

Chapter 5 Intergovernmental Financial Issues

Overview Grants from the Commonwealth are an essential source of revenue for all states. The grants are made necessary by the substantial mismatch between states' service delivery responsibilities and their capacity to raise own-source revenues. Under Australia's federal system, the states have significant service delivery responsibilities, such as health and education, but limited revenue sources. Conversely, the Commonwealth's revenue raising capacity exceeds its service delivery responsibilities. This disparity between revenue raising capacity and service delivery responsibility between the two tiers of government is referred to as vertical fiscal imbalance.

There are two types of Commonwealth grants to the states:

- general purpose payments, which are predominantly goods and services tax (GST) revenue payments. These are untied payments that can be used by the states for any purpose; and
- other Commonwealth grants. These are generally payments tied to a specific function or program against which they are required to be acquitted.

GST Revenue GST revenue represents the largest component of Commonwealth transfers to the states. In 2008-09, the Territory's GST revenue is expected to increase by 10.6 per cent to \$2405.9 million. This is predominantly due to the update of the Territory's relativity for 2008-09 and the expected growth of 7.2 per cent in the GST pool. This compares with 2007-08 when the Northern Territory is expected to receive \$2174.4 million in GST revenue, an increase of 7.9 per cent from 2006-07. The increase in GST revenue estimates for 2007-08 reflects increased Commonwealth estimates of national GST collections, an increased relativity and the Northern Territory's increased share of national population arising from the 2006 Census.

The level of GST revenue received by each state is dependent on total GST collections, states' population shares and relativities as determined by the Commonwealth Grants Commission (the Commission). Accurate forecasting of these parameters can mitigate the risk of significant revenue variations in the Territory budget. However, there are inherent difficulties in estimating the size of the pool, the Territory's population and the Territory's relativity over the forward estimates period.

Table 5.1 shows the budget and forward projections for the Territory's GST revenue. The Territory has adopted the Commonwealth's 2007-08 Mid-Year Economic and Fiscal Outlook estimates for national GST collections and population to 2010-11. These estimates are likely to change following the final determination by the Australian Taxation Office of national GST collections, the Australian Bureau of Statistics' determination of population, and the relativities by the Commonwealth Treasurer. Estimates for 2011-12 reflect Northern Territory Treasury projections.

Table 5.1 also shows the associated sensitivity analysis on the Territory's GST revenue. It shows that a small variation (1 per cent) to the key parameters can have a significant impact on the Territory's revenue. There will be a compounding impact if more than one of the parameters change. The outcomes from the Commonwealth Grants Commission's 2010 Review may also significantly impact on

GST projections from 2010-11. Details of the Commission's deliberations will not be known until February 2010.

Table 5.1: Northern Territory
GST Revenue Projections

	2007-08	2008-09	2009-10	2010-11	2011-12
NT GST revenue (\$M)	2 174.4	2 405.9	2 530	2 657.9	2 788.7
Growth (%)	7.9	10.6	5.2	5.1	4.9
National GST collections (\$M)	42 230	45 270	47 670	50 130	52 637.5
Growth (%)	6.8	7.2	5.3	5.2	5.0
NT population	216 035	219 515	222 985	226 436	229 940
Growth (%)	1.6	1.6	1.6	1.5	1.5
NT share of national population	1.021	1.024	1.026	1.028	1.031
NT relativity	4.36824	4.51835	4.51835	4.51835	4.51835
Sensitivity of the Territory's GST revenue to a one per cent variation in key parameters					
National GST collections					
One year only variation (\$M)		20.9	22.1	23.3	24.5
Ongoing variation (\$M)		20.9	44.4	70.6	99.5
Population					
One year only variation (\$M)		23.9	25.1	26.3	27.6
Ongoing variation (\$M)		23.9	50.4	79.7	111.9
Relativity					
One year only variation (\$M)			25.1	26.3	27.6
Ongoing variation (\$M)			25.1	52.9	83.5

Source: Northern Territory Treasury, Commonwealth Government

Other Commonwealth Grants

Other Commonwealth grants are predominantly in the form of specific purpose payments (SPPs). These payments are usually tied to a specific program or function against which they must be acquitted. SPPs are an important means of addressing the large vertical fiscal imbalance that exists in Australia's federal system. In 2008-09, the Territory is expected to receive about \$566.1 million in other Commonwealth grants. The majority of these payments will be in the areas of health, education and transport. A detailed summary of SPPs is included in *Budget Paper No.3*.

