

Australian Government Grants

Overview

Australian Government grants are an important source of revenue for all states. The grants are necessary as, under Australia's federal system, the states have significant service delivery responsibilities but limited capacity to raise own-source revenue, while the Australian Government's revenue raising capacity exceeds its limited responsibility for providing services. The mismatch between the revenue powers and service delivery responsibilities of the Australian and state governments is described as vertical fiscal imbalance, and has increased following goods and services tax-related tax reform and the abolition of a range of state taxes.

There are two types of Australian Government grants to states:

- general purpose grants, which include GST revenue payments and national competition payments. These are untied payments that can be used by the states for any purpose; and
- specific purpose payments (SPPs), which are generally earmarked for specific purposes.

The table below highlights the importance of Australian Government grants to the states and the Northern Territory in particular.

Table 5.1: Sources of Revenue for the Northern Territory and All States in 2005-06

	Northern Territory % of Total Revenue	All States % of Total Revenue
General Purpose Payments ¹	65.5	28.5
Specific Purpose Payments ²	14.2	19.6
Own-Source Revenue	20.3	51.9
Total	100.0	100.0

1 GST and National Competition Payments.

2 SPPs 'to' and 'through' the States.

Sources: Statement of Estimated Payments to the states and territories, 23 March 2005; state and territory 2004-05 mid-year reports.

Note: To allow comparison with other states, this table is based on estimates provided to the March 2005 Treasurers' Conference.

The Northern Territory is much more reliant on Australian Government grants than other states, with around 80 per cent of its revenue sourced from the Australian Government. In other states, Australian Government grants account for around 48 per cent of revenues. This greater reliance on Australian Government grants reflects the higher cost and demand for government services and the low revenue-raising capacity of the Territory relative to other states.

Intergovernmental Agreement

The June 1999 Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations (the Intergovernmental Agreement) defines the principles and institutional arrangements by which the Australian Government collects GST revenue on behalf of the states. Since its implementation in July 2000, the Intergovernmental Agreement has been the centrepiece of financial relations between the two levels of government.

The Australian Government has collected revenue on behalf of the states since the 1940s, when the states' income taxation powers were transferred to the Australian Government. Prior to the Intergovernmental Agreement, the amount of federal taxation revenue passed on to the states was at the discretion of the Australian

Government. Competing budget pressures and policy priorities had resulted in a decreasing share of Australian Government revenue, particularly untied revenue, being passed on to the states over time.

By the 1990s, financial arrangements between the two levels of government were both inefficient and becoming unsustainable. The cost of providing state services, particularly health and law and order, was growing faster than revenue from the Australian Government. At the same time, the relative importance of state own-source revenue was increasing as the states sought to fund the increasing demand for, and costs of, government services.

The primary objectives of the tax reforms introduced under the Intergovernmental Agreement were:

- to guarantee states access to a source of untied revenue whose growth would, over time, better align with growth in the cost of state services;
- to allow for the staged abolition of a specified list of state taxes; and
- to simplify Australian – State financial relations.

Under the Intergovernmental Agreement, all GST revenue is provided to the states and distributed in accordance with the principle of horizontal fiscal equalisation.

The Intergovernmental Agreement requires the states to:

- forgo financial assistance grants, which provided the bulk of untied grants to the states before the introduction of the GST;
- abolish a range of their own taxes, including financial institutions duty, stamp duty on shares and marketable securities and bed taxes;
- review the need to maintain debits tax (debits tax will be abolished in the Territory from 1 July 2005); and
- review the need to maintain a number of other taxes by 2005.

A key feature of the Intergovernmental Agreement is a guarantee that no state will be financially disadvantaged by the tax reforms introduced in 2000. To satisfy that commitment, the Australian Government agreed to provide budget balancing assistance (BBA) to offset the revenue shortfall for as long as any state is worse off than under previous funding arrangements. In principle, BBA should be available permanently, however the Australian Government has indicated its intention, through regulation, to end BBA arrangements after 2005-06.

