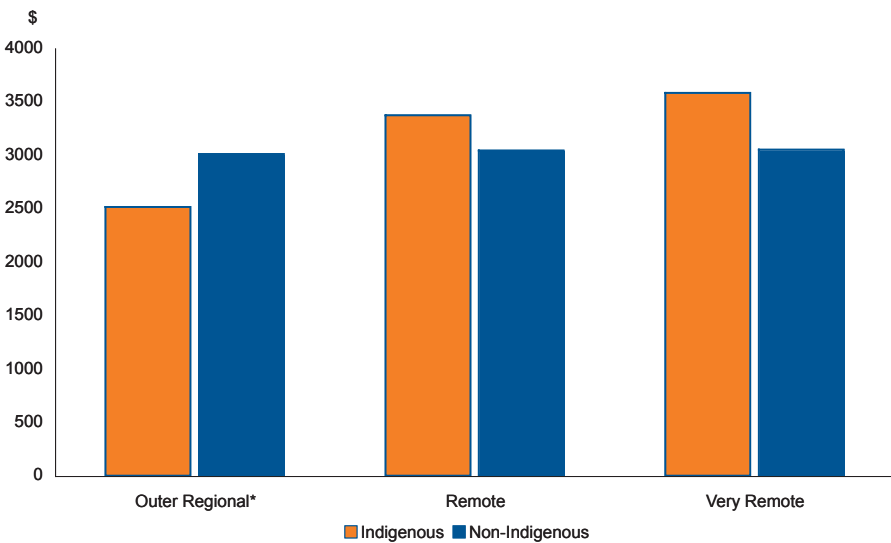
Graph A1.5: Reported separation rates for all hospitals, 2001-02



Source: AIHW (2005c), Expenditures on health for Aboriginal and Torres Strait Islander peoples, 2001-02

Additional to this higher usage rate, there is evidence that the average cost per separation across all hospital sectors for the Indigenous population is higher than for the non-Indigenous population, with the possible exception of Royal Darwin and Darwin Private hospitals (Graph A1.6). The effect of generally higher costs of providing health services to the Indigenous population, coupled with significantly higher usage rates, is reflected in higher per capita expenditure related to the Indigenous population for most health care services (Table A1.2). The per capita expenditure differential between the Indigenous and non-Indigenous population subgroups in the Territory for admitted patient services is significantly larger than the national averages.¹⁶

Graph A1.6: Average cost per separation, all hospitals, Australia 2001-02



Source: AIHW (2005c), Expenditures on health for Aboriginal and Torres Strait Islander peoples, 2001-02. *Darwin is classified here as an outer regional area

¹⁶ For details on the components of each health service category, see AIHW (2005c), [Expenditures on health for Aboriginal and Torres Strait Islander peoples, 2001-02](#).

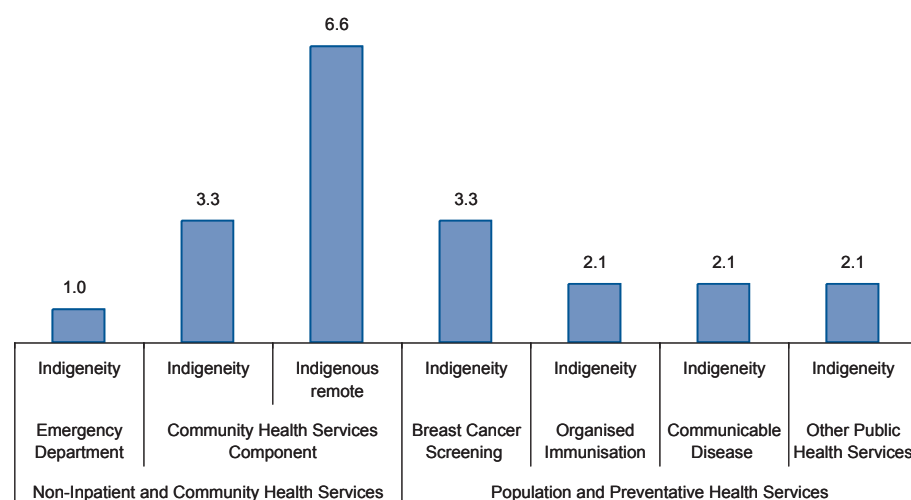
Table A1.2: Expenditure per person on selected health services from all funding sources at current prices, Australia 2001-02

Health good or service type	Per capita expenditure (\$)	
	Indigenous	Non-Indigenous
Hospitals	1 852.75	1 132.01
Total admitted patient services	1 488.38	945.80
Non-admitted patient services	310.57	164.42
Medical services	217.19	586.27
Community health services	959.30	148.27
Dental services	47.59	197.01
Other professional services	36.76	118.83
Pharmaceuticals	144.36	475.43
Aids and appliances	34.51	130.52
Services for older people	108.83	242.24
Patient transport	136.95	47.09
Public health activities	158.15	54.33
Other health services	110.44	76.97

Source: AIHW (2005c), Expenditure on health for Aboriginal and Torres Strait Islander peoples, 2001-02

One aspect of the Commission's calculation of GST revenue redistribution due to Indigenous influences is its assessment of Indigenous relative expenditure need in the health services category. For this purpose, the Commission applies AIHW and ABS data to calculate appropriate use and cost weights. The Indigenous cost weights for various components of health services are summarised in Graph A1.7.

Graph A1.7: Health cost weight values for indigeneity, by category, component and type, Commission's 2004 Review



Source: Commission (2004b), 2004 Review Working Papers, vol.4

Education, Training and Employment

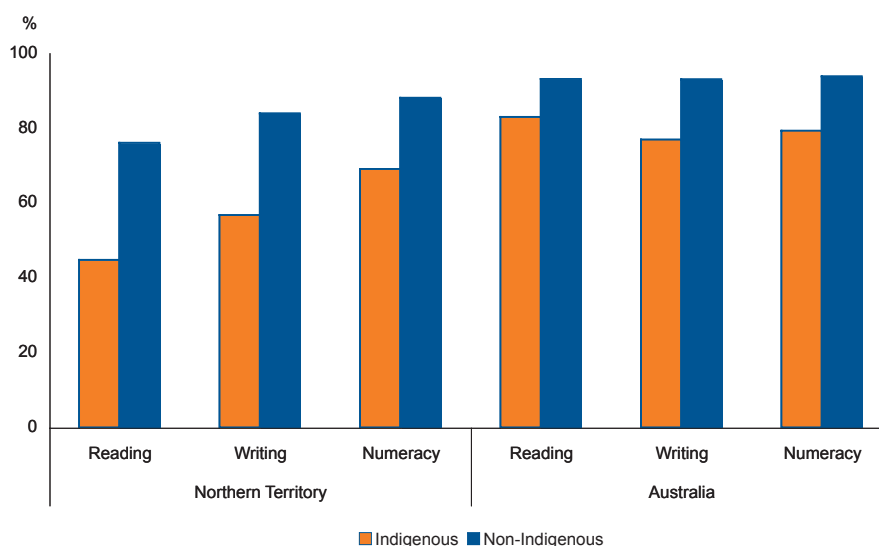
The demand for education and training services is closely related to the age composition of a population. The fact that about half the Territory's Indigenous population is aged under 21 years is reflected in the enrolment figures for Territory schools: 41.2 per cent of full-time students in Territory government schools in 2005 were Indigenous, compared to 58.8 per cent non-Indigenous students.¹⁷ However, Indigenous people continue to achieve poorer educational outcomes and participate in education and training at lower rates than the Australian average. For example, school classroom surveys in 2004 show that

¹⁷ ABS (2006), *Schools Australia 2005*, cat no. 4221.0

Indigenous students, especially in the Northern Territory, had significantly lower reading, writing and numeracy achievements than non-Indigenous students (Graphs A1.8 and A1.9). Furthermore, whereas the apparent retention rates for full-time Indigenous students have been increasing, they remain significantly lower than for non-Indigenous students, especially in the post-compulsory years 11 and 12 (Graph A1.10).

The effects of these poorer educational outcomes are reflected in labour force participation and unemployment rates. Labour force participation amongst the Indigenous population is significantly below non-Indigenous participation rates (Graph A1.11). Compounding this statistic is the fact that Indigenous people in the labour force are about three times more likely to be unemployed than non-Indigenous people (Graph A1.12). In addition, Indigenous people who are employed tend to be employed on a part-time basis more so than non-Indigenous people. Community Development Employment Projects (CDEP) account for a relatively large population of Indigenous employment, particularly in remote and very remote areas. It is estimated that CDEP employed 21 per cent of the Indigenous labour force in 2002.¹⁸

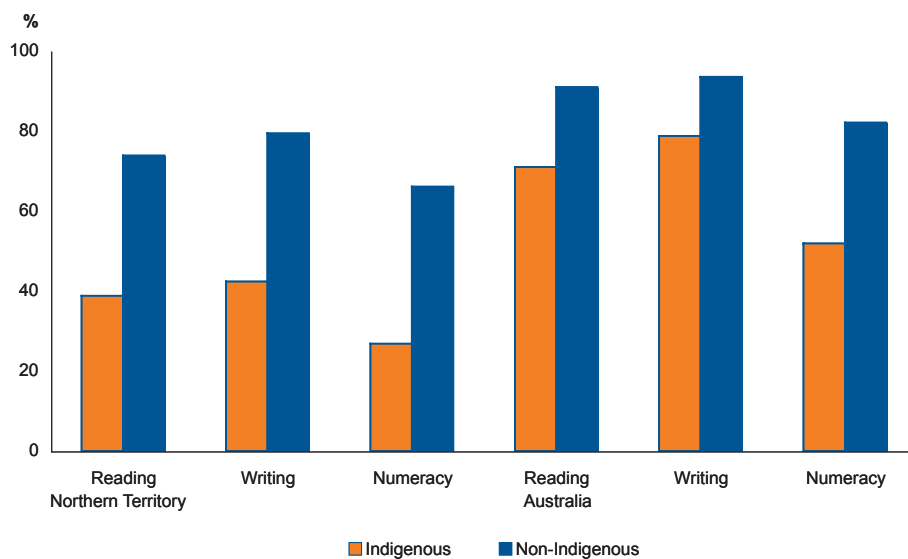
Graph A1.8: Proportions of year 3 students who achieved the reading, writing and numeracy benchmarks, 2004



Source: Ministerial Council on Education, Employment, Training and Youth Affairs (MCEETYA) (2004), National Report on Schooling in Australia 2004

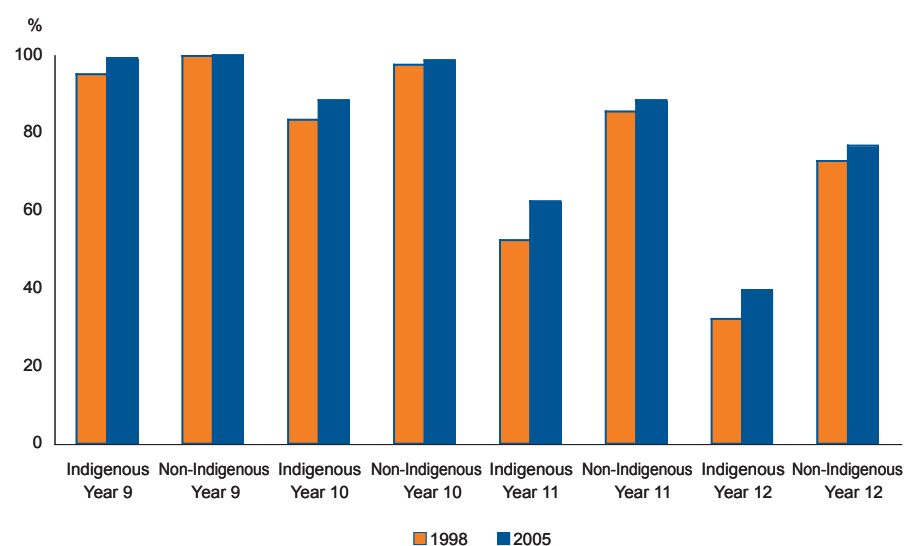
¹⁸ SCRGSP (2005b), *Overcoming Indigenous Disadvantage: Key Indicators 2005*, pp11.3-11.15.