SPPs have historically been governed by formal agreements between the Commonwealth 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 through matching or maintenance of effort requirements;
- restriction on how funded programs may be delivered; and
- performance and reporting requirements.

The existing SPP arrangements are currently being reformed by the Council of Australian Governments (COAG) as part of the reform to the architecture of Commonwealth-State Financial Relations. While the reforms will result in changes to SPP arrangements, the Commonwealth has provided assurances that the total level of SPP funding will not decrease. The reforms to Commonwealth-State financial relations are discussed later in this chapter.

Commonwealth Grants Commission

The role of the Commission is to recommend to the Commonwealth an annual set of relativities that determine the distribution of GST revenue among the states. The Commission is required under the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations to base its recommendations on the principle of horizontal fiscal equalisation, 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.
(Commonwealth Grants Commission 2008 Update)

Each state's relativity reflects unavoidable differences in revenue raising capacity (revenue needs) and costs of providing general government services (expenditure needs), and states' shares of SPP funding. Needs reflect differences in states' economic, demographic and physical circumstances and can be positive or negative. Because the Commission assesses needs within a defined level of available funds, a necessary consequence is that a positive need of one jurisdiction means it will be offset by a negative need in at least one other jurisdiction.

The Territory is assessed as having the highest level of needs of all jurisdictions. This is primarily due to the high costs of providing virtually all government services in the Territory and, to a lesser extent, the Territory's below average capacity to raise own-source revenue. This is partly offset by the Territory's relatively high share of SPP funding. Table 5.2 shows the relative revenue, expenditure and SPP needs of each jurisdiction.

Table 5.2: GST Relative Needs 2006-07 (\$ per capita)

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$
Revenue raising capacity	- 19.82	348.67	- 227.54	- 1 104.85	597.31	886.36	428.24	252.88
Expenditure requirements	- 62.65	- 491.98	14.30	492.32	- 85.29	388.87	- 123.21	8 798.76
SPP needs	- 2.63	44.23	- 11.23	- 24.95	- 14.57	- 28.85	99.03	- 509.17
Total needs – difference from equal per capita	- 85.10	- 99.08	- 224.47	- 637.48	497.45	1 246.38	404.06	8 542.48

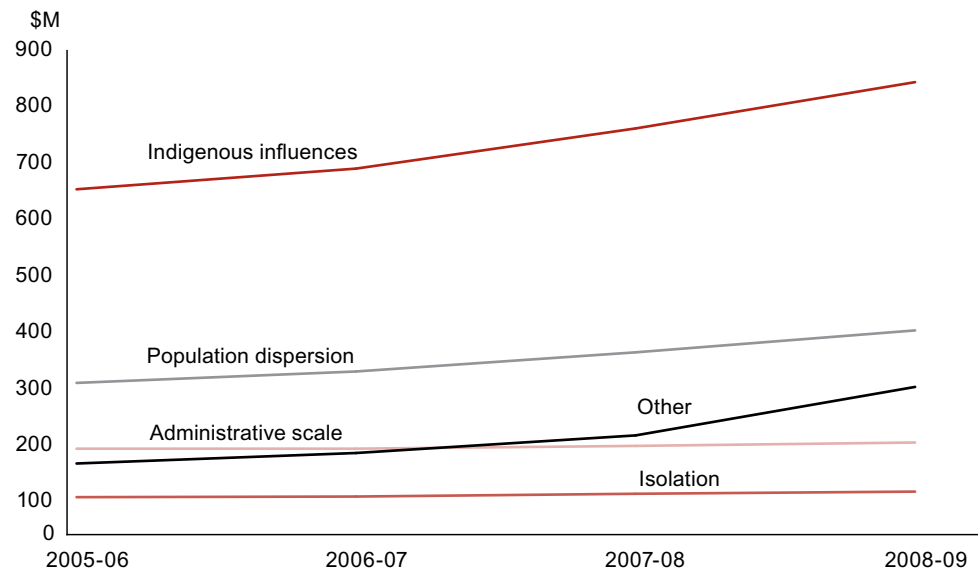
Source: Commonwealth Grants Commission 2008 Update