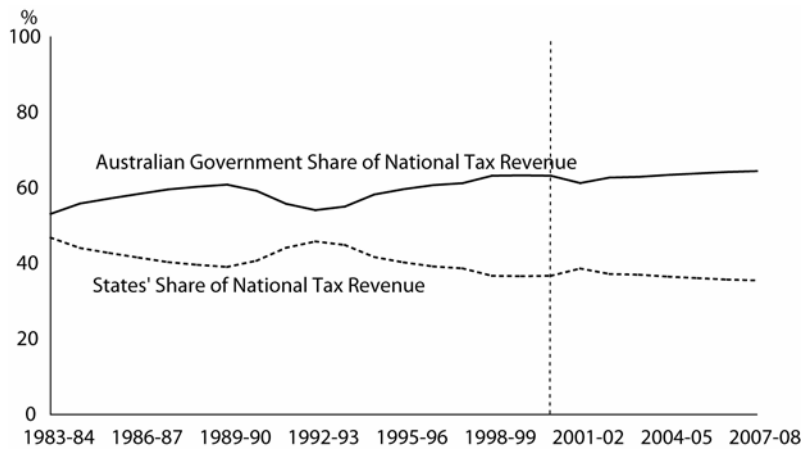
Although the Australian Government forecasts that no state will require BBA in 2005-06, if the economy slows more than expected, it is likely that New South Wales will continue to require this assistance. The Territory has not required BBA since 2002-03.

In aggregate, the states are expected to be \$1.9 billion better off in 2004-05 than they would have been without tax reform, however the impact of tax reform on states has varied. Individual states have now had between one and three years during which GST revenue has been higher than under previous funding arrangements. This result is largely due to robust economic conditions and a low inflationary environment that have provided strong growth in all government revenues, including GST. However, the growth in GST revenue has not been sufficient to correct a continuing decline in the states' share of national tax revenue.

Chart 5.1 illustrates the continuation of a long-term trend decline in the states' share of national revenue, including state own-source revenue, after the introduction of the GST in 2000. Although the GST has grown strongly since 2000, the relative

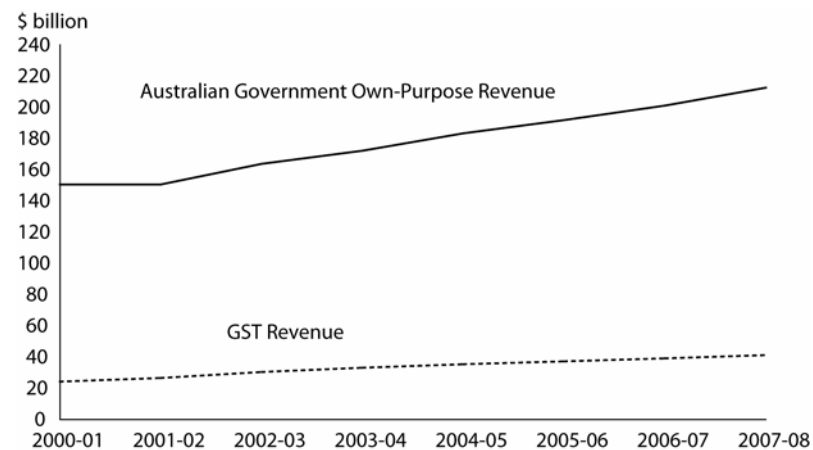
strength and size of the Australian Government tax base ensures that the proportion of national revenue assigned to state purposes continues to reduce. In 1983-84, nearly half of national revenue was dedicated to state services. On current forward estimates, this proportion will have fallen to about 36 per cent by 2007-08.

Chart 5.1: State and Territory Share of National Taxation Revenue



Although the GST revenue passed to the states has grown more strongly than expected since 2000, Australian Government revenues have also increased significantly. Despite a temporary slowing in income and company tax collections in 2001-02, Australian Government own-purpose revenue has grown by over \$30 billion since the GST was introduced. As a result, the Australian Government's projected cash surplus of \$6.2 billion in 2004-05 alone is greater than the accumulated benefit of the GST to all states and territories since 2000, and is over 17 per cent of total GST revenue passed on to the states in 2004-05.

Chart 5.2: Growth in Australian Government Revenue



The Intergovernmental Agreement provided for an annual meeting of all Australian Treasurers, known as the Treasurers' Conference, to oversee its operation. The fifth annual Treasurers' Conference was convened on 23 March 2005, at which the agenda was dominated by the states' undertaking in the Intergovernmental Agreement to "review the need" for a range of taxes by 2005.

At the meeting, the Australian Government effectively re-interpreted the Intergovernmental Agreement by arguing that the states had committed to abolish the taxes listed for review if growth in the GST made it affordable to do so. The Intergovernmental Agreement, however, contains no mention of affordability, or of a commitment to abolish the taxes listed for review.

The states' understanding is that the possible need to retain some taxes nominated for review was envisaged when the Intergovernmental Agreement was developed. This view is supported by the fact that taxes for review were explicitly removed from the list of taxes for abolition as a consequence of the 1999 amendment by the Australian Democrats to the overall tax reform package.