Graph A1.9: Proportions of year 7 students who achieved the reading, writing and numeracy benchmarks, 2004



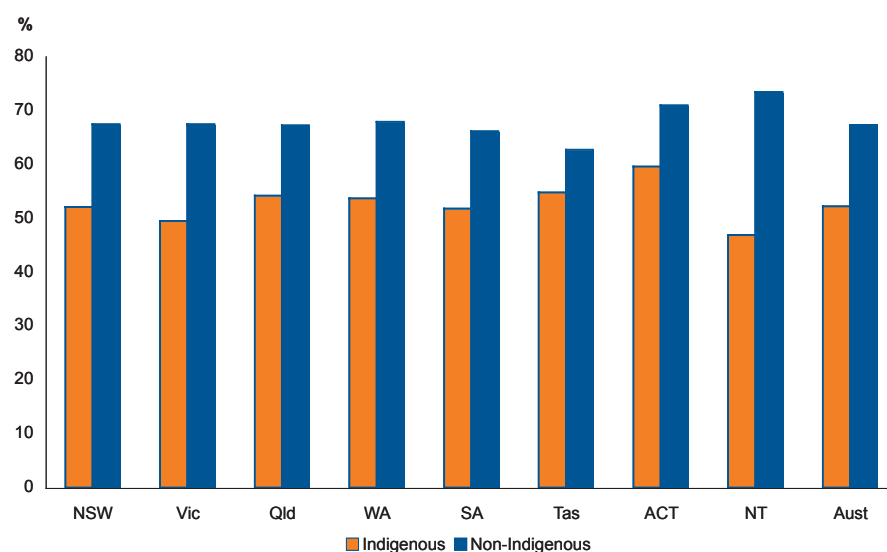
Source: MCEETYA (2004), National Report on Schooling in Australia 2004

Graph A1.10: Apparent retention rates, full-time students, 1998 and 2005



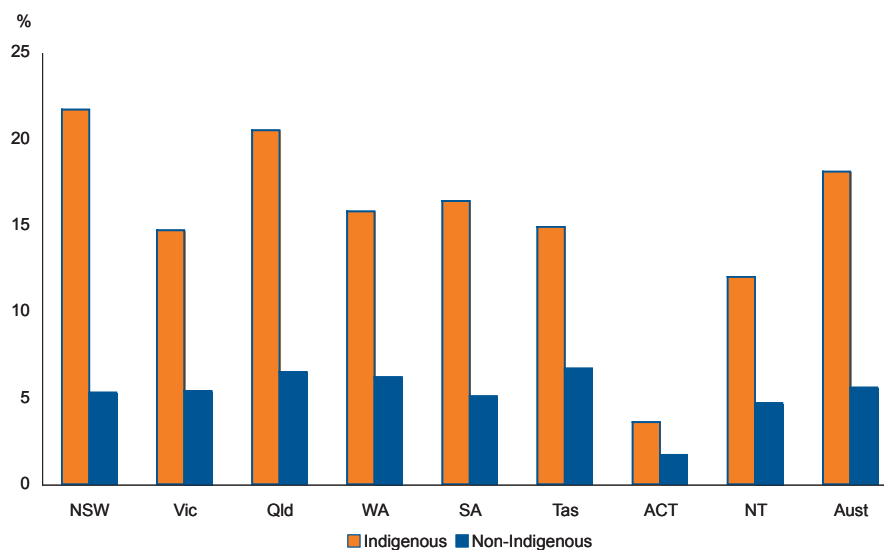
Source: ABS (2006), Schools, Australia, 2005, Cat. No. 4221.0

Graph A1.11: Age standardised labour force participation as a proportion of the population aged 18 and over, 2002



Source: SCRGSP (2005b), Overcoming Indigenous Disadvantage: Key Indicators 2005

Graph A1.12: Age standardised unemployment rate, aged 18 years and over, 2002



Source: SCRGSP (2005b), Overcoming Indigenous Disadvantage: Key Indicators 2005

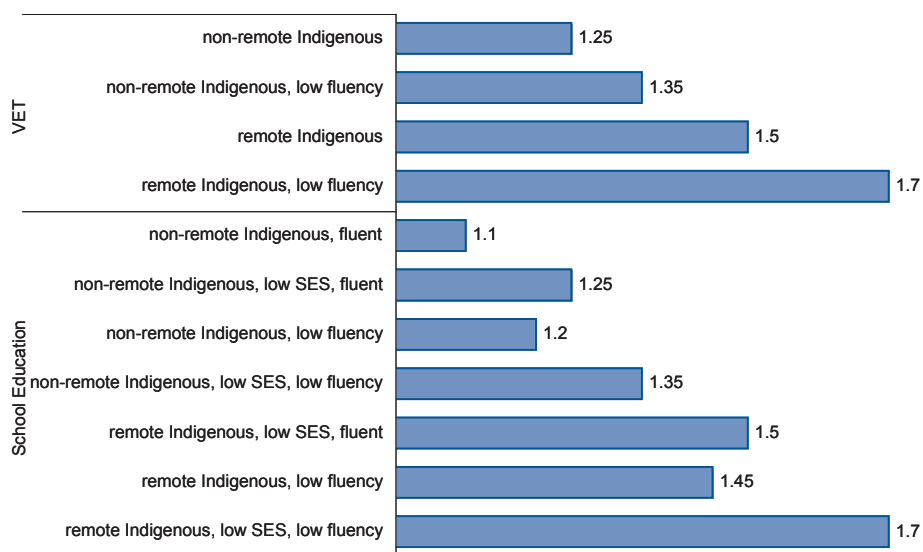
In the Commission's assessment of the Vocational Education and Training (VET) and schools education categories for its calculation of GST revenue distribution, it uses actual Indigenous and non-Indigenous student enrolment numbers to calculate use weights. Indigeneity is also included as a variable for estimates of post-compulsory enrolment composition. These enrolment figures are compared to actual demographic statistics for these age groups. As a result, the Commission's applied Indigenous use weight for government education is lower than one. Due to the lack of published data on cost differentials of education services for the Indigenous population, judicious consideration is given by the Commission to related findings. Reference is made to past practice and assumptions made by the Australian and New South Wales Governments in their funding allocations.¹⁹ In regard to remoteness costs, policy and funding judgements made by other jurisdictions are taken into consideration (Graph A1.13). In the education section of the Report on Indigenous Funding, the Commission states:

*"The work we have done on costs suggests remote area costs are 35 to 75 per cent above the Australian average. Some extra allowance to reflect levels of disadvantage and to address improved participant outcomes in these areas might suggest an allowance of 250 per cent or more compared with the Australian average level."*²⁰

¹⁹ Commission (2004b), *op cit*, vol.7, p198.

²⁰ Commission (2001), *op cit*, p209.

Graph A1.13: Education and training cost weight values for indigeneity, by category and type, Commission's 2004 Review

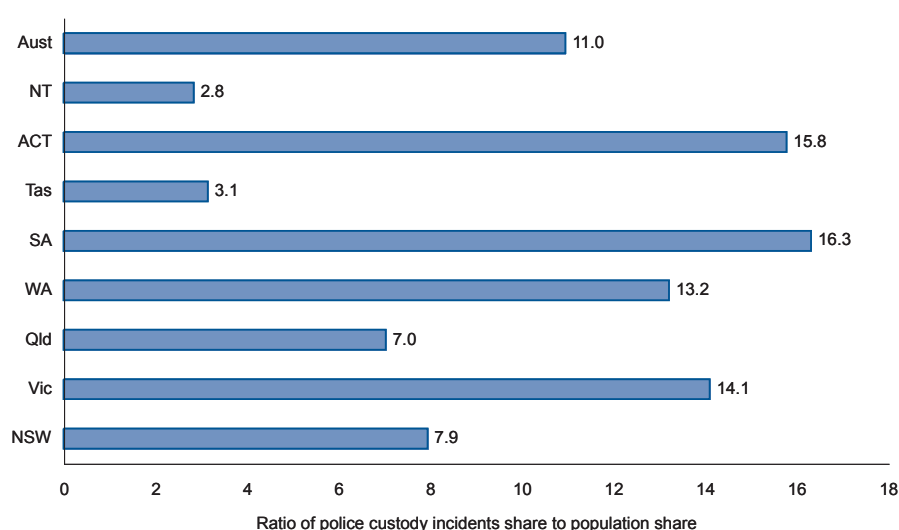


Source: Commission (2004b), 2004 Review Working Papers, vol.4

Law and Order

Data collected by the ABS and AIC demonstrates very high Indigenous usage rates of policing, justice and corrective services across all jurisdictions, and a higher likelihood for Indigenous people to be either the perpetrator or victim of violent crime (Graphs A1.14, A1.15 and A1.16). Imprisonment rates and rates of police custody incidents for Indigenous persons are significantly higher than for non-Indigenous persons. This is corroborated by survey data collected by NTPFES that indicates that the bulk of protective custody incidents in the Territory involved Indigenous persons.²¹

Graph A1.14: Over-representation ratio of police custody incidents involving Indigenous people, by jurisdiction, 2002



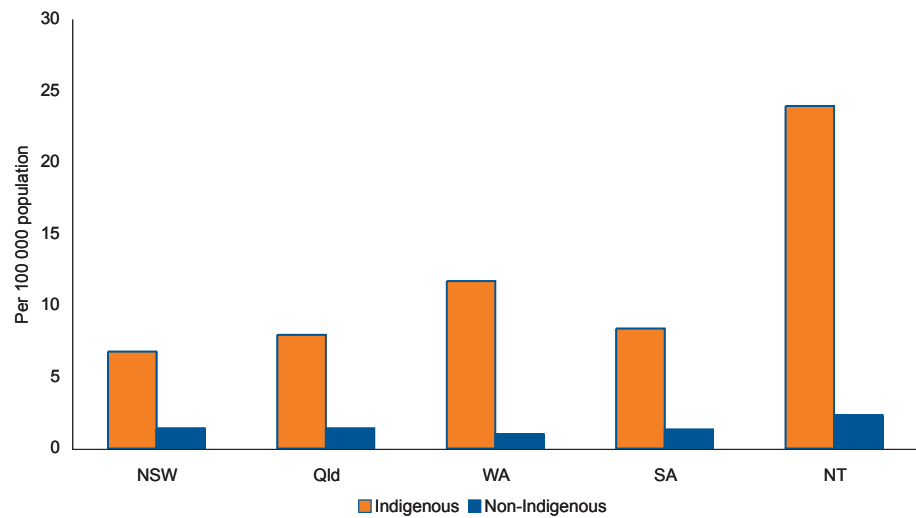
Source: Australian Institute of Criminology (2005), 2002 National Police Custody Survey, No.13

Graph A1.14 shows a lower proportion of incidents involving Indigenous people in the Northern Territory related to the population share compared to other jurisdictions. However, the percentage of incidents involving Indigenous persons in the Territory is higher than the national average (82 per cent versus

²¹ For example, the NTPFES 2004-05 Annual Report noted that of a total 21 857 persons taken into police protective custody, 20 387 were Indigenous and 1 470 were non-Indigenous. This represents a protective custody incidence rate of 54 994 per 100 000 Indigenous people aged 17 years and over, compared to a rate of 1 364 per 100 000 non-Indigenous people aged 17 years and over. NTPFES (2005), [NTPFES 2004-05 Annual Report](#), p158.

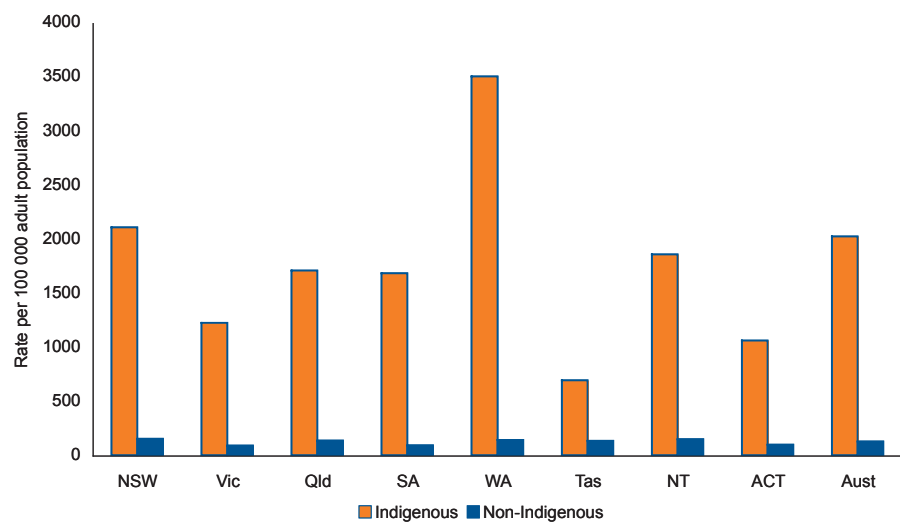
26 per cent), reflecting the higher population share (28.8 per cent compared to 2.4 per cent nationally).

Graph A1.15: Homicide death rate, age standardised, by state, 1999-2003



Source: SCRGSP (2005b), Overcoming Indigenous Disadvantage: Key Indicators 2005

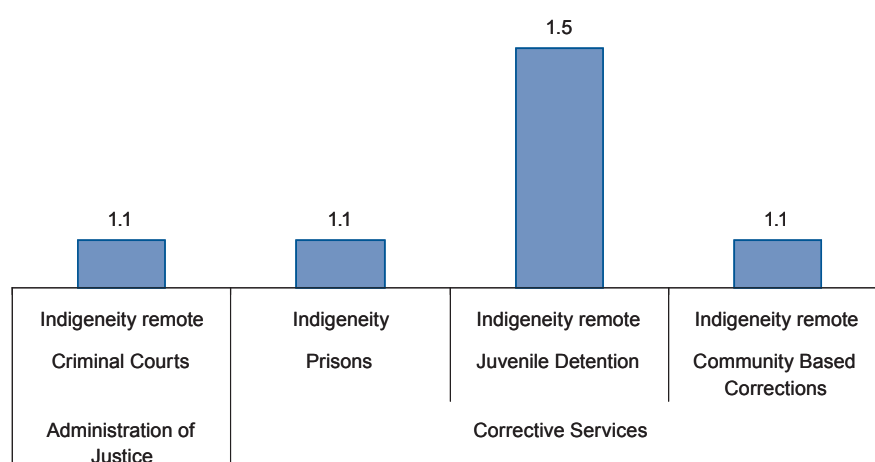
Graph A1.16: Imprisonment rates, per 100 000 of relevant population group, 2005



Source: ABS (2005a), Prisoners in Australia, 30 June 2005, cat. No. 4517.0

For the categories of police, corrective services and administration of justice, the Commission applies use and cost weights in its assessment of relative needs. For police services, a combined use/cost weight of 3.5 is applied, based on regression modelling. For all other categories, Indigenous use weights are calculated based on available data, and vary according to factors such as age and sex. The Indigenous cost weights for administration of justice and corrective services are summarised in Graph A1.17.

