2025 Commonwealth Grants Commission Methodology Review

Northern Territory Department of Treasury and Finance Submission to Significant changes since the Draft Report

NORTHERN TERRITORY GOVERNMENT

Contents

1. Motor Taxes

The change to reintroduce a differential assessment for motor vehicle stamp duty is supported, noting the decision is consistent with equalisation principles, materiality testing and Commission guidelines.

2. Schools

The Department:

- Notes the intended changes to socio-educational advantage.
- Submits that the Commission should re-examine Commonwealth funding methods for Government schools in the 2026 Update due to major changes in funding arrangements in three states in mid-late 2024.

With respect to socio-educational disadvantage, the Department recognises that there are practical difficulties with the schools assessment due to the modelling approach and high rates of co-incidence of disadvantage. The inter-related nature is noted at paragraph 15 of the paper, which advises that the First Nations variable is impacted by the choice of socio-educational disadvatnage measure. The Department relies on Commission advice that for this particular change, the net impact between the First Nations and socio-education disadvantage measures largely offset for the Territory and makes no further comment on the changes. This is on the practical view that even where there is a strong conceptual case for an individual variable, the outcomes may differ once modelled.

By way of information since the Draft Report, it is advised that:

- On 31 July 2024, the Territory signed the Better Fairer Schools Agreement 2025-2034. Subsequently, Western Australia, Tasmania and the Australian Capital Territory have also signed. Each state appears to have slightly different arrangements, with the Northern Territory's being the most significant.

  The Territory bilateral includes an increased Commonwealth contribution, of up to 40% of the Territory's Schooling Resource Standard (SRS) by 2029, for government schools. Under the current method for assessing Commonwealth funding for government schools, this increased contribution would effectively be entirely unwound through GST, as the method only allows each state to retain the same, national-average, Commonwealth contribution rate to the SRS (currently around 19%).

  It is noted that the current approach to Commonwealth funding for government schools arose from the 2015 Terms of Reference, which were reconsidered in the 2020 Review and methods considered 'settled'. However at that time it was not contemplated that any jurisdiction would have an arrangement similar to the current Territory bilateral.

  It is not yet clear if similar issues will arise in other states as most large jurisdictions have not signed new agreements at this time. However, if no other states sign, it appears likely that signatory states could be disadvantaged by current methods given a higher Commonwealth contribution rate of up to 22.5% for government schools.

  At a minimum, the Commission should consider the implications for policy neutrality, as the current method dis-incentivises states from signing the Better Fairer Schools Agreement 2025-2034 and may directly penalise first movers.

  The new schools funding agreements would ideally be dealt with through an updated Terms of Reference. However even if this does not occur, the Territory submits reconsideration of the method is warranted from the 2026 Update due to the significant change in agreement contexts.

As a further consideration, the signing of the Territory bilateral is likely to result in significant changes to Territory schools expenditure to achieve the commitment of 100% of the SRS over the term of the agreement. Given the outsized levels of disadvantage in the Territory, this may impact the appropriateness of the regression variables, noting also that the difference between regressed costs and the SRS is greatest in the Territory. This may be relevant for the 2030 Review.

3. Health

The Department:

- Notes the Commission's intent to revert to the 2020 Review approach of using private patient separations as the indicator of non-state sector admitted patient activity.
- Notes the Commission has re-tested socio-economic disadvantage broadly and has not changed methods other than for Commonwealth grants to First Nations community-controlled health services.
- **Supports** the Commission using the actual distribution of Commonwealth grants to First Nations community-controlled health services as the estimate of non-state sector expense needs.
- Notes the Commission's intention to not round the non-state sector substitutability ratios and considers this a judgement decision.
- **Does not support** the proposed approach or criteria to ceasing non-hospital transport, aeromedical services and Patient Assistance Transport Scheme, assessment before the 2030 Review.
- Notes the change to exclude COVID-19 clinics from community and public health activity data.
- Notes the 12.5% discounting of non-state sectors in addition to community and public health.

With respect to socio-economic status, the Department notes the Commission proposes no change for the state sector and non-state sector, other than the Commonwealth grants to First Nations community—controlled health organisations expenses. That analysis is broadly agreed though will remain relevant for the 2030 Review as health drivers more broadly may require further consideration.

For the Commonwealth grants to First Nations community—controlled health organisations expenses, the changes are strongly supported for the reasons set out by the Commission. It is clear that the Commonwealth funding model uses an appropriate methodology which should only be replaced by a Commission method if the Commission can be satisfied that its' approach is equivalent or superior. Importantly, data limitations in the Commission method should not be the primary driver of state assessments relative to the Commonwealth's model. As data limitations appear to be a significant driver if remote/very remote socio-economic status continue to remain excluded per the 2020 Review method, the decision to align with Commonwealth methods is sensible. Further, adopting the Commonwealth model avoids issues such as the level of substitutability, which the Territory has had longstanding reservations including in the 2020 Review, or issues relating to activity as raised in the Department's submission to the Draft Report.

