

# Northern Territory Submission GST 2025 Method Review

Fiscal Equalisation, supporting principles and assessment  
guidelines

Terms	Full form
CGC	Commonwealth Grants Commission
CGC HFE Paper	Commonwealth Grants Commission's 2025 Methodology Review: Fiscal equalisation, supporting principles and assessment guidelines consultation paper
Closing the Gap	National Agreement on Closing the Gap
HFE	Horizontal Fiscal Equalisation
PC HFE Inquiry	Productivity Commission 2018 Inquiry Report – Horizontal Fiscal Equalisation
NHHA	National Housing and Homelessness Agreement
Review	Corresponding 5-year GST Methodology Review, unless otherwise indicated
State(s)	Includes Territories unless otherwise indicated
Territory	The Northern Territory
ToR	Terms of Reference
Update	Corresponding annual GST Revenue Sharing Relativities Update Report, unless otherwise indicated
WA HFE Paper	Western Australia Occasional Paper – Principles of Horizontal Fiscal Equalisation

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# 1. Territory position on Horizontal Fiscal Equalisation

## 1.1. Overview

The Territory submits that a discussion on HFE is appropriate to recognise that:

- HFE should be considered in the broader federal financial relations framework, including that multiple major funding agreements are scheduled for renegotiation during the 2025 Review period.
- HFE seeks to provide states with capacity to deliver state-average services. It does not provide fiscal capacity to make additional investments to address pre-existing structural disadvantages.
- Consideration should be given to whether the definition of HFE, and GST distribution methods are achieving, or at least not restricting, achievement of outcomes, such as allowing additional investment to address entrenched Indigenous disadvantage.
- As practical difficulties can arise in targeting outcomes, the Territory in-principle supports the current averaging approach, as a useful and practical approach to HFE, subject to recognition that:
  - HFE is limited in its ability to address certain types of pre-existing structural disadvantage between non-average states, and
  - where Commonwealth revenue is provided to a state to address this type of pre-existing structural disadvantage, it may be appropriate to exclude that revenue for GST distribution purposes.

### 1.1.1. Federal Financial Relations and Policy Context

GST is the largest intergovernmental funding source, and HFE is the primary mechanism to equalise fiscal advantages and disadvantages between states to support equitable levels of services for Australians. Federal financial relations are not static, but rather are an evolving landscape, with regular policy changes and all agreements being subject to periodic reviews. In this context, it is appropriate that HFE principles are not applied in isolation, but rather take a holistic view of any relevant changes to the national funding landscape.

The Territory submits that there have been significant changes in intergovernmental funding since the 2020 Review. There are also multiple major upcoming funding agreements scheduled to be renegotiated during the 2025 Review period, including the *National Health Reform Agreement*, *National School Reform Agreement*, and *National Housing and Homelessness Agreement (NHHA)*. Several significant Territory bilateral funding agreements will also commence, or be negotiated, during the period of the 2025 Review, including the successor to the *National Partnership on Remote Aboriginal Investment - Extension*, the *Federation Funding Agreement Schedule for Restoring funding for Northern Territory Homelands*, and the successor to the *National Partnership on Remote Housing Northern Territory*.

These agreements are in addition to recent Commonwealth announcements, that a focus on making progress toward the targets under the *National Agreement on Closing the Gap* (Closing the Gap). Examples include the provision of \$100 million in the 2023-24 Commonwealth Budget to establish an Outcomes Fund to address entrenched community disadvantage, to be co-designed with states and territories during the 2025 Review period, and \$250 million for *A Better, Safe Future for Central Australia*. These measures are in addition to state own-budget expenditure and funding for the non-government sector within these service areas, which may evolve as funding arrangements change.

A common theme in each of the above agreements will be whether existing arrangements are providing adequate funding to meet their objectives. Addressing entrenched generational indigenous disadvantage is a notable policy objective across most funding agreements to the extent it is now recognised as a separate funding category in some agreements.

The Territory submits that it is important to ensure that HFE, as understood and applied in the 2025 Review, does not operate contrary to social policy outcomes. Specifically, consideration should be given to ensure the current definition, and application, of HFE does not offset funding that is meant to address pre-existing structural disadvantage that is not captured in “what states do” and state average policies.

### 1.1.2. What is the scope of Horizontal Fiscal Equalisation, and does it address pre-existing structural disadvantage?