Graph A1.17: Law and order cost weight values for indigeneity, by category, component and type, Commission's 2004 Review



Source: Commission (2004a), 2004 Review Working Papers, vol.6

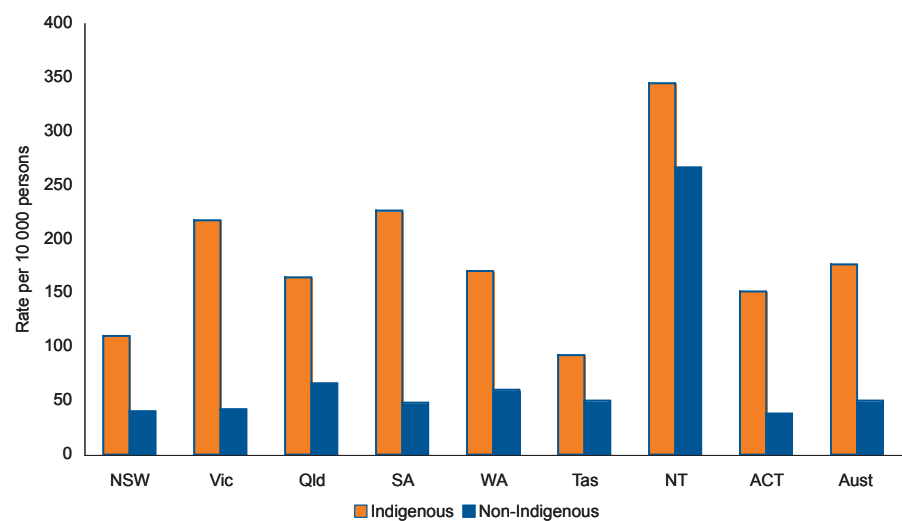
Housing and Welfare

Based on data collected by Australian Government agencies and under the auspices of agreements and programs such as the Commonwealth-State Housing Agreement (CSHA), Supported Accommodation Assistance Program (SAAP), Commonwealth-State and Territory Disability Agreement (CSTDA) and Home and Community Care (HACC), there is clear evidence of higher rates of homelessness, housing overcrowding and suicide for the Indigenous population than by the non-Indigenous population. (Graphs A1.18, A1.19, A1.20 and A1.21). This translates into higher usage rates of housing and welfare services: Indigenous people tend to access aged care at younger ages, use disabled and supported accommodation services more, and are proportionately much more likely to live in public housing (Graphs A1.22 and A1.23).²² Furthermore, Indigenous children are over-represented in residential care and child protection statistics.²³

²² In 2004-05, approximately 42 per cent of HACC clients in the Northern Territory were Indigenous, well above the Indigenous population share of people aged 50 years or over. During this period Indigenous clients were reported to use about 69 per cent of total hours of HACC service provision, implying a significant cost differential between servicing Indigenous and non-Indigenous clients. Likewise, about 80 per cent of HACC service provider units in the Territory are reportedly located in remote or very remote (and mainly Indigenous) communities, implying a further cost differential in servicing some Indigenous clients. (Australian Government (2006), *COGNOS data repository*, at <https://secure.health.gov.au>; DHCS (2003), *Home and Community Care Northern Territory: Program Plan 2003/04*, pp3-4.) Similarly, Indigenous Territorians are over-represented as users of disability services provided under the CSTDA. In 2003-04, 41.7 per cent of users of CSTDA-funded services were Indigenous, compared to 54.8 per cent non-Indigenous and 3.5 per cent not stated or collected. (AIHW (2005d), *Disability support services 2003-04: National data on services provided under the Commonwealth State/Territory Disability Agreement*, p28.

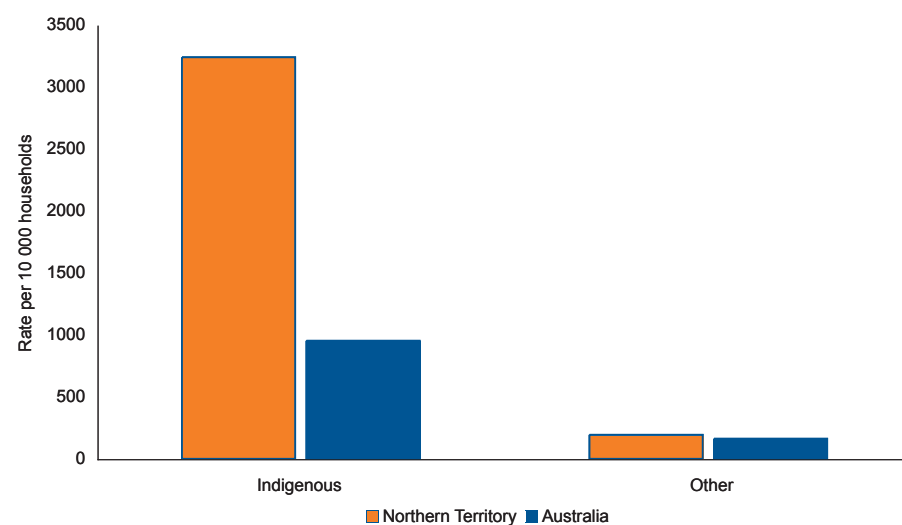
²³ Commission (2004b), *op cit*, vol.7, p188.

Graph A1.18: Rates of Homelessness on Census night 2001



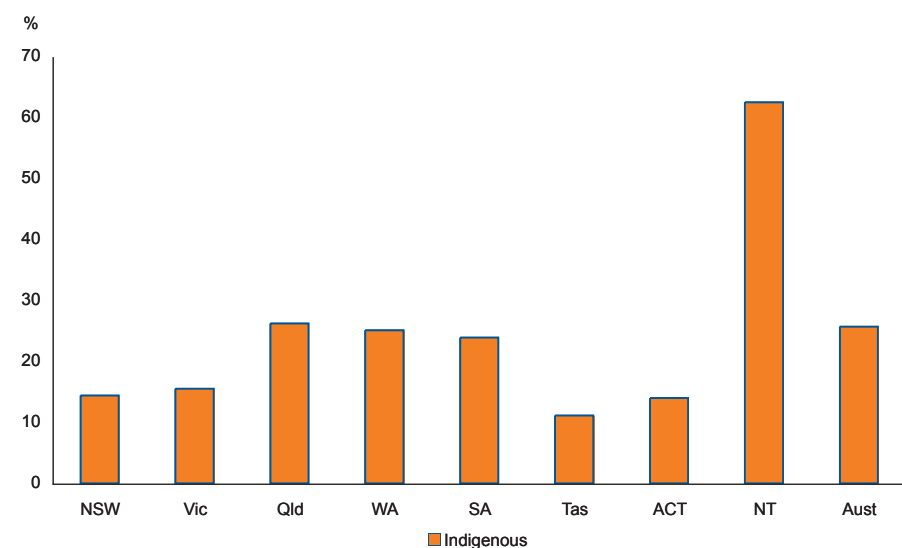
Source: AIHW (2005b), The Health and Welfare of Australia's Aboriginals and Torres Strait Islander People 2005

Graph A1.19: Overcrowded households, 2001



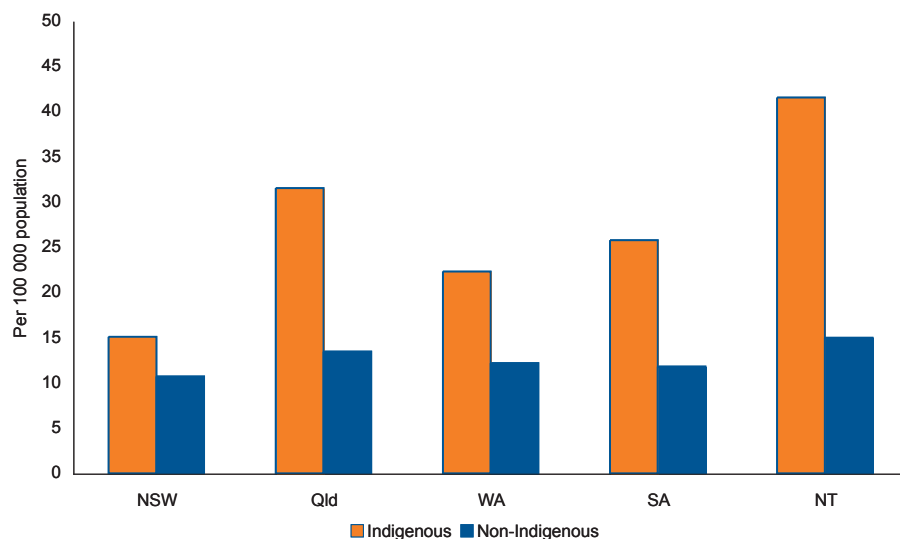
Source: AIHW (2005d), Indigenous housing needs 2005: a multi-measure needs model, Cat. No. HOU 129

Graph A1.20: Proportion of Indigenous people 15 years and over living in overcrowded housing, by state, 2002



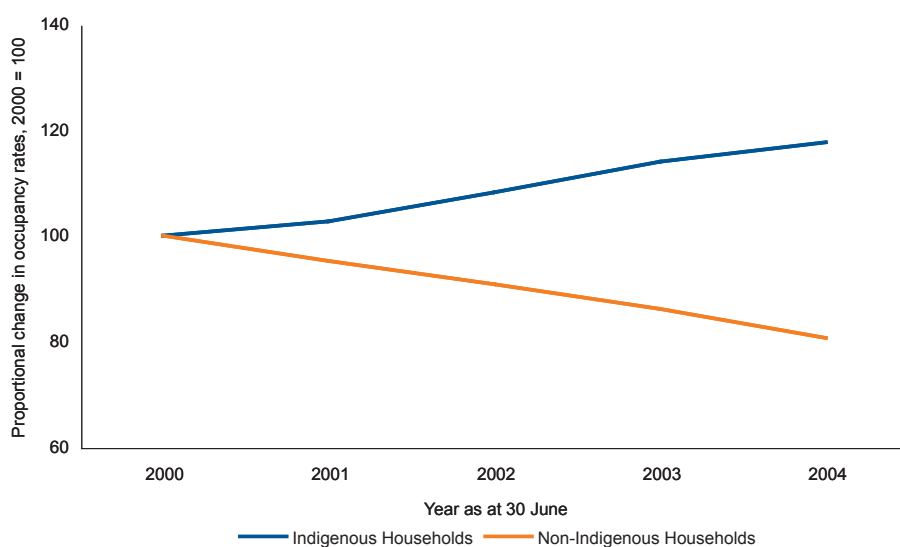
Source: SCRGSP (2005a), Report on Government Services 2005

Graph A1.21: Intentional self-harm death rates (per 100 000 population), age standardised, 1999-2003



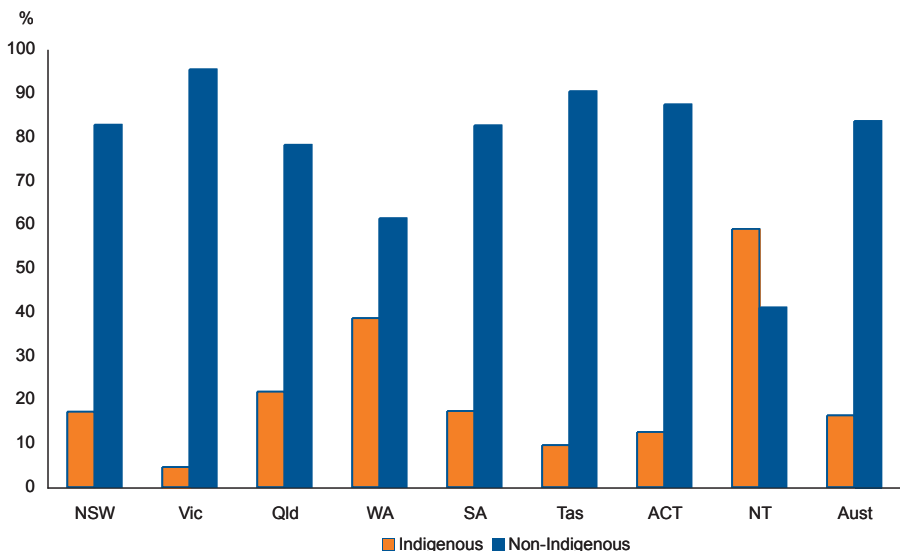
Source: SCROGS (2005b), Overcoming Indigenous Disadvantage: Key Indicators 2005

Graph A1.22: Proportional change in household occupancy rates of mainstream public housing and state-owned and managed Indigenous housing, 2000-04



Source: Commonwealth-State Housing Agreement National Data Reports Public Rental Housing, 2001-02, 2002-03, 2003-04

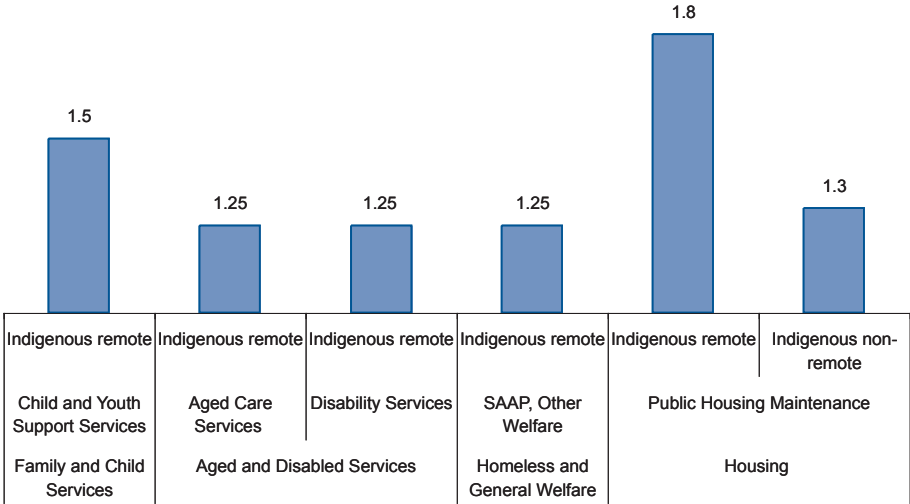
Graph A1.23: Proportion of SAAP clients, by Indigenous and non-Indigenous status, 2004-05



Source: AIHW (2006), Homeless People in SAAP: SAAP National Data Collection Annual Report 2004-05; ABS (2004a), Experimental Estimates and Projections, Aboriginal and Torres Strait Islander Australians: 1991-2009, Cat No. 3238.0 2002-03, 2003-04

The Commission, in its expenditure needs assessments for housing and welfare-related services, uses data from the sources presented here to calculate various indigeneity use weights across categories.²⁴ Conversely, comprehensive information on Indigenous cost differentials is generally not available. The Commission therefore applies related evidence and judgement in allocating cost weights for indigeneity, including the influences of remoteness and traditional lifestyles have on service delivery. The cost weight values are summarised in Graph A1.24.