The states, therefore, have strongly contested the Australian Government's position and have also argued that any notion of affordability must capture expenditure pressures as well as revenue gains. Furthermore, the Australian Government's reinterpretation of the Intergovernmental Agreement is inconsistent with its original advice to the states – that the benefits of tax reform were intended to fund improvements in state services.

The Australian Government's offer to the states in March 2005 required the states to commence the abolition of taxes listed for review from 1 July 2006, in return for which the Australian Government would extend BBA for two years to 2007-08. Under the Australian Government's projections, the aggregate financial benefit of tax reform to the states would be substantially eroded, and New South Wales would not realise any financial improvement until 2008-09, close to a decade after the Intergovernmental Agreement came into effect.

The Australian Treasurer indicated that, in his view, any blanket refusal would represent a breach of the Intergovernmental Agreement. As a result there are real concerns that the Australian Government is prepared to unilaterally reinterpret or walk away from the Intergovernmental Agreement. This could result in new financial arrangements with the Australian Government that would disadvantage the states, allowing for greater restrictions on funding provided by the Australian Government, and possibly involving less overall grant revenue.

The Northern Territory Government has consistently indicated its support for future tax reform, while also acknowledging that the intent of the Intergovernmental Agreement was to give states access to a growth tax that would enable them to respond more effectively to increasing demand for services.

In April 2005, the Territory joined with most states in putting forward an alternative tax reform proposal to the Australian Treasurer, which involves the abolition of a range of stamp duties over five years commencing in 2006-07. For further details, see Chapters 4 and 6 of this Budget Paper.

GST Revenue

The Territory expects to receive \$1739.1 million in GST revenue in 2004-05, a 3.5 per cent increase from the \$1680.9 million received in 2003-04. For 2005-06, a stronger increase of 5.2 per cent to \$1829.3 million is expected, reflecting stable relativities and improved population growth. The Territory's estimates of GST growth for 2004-05 and 2005-06 are marginally lower than those of the Australian Government due to more conservative population growth projections.

Commonwealth Grants Commission

The role of the Commonwealth Grants Commission (the Commission) is to advise the Australian Government on relativities for use in the distribution of GST revenue among the states. The Intergovernmental Agreement requires these recommendations to be based on the principle of 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. (Commission 2005 Update Report)

The Commission's recommendations are expressed in per capita relativities for each state. The relativities take into account differences in:

- states' expenditure needs, including both the cost of, and demand for, government services; and
- states' capacity to raise own-source revenues.

Every five years, the Commission undertakes a major review of its method used to determine per capita relativities. This process is necessary to ensure that relativities continue to reflect the contemporary public administration, service provision and revenue raising environment of state governments. The last review was completed in February 2004. The method implemented in the 2004 Review will be used as the basis for determining GST distribution among states to 2009-10. Relativities will be updated using the latest available financial, economic and demographic data.

2005 Update

The Report on State Revenue Sharing Relativities – 2005 Update details the results of the Commission's latest analysis of data. In its 2005 Update, the Commission recommended an increase in relativities for Victoria, New South Wales, the Australian Capital Territory and the Northern Territory. The remaining jurisdictions experienced a decrease in relativities. The 2005 Update relativities will be used to distribute GST revenue among the states in 2005-06.

The table below shows the change in per capita relativities and each state's share of GST revenue using the 2004-05 GST pool between the 2004 Review and 2005 Update.

Table 5.2: Impact of the 2005 Update

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
2004 Review									
Relativity	0.86750	0.86534	1.05504	1.03054	1.20407	1.55939	1.12930	4.26538	1.00000
Grant Share (%)	29.10	21.40	20.28	10.14	9.22	3.74	1.83	4.25	100.00
2005 Update									
Relativity	0.86846	0.87552	1.04389	1.02500	1.20325	1.55299	1.14300	4.26682	1.00000
Grant Share (%)	29.14	21.65	20.06	10.08	9.21	3.73	1.85	4.25	100.00
Impact (\$M)	12.0	106.2	-93.7	-24.0	-3.2	-6.8	9.2	0.3	0.00
Impact (\$ per capita)	1.79	21.48	-24.39	-12.20	-2.09	-14.16	28.44	1.51	0.00

Source: Commonwealth Grants Commission Report on State Revenue Sharing Relativities - 2005 Update.