The actual scope and limits of HFE are complex, technical, and not well understood outside of officials in state Treasury departments and the CGC. The Territory observes that the common, but erroneous, belief is that HFE provides all states with fiscal capacity to meet all aspects of disadvantage. This can lead to claims, particularly in the context of other Commonwealth funding agreements, that “needs-based” funding is unnecessary as adequate funding should have been provided through GST arrangements.

These issues were discussed in the *Productivity Commission 2018 Inquiry Report – Horizontal Fiscal Equalisation* (PC HFE Inquiry), as well as past Reviews, and are not new issues. However, it is important to consider the limitations of HFE when considering its interpretation as required within the 2025 Review Terms of Reference (ToR) set by the Commonwealth Treasurer.

The Territory observes that since 2018, a definition of HFE is now provided for in section 16AB(2) of the *Commonwealth Grants Commission Act 1973* (Cth), which requires that:

*“...the Minister is to pursue the objective of ensuring ... that [the states] each have the fiscal capacity to provide services (including associated infrastructure) at a standard that is at least as high as the standard for whichever of New South Wales and Victoria has the higher standard.”*

This definition does not prescribe how the appropriate standard of services for each jurisdiction should be determined, which is ordinarily interpreted by the CGC. In practice, the standard service level has been determined by reference to state average policy, and equalises “what states do”. This essentially seeks to provide states with the ability to provide an average level of expenditure after accounting for relevant differences between each jurisdiction, such as demographics and service delivery costs.

While this definition of HFE results in a substantial level of equalisation (as represented in each jurisdiction’s relativities), the limitation is that it does not seek to make any judgement on whether the average level of expenditure is sufficient to deliver similar outcomes in each jurisdiction. Where a state has lower outcomes, which are not reflected in or able to be addressed through state-average levels of expenditure (i.e. has “pre-existing structural disadvantage”), HFE will not provide that state with additional capacity to address any pre-existing structural disadvantage.

This issue arises in the Territory, which faces higher levels of disadvantage across most assessment categories, most clearly in indigenous outcomes as evidenced under Closing the Gap metrics, but may also arise in other contexts, such as the Territory’s lower baseline infrastructure density and stock levels. The Territory is also a non-dominant state and generally less reflected in “what states do” on average.

This was acknowledged in the PC HFE Inquiry, which noted (at page 277):

*“...in considering proposals for change in [whether indigeneity should be included in HFE], there is a need to disentangle what exactly the inclusion of Indigeneity within HFE does, and does not, attempt to do. It is legitimate that such considerations are included in equalisation – as a way of measuring States’*

*relative fiscal capacities – if they are a significant driver of jurisdictional spending (and they are). But this is only intended to recognise the existing differences States face in providing an average standard of services. It is not designed to allocate GST revenue in a way that would allow States to make additional investments to reduce levels of pre-existing structural disadvantage they face."*

The Territory considers that these statements by the PC HFE Inquiry, and made in past Territory submissions, are not new or controversial and merely seek to explain what is, and is not, achieved by past HFE methods.

While it is open for the CGC to change HFE definitions to provide additional capacity to address pre-existing structural disadvantage, rather than the current system which focusses on equalising to average services, the Territory also recognises that this would be a departure from longstanding past practice, and there are significant, well documented, practical difficulties, including the difficulty in establishing appropriate standards to define disadvantage, the level of subjectivity and judgement required, as well as calculation and data issues.

Accordingly, the Territory is not seeking the CGC to amend its definition of HFE. However, the Territory is seeking recognition of the limitations of the current application of HFE and state pre-existing structural disadvantage that may persist. This is to:

- assist in improving public understanding on what is, and is not, achieved through HFE, and
- clarify GST treatment for Commonwealth payments that are made to a state for pre-existing structural disadvantage that is outside state-average policy.

### 1.1.3. What are the implications for Commonwealth payments?

The usual GST distribution Terms of Reference provide that Commonwealth funding is to be taken into account in determining HFE arrangements. This is well-established and appropriate where Commonwealth funding is for an aspect of average state services that is within-scope for HFE, as Commonwealth revenue is an additional source of funding for that state service. This treatment should remain the default position for most Commonwealth payments.