Graph A1.24: Housing and welfare cost weight values for indigeneity, by category, component and type, Commission's 2004 Review



Source: Commission (2004b), 2004 Review Working Papers, vol.4

²⁴ Commission (2004b), *op cit*, vol.7, pp201-202.

Appendix 2: Agenda for Action

In recognition of the long-term and significant socioeconomic disadvantages experienced by Indigenous Territorians and the difficult challenges of delivering government services to the Indigenous population, the Northern Territory Government has undertaken a number of strategic initiatives aimed at achieving more effective service delivery and more positive outcomes for the Territory's Indigenous communities. The most significant initiative to date is the recently released *Agenda for Action: A Whole of Government Approach to Indigenous Affairs in the Northern Territory 2005-2009*. The Agenda for Action sets out the Territory Government's priorities over the next four years, and follows from the landmark *Overarching Agreement on Indigenous Affairs* signed between the Australian and Northern Territory Governments in 2005, which aims to improve coordination and bilateral action on Indigenous policies and programs. The Agenda for Action has identified six priority areas for the Northern Territory Government to address:

- establishment of a whole of government approach and better policy and program delivery coordination between all government agencies;
- more investment in Indigenous education and training;
- creation of local jobs for local people, and use of land rights to boost community economies;
- encouragement of quality community governance and community-building activities;
- improvement of housing, roads, communications infrastructure and other essential services in Indigenous communities; and
- promotion of safer Indigenous communities.²⁵

The Agenda for Action is designed to work in conjunction with other whole of government and agency-level strategic initiatives currently in place, including:

- Indigenous Education Strategic Plan 2006-2009;
- Building Healthier Communities 2004-2009: A Framework for Health and Community Services;
- Indigenous Economic Development Strategy 2005;
- Building Better Schools;
- Indigenous Employment and Career Development Strategy 2002-2006;
- Indigenous Economic Forum;
- Partnership with Thamarrurr;
- Aboriginal Family Violence Strategy; and
- Strong Family, Strong Community, Strong Future Project.

Additionally, many agencies provide programs and services targeted specifically at the Indigenous population, including the Department of the Chief Minister's (DCM) Office of Indigenous Policy and the Department of Local Government, Housing and Sport's (DLGHS) Aboriginal Interpreter Service.

²⁵ NTG (2006), *Agenda for Action: A whole of government approach to Indigenous Affairs in the Northern Territory 2005-2009*, p2.

Appendix 3: Expenditure Analysis by Agency

In this appendix, a brief summary of the treatment and estimation of expenditure related to the Indigenous population is given for each Northern Territory Government agency. Agencies are grouped according to three categories: service agencies, support agencies and central agencies.

Service Agencies

Aboriginal Areas Protection Authority (AAPA)

The main function of AAPA is the protection of Aboriginal sacred sites, thus expenditure by this agency was treated as wholly related to the Indigenous population.

Estimated total proportion of Indigenous-related expenditure: 100%

Department of Business, Economic and Regional Development (DBERD)

The main functions of DBERD include development of business and industry and encouragement of investment and economic innovation in the Territory. As these functions are indirectly beneficent to the general Territory population, most output groups were allocated an EPC share of 28.8 per cent of expenditure related to the Indigenous population. However, some of DBERD's programs pertain more specifically to the Indigenous population, such as 'Regional and Indigenous Economic Development' and 'Desert Knowledge Economy'. These were assigned higher shares, as estimated by DBERD.

Estimated total proportion of Indigenous-related expenditure: 40.1%

Department of Employment, Education and Training (DEET)


DEET's primary functions are to provide services in education, training, employment promotion and occupational health and safety regulation. Shares of expenditure related to the Indigenous population were estimated using a range of data sources. For most of DEET's output groups, data on enrolment numbers were applied to apportion usage rates. In the case of the output group 'Government Education', which represents almost three quarters of DEET expenditure, usage rates were given a cost weighting by disaggregating expenditure to an individual school level, and apportioning expenditure proportionate to each school's Indigenous and non-Indigenous enrolment rates and the total operational costs of the school. For some sub-output groups under 'Employment Initiatives' and 'Vocational Education and Training Services', data on participation rates in vocational education and training (VET) from the Productivity Commission's *Report on Government Services 2005 – Indigenous Compendium* were applied.²⁶

Estimated total proportion of Indigenous-related expenditure: 40.1%

Department of Health and Community Services (DHCS)

DHCS is responsible for providing acute care, community and remote health services, and community services for families and children, aged and disabled people, mental health and alcohol and drug abuse treatment. Estimates of expenditure related to the Indigenous population were based on data collected by DHCS at sub-output group and cost centre levels. These estimates were supported by robust data collected by the AIHW and ABS on morbidity rates,

²⁶ SCRGSP (2005a), *Report on Government Services 2005 – Indigenous Compendium*, Table 4A.1, at <http://www.pc.gov.au/gsp/reports/rogs/compendium2005/attachments.pdf>.



health services usage rates and cost differentials. For many of DHCS's community services, robust data on usage rates and cost differentials are collected by and for the Australian Government.

The differences in usage rates and cost weightings between sub-output groups are largely a reflection of the geographic location of the program and the socio-demographic profile of these locations. However, for virtually all DHCS services and programs, expenditure related to the Indigenous population was significantly higher than the EPC share. DHCS has one minor output group specifically related to the Indigenous population: the Office of Aboriginal Health, Family and Social Policy, for which expenditure related to the Indigenous population was apportioned at 100 per cent.

Estimated total proportion of Indigenous-related expenditure: 59.4%

Department of Justice (Justice)

The main functions of Justice include the provision of legal, court and correctional services, and community services such as the Registrar-General, the Office of the Public Trustee, the Anti-Discrimination Commission, the Information Commissioner, consumer and business affairs and the Office of Crime Prevention. For programs that do not directly relate to providing client services or are services universally accessible or beneficent (such as legal policy services or services provided by the Office of the Public Trustee), an EPC share of expenditure related to the Indigenous population was apportioned.

For court services, there was reliable data on criminal court appearances by Indigenous and non-Indigenous people (71.6 per cent of court appearances in 2003-04 involved Indigenous defendants). However, an exact cost separation of civil and criminal cases before the lower and higher courts was not available. Additionally, in the civil jurisdiction it is not mandatory to identify a person's Indigenous status, and many of the matters before civil courts involve corporations and businesses. For these reasons, Justice officials were required to make a number of estimations to arrive at a final apportionment. The total expenditure share related to the Indigenous population for lower and higher courts were estimated at 49 and 53 per cent respectively.

For other sub-output groups under 'Correctional Services' and 'Community Services', data provided by the Australian Institute of Criminology and the Productivity Commission's *Report on Government Services 2005: Indigenous Compendium* for Indigenous proportions of average daily prison, community corrections and juvenile detention populations for 2002-04 were applied.²⁷

Estimated total proportion of Indigenous-related expenditure: 62.3%

Department of Local Government, Housing and Sport (DLGHS)

DLGHS is responsible for providing services related to local government and community governance and development, housing, certain libraries, Indigenous affairs, and sport and recreation. The figures provided on expenditure shares related to the Indigenous population were largely based on judgements by DLGHS officials, as data on Indigenous usage for many of its services and programs are not collected. Estimates for Indigenous-related expenditure on local government and community development reflected the significant resources invested in Indigenous community councils and local governments in

²⁷ *Ibid*, tables 7A.1 and 7A.2; Australian Institute of Criminology (2005b), [Statistics on Juvenile Detention in Australia 1981-2004](#), pp24 and 26.

regional and remote areas, where the majority of the population is Indigenous. Expenditure on library services and most sport and recreation programs were apportioned on an EPC basis. Some DLGHS programs, including 'Indigenous Housing Services', 'Community Harmony', 'Aboriginal Interpreter Services' and the 'Indigenous Sports Program' are Indigenous-specific, therefore expenditure was wholly attributed to the Indigenous population. Although 'Indigenous Housing' is treated as a separate program, the usage rate of the mainstream program 'Housing Services' by Indigenous people is also significant, and was estimated at 48 per cent for 2004-05.

Estimated total proportion of Indigenous-related expenditure: 69.0%

Department of the Legislative Assembly (DLA)

The main responsibilities of the DLA are to provide services for the functioning of the Northern Territory's Legislative Assembly. These include Assembly services, members' and clients' services and building management services. As the DLA's functions relate to providing political representation to all Northern Territory residents, its expenditure related to the Indigenous population was apportioned at EPC.

Estimated total proportion of Indigenous-related expenditure: 28.8%

Department of Natural Resources, Environment and the Arts (NRETA)


The main aim of NRETA is to integrate conservation and research of the natural environment and the Territory's culture and history, with the aim of promoting and displaying this information to the public, and of conserving, monitoring and ensuring that the Territory's resources are used sustainably. The agency's main functions therefore relate to environment and heritage research and preservation, conservation and natural resource policy and management, and arts, museums and certain library services. These functions include management of the Environmental Protection Agency and many of the Territory's parks and reserves.

Expenditure on the services NRETA provides to the general public, such as arts, museums, parks management, environment and heritage services, were attributed to the Indigenous population on an EPC basis. For many programs under the output group 'conservation and natural resource management', such as native vegetation development and bushfire, weeds and pastoral lands management, NRETA officials were able to provide data on usage rates of services, and expenditure related to the Indigenous population was apportioned accordingly. Spending on the Strehlow Research Centre, a cultural precinct devoted to the preservation and research of Indigenous ceremonial life, was wholly apportioned to the Indigenous population.

Estimated total proportion of Indigenous-related expenditure: 29.3%

Department of Planning and Infrastructure (DPI)

DPI's main responsibilities are road network management, transport, Indigenous essential services infrastructure, land planning, development and management, and infrastructure development in the Territory. Expenditure on DPI functions except roads network management and Indigenous essential services was apportioned to the Indigenous population on an EPC basis, on the premise that these services are of direct or indirect benefit to the Territory population as a whole. Road network management was attributed according to the particular



nature of roads and the population each road serves. Indigenous essential services infrastructure expenses, which represented almost 20 per cent of DPI's budget, was wholly apportioned to the Indigenous population.

Estimated total proportion of Indigenous-related expenditure: 49.4%

Department of Primary Industry, Fisheries and Mines (DPIFM)

DPIFM's main responsibilities lie with developing and managing projects related to fisheries, and mineral, energy and primary industries. The majority of expenditure on sub-output groups relating to industry development was apportioned to the Indigenous population on an EPC basis, on the premise that the benefits thereof are accrued directly or indirectly by the entire Territory population. However many of DPIFM's mainstream programs, in particular relating to fisheries, minerals and energy management, have a specific focus or provide specific benefits to predominantly Indigenous communities. Based on data provided by DPIFM officials, expenditure on these programs related to the Indigenous population have been apportioned accordingly. Spending on the sub-output groups 'Indigenous Horticulture Development' and 'Indigenous Liaison Services' has been wholly attributed to the Indigenous population.

Estimated total proportion of Indigenous-related expenditure: 36.5%

Northern Territory Electoral Commission (NTEC)

NTEC administers community, local and Territory-wide elections and provides other electoral services for the Northern Territory population. Although the functions of NTEC can be viewed as of universal benefit to the Territory population, the extra focus and costs incurred on providing electoral services to the Indigenous population, in particular related to electoral awareness, conducting local, community and Legislative Assembly elections, and corporate services, resulted in a determination by NTEC officials that the expenditure share related to the Indigenous population was on average higher than EPC.

Estimated total proportion of Indigenous-related expenditure: 41.2%

Northern Territory Police, Fire and Emergency Services (NTPFES)

The functions of NTPFES are to provide police, fire, rescue and emergency services to the Territory population, with the aim of reducing crime and the effects of emergencies and disasters. Expenditure for services provided under the output groups 'Fire Prevention and Response Management' and 'Emergency Services' was generally apportioned to the Indigenous population on an EPC basis. However certain programs, such as professional 'Fire Service Operations', 'Counter Terrorism' and 'Counter Disaster Training' were considered to be mainly beneficent to the Territory's urban populations; expenditure shares of these programs related to the Indigenous population thus reflected ABS data on the proportion of Indigenous residents in Darwin, Alice Springs, Katherine, Palmerston, Litchfield, Jabiru, Nhulunbuy and Tennant Creek.²⁸

The methodology employed by NTPFES to estimate its Indigenous-related expenditure for the output groups 'Road Safety Policy', 'General Policing', 'Crime Detection, Investigation and Prosecution' and 'Community Safety and Crime Prevention' first began with estimating usage rates of services by applying

²⁸ ABS (2005b), *ABS Regional Statistics – Northern Territory 1362.7*, Table 3.6, at [http://www.ausstats.abs.gov.au/Ausstats/subscriber.nsf/0/65E36CA8D1CE91B9CA25705800756CF0/\\$File/13627_2005.pdf](http://www.ausstats.abs.gov.au/Ausstats/subscriber.nsf/0/65E36CA8D1CE91B9CA25705800756CF0/$File/13627_2005.pdf).

externally-produced data on court appearances, offender rates and community safety expenditure by Indigenous and non-Indigenous status.²⁹ All stations and units that are wholly Indigenous-related, plus Aboriginal Community Police Officers (ACPOs) who are stationed at other non-wholly Indigenous-related units (such as Darwin or Casuarina stations), were then identified and a cost estimate was made using given benchmarks. This Indigenous-specific expenditure was then added to each sub-output group, thus providing the final estimate of Indigenous-related expenditure.