For the non-hospital transport method, the Department does not agree with re-opening this prior to the 2030 Review, and if this remains the Commission's preference, submits that the issue requires more robust principles. Abolishing the current method will not solely depend on whether aeromedical costs are incorporated into the Independent Hospital and Aged Care Pricing Authority (IHACPA) National Weighted Activity Unit (NWAU). Rather, it also depends on how those changes are incorporated.

Particularly, if IHACPA incorporates transport costs into NWAU calculations using a method that is different to the Commission's current health cohorts, then there is potential for unintended impacts. For example, if aeromedical costs are calculated by IHACPA using a population cohort, geography definition, or another method that does not align with existing Commission cohorts, then including those costs into the health method would redistribute the IHACPA costs in a way that has not been considered or tested. This would be distortionary without also considering recalibration of the health method more broadly. However such a recalibration is likely too significant of a change in an update year and therefore not supported.

Accordingly, the Department submits that the change should not occur until a review year and that the proposed criteria at paragraphs 54 and 55, which focus solely on data availability and NWAU incorporation, are too simplistic and not supported.

Instead, at most it may be agreed that in an update year a method change could be necessary to ensure expenses or drivers are not double-counted as a data issue. However the Department's primary position is that the change is likely a substantive method change and should be considered in a Review year due to potential materiality and complexity.

4. Housing

The Department:

- Prefers the Draft Report's individuals approach to the newly proposed 'average household size' approach
- Considers that the household size approach has reasonably significant unintended consequences for remote areas, particularly in states other than the Territory, due to the first step in paragraphs 89-91 being based on actual housing stocks which have not been equalised for state circumstances,
- Proposes an alternative option that the Territory, as the most significant outlier, instead first be provided an uplift for indigenous remote and very remote houses, to achieve an average household size of other states in that cohort, in determining the cohort's expense shares (and then following the proposed average household size method), until a more appropriate method can be developed,
- However, strongly supports the average household size approach over the 2020 Review methods.

The Department notes that the housing change is, by far, the largest change since the Draft Report, with an indicative change of -$930 per capita to the Territory compared to the Draft Report. The Department considers that the housing method continues to have conceptual and methodological difficulties and should be a priority in the 2030 Review. This view does not detract from acknowledging the significant work by the Commission to improve the method in response to state and territory consultation.

The Department advises that it is unlikely that data establishing a cost-weight for overcrowded dwellings is available, and in any event even if this existed would be difficult to calculate in a policy natural manner due to the Territory being a sole outlier. Further, the Department considers (consistent with its supplementary submission to the Draft Report) that the core issue is not greater costs per house due to overcrowding, but rather the need to supply more houses to address overcrowding and achieve similar services to other states. As such, this option is not considered practical for the 2025 Review and this section focusses on the average household size approach.

For brevity and ease of reference, unless otherwise indicated, this section refers to the low-income very remote indigenous cohort as "remote indigenous".

The average household size method is described essentially as a two-step process, firstly by dividing national expenses into cohorts based on social housing shares (plus loadings) per the 2020 Review method, and secondly by dividing those cohorts between states based on cohort-average household sizes.

The second step is broadly appropriate and is a significant improvement from the 2020 Review method, for the reasons already discussed at length in earlier papers.

The Department submits that the first step however remains problematic and results in an inequity, particularly in other states with remote indigenous populations and as evidenced in South Australia and Western Australia's large negative per capita impacts.

This arises because the Territory is an extreme outlier in remote indigenous cohorts due to non-policy circumstances, particularly a lack of private housing and resultant severe overcrowding as noted at paragraph 82. This is not experienced at similar levels by any other state as illustrated at Figure 6 in the Commission's paper, where the Territory is the only jurisdiction above the national average (similar results arise in Figure 7, noting Victoria has a significantly smaller remote indigenous population). It is also noted that the Territory is large enough in this cohort to materially influence the average.

The difficulty with applying an adjustment in the second step only is that it results in a distorted measure of "what states do", as it assesses each state other than the Territory as if it had a policy of providing a larger remote indigenous household size than any of those states actually deliver. Put another way, it implies that all states with remote indigenous households should have a policy of overcrowding, due to the Territory's lower non-state stock, despite this is not being those states' policies or circumstances.

It is also distortionary because the expenses used to equalise the Territory's household sizes are limited to being drawn solely from the remote indigenous cohorts. That is, funding cannot be drawn from other cohorts, implying states such as Victoria or the Australian Capital Territory which have no very remote populations cannot be drawn on to equalise the Northern Territory to an average service level. This significantly limits the level of equalisation available for remote indigenous persons and is likely to disproportionately disadvantage states other than the Territory with remote indigenous populations.

The Department submits that in this context, equalisation is best accommodated by assessing the Territory as needing to supply a higher rate of social houses to provide a similar average household size to the other states due to its higher overcrowding and smaller non-state sector, but the corollary is not that the other states with remote indigenous populations would provide fewer houses, noting their similar household sizes once the Territory is excluded. While this principle is similar to the Commission's proposal, the key difference is that it is submitted that the adjustment should occur by inflating the Territory's social stock at the first step, increasing total remote indigenous cohort expenses, while the Commission proposes an adjustment in the second step only.