The costs of providing services in the Territory are high because of:

- the very large proportion of the Indigenous population residing in the Territory, which increases the use and costs of many services;
- the small but widely dispersed population over a large and remote land mass;
- large diseconomies of scale in central administration and the need to provide a high proportion of services in small and dispersed communities;
- small private sector relative to demand, particularly in the area of health services; and
- the Territory's isolation from major supply centres.

Chart 5.1 shows the main factors that contribute to the difference between the Territory's equalised share and equal per capita share of GST revenue. Indigenous influences account for about 45 per cent of the total expenditure needs of the Territory.

Chart 5.1: Contribution of
Expense Disabilities to
Redistribution of Northern
Territory GST Revenue



Source: Commonwealth Grants Commission

2008 Update

Each year, the Commission updates its relativities for the latest available financial, economic and demographic data. In February 2008, the Commission released its Report on State Revenue Sharing Relativities 2008 Update. The 2008 Update report details states' relativities that will be used to distribute the GST pool in 2008-09.

Table 5.3 compares the changes in relativities between the 2007 and 2008 Updates. In the 2008 Update, the Commission recommended an increase in relativities for New South Wales, Victoria, South Australia, the Australian Capital Territory and the Northern Territory. Queensland, Western Australia and Tasmania experienced a decrease in their relativities between updates. Notable developments in the 2008 Update are:

- Western Australia replaced New South Wales as the state with the strongest fiscal capacity; and
- Queensland joined New South Wales, Victoria and Western Australia in requiring less than its per capita share of the GST pool.

Table 5.3: GST Relativities, Grant Shares including Health Care Grants and Population

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
2007 Update								
Relativity	0.89079	0.90096	1.00607	0.94747	1.20791	1.54465	1.16293	4.36824
Grant share (%)	29.14	22.30	20.05	9.49	9.07	3.61	1.87	4.46
Population share (%)	32.75	24.78	19.95	10.03	7.52	2.34	1.61	1.02
2008 Update								
Relativity	0.91060	0.92540	0.96508	0.88288	1.20856	1.52994	1.17205	4.51835
Grant share (%)	29.70	22.93	19.37	8.89	9.04	3.56	1.88	4.62
Population share (%)	32.62	24.79	20.07	10.08	7.48	2.33	1.61	1.02
Impact (\$M)	341.5	316.9	- 409.3	- 326.7	5.8	- 16.2	8.2	79.8
Impact (\$pc)	49.31	60.47	- 97.03	- 154.04	3.68	- 32.74	24.02	369.48

Source: Commonwealth Grants Commission, Commonwealth Government, Northern Territory Treasury

The outcome for the Northern Territory in the 2008 Update was an increase in its relativity from 4.36824 to 4.51835. This translates to a notional increase of \$79.8 million in the Northern Territory's share of GST revenue between updates, based on 2007-08 GST pool and population estimates. In per capita terms, the largest positive impacts were in the Northern Territory (\$369.48), Victoria (\$60.47) and New South Wales (\$49.31). Conversely, the per capita share of GST revenue decreased for Western Australia (-\$154.04), Queensland (-\$97.03) and Tasmania (-\$32.74).