Estimated total proportion of Indigenous-related expenditure: 57.3%

Tourism NT

Tourism NT is responsible for influencing the development of the Northern Territory as a competitive tourism destination, and promoting the Territory and its tourism industry to both domestic and international markets. These services are considered here to be of direct or indirect economic benefit to the general Territory population, and therefore its expenditure related to the Indigenous population has been apportioned on an EPC basis even though some Tourism NT programs specifically target Indigenous tourism development.

Estimated total proportion of Indigenous-related expenditure: 28.8%

Ombudsman's Office

Services provided by the Ombudsman's Office, including the Health and Community Services Complaints Commission, are considered here to be universally accessible to the Territory's population, and ultimately of indirect benefit to the general population insofar that they improve transparency, accountability and quality of government services. For these reasons, expenditure for this agency related to the Indigenous population was apportioned on an EPC basis.

Estimated total proportion of Indigenous-related expenditure: 28.8%

Territory Discoveries

The main activities of Territory Discoveries involve providing services to the tourism industry by developing tourism products for sale to consumers in the domestic and select international marketplaces. These services are considered here to be of direct or indirect economic benefit to the general Territory population, and therefore its expenditure related to the Indigenous population has been apportioned on an EPC basis.

Estimated total proportion of Indigenous-related expenditure: 28.8%

Territory Wildlife Parks (TWP)

TWP is responsible for managing the Territory Wildlife Park at Berry Springs and the Alice Springs Desert Park. As the services provided by TWP are accessible by all Territory residents, and the spin-off economic benefits to the Territory's tourism industry are considered here to be of direct or indirect benefit to the general population, TWP's expenditure related to the Indigenous population was apportioned on an EPC basis.

Estimated total proportion of Indigenous-related expenditure: 28.8%

²⁹ 2004-05 data on court appearances and offender rates were collected by the Commission from state data returns (unpublished). Indigenous-related expenditure shares for NTPFES community safety programs were calculated by the Commission using 2001 ABS Census data and a determined cost weighting (unpublished).



Support Agencies

The methodology used by this review to estimate government support and central agencies' expenditure related to the Indigenous population is based on the premise that these agencies offer services to other agencies that support their activities and services to the general population. Essentially, support and central agencies' expenditure is treated as a form of corporate costs for service agencies: if they did not exist as separate entities, their functions would need to be incorporated into the corporate and administrative activities of all service agencies. On these grounds, the estimates for support and central agencies have generally been based on the average expenditure related to the Indigenous population for all other agencies. If data is available, support and central agencies' expenditure is apportioned to each agency it provides for services for, and weighted accordingly.

Construction Division

The Construction Division is responsible for the delivery of the Northern Territory Government's infrastructure program through the design, procurement and supervision of the construction and maintenance of built assets for client agencies. Its activities comprise management of capital works, minor new works and repairs and maintenance projects. Given that its primary focus is on universally accessible infrastructure and roads construction projects, rather than direct support of service agencies' activities, the benefits of its activities are considered here to be accrued by the general population directly. As such, expenditure by the Construction Division related to the Indigenous population has been apportioned on an EPC basis.

Estimated total proportion of Indigenous-related expenditure: 28.8%

Data Centre Services (DCS)

DCS delivers a range of information technology services to all Northern Territory Government agencies. Its key functional responsibilities include mainframe and mid-range server management, database administration, and management of data storage and whole of government web, email and communications technology services. DCS officials were able to provide disaggregated data on DCS expenditure for each agency. The final estimate of DCS expenditure related to the Indigenous population was thus calculated by weighing the share of DCS expenditure on each agency with each agency's data return on Indigenous-related expenditure shares. For example, DCS's expenditure on services provided to DHCS (which reported a share of 59.4 per cent of expenditure as related to the Indigenous population) would be considered to be related to the Indigenous population at 59.4 per cent as well.

Estimated total proportion of Indigenous-related expenditure: 49.9%

Office of the Commissioner for Public Employment (OCPE)

OCPE is generally the employer of all Northern Territory Government employees, and provides employment framework and workforce development services to all agencies. These services include those provided through a bureau for Indigenous workforce development. It is also responsible for formulating policy advice for the Northern Territory Government on public employment issues. As such, the initial estimates of expenditure attribution formulated by this report treated OCPE as an agency that provides support to the services of all other government agencies. However, OCPE officials contended that

an important role of the agency is to provide services directly to public sector employees. These include industrial and employee relations, and employment appeal and complaints review services. It was argued that the proportion of Indigenous employees in the Northern Territory public service workforce, which is approximately seven per cent, should therefore be the basis of expenditure attribution. Given the dual responsibilities, this report has attributed expenditure to the Indigenous population on an EPC basis.

Estimated total proportion of Indigenous-related expenditure: 28.8%

Department of Corporate and Information Services (DCIS)

DCIS is responsible for providing centralised corporate support services to all Northern Territory Government agencies. Its services include financial and human resources administration, procurement, archives, information technology management and leased property management. Similar to DCS, the activities of DCIS support the delivery of services for all government agencies. DCIS officials were able to provide disaggregated data on DCIS expenditure for each agency. The final estimate of DCIS expenditure related to the Indigenous population was thus calculated by weighing the share of DCIS expenditure on each agency with each agency's data return on Indigenous-related expenditure shares.

Estimated total proportion of Indigenous-related expenditure: 48.9%

Government Printing Office (GPO)

GPO provides cost-effective and secure printing and publication services to the Northern Territory parliament and government. Similar to DCS and DCIS, the activities of GPO support the delivery of services for all government agencies. GPO officials were able to provide disaggregated data on GPO expenditure for each agency. The final estimate of GPO expenditure related to the Indigenous population was thus calculated by weighing the share of GPO expenditure on each agency with each agency's data return on Indigenous-related expenditure shares.

Estimated total proportion of Indigenous-related expenditure: 44.7%


NT Fleet

NT Fleet manages the light and heavy vehicle fleet for all Northern Territory Government agencies, except for NTPFES. Management of the government's vehicle fleet incorporates acquisition, vehicle hire, maintenance and disposal. Similar to DCS, DCIS and GPO, the activities of NT Fleet support the delivery of services for all government agencies. NT Fleet officials were able to provide disaggregated data on NT Fleet's expenditure for each agency. The final estimate of the agency's expenditure related to the Indigenous population was thus calculated by weighing the share of NT Fleet's expenditure on each agency with each agency's data return on Indigenous-related expenditure shares.

Estimated total proportion of Indigenous-related expenditure: 48.7%

Auditor-General's Office

The main responsibility of the Auditor-General's Office is to provide the parliament and the Northern Territory public with an independent analysis of the financial information, internal controls and performance management systems for the entire Northern Territory Government sector. As such, although the Auditor-General's Office provides auditing and accountability services to all agencies, its services are considered here to be primarily for the benefit of the



general population. Its expenditure related to the Indigenous population was therefore apportioned on an EPC basis.

Estimated total proportion of Indigenous-related expenditure: 28.8%

Central Agencies

Central Holding Authority (CHA)

The CHA plays a key role in the Northern Territory Government's financial management and recording framework. Essentially it is the 'parent body' that represents the Government's overall financial position and records the financial transactions between the Government and its agencies and government business divisions (GBDs). Its expenditure comprises output appropriation funding, capital appropriation funding, interest payments on Territory borrowings, interest on cash balances of GBDs and government-owned corporations, and the centrally-managed employee costs of superannuation and long service leave. The activities of CHA are thus integral to the overall functioning of the Northern Territory Government, and indirectly support the delivery of services for all Government agencies. For this reason, CHA expenditure share related to the Indigenous population was calculated by using the average expenditure share of all other agencies.

Estimated total proportion of Indigenous-related expenditure: 50.9%

Northern Territory Treasury (Treasury)

Treasury fulfils a whole of government service by providing analysis and advice on economic, fiscal and social policies to government. Its responsibilities include ensuring efficient and sustainable government operations, strategic positioning, sound regulatory practices and effective risk management of the Northern Territory Government's commercial activities. The majority of Treasury's activities, especially in regard to revenue analysis, financial management, and economic and commercial services are thus treated here as support services to all other agencies, and the Indigenous-related expenditure share of these output groups is calculated by applying the average Indigenous-related expenditure share of all other agencies. Exceptions are made for Treasury output and sub-output groups that are considered to be services primarily to the general population, including 'Community Service Obligations' (i.e. subsidy payments to Power and Water Corporation – mainly in urban areas), 'Gambling, Liquor and Other Regulation', and 'Economic Regulation'. Treasury officials provided data on usage rates and approximate cost weightings related to the Indigenous population for these services, and the Indigenous-related expenditure shares were calculated accordingly.

Estimated total proportion of Indigenous-related expenditure: 34.0%

Department of the Chief Minister (DCM)

DCM's main responsibilities include assisting the Chief Minister to ensure the Northern Territory Government's policy priorities are implemented effectively by the public sector. DCM acts to coordinate and provide leadership in whole of government strategic directions and approaches to issues, and offers information and advice to the Northern Territory Chief Minister and Cabinet. Given its central policy coordination role, many of its activities, in particular under the output group 'Policy Advice and Public Sector Coordination', are treated here as services to other agencies, and therefore the average share of Indigenous-related

expenditure for all other agencies has been applied accordingly. However, many of DCM's functions are considered here to be services primarily to the general population or to specific population subgroups. These include most activities under output groups like 'Trade and Major Projects', 'NT Railway', 'Government Business Support' and 'Community Engagement'. Expenditure shares were calculated on an EPC basis, or based on population subgroup proportions or agency estimates of actual expenditure on population subgroups. Expenditure on the 'Office of Indigenous Policy', which provides whole of government Indigenous policy guidance and advice, was wholly apportioned to the Indigenous population.

Estimated total proportion of Indigenous-related expenditure: 34.6%



Northern
Territory
Government

2006-07 Indigenous Expenditure Review



AUDITOR-GENERAL'S REPORT TO THE UNDER TREASURER ON THE INDIGENOUS EXPENDITURE REVIEW FOR 2006-2007

Scope

I have performed an independent audit of the Indigenous Expenditure Review (IER), being a special purpose report prepared on the Northern Territory's expenditures and revenues for the 2006-07 financial year and which are attributable to the indigenous residents of the Territory.

Northern Territory Treasury is responsible for preparation of the IER and for the fair presentation of data contained therein. Treasury's responsibility also includes establishing and maintaining internal controls relevant to the fair presentation of financial and statistical information in the Review.

Auditor's Responsibility

My responsibility is to express an opinion to the Under Treasurer on the IER based on my audit. My audit was conducted in accordance with Australian Auditing and Assurance Standards and was intended to provide reasonable assurance whether the financial and statistical information presented in the IER is free of material misstatement.

The audit involved performing procedures to obtain audit evidence about the disclosures of financial and statistical information in the IER. The procedures selected as part of an audit depend on the auditor's judgement, including the assessment of the risks of material misstatement of a report due to error. In making those risk assessments, the auditor considers internal control relevant to the preparation and fair presentation of the report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal controls themselves. An audit also includes an evaluation of the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Treasury and agencies, as well as evaluating the overall presentation of information in a report.

The audit of the IER involved the sampling of expenditure data across selected agencies and accompanying audit procedures included:

- a. examining the systems and methods used to allocate direct and indirect costs to indigenous programs;
- b. determining the extent to which service delivery to indigenous groups is identifiable;
- c. to the extent to which service delivery to indigenous groups is not identifiable, identifying the approach by which costs are determined as being related to indigenous activities and forming a view about the validity of the approach adopted;
- d. assessing the reliability of the systems used to capture, store and extract the relevant data; and
- e. forming a view about the validity and reliability of the approaches adopted.

In addition, revenue data and Commonwealth Grants Commission information held by Northern Territory Treasury were reviewed.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Auditor's Opinion

In my opinion, the Indigenous Expenditure Review for the financial year 2006-07 presents fairly, in all material respects, the financial and statistical information that is attributable to the indigenous residents of the Northern Territory.

F McGuinness

Auditor-General for the Northern Territory

1 September 2008

Darwin

Northern Territory

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Note: Agencies referred to in this document are those in place as at 30 June 2007.

Executive Summary

Two years ago, Northern Territory Treasury undertook a review of the Northern Territory Government's Indigenous-related expenditure and revenue for the 2004-05 financial year. The Indigenous Expenditure Review (IER) was the first review of its type by any Australian government and was undertaken at a time when there was considerable scrutiny in relation to the Territory's spending priorities, including suggestions that money designated for Indigenous purposes was being redirected to other areas, including for non-Indigenous services in Darwin. The main purpose of the 2004-05 IER was to inform the debate by providing a robust, transparent measure of Indigenous-related expenditure and revenue. The Northern Territory has committed to regular reviews of its Indigenous-related spending. The 2006-07 IER has been audited by the Northern Territory Auditor-General.

The 2004-05 IER found that around half of the Territory's budget was spent on Indigenous-related services and this exceeded the level of Indigenous-related revenue. Notwithstanding this, the 2004-05 IER highlighted the considerable levels of disadvantage faced by Indigenous Territorians in a range of areas, including income level, health status, educational attainment, and arrest and imprisonment rates. It concluded that:

Despite the high level of expenditure, outcomes for Indigenous Territorians against a wide range of indicators remain poor relative to those of non-Indigenous Territorians. There is clearly a need for additional funding streams to the Territory, so that the social wellbeing of the Indigenous population can be improved, economic participation and productivity be enhanced, and all Australians can benefit from improved economic activity and social cohesion.