If an adjustment is applied to increase the Territory's remote indigenous social housing stock in step 1, to provide average household sizes that are similar to the average of the other states, the results should be a more equitable calculation of the equalisation task and better reflect what states do. Conceptually, this may be described as a non-state sector adjustment to the Territory's social housing stock to reflect its circumstances that are not experienced by any other state.

A similar adjustment does not appear necessary in other cohorts, as Figures 6 and 7 show that in all other cohorts, there is a mix of jurisdictions above and below the national average, or that outlier states are not sufficiently large to materially influence the national average, meaning step 2 is sufficient.

While this is a somewhat novel suggestion as it adjusts one jurisdiction only, it is submitted that the approach is reasonable, practically simple, and empirically justified, given that the Territory's remote indigenous housing situation is clearly a significant outlier.

It is also submitted that this is likely the only practical mechanism that could be effected in the limited time remaining in the 2025 Review. More robust consideration could be given in the 2030 Review.

If this suggestion is not taken up, the Department otherwise supports the average household size method, and submits that notwithstanding the above issues, the average household size method is clearly superior to the 2020 Review method, which had far more significant problems.

To summarise and for clarity, the Department submits that:

- The individuals approach in the Draft Report is preferred.
- If this is not agreed, the average household size approach is supported, with the following changes:

  The Territory's actual social housing stock for low-income remote and very remote indigenous households be uplifted by an amount to provide the Territory with a level of housing to achieve average household size of *other* states in this cohort, as a non-state sector adjustment.
- This should expand the remote and very remote indigenous low-income cohort share of national expenses, but otherwise not change the proposed method.
- If this is not agreed, the average household size approach is supported in the alternative.
- A weighting for overcrowding is unlikely to be possible for the 2025 Review.
- The 2020 Review method is not supported.

5. Other method changes

The Department:

- Notes the change to exclude COVID-19 related expenses in the health investment category as a one-off due to timing issues and recognising the exceptional circumstances of the pandemic, with 2020-21 not being able to be captured in the assessment. However, it is observed that some step-changes to investment categories are expected at every Review. This may positively or negatively impact individual states depending on stock and expense trajectories as the time methods change. In this respect, the issues experienced by Victoria are not unusual in-principle and the conceptual case is limited.
- Notes the changes to retain routes to mines, gas wells, ports and national parks in the rural roads assessment in the synthetic road network.
- Notes the proposed changes to homelessness/housing classifications to reconcile to the Report on Government Services if state data is not available, which appears reasonable.
- **Does not support** the proposed allocation of expenses between urban and non-urban transport (V/Line expenditure), nor such an apportionment being expanded to other states, nor that this be applied outside of a review year.

  Fundamentally, it is not agreed that passenger numbers are an appropriate apportionment for expenses, nor is it agreed that general overhead subsidies relate to urban areas.

  In its 2021 update new issues submission , Victoria advised that *"The amount of subsidy requested by V/Line is based on the costs of providing its timetabled services, such as the number of drivers and conductors required, rolling stock operating expenses, corporate overheads, rolling stock, and track maintenance, marketing and vegetation management. These costs are determined on a system wide basis rather than on a geographic basis."*

  It is not agreed that that these costs would be directly driven by passenger numbers. For example, a train would not have fewer drivers (or the driver have lower wages) if it had empty carriages rather than full. Similarly, it is not clear how track maintenance is dependent on the number of passengers in a train for a given trip. Instead, it appears much more conceptually reasonable that higher-passenger trains would have significantly diminishing marginal costs per passenger. In this case, the proposed apportionment would substantially overstate the allocation to urban areas.

This contrasts with fare revenue, which is directly attributable to trip-weighted passenger numbers.

Similarly, it is not agreed that overhead general subsidies of this nature are appropriate to apportion due to the possibility of cross-subsidies. That is, it appears highly possible that remote train trips are more expensive, and have less offsetting revenue, per passenger, than urban trips. If this occurs, the total net losses of the train operator may be fully relatable to service obligations in rural areas such that no apportionment is appropriate. If this were the case, it may be appropriate for the whole subsidy to be allocated to rural areas regardless of shares of trips or passengers.

Absent information on the profit/loss contribution per passenger per trip per area, significant caution should be exercised in apportioning general operating expenses in line with activity data.

Given the above conceptual and transparency issues, and given the lateness of the proposed change in the Review timeframe which significantly limits scope for submissions, and as other states and territories have no line of sight into Victorian or other state data, it is submitted the Commission should not make the change.

If a change is required for consistency with other states, the Commission should consider minimising the amount allocated to urban areas, in recognition that other states have not yet been provided opportunity for the adjustment, including potentially fully allocating to non-urban.

The Department notes the potential expenses associated with this apportionment could be substantial if expanded to multiple states, particularly as there is a large difference between factors in the urban and non-urban categories. As such, it is preferable this be subject to full state and territory consultation, including sharing any relevant data provided by state agencies. Such a change should not be made outside a review year.

- Notes the proposed exclusion of electricity and water subsidies for the regional cost gradient.