However, this default position is less appropriate where Commonwealth funding is provided to address areas of pre-existing structural disadvantage, and particularly for indigenous disadvantage. Issues arise because not all elements of pre-existing disadvantage are addressed through HFE, and because of mixed responsibility lines, with some elements of disadvantage being a state responsibility, and others a Commonwealth responsibility. This was observed in the PC HFE Inquiry, which noted on the topic of "Confused accountability for addressing Indigenous disadvantage" (at page 278)

*"...A major part of the problem clearly relates to how funding is allocated, and to roles, responsibilities and accountability. These problems beset both funding received via HFE and the interaction with SPPs aimed at assisting Indigenous communities. Currently, there is no general rule for how Indigenous-related Commonwealth payments are treated within HFE. Some payments have an impact on relativities, whereas others do not. For instance, 'Stronger futures in the Northern Territory - Housing', a National Partnership Payment, does not have an impact on relativities (as required by CGC terms of reference), whereas early childhood education National Partnership Payments focused on Indigenous children do have an impact on relativities. As things stand, there is a mixture of impact, no impact, and some discounted impacts.*

*Providing clearer lines of responsibility for service delivery, funding and policy frameworks, as discussed further below, would help to improve outcomes over time. Greater coordination of responsibilities at each level of government may also avoid duplication and overlap, and clarify where the buck stops in terms of funding, service delivery and policy effectiveness..."*

The Territory notes that since the PC HFE Inquiry and the 2020 Review, there have been several new, extended, and upcoming Commonwealth agreements for indigenous disadvantage. This includes the

successor to the *National Partnership on Remote Aboriginal Investment Extension*, the *Federation Funding Agreement Schedule for Restoring funding for Northern Territory Homelands*, and the successor(s) to the *National Partnership on Remote Housing Northern Territory*. Other potentially relevant future agreements may also include the Commonwealth Budget announced “Outcomes Fund” as part of its development of a Framework to Address Community Disadvantage, and measures such as the *A Better, Safe Future for Central Australia*.

While these agreements have traditionally been the subject of Terms of Reference determinations to clarify their treatment, the current CGC framework for treating Commonwealth payments may also warrant further consideration. Potential refinements may include expressly allowing exclusions of Commonwealth revenue for GST purposes where that funding is provided to states to address pre-existing structural disadvantage that is unmet through state-average services. Changes may also involve more nuanced treatments, such as partial exclusions for specific portions of agreements (rather than for whole agreements) where the Commonwealth adopts a mixed role in funding average services and addressing pre-existing structural disadvantage.

Consideration of these changes are warranted due to the potential for GST distributions to offset Commonwealth funding through HFE calculations, and unintentionally entrench disadvantage by removing that capacity to provide needed additional investment. This arises because the current GST HFE methods seek to equalise fiscal capacity to deliver average services while in contrast, tied agreements are generally evaluated against specific outcomes, as set out in the relevant agreement. The difference between the GST equalisation methods and the tied payment objectives can be significant if a non-standard state has pre-existing structural disadvantage which is intended to be addressed through Commonwealth funding.

These issues are pertinent and will arise during the 2025 Review year due to the review of national agreements, commencement of new agreements, and renegotiation of existing arrangements.

The National Housing and Homelessness Agreement (NHHA) is a useful example. NHHA funding is currently provided to states on an equal-per-capita basis. The Productivity Commission’s 2022 *“In need of repair: The National Housing and Homelessness Agreement Review”* Study Report however found (at 6.1) that *“the NHHA has not improved homelessness outcomes”* and *“homelessness funding is not allocated to jurisdictions based on need”* and made several recommendations, including (at 6.3) *“... In the next Agreement, the Australian, State and Territory Governments should commit to a study into the unmet need for homelessness support and a stocktake of current services, to determine the level of funding required to adequately meet the needs of people experiencing or at risk of homelessness.”*

Given the practical limitations of HFE methods, and as homelessness rates differ significantly between jurisdictions with unequal levels of pre-existing structural disadvantage, there is potential for divergent assessments and offsetting funding outcomes. The Territory considers that, in this context, it is important to ensure, where possible, that GST distributions and HFE objectives and methods are not acting in conflict.

As many Commonwealth agreements will remain under negotiation during the 2025 Review, it may not be possible to consider the impacts of any specific funding changes in the 2025 Review. However the Territory submits that, at a minimum, HFE principles and the CGC’s methods must ensure that GST does not act to prevent the additional investment required to address pre-existing structural disadvantage for non-average states, particularly for entrenched indigenous disadvantage, through inappropriate equalisation.