The outcome for the Territory was a marginal increase in its relativity from 4.26538 to 4.26682, which translates to a \$0.3 million increase in the Territory's share of GST revenue based on the 2004-05 GST pool. In per capita terms, the Australian Capital Territory (\$28.44) and Victoria (\$21.48) made significant gains, while Queensland (-\$24.39) experienced the biggest loss.

The Commission's recommended relativities are based on assessments of revenue and expenditure needs for each state and territory. The Commission uses the term 'need' to describe the financial effect on each jurisdiction of:

- unavoidable influences on the use or cost of providing services (expenditure needs);

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

In the last year for which the Commission has completed its assessments (2003-04), the Territory was assessed as requiring to spend \$11 844 per capita to provide a standard level of government services, compared with a national average of \$4876 per capita. The difference between these amounts, \$6968 per capita, is the sum of the Territory's assessed expenditure needs.

Needs may be positive or negative. It is a necessary consequence of the Territory's assessed positive expenditure needs that at least one other jurisdiction will be assessed as having negative expenditure needs.

Expenditure needs are assessed by examining factors that influence the costs of, and demand for, services. The high cost of delivering government services in the Territory is mainly due to its small and widely dispersed population, the unique composition of its population, its harsh physical environment and its relative isolation from Australia's main population centres.

Revenue needs result from factors that influence each state's capacity to generate revenue from its own sources. These factors include differences between states in developed natural resource endowments and the divergent structure of state economies. The Territory is assessed as having low revenue-raising capacity relative to other states (about \$150 per capita less than the national average) and is therefore assessed as having positive revenue needs.

The third broad component of the Commission's assessment is SPPs. The Territory has negative SPP needs as it receives greater than its per capita share of SPP funding, largely due to programs for Indigenous services.

When all expenditure, revenue and SPP needs are combined to calculate shares of the GST pool, the Territory's share of GST revenue is about 4.3 per cent compared to a per capita share of about 1 per cent. New South Wales and Victoria are the only jurisdictions that receive less than an equal per capita share of GST revenue, due to their comparative advantages in raising own-source revenue, and lower than average costs of providing services.

Territory Special Needs

In its Report on State Revenue Sharing Relativities – 2004 Review, the Commission noted that it may not have fully recognised the capital-related needs of the Territory as assessed through the debt charges and depreciation assessments. The differences between the Territory's actual and assessed expenditure in the Commission's capital assessments total more than \$170 million per annum. The Territory believes that these differences arise from needs not captured in the Commission's assessments, and they therefore have a significant impact on the Territory's ability to provide a standard level of government services. As the Territory's capital needs are unlike those of other jurisdictions, it was possible that the Commission's terms of reference limited its scope to assess these needs.

Following concerns raised by the Northern Territory Treasurer, the Australian Government included an additional reference in the 2005 Update terms of reference, instructing the Commission to review the Territory's debt charges and depreciation assessments.

The Territory submitted detailed information to the Commission during the 2005 Update, focusing on the treatment of capital grants and the impact of timing on borrowing needs. Nonetheless, the Commission did not feel able to properly

address the Territory's concerns in the context of an annual update, and elected not to change the methods applied in the debt charges and depreciation assessments.

Despite the outcome of the review, the Commission acknowledged in its 2005 Update that the difference between actual and assessed expenditure in relation to capital assessments remains large. The Northern Territory will continue to assist the Commission to resolve these issues as part of the next methodology review.

Work Program on Simplicity

The Australian system of equalisation is among the most comprehensive of all federations as it equalises both the expenditure needs and revenue-raising capacities of state governments. However, some states have criticised the current approach to equalisation for being overly complex, data intensive and lacking transparency.

At the 2004 Treasurers' Conference a majority of states, with the support of the Australian Government, agreed to a work program to consider simplification of the Commission's methods of distributing GST revenue among states. It was agreed that the work program would not examine the underlying principles of horizontal fiscal equalisation.

The simplification review was led by a steering committee chaired by the Secretary of the Australian Government Treasury, and including the Victorian and Tasmanian Under Treasurers and the Chairman of the Commission. A secretariat comprising officers from the Australian Government Treasury and the Commission was established to support the steering committee.

The steering committee also engaged the Australian Bureau of Statistics, Professor Jonathan Pincus and Dr Arthur McHugh (former Auditor-General of Tasmania) to review aspects of the Commission's methodology.

The states' main contributions to the review included developing simplification options, responding to agenda papers for the steering committee and reviewing the steering committee's final report.