The increase in the Territory's GST is largely attributable to a revised methodology in the roads assessment. The revision to methodology was required due to unreliable data in the previous assessment. The introduction of 2006 Census data in the Commission's assessment also contributed to an increase in the Territory's relativity. The 2006 Census showed a greater than average increase in both the total and Indigenous population for the Territory. These impacts were slightly offset by updates of Australian Institute of Health and Welfare data which showed that Indigenous use of health services had fallen.

The change in other states' relativities between updates was predominantly due to changes in revenue raising capacity. This reflects the different stages of the economic cycle in each jurisdiction. In particular, the continued strength of the resource sector and the flow on impacts of the property market in Western Australia and Queensland have led to these states having greater capacity to raise revenue, and therefore less reliance on GST revenue.

Table 5.4 shows the main contributors to the changes in state relativities between the 2007 and 2008 Updates.

Table 5.4: Main Influences on Changes in State Allocations from the GST Pool, 2008 Update

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M	\$M
Population characteristics	257.9	62.6	- 228.6	- 53.0	- 52.9	- 9.8	- 3.5	27.4	347.8
Stamp duty on conveyances	180.8	93.6	- 143.8	- 138.6	3.8	- 2.8	4.8	2.3	285.2
Roads	- 125.4	- 28.7	76.4	- 5.5	14.1	8.4	- 2.4	63.0	161.9
Mining revenue	42.6	59.9	- 26.1	- 102.2	17.5	1.9	4.0	2.3	128.2
Other	- 14.4	129.5	- 87.2	- 27.4	23.3	- 13.9	5.3	- 15.1	158.1
Total	341.5	316.9	-409.3	-326.7	5.8	-16.2	8.2	79.8	752.2

Source: Commonwealth Grants Commission 2008 Update

2010 Review

Every five years, the Commission conducts a major review of the method used to determine states' 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 Commission received the terms of reference from the Commonwealth for the 2010 Review in May 2005. The terms of reference directed the Commission to report by February 2010 on per capita relativities that should be used to distribute GST revenue between states from 2010-11. In doing so, the Commission has been asked to examine ways to simplify the methodology used to determine the allocation of GST providing it remains consistent with the principle of horizontal fiscal equalisation.

The 2010 Review is an iterative process with significant input from all jurisdictions. A key component of the review process is a series of workplace discussions in each state. The purpose of these discussions is to give the Commissioners and Commission staff an opportunity to gain first hand experience of the issues faced in each jurisdiction in delivering services and to hold informal talks with staff actively engaged in delivering services. The Commission is conducting workplace discussions in every state during the first half of 2008. The Northern Territory's workplace discussions were held in the week of 14-18 April 2008.

Council of Australian Governments Reform Agenda

COAG Working Groups

On 20 December 2007, the Council of Australian Governments (COAG) agreed to an ambitious work plan to progress a comprehensive new microeconomic reform agenda. Seven working groups were established by COAG to develop implementation plans in the areas of:

- health and ageing;
- productivity;
- climate change and water;
- infrastructure;
- business regulation and competition;
- housing; and
- Indigenous reform.

Each COAG working group will be responsible for developing outputs, outcomes and performance indicators which will be included in new SPP arrangements. Treasurers will be responsible for determining the level of funding required in order to achieve the agreed outcomes and outputs and will also provide advice on performance indicators.

Health and Ageing

The Health and Ageing Working Group is responsible for developing plans to improve health outcomes for all Australians and the sustainability of the Australian health system. The reforms will extend across the full range of preventative, primary, acute and aged care health services and across the public and private sectors. In the short term, the health and ageing working group will focus on elective surgery waiting times, investing in aged care and public dental programs, general practice superclinics and preventative health care.

Productivity

The Productivity Working Group will pursue substantial reform in the areas of education skills and early childhood. Early initiatives include improving and expanding vocational and technical education, investing in early education through universal access to learning for all four year old children, development and implementation of a national curriculum in key learning areas and lifting the year 12 retention rate to 90 per cent by 2020.