In doing so, the Territory also submits that past observations on the unclear treatment of funding for indigenous services remains a valid concern and was not resolved in the 2020 Review.

The Territory considers that further submissions on this topic may be made when Commonwealth funding agreements are specifically considered as part of the 2025 Review work plan “Tranche 1” papers.

## 2. Territory response to CGC consultation questions

### 2.1. Introduction

The Territory's submissions in this section respond to the specific consultation questions raised by the CGC in its *2025 Methodology Review: Fiscal equalisation, supporting principles and assessments guidelines consultation paper* (CGC HFE Paper).

These submissions are in the context of the Territory's position on HFE, as set out above, which are the Territory's primary position. Submissions are provided in the order of the CGC HFE Paper.

### 2.2. Horizontal Fiscal Equalisation

*Q1 Does the approach to horizontal fiscal equalisation articulated in the 2020 Review remain the appropriate first step in determining GST distribution in accordance with the GST distribution legislation?*

Subject to the above discussion on the limits of HFE, the changing Commonwealth funding landscape, and ensuring HFE does not prevent additional investment to address pre-existing structural disadvantage, the Territory supports past interpretations.

### 2.3. Supporting Principles

#### 2.3.1. Introduction

The Territory continues to broadly support the existing principles, including that there is no hierarchy of principles, to allow flexibility in evaluating appropriate GST distribution methods to respond to the circumstances of each assessment category on a case-by-case basis. The Territory agrees with the CGC's view in the CGC HFE Paper (at 15) that the primary consideration must always be achieving HFE. Accordingly, regardless of any supporting principles, an assessment method must firstly remain consistent with the objective of HFE, with the principles applying as a secondary consideration.

#### 2.3.2. 'What states do'

*Q1 Does the 'what states do' principle, with assessments based on the weighted average policy of all states, remain appropriate?*

The 'what states do' principle measures average services, revenues and expenditures on a collective basis so will not always be able to assess aspects of pre-existing structural disadvantage in a non-standard state.

The Territory considers that, on practicality grounds, a measurement of average services is however likely to remain the appropriate method of achieving HFE, though improvements to how averages are measured should be considered as part of the 2025 Review. Subject to the CGC's views on the limits of HFE and the treatment of Commonwealth payments, the Territory supports a continuation of 'what states do', including a preference for 'internal standards' rather than 'external standards'.

While in some cases it may be necessary to depart from 'what states do' for practicality reasons, the Territory considers that state averaging remains the appropriate starting point for most assessment categories, and its continuation is supported.



### 2.3.3. Policy neutrality

Q3 Does the policy neutrality principle remain appropriate, recognising there are particular circumstances where further consideration should be given to policy neutrality, such as dominant state issues and some instances of state tax reform?

The Territory supports the continuation of policy neutrality as a principle. Policy neutrality is important to ensure state decisions are driven by policy considerations, rather than the impact on GST funding, as well as to preserve the integrity of HFE in equalising services between jurisdictions. The Territory submits however that any discussion on policy neutrality must be cognisant that policy neutrality is secondary to the objective of HFE, and the assessments must continue to adequately recognise state differences in fiscal capacity.

The Territory notes that submissions on policy neutrality are highly likely to occur in the mining assessment. Specific consideration of those issues is better considered in the context of that category as Western Australia's position as a dominant state is not broadly applicable to other assessment categories. Further discussion on policy neutrality are generally better addressed on a case-by-case basis having regard to specific topics as the considerations differ significantly between assessment categories.

Submissions on policy neutrality are also likely to be relevant to 2025 Review ToR item 6, which directs the CGC to *"...consider if there is a case for [the CGC] to be given the flexibility to consider alternative methods in cases where there is a significant unanticipated shock (such as a pandemic) or where major policy reforms are enacted in between reviews."* It is understood a specific discussion paper on this topic will be prepared for consultation at a later date and the Territory reserves its position. However, the Territory notes that additional policy neutrality issues may arise, such as how to evaluate whether a policy is "major", whether a policy is sufficiently urgent to warrant consideration outside review cycles, and to ensure that any such evaluation does not incentivise states to develop policies in a particular manner, such as favouring major policies over minor ones.