The main outcome of the simplification review was a terms of reference for the Commission's next methodology review. The key concerns for the Territory were that the terms of reference:

- were not so prescriptive that they would constrain the Commission from achieving optimal equalisation outcomes; and
- did not result in the premature introduction of under-developed or incomplete assessments.

The states had widely divergent views about how the Commission's approach to fiscal equalisation should be controlled by its terms of reference. The terms of reference for the upcoming methodology review, agreed at the 2005 Treasurers' Conference, are more prescriptive than the Territory and some other states would prefer, however they represent an acceptable compromise between the views of all states.

GST Revenue Projections

The Territory is heavily reliant on GST revenue funding from the Australian Government to meet its budgetary and fiscal needs. The Territory is susceptible to even slight variances in GST revenue, which can have a substantial impact on the Territory's fiscal position.

Accurate forecasting of the parameters that determine GST revenue can limit the risk to the Territory's budget. However, the lack of historical data on the GST, and the inherent difficulties in estimating the Territory's population and the Commission's relativities over the forward estimates period, make this process difficult.

The Territory's GST revenue grant is determined principally by:

- the total level of GST collected nationally;
- the Territory's share of the national population; and
- the Territory's per capita revenue-sharing relativity as determined by the Commission.

Recent economic data and forecasts suggest a slowdown in the Australian economy over the next few years. As a result, a down-side risk scenario has been developed to illustrate the effect of significant fluctuations to key parameters affecting Territory revenue.

GST Collections

In accordance with the Intergovernmental Agreement, the pool of national GST collections is made available to states. Variations in the size of the GST pool have a direct impact on the size of the Territory's GST revenue grant.

The Australian Government provides states with estimates of GST collections in its annual Budget and in its Mid-Year and Economic Fiscal Outlook (MYEFO). Since the introduction of the tax in 2000, collections have been highly volatile and difficult to predict. Australian Government Treasury remains the most informed source of GST estimates, given its access to the latest key statistical and collections data. On this basis, the Territory has adopted the Australian Government estimate of the total GST pool over the budget and forward estimates period, however it should be cautioned that the underlying economic parameters are estimates that are six months old.

In its MYEFO, the Australian Government revised its 2004-05 GST estimate upward by \$654 million to \$35.4 billion¹, a growth of 6.7 per cent on 2003-04 collections. This was due to better than expected growth of the Australian economy in the first six months of 2004-05, particularly in consumption spending. Current indicators suggest that this level of collections will be met, however the final amount will not be known until the GST Determination in June 2005.

The Australian Treasury has estimated GST growth of 5.2 per cent and 5.3 per cent in 2005-06 and 2006-07 respectively. This is slightly below the long-term assumed growth rate of 5.5 per cent and reflects an expectation of a slowdown in the national economy over the next two years. Economic forecasters have expressed a similar concern for medium-term economic growth and the resulting level of GST collections. The March 2005 Access Economics forecast of 2005-06 growth in consumption expenditure falls to 2.6 per cent, compared with 3.9 per cent in 2004-05. If the Access Economics forecast is realised, Australian Government estimates of GST growth may be optimistic.

The prospect of lower GST growth represents a significant down-side risk to the Territory's GST revenue grant and its overall budgetary position. A down-side risk scenario has been calculated using a more conservative 4.5 per cent growth in GST

¹ This amount includes \$219.4 million of compensation for the Australian Government's GST deferral measure.

collections for 2005-06 and 2006-07. This is higher than the 3 per cent down-side growth estimate used in the Territory's 2004-05 Budget, and reflects a balance of contemporary economic opinion, as well as an improved understanding of the performance of the GST. If realised, the down-side risk to GST collections would reduce the Territory's GST revenue grant by \$10.5 million in 2005-06 and by \$22.6 million in 2006-07. Beyond 2006-07, GST collections have been assumed to return to the long-term growth rate of 5.5 per cent.

Territory's Share of the National Population

The Territory's share of national population is a second factor in determining its share of GST revenue. Variations in the Territory's population growth relative to the other jurisdictions have a direct impact on the Territory's GST revenue grant. The 2004-05 population estimates will be finalised in June 2005, when the Australian Statistician makes his final determination of the population as at 31 December 2004.

The Territory estimates its 2004-05 population growth at 1.2 per cent, marginally higher than national growth. This is a significant upward revision of 1.0 per cent from the 2004-05 Budget forecast and is primarily due to reduced interstate migration loss from, and increased overseas migration into, the Territory. If realised, the Territory's share of national population would increase marginally from 0.9932 per cent to 0.9939 per cent. The Australian Government's estimate of the Territory's 2004-05 population growth, provided in the March 2005 Statement of Estimated Payments, is slightly higher at 1.4 per cent.