Since the 2004-05 IER was completed, a number of initiatives have increased Indigenous spending in the Northern Territory. In 2005, the Commonwealth and Northern Territory governments signed an overarching agreement that was intended to support ongoing improvements in services for Indigenous Territorians by pooling housing funding, boosting employment and economic growth, strengthening and supporting the Indigenous arts sector, and supporting effective arrangements for Indigenous representation at regional and local levels.

In 2007, the Commonwealth announced its Northern Territory Emergency Response (NTER) and increased levels of short-term funding in relation to child health and protection, community safety, education and housing in remote Indigenous communities. A review into the NTER, including future funding commitments, is currently under way. In August 2007, the Territory Government also announced further investment of \$286 million in its Closing the Gap of Indigenous Disadvantage initiative, a multi-tiered package seeking to improve the socio-economic wellbeing of Indigenous Territorians with achievable targets for 5, 10 and 20 years that address the child protection system, housing, unemployment, offender rehabilitation, health, alcohol misuse and education.

This second IER covers the 2006-07 financial year and predates the effect on Northern Territory finances of these initiatives but provides a baseline against which these initiatives can be compared, both in terms of investment and outcomes.

The 2006-07 IER builds on the 2004-05 report and, as a result of improved data sources, has undertaken a more rigorous examination of expenditure, in some cases down to individual unit records (e.g. separations, police incidents) and sub-program level data. This review makes a number of methodological changes to provide a more contemporaneous assessment of goods and services tax (GST) revenue and own-source revenue, and incorporates results from the Australian Bureau of Statistics' (ABS) 2006 Census of Population and Housing. Indigenous persons comprise 30.4 per cent of the Territory's population. The 2004-05 results have also been reviewed to allow like-for-like comparisons with the 2006-07 IER.

Tables 1 and 2 show the key findings of the 2006-07 IER and can be summarised as:

- 52.4 per cent of the Territory's expenditure in 2006-07 was Indigenous-related;
- 44.4 per cent of the Territory's revenue in 2006-07 was Indigenous-related;
- Indigenous-related expenditure exceeds that of revenue by 8.0 per cent or around \$248 million; and
- on a per capita basis, spending on Indigenous Territorians is 2.5 times that of non-Indigenous Territorians.

The 2006-07 IER examined spending by service delivery agencies that primarily provide services to individuals. Table 1 shows 63 per cent of Northern Territory Government expenditure is by service delivery agencies that provide human services. Indigenous-related spending is 56.4 per cent of expenditure in these agencies and represents 3.0 times per capita spending compared to non-Indigenous persons. These agencies include the (former) Departments of Health and Community Services, and Employment, Education and Training, and Northern Territory Police, Fire and Emergency Services.

Table 1: Estimate of Northern Territory expenditure related to the Indigenous population 2006-07

	Agency expenditure \$M	Agency share of NT total expenditure %	Indigenous-related expenditure %	\$M
Service agency – human services	1 950.2	62.8	56.4	1 099.2
Service agency – economic services	541.5	17.4	43.2	234.1
Support agency	142.3	4.6	50.9	72.5
Central agency	473.2	15.2	46.9	221.7
Total	3 107.2	100.0	52.4	1 627.5

Source: Northern Territory Treasury.

Table 2: Estimate of Northern Territory revenue related to the Indigenous population 2006-07

	Total revenue		Indigenous-related share	
	%	\$M	\$M	%
GST revenue	62.2	2 015.3	1 106.5	54.9
Tied grants	15.3	494.9	186.4	37.7
Own-source revenue	22.6	732.0	146.5	20.0
Total	100.0	3 242.2	1 439.5	44.4

Source: Northern Territory Treasury.

So that comparisons can be made between the 2004-05 and 2006-07 results, the 2004-05 data has been adjusted to incorporate methodological and data changes. Table 3 compares the updated data for 2004-05 with the original 2004-05 results.

Table 3: Adjusted and original published 2004-05 Indigenous-related revenue and expenditure

	2004-05 IER original data Indigenous-related share	2004-05 IER adjusted for methodology and population changes Indigenous-related share	Change
	%	%	percentage point
Revenue	43.2	45.9	2.7
Expenditure	49.7	50.1	0.4

Source: Northern Territory Treasury.

The increase in estimated revenue reflects the application of expense disabilities to actual GST revenue received and the adoption of 2006 Census figures.

The impact of the Census on expenditure was less pronounced as most service agencies used actual use and cost data (where available) that reflects contemporary population data.

Table 4 shows a summary of key results on a like-for-like basis between the two reviews. The key points arising from this review are that between 2004-05 and 2006-07:

- Indigenous-related revenue declined by 1.5 percentage points;
- Indigenous-related expenditure increased by 2.3 percentage points;
- the percentage point difference between Indigenous-related expenditure and revenue almost doubled, increasing from 4.2 to 8.0; and
- the per capita ratio of Indigenous expenditure to non-Indigenous expenditure increased from 2.3 to 2.5.

Table 4: Comparison of results between 2004-05 and 2006-07 Reviews

	Revised 2004-05	2006-07	Change
Indigenous-related revenue (per cent)	45.9	44.4	-1.5
Indigenous-related expenditure (per cent)	50.1	52.4	2.3
Difference (percentage points)	4.2	8.0	3.8
Per capita ratio – Indigenous : non-Indigenous expenditure	2.3	2.5	0.2

Source: Northern Territory Treasury.

The Indigenous share of total revenue fell primarily as a result of a decline in the Indigenous-related share of GST funding, and a decline in the contribution of GST to overall Territory revenue. The increase in expenditure, while significant, is in part likely to be as a result of improved data collection techniques in the 2006-07 IER.

The findings of the 2006-07 IER consolidate and strengthen those arising from the 2004-05 IER. The Northern Territory Emergency Response and Closing the Gap initiatives will progressively impact on results, from 2007-08 onwards, and represent increased focus and commitment from both the Territory and Commonwealth governments to address long-term disadvantage faced by Indigenous Territorians.

Introduction

This is the second review of Indigenous-related expenditure and revenue undertaken by Northern Territory Treasury, the first being undertaken in 2006. These reviews are intended to inform the ongoing and important debate about government spending on services for Indigenous people by providing a robust and transparent estimate of Northern Territory Government expenditure and revenue that is related to the Territory's Indigenous population. Indigenous people make up 30.4 per cent of the Territory's population.

Apportioning Government revenue and expenditure between population subgroups is difficult and has not been done by other jurisdictions. Government expenditure takes many forms and includes direct service delivery where types of users can be identified (e.g. hospital services, schools and public housing), services directed towards particular groups including industries (e.g. tourism marketing expenditure, work safety programs), and expenditure associated with the machinery of government (e.g. Treasury, Legislative Assembly).

Similarly, much of government revenue is not hypothecated to particular functions. However, in order to produce a complete assessment of government expenditure and revenue, the 2004-05 IER included an apportionment for Indigenous and non-Indigenous purposes for all types of Territory Government revenue and expenditure. The 2006-07 IER has continued with the comprehensive approach but, in addition, has separated service delivery expenditure primarily directed to individuals from that of economic-type or industry-based expenditure.

The first review examined the Northern Territory's Indigenous-related expenditure and revenue in the 2004-05 financial year. It found that:

- 49.7 per cent of the Territory's expenditure was Indigenous-related;
- 43.2 per cent of the Territory's revenue was Indigenous-related;
- Indigenous-related expenditure exceeded revenue by 6.5 percentage points or approximately \$175 million; and
- despite high levels of expenditure, more funding was required to address long-term Indigenous disadvantage.

Since the publication of the first review, all governments through the Council of Australian Governments (COAG) have committed to improving Indigenous outcomes. It is expected that National Partnerships payments will be available to contribute towards closing the gap in Indigenous outcomes. COAG has also committed to a process whereby all governments will report on Indigenous spending in both targeted and mainstream programs. This will assist in providing greater transparency of Indigenous-related expenditure by all Australian governments.

The methodology for the 2006-07 IER is broadly consistent with that of the 2004-05 IER and is briefly outlined below. A more detailed explanation of the methodology is contained in the 2004-05 report. Changes to the methodology used in this review are also outlined.

Part A discusses the estimation of the Indigenous-related expenditure.

Part B discusses the estimation of Indigenous-related revenue.

Part C summarises results and compares the 2004-05 and 2006-07 results.

Part A: Expenditure

The majority of services provided by the Northern Territory Government to Indigenous Territorians are mainstream programs to individuals. Due to the breadth and depth of disadvantage experienced by Indigenous Territorians (measurable across a wide range of indicators, such as health status, educational attainment, incomes and arrest and imprisonment rates), Indigenous people are disproportionately high users, in some cases dominant users, of mainstream government services in the Territory.

The Territory also has services and programs that are specifically targeted to Indigenous people. Examples include Indigenous housing programs, services provided through the Indigenous Education Strategy, the Indigenous Economic Development Strategy and the Aboriginal Family Violence Strategy. These programs and related services are generally provided to individuals or a specific subgroup of the population.

In addition, there are a range of government programs and services where benefits accrue to the whole population but where the direct beneficiaries are a small number of people. Tourism marketing is a case in point. Tourism marketing expenditure directly benefits tour operators that receive bookings directly as a result of inclusion in promotional material. Indirect benefits accrue to most members of the community through purchasing by tourists of a wide range of goods and services. Tourism marketing of the Territory often features Aboriginal culture and experience and many tourists, both international and domestic, have direct experiences with and or purchase products from Aboriginal people and or enterprises.

Four methods of allocating Indigenous expenditure were considered in this and the 2004-05 IER:

- equal per capita;
- use of services;
- use and cost of services; and
- modified use and cost of services.

Equal per capita attribution assumes that services are available to, and are used by all Territorians at a similar unit cost. However an equal per capita approach does not take into account differential use rates, cost factors or Indigenous-specific programs.

A use of services approach is a more reasonable basis for attribution as it accounts for differential rates of accessing services by population subgroups. It does not, however, address differentials in the cost of delivering services to particular population subgroups.

Including both use and cost of services is a more robust measure that recognises differential costs in providing services to various population subgroups. Governments also provide a range of services where benefits accrue to the whole community. Examples of such investment include tourism, mining, fisheries and agriculture.

Using a use and cost measure in these circumstances is likely to significantly underestimate the benefits accruing to a range of population subgroups that are not direct beneficiaries of the government investment. Hence a modified use

and cost of services methodology has been adopted, as was the case in the 2004-05 IER. This accounts for programs and services that provide an indirect benefit to the whole community such as industry development or tourism.

Although the underlying methodology applied to estimating Indigenous expenditure is unchanged, improved data and recording methods enabled major service delivery agencies to take a more rigorous approach to the 2006-07 IER than the 2004-05 IER. This has included disaggregation of financial data to lower units (e.g. individual cost centres) and using unit use record rather than collated data (e.g. hospital separations, police activity data). In some cases, different data sources are used and, as such, direct comparisons cannot be made with the earlier review. The Territory Government has committed to preparing regular reports on Indigenous expenditure and further improvements to data collection and analysis are expected.

In order to estimate Indigenous-related expenditure, government agencies have been classified into four categories:

- service agencies that primarily provide services to individuals (such as Department of Health and Community Services (DHCS), Department of Employment, Education and Training (DEET), and Northern Territory Police Fire and Emergency Services (NTPFES));
- service agencies that provide economic-type services (Department of Business, Economic and Regional Development, Department of Primary Industries, Fisheries and Mines, and Tourism NT);
- support agencies that provide services for other government agencies (such as the Department of Corporate and Information Services (DCIS) and NT Fleet); and
- central agencies that provide general whole of government services to government, all agencies and in some cases direct services (such as the Department of the Chief Minister (DCM) and Northern Territory Treasury (NTT)).

Results

Service Agencies – Services to Individuals

Service agencies primarily providing services to individuals accounted for 63 per cent of the Territory's expenditure in 2006-07 and are listed in Table 5. Over two-thirds of this amount was expenditure by the two largest agencies, DHCS and DEET.

For these agencies, Indigenous-related expenditure has been estimated by applying use and cost factors at a program or sub-program level. Where use and cost data was not available, other third-party data sources and/or judgement from operational managers have been applied to determine the Indigenous-related expenditure. Equal per capita apportionment has been used where services are assumed to be available to, and used equally by, all Territorians. Corporate and administrative costs for each agency have been apportioned based on the average expenditure share of all the other program areas of each agency. This assumption reflects that Indigenous persons are a highly significant, and for some agencies a dominant, proportion of service users in the Territory and that mainstream services are specifically designed for the relevant population.

Table 5 shows that for these agencies, the Indigenous-related proportion of expenditure was 56.4 per cent.

Table 5: Estimate of Indigenous-related expenditure for service agencies that primarily provide services to individuals 2006-07

	Agency expenditure	Agency share of NT total expenditure	Indigenous-related expenditure	
	\$M	%	%	\$M
Service agencies – services primarily to individuals	1 950.2	62.8	56.4	1 099.2
Department of Health and Community Services	743.7	23.9	59.9	445.5
Department of Employment, Education and Training	598.7	19.3	46.2	276.7
Department of Local Government, Housing and Sport (including Territory Housing)	247.4	8.0	65.7	162.4
Northern Territory Police, Fire and Emergency Services	192.4	6.2	58.7	112.9
Department of Justice	144.6	4.7	64.0	92.5
Department of the Legislative Assembly	17.7	0.6	30.4	5.4
Aboriginal Areas Protection Authority	2.6	0.1	100.0	2.6
Ombudsman's Office	1.6	0.1	35.0	0.6
Northern Territory Electoral Commission	1.4	0.1	44.4	0.6

Source: Northern Territory Treasury.