The Territory also observes that many of the policy neutrality issues, such as those in the mining and stamp duty assessments, and arguments on the impacts on state tax reform agendas, are well-understood and frequently discussed. As policy issues often persist over time, and as states will always have opportunity to engage in policy reforms, some consideration may also be warranted on how to determine whether a known policy neutrality issue continues to be relevant, or whether such an issue should be 'closed out'.

### 2.3.4. Practicality

Q4 Does the practicality principle remain appropriate for ensuring assessment methods are simple, reliable and fit for purpose?

The Territory broadly supports the practicality principle, which is a necessary part of ensuring GST distribution methods are workable, simple, achievable and robust.

The Territory notes that several 'fit for purpose' issues became relevant following the 2020 Review due to the COVID-19 pandemic. The Territory reiterates its previous reservations on the CGC's interpretation of 'fit for purpose' in this context, and in particular, that caution should be adopted to ensure 'fit for purpose' tests continue to be used only for genuine data issues, and that practicality principles are not expanded to allow arbitrary adjustments in response to actual structural or behavioural changes (even if those changes are temporary).

Notwithstanding these concerns, the Territory does not seek an amendment to the practicality principle at this time, as 'fit for purpose' must remain a flexible concept to allow case-by-case responses to a variety of data issues. The Territory also recognises that COVID-19 pandemic issues may have been temporary rather than persisting to the extent of warranting a change in principles, though issues around the suitability of 2021 Census data may continue.

The issues on how sudden data shocks are dealt without outside review periods may also be more appropriately addressed through submissions in the discussion on 2025 Review ToR item 6.

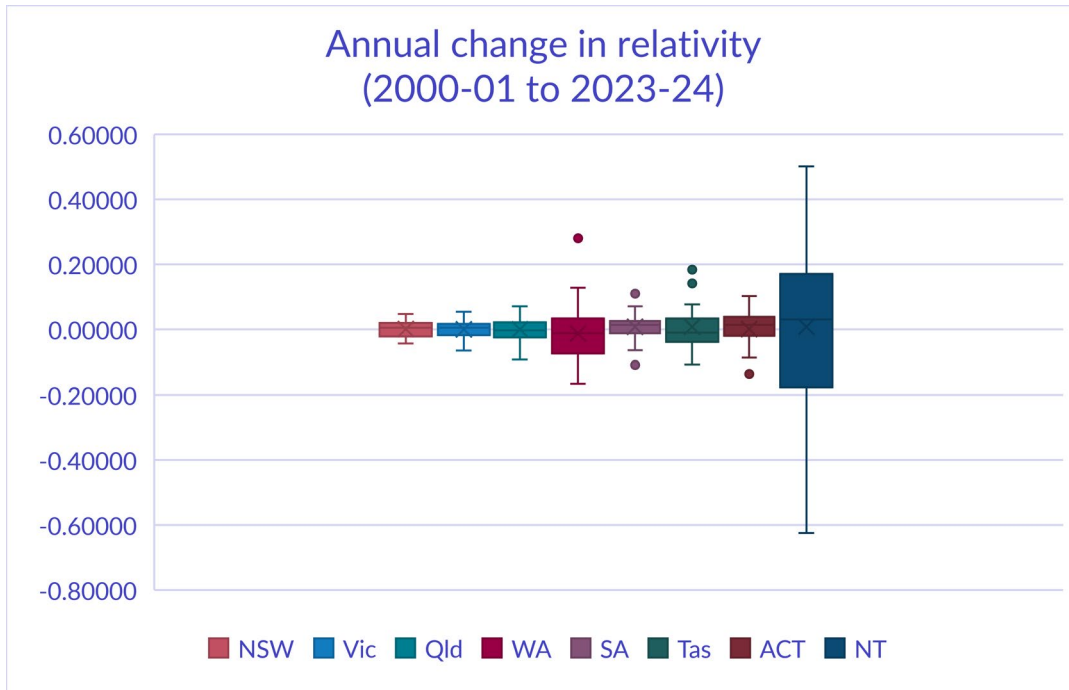
### 2.3.5. Contemporaneity

Q5 Does the 3-year lagged average approach continue to provide the best balance between contemporaneity, predictability and stability in measuring states' fiscal capacities?

The Territory supports a continuation of 3-year lagged averaging, and does not support a shorter or longer period, or the use of forecasts.