Population growth used in the budget and forward estimates period is 1.1 per cent in 2005-06, 1.0 per cent in 2006-07 and 2007-08 and 0.8 per cent in 2008-09. Although higher than the previous forward estimates these estimates are conservative when compared to long-term averages and the Australian Government's forecast of between 1.1 and 1.3 per cent growth.

The down-side risk of a lower than expected population growth for the Territory is represented by an assumed 0.2 percentage point reduction in expected growth over the budget and forward estimates period. If realised, it would translate to a decline in Territory GST revenue of about \$3.7 million in 2005-06 and \$7.6 million in 2006-07.

Commonwealth Grants Commission's Relativities

The third element in determining the Territory's share of GST revenue is the recommendations of the Commission. The Territory's relativity has historically been the most volatile relative to the other jurisdictions. A small variation in the Territory's relativity has a significant impact on its GST revenue grant, posing a significant risk to the Territory's budgetary position. Neither the Australian Government nor the Commission provide estimates of future relativities.

In its 2005-06 Update, the Commission has assessed a relativity of 4.26682 for the Territory. Future Commission relativities remain a considerable source of uncertainty. The Territory has forecast a moderate decline in the Commission relativity from 2006-07 onwards to account for anticipated revisions to the Commission's assessment of states' revenue capacity due to a slowing of the property market in the southern states.

The table and chart below show the budget and forward projections of the Territory's GST revenue and each of the key parameters. Also shown is the down-side risk scenario. The down-side risk provides a level of risk to the estimates in aggregate, rather than a risk to each of the components of GST revenue individually.

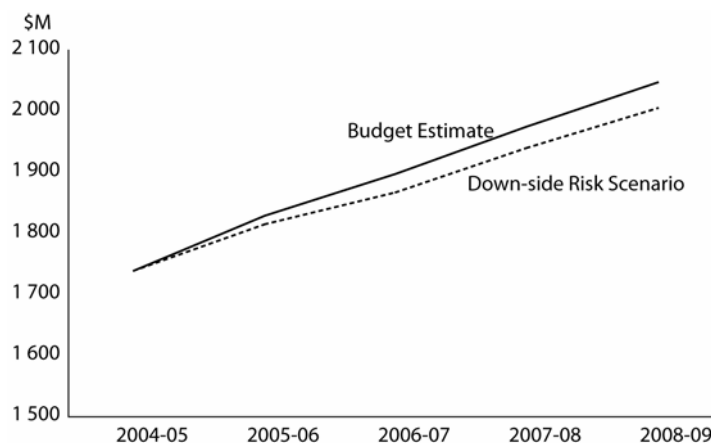
Table 5.3: Northern Territory GST Revenue Projections

	2004-05	2005-06	2006-07	2007-08	2008-09
Budget Estimates (\$M)	1 739.1	1 829.3	1 897.7	1 975.1	2 047.5
Total GST (\$M)	35 444	37 287	39 247	41 348	43 622
Growth (%)	6.7	5.2	5.3	5.4	5.5
Population	201 198	203 411	205 445	207 500	209 160
Growth (%)	1.2	1.1	1.0	1.0	0.8
Share ¹ (%)	0.9939	0.9931	0.9915	0.9901	0.9869
Commission Relativities	4.26538	4.26682	4.24682	4.22682	4.20682
Change (%)	-2.8	0.0	-0.5	-0.5	-0.5
Down-side Risk (\$M)		1 815.2	1 867.6	1 942.2	2 009.3
Total GST (\$M)		37 039	38 706	40 835	43 081
Growth (%)		4.5	4.5	5.5	5.5
Population		203 009	204 633	206 270	207 508
Growth (%)		0.9	0.8	0.8	0.6
Share ¹ (%)		0.9912	0.9876	0.9843	0.9792
Commission Relativities		4.26682	4.24682	4.22682	4.20682
Change (%)		0.0	-0.5	-0.5	-0.5
Variation (\$M)		-14.1	-30.1	-32.9	-38.2

Source: Northern Territory Treasury

¹ Share of national population.

Chart 5.3: GST Revenue Projections



National Competition Payments

Competition payments were introduced in 1997, in accordance with the National Competition Policy (NCP) agreements between the Australian Government and states that were signed in 1995. Under these agreements, the Territory is required to review legislation that restricts competition, ensure competitive neutrality in the operations of government businesses and comply with national reform frameworks relating to the gas, water and road transport sectors. The payments are conditional on compliance with reform commitments, as assessed by the National Competition Council (NCC).