Measuring Indigenous-related Expenditure

There is no accepted method for accounting for expenditure that is Indigenous-related. Accounting of this nature is complex and requires the exercise of judgement. Classification of Indigenous-specific programs and services where direct use by Indigenous persons can be measured is relatively uncontroversial. While cost differentials between population groups are difficult to estimate and are likely to vary significantly by location and between functional areas, these are generally acknowledged and are a key component of the assessment of state revenue share relativities by the Commonwealth Grants Commission.

However there are state expenditures that do not directly provide a service to the public, for example central agencies or support agencies, or are of an administrative or corporate nature, essential to the delivery of direct services. There are also expenditures that do not have a readily identifiable service population or where there may be little or no direct interaction with individuals but where benefits accrue to the whole population. The Indigenous-related proportion of these expenses is more problematic to identify.

The underlying methodology of the IER requires the allocation of every dollar of expenditure to either a non-Indigenous person or an Indigenous person. This requires specific allocation of expenditure, over and above that related to Indigenous-specific programs or direct use of services, to be made.

For the types of expenditure where a 'use and cost' measure is not applicable, the underlying purpose of the program or expenditure is the basis of the attribution.

Where population groups are significant, such as the Indigenous proportion of the Territory's population, a 'purpose of program' methodology is likely to be more robust than if applied to population minorities, for example, Indigenous persons in New South Wales. Examples of such programs include road safety, certain health prevention measures, invasive pest control and tourism.

Administrative functions, and the roles of support and central agencies can be regarded as back office functions that support the delivery of direct services by service agencies. On this basis, the expenditure is based on the average proportions of expenditure applying to the direct service elements. The actual structure of agencies constituting the administrative functions, support and central agencies is, to some extent, artificial as these structures could be contained within a shared service environment, internally within agencies or a hybrid approach.

By purpose of program, agencies providing economic-type services seek to benefit the population or population of a particular region more generally through promotion of economic growth. While there may be direct beneficiaries of certain investment, for example a pastoralist receiving drought assistance or a mango farmer receiving a small business grant, the whole population benefits through impacts such as employment, increased production and better quality product. Hence attribution of Indigenous expenditure based on a per capita distribution of the target population subgroup is consistent with program purpose.

Services Agencies – Economic-type Services

These agencies account for 17.4 per cent of Territory expenditure, with more than half this amount (9.7 per cent) contributed by Department of Planning and Infrastructure (DPI), primarily as a result of roads expenditure.

For these agencies, equal per capita apportionment of expenditure has generally been applied except for specific programs targeting Indigenous people. As discussed above, this approach has been adopted to reflect the broader economic benefits that accrue from government investment.

For roads expenditure, the location of users has also been used to attribute expenditure. This approach is required for consistency with the attribution of revenue to the Indigenous population on the basis of the Commission's assessment of the Territory's dispersion expense disability.

Table 6 shows that for these agencies, the Indigenous-related proportion of expenditure was 43.2 per cent.

Table 6: Estimate of Indigenous-related expenditure for service agencies that primarily provide economic-type services 2006-07

	Agency expenditure	Agency share of NT total expenditure	Indigenous-related expenditure	
	\$M	%	%	\$M
Service agencies – economic-type services	541.5	17.4	43.2	234.1
Department of Planning and Infrastructure (including Construction Division)	301.8	9.7	49.3	148.6
Department of Natural Resources, Environment and the Arts	110.8	3.2	35.3	39.2
Department of Primary Industry, Fisheries and Mines	61.0	2.0	35.5	21.7
Tourism NT	32.3	1.0	32.4	10.5
Department of Business, Economic and Regional Development	21.0	0.7	46.0	9.7
Territory Discoveries	6.7	0.2	30.4	2.0
NT Build	6.3	0.2	30.4	1.9
Land Development Corporation	1.6	0.1	30.4	0.5

Source: Northern Territory Treasury.

Sensitivity Analysis

There are a range of services provided by Government where use and cost by individuals can not be easily attributed to population subgroups. These services include tourism, land development and economic development.

This report has attributed these expenses to the Indigenous population based on the overarching program purpose, which is to benefit the total population or population of a particular region. This assumption has been made to provide consistency with the base assumption that GST revenue is distributed on an equal per capita basis prior to adjusting for disabilities.

However, given that many individuals are not directly affected by these services, an alternative approach could be to exclude attribution of this expenditure.

Using this approach, no Indigenous-related expenditure would be attributed to Tourism NT, the Department of Business, Economic and Regional Development, Territory Discoveries, NT Build and Land Development Corporation.

The effect of this approach would be to reduce the estimate of Indigenous-related expenditure by 0.8 percentage points to 51.6 per cent.

If these agencies were removed altogether, the Indigenous-related proportion of expenditure would increase to 52.7 per cent. Revenue should also be reduced by the amount of expenditure of these agencies. If the equivalent amount of revenue was attributed on an equal per capita basis, this would have the impact of increasing the Indigenous-related proportion of revenue to 44.7 per cent.

Support Agencies

Support agencies comprise 4.6 per cent of the Territory's budget, the most significant support agency being DCIS, which contributes 2.9 per cent.

Indigenous-related expenditure on support agencies has been apportioned in the same way as corporate and administrative costs by adopting the weighted average Indigenous-related expenditure for each service agency.

For example, DCIS provides human resource, payroll and communications services to other agencies. DCIS's expenditure has been allocated to each agency with the Indigenous-related proportion of DCIS expenses weighted according to each agency's contribution to DCIS's total expenditure.

Table 7 shows that the Indigenous-related share of support agency expenditure is 50.9 per cent.

Table 7: Estimate of Indigenous-related expenditure for support agencies 2006-07

	Agency expenditure	Agency share of NT total expenditure	Indigenous-related expenditure	
	\$M	%	%	\$M
Support agencies	142.3	4.6	50.9	72.5
Department of Corporate and Information Services	90.6	2.9	53.2	48.3
NT Fleet	22.9	0.7	50.6	11.6
Data Centre Services	14.5	0.5	50.6	7.3
Office of the Commissioner of Public Employment	5.8	0.2	30.6	1.8
Government Printing Office	5.3	0.2	48.0	2.6
Auditor-General's Office	3.1	0.1	30.4	1.0

Source: Northern Territory Treasury.

Central Agencies

Central agencies contribute 15.2 per cent of the Territory's expenditure with the Central Holding Authority accounting for 10.4 per cent.

The role of central agencies is threefold, acting like support agencies in providing services to other agencies, providing services directly to government (and indirectly to the general population) and as service providers in their own right. For support services provided to service agencies, the average expenditure related to the Indigenous population of all service agencies has been applied. For services provided directly to government, equal per capita apportionment has been used. Where services are provided to the general population or a specific group of the population, usage rates or appropriate population shares based on ABS data have been applied.

Table 8 shows the proportion of Indigenous-related expenditure for central agencies is 46.9 per cent.

Table 8: Estimate of Indigenous-related expenditure for central agencies 2006-07

	Agency expenditure	Agency share of NT total expenditure	Indigenous-related expenditure	
	\$M	%	%	\$M
Central agencies	473.2	15.2	46.9	221.7
Central Holding Authority	323.0	10.4	53.5	172.9
Northern Territory Treasury	93.2	3.0	30.3	28.2
Department of the Chief Minister	56.9	1.8	36.3	20.6

Source: Northern Territory Treasury.

Estimate of Indigenous-related Expenditure

Table 9 summarises the proportion of expenditure related to the Indigenous population by agency, by category of service, support and central agencies. The total Indigenous-related expenditure includes both direct and indirect expenditure. Indigenous-related expenditure is estimated at 52.4 per cent of the Territory's total expenditure. For all service agencies, the Indigenous-related proportion of expenditure is 53.5 per cent and, for service agencies primarily providing human services to individuals, the proportion increases to 56.4 per cent.

Table 9: Estimate of Northern Territory expenditure related to the Indigenous population 2006-07

	Agency expenditure	Agency share of NT total expenditure	Indigenous-related expenditure	
	\$M	%	%	\$M
Service agency – human services	1 950.2	62.8	56.4	1 099.2
Service agency – economic services	541.5	17.4	43.2	234.1
Support agency	142.3	4.6	50.9	72.5
Central agency	473.2	15.2	46.9	221.7
Total	3 107.2	100.0	52.4	1 627.5

Source: Northern Territory Treasury.

Commonwealth Grants Commission Assessed and Actual Expenditure

There are a number of common misconceptions about data published by the Commonwealth Grants Commission and how this relates to individual jurisdictions' spending on functional areas or spending that is related to Indigenous people.

The purpose of the Commission's assessment is to recommend to the Commonwealth Treasurer distribution of GST revenue between states such that each can provide an 'average' level of service to its citizens after assessment of states' relative fiscal capacities.

GST revenue is provided to states as untied revenue. This means that each state is able to determine how this revenue is expended. The Commission's assessment is not intended to compare state policies and expenditure or to evaluate the efficacy of state policies.

The Commission publishes information on assessed and actual expenditure by functional area and this is often misinterpreted as an expenditure benchmark.

The 'Actual' expenditure reported by the Commission is an estimate of the amount that each state spends on particular functions. The Commission's assessments are based on ABS Government Finance Statistics (GFS) data over the preceding five years (i.e. the Commission's 2006 Update uses data from 2000-01 to 2004-05). Thus the data does not necessarily represent current government expenditure patterns.

There are significant difficulties obtaining GFS data at the detailed level required by the Commission, particularly where programs have significant overlap with other functions. For example, police expenditure on child protection in the Territory is captured in the police category rather than the family and children's services category. Expenses related to depreciation, debt and superannuation are allocated to general public services

and not to the functional area to which the expenses apply. Costs for a health clinic in a remote community would be captured in a health assessment rather than categorised in services to Indigenous communities.

Due to the difficulties in categorising expenditure, GFS data is divergent between states as states do not classify expenditure in the same way. This means that similar expenditure may be reported in different categories between states. Analysis of individual categories is therefore misleading. All governments and the Commission have recognised that using data at this level of disaggregation and in this way is not as robust as required and hence the Commission's next Review of Relativities in 2010 will rely on far less disaggregated data and will be based on greater simplicity and transparency.

Importantly the Commission does not estimate or report on Indigenous expenditure by states.

'Assessed' expenditure is the Commission's estimate of what states would need to spend on each function in order to provide an 'average' level of service based on the 'average' policies of all states, after taking into account the particular characteristics of each state including its demography, geography and needs such as health and education. 'Average' policies or costs are unlikely to apply to any particular state and this is especially so for the Territory, which has circumstances markedly different to other states. To use the Commission's assessed expenditures as benchmarks would imply that all state policies and priorities are the same.

The detailed calculations used by the Commission are specific to the equalisation model to which they contribute and it is inappropriate to use the Commission's 'actual' or 'assessed' expenditure as benchmarks.

Part B: Revenue

The Territory has three main types of revenue:

- GST revenue;
- tied grants (including specific purpose payments (SPPs); and
- own-source revenue comprising Territory taxes, interest and other income.

GST Revenue

GST revenue accounts for over 62 per cent of the Northern Territory's budget. The distribution of GST revenue among states is determined by the Commonwealth Treasurer, taking into account recommendations of state revenue-sharing relativities as assessed by the Commission.

The principle underpinning the Commission's recommendations of relativities is horizontal fiscal equalisation, which is defined as:

State governments should receive funding from the pool of goods and services tax revenue and health care grants such that, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the capacity to provide services at the same standard.

The relativities are based on assessments of per capita revenue and expenditure needs for each state. The term 'need' is used to describe the financial effect on each jurisdiction of:

- unavoidable influences on revenue-raising capacities (revenue needs);
- unavoidable influences on the use or cost of providing services (expenditure needs); and
- its per capita level of SPPs in relation to the national average (SPP needs).

In 2006-07, the Territory's relativity was 4.32755, reflecting the higher costs and greater expenditure requirements of the Territory population, combined with a lower relative capacity to raise own-source revenue compared to the average of state jurisdictions. The Territory receives a higher than per capita level of SPP funding from the Commonwealth and this offsets its GST share. The Territory's needs-based share of the \$39.6 billion GST pool in 2006-07 was \$2.0 billion.

The Northern Territory's overall disability is around 2.5. This means that, after taking into account revenue and expenditure differences, it costs 2.5 times more to deliver standard services in the Territory. The additional capacity to provide standard services is limited to the GST pool, which represents about 55 per cent of state revenue. Thus, the Territory needs over four times per capita more from the GST pool to meet its overall disability factor of 2.5.

The Commission assesses the additional amount in excess of a per capita allowance that is required to provide services in the Territory. Table 10 shows the contribution of various categories, called expense 'disabilities' by the Commission, to the Territory's above equal per capita share of GST based on the 2005-06 GST revenue and health care grants pool. The Commission identified \$706 million of redistribution as being wholly Indigenous-related (Indigenous influences, native title and land rights disabilities). A further \$288 million can be identified as Indigenous-related based on other disability factors and an assessment of the relevant Indigenous population to which the disability applies.

Table 10: Influences on GST revenue redistribution

	Redistribution amount	Indigenous-related share	Comment
	\$M	%	\$M
Indigenous influences	691.2	100.0	691.2
Native title and land rights	14.9	100.0	14.9
Other socio-demographic influences	79.5	41.1	32.7
Administrative scale	194.5	32.1	62.5
Service delivery scale	68.4	79.9	54.7
Population dispersion	331.6	53.4	177.1
Urban influences	-32.8	53.4	-17.5
Input costs	251.1	30.4	76.3
Economic environment	49.4	30.4	15.0
Physical environment	70.9	30.4	21.6
Other factors	-204.0	65.7	-133.9
Total	1 514.7	65.7	994.5

Source: Northern Territory Treasury, Commonwealth Grants Commission (2006 Update), Australian Bureau of Statistics.