The Territory considers that relative volatility is a key concern due to the substantial impact annual variances have on the Territory's ability to provide continuity of services and prepare budgets annually. Territory revenue volatility over time is far greater than in any other jurisdiction. Chart 1 illustrates the range of year-on-year change in each jurisdiction's relative over time. As shown, the annual change in the Territory's relative varies to a far greater extent than any other jurisdiction, with volatility so large that the middle 50% of the Territory's relative volatility is greater than the total variance in most other jurisdictions.

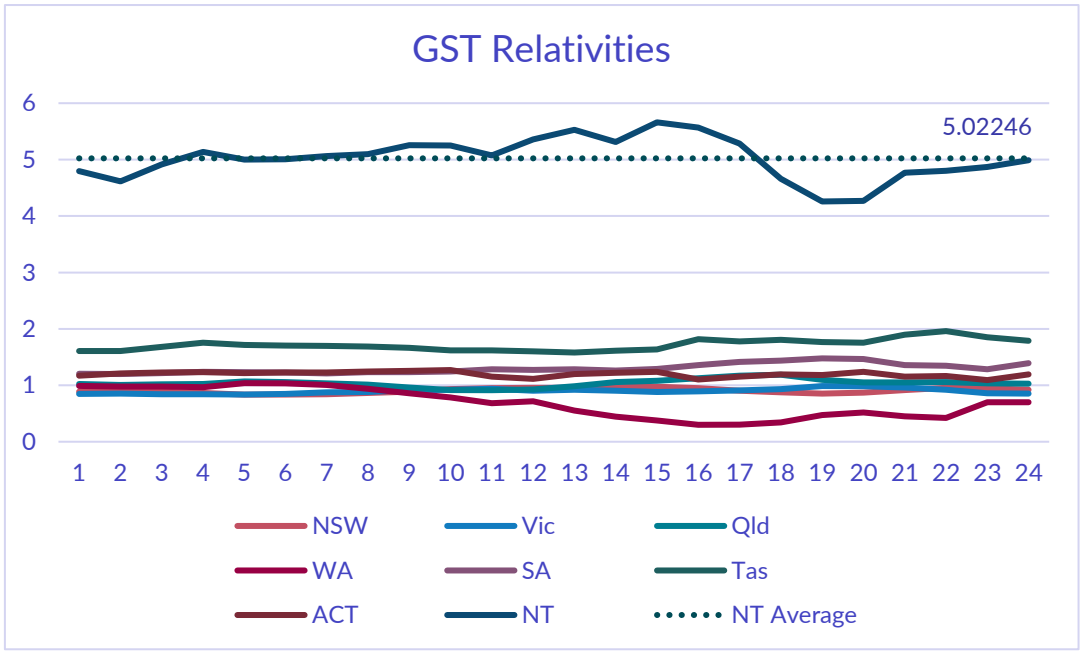
Chart 1 Annual change in relative (2000-01 to 2023-24)



Boxed area represents the range containing 50% of revenue volatility, with whiskers representing total range excluding outliers (dots). Relativities as reported in supporting table S8-2 to the 2023 Update and includes the impact of 2018 legislative changes.

Despite this substantial relative volatility, there has been little long-term structural change in the Territory's economy. Chart 2 illustrates that while there are large annual variances in the Territory's relative, the long-term average has been around 5 since the GST was first introduced.

Chart 2 – GST relativities over time



Source: 2023 Update.

The Territory's relativity stability issues are quite distinct from the drivers of change in most other jurisdictions. In recent years, there has been substantial commentary on the changes in Western Australia's relativity, which has been referred to as volatility. However, Western Australia's change is explained by structural change in its economy, due to large increases in its mineral production capacity. Similarly, volatility in Queensland and New South Wales with coal and stamp duty revenues reflect structural step-changes in those states' fiscal capacity. In contrast, there are far fewer clear reasons why the Territory's relativity has varied to such a significant extent over time, and in unpredictable patterns. Changes in the Territory's relativity are instead often magnified by a combination of minor data issues, and the absence of a major city or inner regional area which acts as a source of fiscal stability in other states.

The impact to the Territory budget from this relativity instability is far greater than any other jurisdiction, due to both the Territory's larger annual changes, and its smaller own-source revenue base to draw from. Table 1 illustrates the average change in each jurisdiction's relativity over time compared against that jurisdiction's assessed payroll tax base. Payroll tax is selected for illustration purposes, as it is one of the most stable and comparable own-source revenue bases.