In the negotiations in the lead up to the signing of the agreements, it was generally recognised that the costs of the reform program – in lost revenues and managing the adjustment process – would largely be borne by the states. On the other hand, the Australian Government, through its broader tax base, would capture most of the fiscal benefits. Therefore, competition payments were devised as the mechanism

through which the Australian Government would share the dividends of national micro-economic reform with the states.

Competition payments are distributed among the states on an equal per capita basis. The Territory was entitled to \$7.6 million in competition payments in 2004-05. Payments to the Territory, however, are estimated at \$8.4 million (contingent on final prices and population outcomes). This reflects reinstatement of \$1.1 million in 2003-04 competition payments that were temporarily suspended pending satisfactory completion of reforms and the NCC's recommendation for a permanent reduction of 5 per cent (\$0.4 million) in 2004-05 competition payments for the retention of restrictions on takeaway liquor trading.

The Territory's competition payment entitlement for 2005-06 is about \$7.8 million. This amount has been included as the estimate for 2005-06, however the actual amount received will be contingent upon the Australian Treasurer's consideration of the NCC's assessment of the Territory's compliance with NCP reform commitments.

The Australian Government announced in 2004 that one of its major election commitments, the National Water Initiative, will be funded by the abolition of competition payments after 2005-06. The fiscal benefits of competition reforms will continue to accrue to the Australian Government, while the states and territories will continue to bear the costs of reform through ongoing regulatory review processes implemented under the NCP agreements.

Specific Purpose Payments

Specific Purpose Payments (SPPs) are grants from the Australian Government which are usually tied to some specific program or function against which they must be acquitted. SPPs are a major mechanism by which the vertical fiscal imbalance between the Australian and state levels of government is corrected.

In 2005-06, the Territory will receive about \$341 million in SPPs, representing 16 per cent of Australian Government grants and around 14 per cent of total general government revenue.

SPPs are usually governed by formal agreements between the Australian Government and the states which set out conditions such as:

- the programs and functions for which the funds may be used;
- the contribution of state discretionary funds;
- restrictions on how funded programs may be delivered;
- performance and reporting requirements; and
- punitive sanctions for the breach of other conditions in the agreements.

General Issues with SPPs

Although SPPs are a means of reducing vertical fiscal imbalance between the states, they also provide the Australian Government with the ability to exert a policy influence over areas of service provision which are historically or constitutionally a state responsibility. SPPs are increasingly regarded by the Australian Government as a means of aligning the delivery of state services with its own policy objectives.

SPPs are an accepted feature of Australian intergovernmental financial relations, and are an important source of revenue for the states. Nonetheless, there are numerous problems with the current implementation of SPP arrangements, including:

- inefficiency – SPPs carry a large administrative burden and involve duplication of functions at the national and state levels of government;

- distortion of services – the input controls and performance requirements in SPPs often do not promote optimal outcomes, and stifle innovation in service delivery; and
- reduced budget flexibility – input controls in SPP agreements effectively control large amounts of state discretionary revenue, substantially reducing state budget flexibility.

The Way Forward

The states have approached the Australian Government repeatedly in recent years to seek agreement on a set of principles and guidelines for the negotiation of future SPP agreements. These may include:

- the simplification of reporting requirements;
- the use of output performance measures in preference to input controls; and
- greater flexibility in the use of SPP funding.

The indications are that the Australian Government is not prepared to consider SPP reform at present. The Australian Government has in fact hardened its position, using SPP agreements to promote its industrial relations agenda, introducing stronger input controls, and applying financial penalties for technical breaches of SPP agreements, such as missing reporting deadlines.

Major Agreements Negotiated in 2004-05

AusLink

The current AusLink agreement is due to expire on 30 June 2005.

Funding by the Australian Government under the revised agreement will be provided for selected projects rather than on the basis of the national planning framework. Furthermore, states are now required to take on the financial risk of any projects where there are any cost over-runs.

Concerns have been raised by the states over the fact that the agreement does not take into account the nature of transport spending, which is inherently volatile between years. This impacts on the states' maintenance of effort requirements under the agreement.

States have also objected to the intrusion of the Australian Government's industrial relations agenda in the form of a requirement that large capital projects comply with the National Building Code and guidelines.

Australian National Training Agreement (ANTA)

The original Australian National Training Agreement (ANTA) was due to expire in December 2003. However due to a breakdown of negotiations between the states and the Australian Government, the original agreement was extended for an additional year.