The Commission also takes into account the distribution of SPPs in estimating the financial capacity required to achieve fiscal equalisation. If a state receives a higher level of SPPs, it will result in less GST and vice versa. In 2006-07, the Northern Territory was assessed as receiving \$84 million more than its share of Indigenous-related SPPs. This amount is offset against the Commission's assessed Indigenous needs shown above in Table 10. This effect is shown in Table 11.

Table 11: Indigenous-specific GST funding 2006-07

	\$M
Total disabilities	1 514.7
Indigenous-specific GST funding	994.5
Less indirect effects of Indigenous-specific SPPs	84.1
Net Indigenous-specific GST funding	910.4

Source: Northern Territory Treasury, Commonwealth Grants Commission (2006 Update).

The Commission's published expense disabilities are based on estimates of the preceding year's GST revenue and health care grants pool, that is 2005-06. To provide a more contemporaneous assessment of Indigenous-related revenue, the Commission's assessment of expense disabilities and Indigenous-specific SPPs has been applied to the 2006-07 pool. This is a variation in the methodology from the 2004-05 IER. Table 12 sets out the calculation.

Table 12: Adjusted Indigenous-specific GST funding 2006-07

Net Indigenous-specific GST funding from Table 11 (\$M)	910.4
NT equalisation distribution of the estimated 2005-06 GST revenue and health care grants pool (a) (\$M)	1 921.0
NT actual 2006-07 GST revenue and health care grants (b) (\$M)	2 108.8
Growth factor (b/a-1) (%)	9.77
Adjusted net Indigenous-specific GST funding (\$M)	999.4

Source: Northern Territory Treasury.

The remaining GST revenue has been allocated to the Indigenous population on an equal per capita basis, as shown in Table 13.

Table 13: Indigenous-related GST funding 2006-07

	\$M
Remainder of GST revenue	352.5
Indigenous equal per capita share of remainder	107.2
Plus net Indigenous-specific funding from Table 12	999.4
Indigenous share of GST revenue based on 2006-07 GST and health care grants pool	1 106.5

Source: Northern Territory Treasury.

As noted above, the Indigenous-related GST revenue share in the 2004-05 IER was determined by applying the expenditure disabilities identified by the Commission and applying them without adjustment to the expected 2004-05 distribution of GST revenue. The 2006-07 IER modifies this methodology to scale the factors upwards to reflect actual GST revenue received in 2006-07. This results in a higher share of revenue being classified as Indigenous-related. The impact of adopting the revised methodology is to increase Indigenous-related revenue by 1.3 percentage points in 2006-07 and 1.6 percentage points in 2004-05.

Tied Grants

Tied grants make up about 15 per cent of the Territory's budget and comprise mainly SPP grants from the Commonwealth that must be acquitted against a specific program or function.

SPPs reflect Commonwealth policy priorities and negotiated agreements between the Commonwealth and the Northern Territory. The method of distribution of SPPs among the states varies between grants.

There are two financial impacts relating to SPPs and other tied grants. The first impact is the direct amount received by the Territory in tied grants. In 2006-07, tied grants of \$495 million were received by the Territory. Of this amount, \$53.4 million was directed as either Indigenous-specific grants or to remote and very remote areas (where the population is predominantly Indigenous). Indigenous-specific grants (Aboriginal Rental Housing Program and Indigenous Education Strategic Initiatives Program) have been wholly attributed to the Indigenous population, while those grants directed to remote and very remote areas have been attributed according to the Indigenous proportion of the population living in the relevant areas. Non-Indigenous-specific tied grants have been distributed on an equal per capita basis. This results in an Indigenous-related share of tied grants of 37.7 per cent or \$192 million. Table 14 outlines the calculations.

Table 14: Indigenous and non-Indigenous SPPs 2006-07

	\$M
Total tied grants	494.9
Indigenous-specific SPPs	47.4
Remote/very remote area SPPs (79.9% attribution of \$6.0M)	4.8
Total Indigenous-specific/remote SPPs (a)	52.2
Remaining tied grants	441.4
Equal per capita of remaining tied grants (b)	134.2
Total Indigenous tied grant revenue (a+b)	186.4

Source: Northern Territory Treasury, Commonwealth Government.

Own-source Revenue

Own-source revenue makes up 22 per cent of the Territory's budget and comprises Territory taxes, interest received and sales of goods and services. For Territory taxes, the proportion of revenue contributed by the Indigenous population has been calculated using proxies as shown in Table 15. Other own-source revenue has been treated on an equal per capita basis.

Table 15: Estimated proportion of own-source taxes contributed by the Indigenous population 2006-07

	Revenue	Indigenous-related share	Proxy
	\$M	%	\$M
Payroll tax	124.3	7.0	8.7
			Indigenous employment share less Community Development Employment Projects (CDEP)
Stamp duty on conveyances	106.8	7.4	7.9
			Proportion of Indigenous persons aged 18 years or older living in homes where a resident owned, or was purchasing, the home
Gambling taxes	64.5	14.6	9.4
			Proportion of Indigenous persons living in main urban centres
Stamp duty on insurance	23.1	14.6	3.4
			Proportion of Indigenous persons living in main urban centres
Stamp duty on motor vehicle registrations and transfers	19.8	12.0	2.4
			Proportion of Indigenous households with one or more vehicles
Light vehicle registration fees and taxes	11.8	12.0	1.4
			Proportion of Indigenous households with one or more vehicles
Heavy vehicle registration fees and taxes	10.3	12.0	1.2
			Proportion of Indigenous households with one or more vehicles
Hiring duty	5.0	14.6	0.7
			Proportion of Indigenous persons living in main urban centres
Other	2.4	31.6	0.8
			Equal per capita
Total	368.0	9.7	35.9

Source: Northern Territory Treasury, Australian Bureau of Statistics.

Table 16 shows the overall treatment of own-source revenue.

Table 16: Summary of overall treatment of own-source revenue 2006-07

	Total Revenue		Indigenous-related share	
	%	\$M	\$M	%
Own-source taxes	50.3	368.0	35.9	9.7
Other own-source revenue	49.7	364.0	110.7	30.4
Total	100.0	732.0	146.5	20.0

Source: Northern Territory Treasury.

In this review, the methodology for apportioning own-source revenue was revised to reflect more appropriate proxy indicators, mainly in respect of motor vehicles. Table 17 compares 2004-05 and 2006-07 results using the proxies used in this review. The change in proxy indicators results in a minor reduction in the share of own-source revenue classified as Indigenous-related.

Table 17: Comparison of 2004-05 and 2006-07 methodology for calculating Indigenous-related share of own-source revenue

	2004-05 methodology Indigenous-related share of own-source revenue	2006-07 methodology Indigenous-related share of own-source revenue	Change
	%	%	percentage point
2004-05	19.1	18.6	-0.5
2006-07	20.5	20.0	-0.5

Note: Includes component arising from changes in population share between 2001 and 2006 Census.

Source: Northern Territory Treasury.

Estimate of Indigenous-related Revenue

Table 18 combines the revenue components to total the estimate of Indigenous-related revenue in 2006-07. Indigenous-related revenue is estimated at \$1439.5 million or 44.4 per cent of total revenue.

Table 18: Estimation of Northern Territory revenue related to the Indigenous population 2006-07

	Total Revenue		Indigenous-related share	
	%	\$M	\$M	%
GST revenue	62.2	2 015.3	1 106.5	54.9
Tied grants	15.3	494.9	186.4	37.7
Own-source revenue	22.6	732.0	146.5	20.0
Total	100.0	3 242.2	1 439.5	44.4

Source: Northern Territory Treasury.

Part C: Summary of Results and Comparison Between 2004-05 and 2006-07

Summary of Results

This report provides an estimate of the Indigenous-related expenditure, and revenue received by, the Territory Government in 2006-07. The key results are:

- 52.4 per cent of the Territory's expenditure in 2006-07 was Indigenous-related;
- 44.4 per cent of the Territory's revenue in 2006-07 was Indigenous-related;
- Indigenous-related expenditure exceeds that of revenue by 8.0 per cent or approximately \$248 million; and
- on a per capita basis, spending on Indigenous Territorians is 2.5 times that of non-Indigenous Territorians.

The 2006-07 results show a significant variation in both revenue and expenditure from the published 2004-05 IER. However, as noted above, methodological changes between the reviews mean that the results are not directly comparable and do not reflect key changes in data parameters relating to population. The impact of the 2006 Census estimate of the Indigenous population is discussed below.

Population

The Australian Bureau of Statistics (ABS) released its 2006 Census in June 2007. The proportion of the Northern Territory's population that is Indigenous is estimated at 30.4 per cent compared to 28.8 per cent at the 2001 Census. Other population proxies have also been updated and include urban and remote populations and age distributions.

The 2006-07 IER uses the 2006 Census proportions while the 2004-05 IER used the 2001 Census proportion. As a result, where per capita apportionment of either revenue or expenditure has been used, differences between the 2004-05 IER and the 2006-07 IER are likely to be exaggerated. It is generally agreed that the 2006 Census improved Indigenous population estimation, particularly in rural and remote areas as a result of a remote area post enumeration survey (PES). Thus, Northern Territory Treasury considers that the change in population share reflects both actual population change and an element related to improved enumeration by the ABS in the 2006 Census. The changes impact on both revenue and expenditure.

In order to adjust for these differences, results from the 2004-05 IER have been adjusted to reflect the higher Indigenous population share identified in the 2006 Census. This provides a more appropriate comparison. This has been combined with the methodological changes outlined in Parts A and B to show a like-for-like comparison of expenditure and revenue between 2004-05 and 2006-07.

Summary of Expenditure Incorporating Data and Methodological Revisions

The impact of the population changes on expenditure percentages is relatively minor. This is because the use and cost methodology adopted by agencies factors in actual use of services by the Indigenous population. The most significant impacts occur for those agencies providing whole of population services or where economic benefits accrue to the whole community. These agencies account for a relatively small component of overall Territory Government expenditure.

Updating the 2004-05 IER to reflect the 2006 Census data shows an increase in the proportion of expenditure that is Indigenous related from 49.7 per cent to 50.1 per cent, an increase of 0.4 percentage points.

Comparing the 2006-07 IER with the 2004-05 IER on a like-for-like basis shows a 2.3 percentage point increase in Indigenous-related expenditure. However, due to the increased rigour applied by agencies in the latest review, part of this difference is likely to reflect improved reporting rather than increased levels of expenditure.

Table 19: Impact on Indigenous-related expenditure of methodological and data changes between 2004-05 and 2006-07 Reviews

	2004-05 IER original data Indigenous-related share of revenue	2004-05 IER adjusted for methodology and population changes Indigenous-related share of revenue	2006-07 IER Indigenous-related share of revenue	Change
	%	%	%	percentage point
Service agencies	50.9	51.2	53.5	2.3
Support agencies	46.5	47.1	50.9	3.8
Central agencies	45.6	46.1	46.9	0.8
Total	49.7	50.1	52.4	2.3

Source: Northern Territory Treasury.

Summary of Revenue Incorporating Data and Methodological Revisions

Table 20 shows that after combining methodological changes shown above with the use of the 2006 Census results, Indigenous-related revenue for 2004-05 would need to be revised by 2.7 percentage points to 45.9 per cent to be comparable with the 2006-07 data and methodology.

Based on a comparison with the 2006-07 IER and revised 2004-05 data, the share of Territory revenue that is Indigenous-related has declined from 45.9 per cent in 2004-05 to 44.4 per cent in 2006-07.

The decline shown in the 2006-07 IER reflects both a fall in the share of total revenue contributed by GST and a reduction in the share of GST revenue that is Indigenous-related. The latter component reflects that the proportion of the Commission's equalisation distribution (i.e. that above a per capita distribution) allocated to Indigenous influences, native title and land rights declined from 48.4 per cent to 46.6 per cent. This fall was only partially offset by an increase in the Indigenous-related component of the Commission's dispersion assessment which increased from 21.4 per cent to 21.9 per cent.

Table 20: Impact on Indigenous-related revenue of methodological and data changes between 2004-05 and 2006-07 Reviews

	2004-05 IER original data Indigenous-related share of revenue	2004-05 IER adjusted for methodology and population changes Indigenous-related share of revenue	2006-07 IER Indigenous-related share of revenue	Change
	%	%	%	percentage point
GST revenue	52.7	56.4	54.9	-1.7
Tied grants	36.1	37.6	37.7	0.1
Own-source revenue	19.1	19.5	20.0	0.5
Total	43.2	45.9	44.4	-1.5

Source: Northern Territory Treasury.

Summary

Table 21 shows a summary of key results on a like-for-like basis between the two reviews. The key points arising from this review are:

- Indigenous-related revenue declined by 1.5 percentage points between 2004-05 and 2006-07;
- Indigenous-related expenditure increased by 2.3 percentage points over the same period;
- the percentage point difference between Indigenous-related expenditure and revenue almost doubled between the two reviews increasing from 4.2 to 8.0; and
- the per capita ratio of Indigenous expenditure to non-Indigenous expenditure increased from 2.3 to 2.5.

Table 21: Comparison of results between 2004-05 and 2006-07 Reviews

	Revised 2004-05	2006-07	Change
Indigenous-related revenue (per cent)	45.9	44.4	-1.5
Indigenous-related expenditure (per cent)	50.1	52.4	2.3
Difference (percentage points)	4.2	8.0	3.8
Per capita ratio – Indigenous expenditure: non-Indigenous expenditure	2.3	2.5	0.2

Source: Northern Territory Treasury.

Northern Territory Treasury
38 Cavenagh Street
GPO Box 1974, Darwin NT 0801
Telephone: (08) 8999 7406
Facsimile: (08) 8999 7150
Website: www.nt.gov.au/ntt



Northern Territory Government