Table 1 – Relativity volatility compared to assessed payroll tax capacity

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT
Relativity Volatility as % of Assessed Payroll Tax Capacity <sup>1</sup>	6%	6%	11%	15%	13%	23%	16%	61%

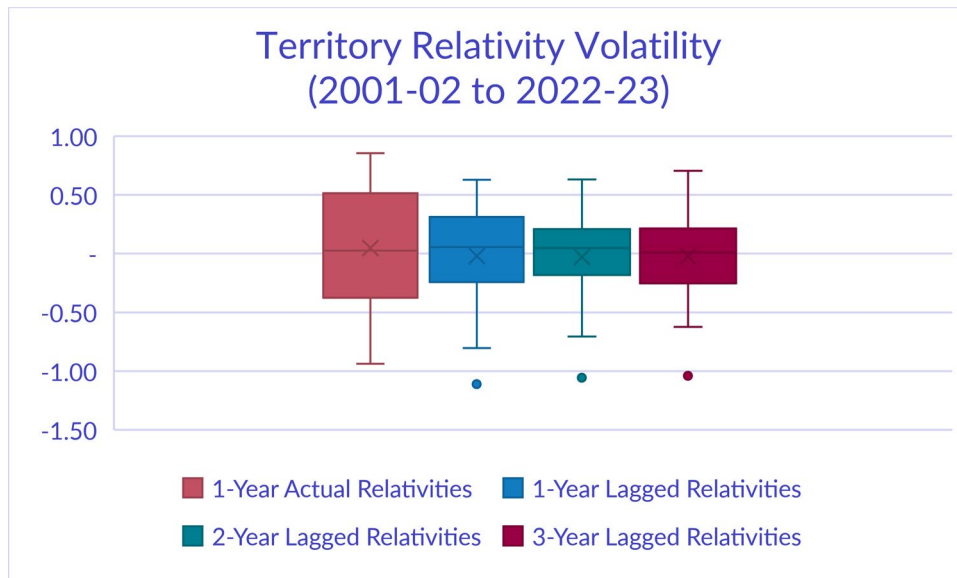
<sup>1</sup> Department of Treasury and Finance calculations based on 2023 Update data.

The above table illustrates that Territory's average relativity instability is equivalent to more than 60% of its assessed payroll tax base, compared with 6% to 23% in other states.

In this context, the Territory does not support any changes to the contemporaneity principle which could increase its relativity volatility. This would have severe detrimental impacts to the Territory's ability to prepare annual budgets, and provide consistent services. These negative impacts would be far more detrimental to the Territory than any potential gains in other jurisdictions.

Chart 3 illustrates that Territory relativity volatility under a 1-year assessment period, either as assessed or lagged, would increase Territory revenue volatility, potentially significantly. A 2-year assessment period appears to result in a slight decrease in volatility, however not substantially enough to warrant a change to current methods.

Chart 3 – Territory relativity volatility under different assessment periods (2001-02 to 2022-23)



Source: CGC calculations, excludes change from 2000-01 to 2001-02 as an outlier. Relativities differ from Chart 1 due to different calculation and presentation methods.

The Territory likewise does not support a longer assessment period. A longer period presents difficulties as GST distributions may no longer reflect contemporary state circumstances, and the 'drivers of change' would become increasingly opaque and less relevant due to the widened gap between the assessed year rolling in and the lagged year rolling out.

The Territory may make further submissions on its relativity volatility throughout the 2025 Review.

### 2.3.6. Preliminary view on supporting principles

Q6 Do states agree there is no need to introduce any new principles?

The Territory agrees that existing supporting principles largely remain appropriate and should continue without additional principles. The Territory notes the discussion in the March 2023 *Western Australia Occasional Paper – Principles of Horizontal Fiscal Equalisation* (WA HFE Paper), which proposes a number of matters including "policy consistency" and "conservatism". The Territory provides its submissions on these aspects of the WA HFE Paper without further commenting on the other discussions in that paper.

The Territory does not support a "policy consistency" principle, and agrees with the CGC's views that this would be unlikely to be workable in practice.