On 22 October 2004, the Prime Minister announced the abolition of the Australian National Training Authority from 30 June 2005, with responsibility for ANTA being subsumed within the Department of Education, Science and Training.

The agreement was extended for a further six months (expiring on 30 June 2005). This has posed a significant issue for the states over vocational education and training (VET) funding commitments, which are provided on a calendar year basis. In order to receive their allocated Australian Government funding for VET, states have had to commit to the annual funding levels with no secured financial commitment by the Australian Government after 30 June 2005.

The current proposed agreement requires an additional funding commitment from the Australian Government and the states. Under the proposal, the states will be required to match the additional Australian Government contributions, with part of the funds being allocated to recurrent funding and the balance being directed to the National Strategic Initiatives Fund, a new arrangement under the proposed agreement. States have raised questions as to whether this may affect currently funded programs and may not necessarily address skill shortages identified. Current negotiations suggest that the Australian Government will increase its funding level by \$174.7 million over the life of the agreement.

The National Strategic Initiatives Fund will be used to support national initiatives intended to improve the flexibility and responsiveness within the VET system and enhance training outcomes. At this stage, the arrangements are unclear and it is unknown how the funding will be allocated or what projects are likely to come under the fund.

The proposed agreement contains increased reporting and audit requirements for the states, which are likely to provide an additional administrative burden for service providers.

The new ANTA, covering funding from 2005-2008, is now unlikely to be finalised by June 2005. Funding from the Australian Government from 1 July 2005 is not certain until final agreement is reached. Negotiations are continuing at the ministerial and senior officials levels.

Government Schools Grants

The Territory and the Australian Government are close to finalising funding arrangements for government and non-government schools for the 2005-2008 quadrennium. Bilateral funding agreements between the Australian Government and each of the states and territories are subject to the *Schools Assistance Act 2004* (the Act), the Regulations and Administrative Guidelines.

The draft bilateral agreement for the Territory has remained relatively free of input controls, however numerous new conditions have been attached to Australian Government funding, including the commitment to:

- strengthen the autonomy of principals and school governing bodies over education programs and staffing;
- publicly provide performance information for individual schools;
- extend common testing standards to include Civics and Citizenship education, and Information and Communications Technology; and
- provide student reports against national benchmarks for specified years of schooling.

The Australian Government has used the schools funding agreement to promote its industrial relations agenda, requiring capital projects in excess of \$5 million to comply with the National Code of Practice for the Construction Industry and implementation guidelines. This condition does not affect the Territory, which already falls under Australian Government industrial relations powers.

The terms of the draft agreement are reasonably flexible, and are broadly consistent with the current direction of education policy in the Territory. However, there is concern that the states may be expected to sign bilateral agreements before the regulations to the Act, which may contain significant funding conditions, are finalised in May 2005.

Indigenous Education

Progress on the 2005-2008 Indigenous Education agreement, covering a range of programs under the *Indigenous Education (Targeted Assistance) Act 2000*, was delayed in 2004 due to the timing of the Australian election, however negotiations are close to conclusion.

The Indigenous Education agreement covers funding for government and non-government education providers for a range of purposes, including Supplementary Recurrent Assistance, Indigenous Tutorial Assistance, and specialised literacy and numeracy programs.

The new agreements, covering the 2005-2008 quadrennium, include revisions to the targeting of the tutorial assistance program, and a stronger emphasis on performance targets.

Subject to agreement on performance targets, the Indigenous Education agreement between the Australian Government and the Northern Territory should be finalised in the near future.

Supported Accommodation Assistance Programme V (SAAP V)

The current SAAP Agreement is due to expire on 30 June 2005.

Negotiations for SAAP V have been ongoing at both officer and ministerial level and it is anticipated that the revised agreement will commence on 1 July 2005.

The major issues surround the funding contributions of the states and the Australian Government. The Australian Government is seeking an increased financial commitment by the states to compensate for the redirection of Australian Government funds to a separate innovation fund for pilot programs. To maintain current levels of funding for SAAP programs, the Territory is being asked to increase its funding commitment by about 30 per cent while the Australian Government reduces its funding by about 16 per cent.

The states have highlighted that growth in demand for SAAP services is expected to increase costs at a faster rate than the indexation of the Australian Government's contribution.

Service providers have commented that they are happy with the current programs offered under SAAP IV and are concerned that any further pilot programs will merely limit funding to programs currently on offer.