The Territory does not support any version of a "conservatism" concept, which the WA HFE papers defines as: "In the face of uncertainty, the CGC should err on the side of a smaller GST redistribution through discounts towards equal per capita" (WA HFE Paper, page 29). The Territory's view is that there is no conceptual or practical basis for this principle, which appears likely to result in under-estimation of HFE.

The Territory's position is that uncertainty is not a valid reason to assume that a distribution closer to an equal-per-capita assessment is the appropriate basis to achieve HFE. An equal-per-capita assumption will only achieve HFE in limited circumstances where there is both a conceptual and evidential case to do so. A blanket conservatism assumption which always adjusts toward equal-per-capita would not be sufficiently responsive to the conceptual case for a differential assessment.

For example, there is a strong evidential and conceptual case that costs in very remote regions are higher than in non-remote areas. However, remote data is often challenged by a range of issues, including fewer or less robust administrative sources to draw from, small samples, complex needs, and limited alternative data sets. Accordingly, an element of uncertainty can arise in calculating a specific differential assessment for remoteness. Attempting to resolve this uncertainty by discounting toward equal-per-capita would serve to undermine the strong conceptual case in support of a differential remoteness assessment.

The Territory notes in any event that the creation of a statutory minimum relativity already mitigates the downside risk to jurisdictions with relativities of less than 1, and there is no need to further address this through the creation of new HFE principles or changes to methods.

## 2.4. Assessment guidelines

Q7 Do the assessment guidelines, and the Commission's application of those guidelines, remain appropriate?

Consistent with past submissions, the Territory is broadly opposed in-principle to the application of discounting and materiality thresholds. These approaches can undermine HFE. Further discussion on this is provided below. However, the Territory considers the CGC's current practices, and its approach in the 2020 Review to remove or reduce discounts, has been pragmatic and seeks to maintain a reasonable balance between the need to maintain HFE principles and simplicity in the overall assessment. Accordingly, if the Territory's in-principle position is not accepted, the current assessment guidelines should continue.

### 2.4.1. Materiality thresholds

Q8 should the material thresholds be increased broadly in line with state spending per capita (to \$45 per capita for assessment of a driver and \$15 per capita for a data adjustment)?

Consistent with past submissions, the Territory does not support materiality thresholds or discounting in-principle. Materiality thresholds can cause a departure from HFE and contribute to assessment inaccuracies over time. There are also some mathematical difficulties in applying materiality thresholds, for example, the difference between a single change that is material in a single year or category, and the materiality of a compound effect of multiple changes. If materiality thresholds are set too high, they can also have the effect of entrenching existing methods, and may promote discussion on radical changes rather than incremental improvements.

However, it is recognised that materiality thresholds are established practice, and offer simplicity gains. Further, some of the issues with materiality can be alleviated through pragmatic and flexible consideration around materiality thresholds.

In considering whether to index materiality thresholds, the Territory's preferred position is to not index at this time. However, any discussion on indexation should include a sensitivity analysis on whether the indexation causes, or would have caused, any assessment methods to become immaterial and if so, the impact on assessment outcomes.

Should indexation be considered to be desirable, the Territory's view is that it is more appropriate to index to cost-growth, rather than reflecting growth from expanded state services. A further particular difficulty is that recent state and Commonwealth expenditure rapidly rose due to the COVID-19 pandemic response. However, this effect may be temporary, rather than representing an actual long-run change in state

responsibilities, or structural changes in state costs as would persist beyond 2025. This poses particular risks if the reference period is set to 2020-21 or 2021-22, and the opposite risk in 2019-20.

Accordingly, nominal state growth in government expenditure and nominal growth in Gross Domestic Product are not reflective of an appropriate rate of indexation. In this context, of the three options provided by the CGC, the state government price index is the more appropriate indexation measure.

## 2.4.2. Discounting assessments

Q9 Does the 2020 Review approach to discounting remain appropriate?

Consistent with past submissions, the Territory is opposed in-principle to extensive discounting, recognising that discounting has the effect of presuming that an equal-per-capita assessment is the superior method of determining state fiscal capacity. This assumption is only realistic in limited circumstances where there is a conceptual case to do so. Issues such as data uncertainty or methodological difficulties do not always warrant a discounting approach.

However, the Territory notes that the 2020 Review removed or reduced several discounts that had applied in prior reviews. The Territory also agreed generally with the CGC's principled and conceptual approach when it evaluated the need for discounting in the 2020 Review.