Climate Change and Water

The Climate Change and Water Working Group will develop plans to ensure a national response to climate change including a single national emissions trading scheme and sustainable water use across Australia. Work will include a plan for achieving an expanded Mandatory Renewable Energy Target.

Infrastructure

The Infrastructure Working Group will ensure better coordination of infrastructure planning and investment. In 2008, a national infrastructure audit will be undertaken to develop a list of priority infrastructure that is required to improve national productivity.

Business Regulation and Competition

The Business Regulation and Competition Working Group is responsible for accelerating and broadening the regulation reduction agenda, improving processes for regulation and review, and delivering significant improvements in Australia's competition, productivity and international competitiveness.

Housing

The Housing Working Group will examine ways to improve housing affordability and ease rental stress in Australia. The working group will examine key housing initiatives that will: facilitate improved housing supply through release of surplus government land; provide incentives to build affordable housing; and increase the number of homes for homeless people.

Indigenous Reform

The Indigenous Reform Working Group is responsible for developing strategies to close the gap on Indigenous disadvantage, in particular, closing the life expectancy gap within a generation and halving the gaps in child mortality rates, reading, writing and numeracy outcomes and Indigenous employment outcomes within a decade. Additional targets include providing all four-year olds in remote communities with access to early childhood education within five years, and halving the gap for year 12 (or equivalent) attainment by 2020. The working group will develop action plans in the areas of health, education, affordable housing and water supply in the bid to improve the welfare of Indigenous Australians. Early reforms will target reducing the number of Indigenous people on elective surgery waiting lists and those who are homeless, and provide 48 000 dental services for Indigenous Australians over four years. In 2008, the working group will develop reform proposals on Indigenous early childhood development, protective security from violence for Indigenous parents and children, remote service delivery and workforce planning, economic participation and active welfare.

Reform of Commonwealth-State Financial Relations

Underpinning the COAG agenda is a reform of the architecture of Commonwealth-State financial relations. The changes to the intergovernmental financial arrangements were largely driven by state concerns regarding the structure of the current SPP arrangements. States have consistently argued that the current SPP arrangements lead to inefficiencies, including duplication of functions at both levels of government, distortion of services and reduced state budget flexibility by limiting states' ability to increase funding in other priority areas.

The centrepiece of the new arrangements will be a clear statement of the roles and responsibilities of the Commonwealth and the states. This will result in reduced duplication and waste and enhance accountability to the community. Furthermore, SPPs will focus on outcomes and outputs rather than include stringent input controls on how states deliver and/or fund services. As a result, states will have greater flexibility to tailor services to meet individual community needs.

Therefore the reforms to Commonwealth-State Financial Relations are designed to reduce the administrative and reporting burden on the states and to improve the efficiency of these payments in delivering agreed outcomes. This will be achieved through a reduction in the number of SPPs, without reducing Commonwealth funding.

The majority of the current SPPs will be aggregated into the new national SPPs. National SPPs will cover the core government areas of health, affordable housing, early childhood and schools, vocational education and training, and disability services. National SPPs will be ongoing rather than tied to fixed terms, with periodic review to ensure that funding levels are adequate to meet the objectives of the SPPs. Treasurers will negotiate funding levels and appropriate indexation formulae for each SPP.

Central to each of the new national SPP agreements will be mutually-agreed Statements of Objectives, Outcomes and Outputs. The agreements will clearly set out:

- what the Commonwealth and the states expect to achieve from the joint involvement – the objectives and expected outcomes (including a new focus on enhancing social inclusion and addressing Indigenous disadvantage);
- the role of each jurisdiction, their responsibilities and accountabilities; and
- performance indicators to assess progress in achieving stated objectives.

The remaining SPPs will be converted to National Partnership payments or general revenue assistance. National Partnerships will be agreements between the Commonwealth and the state to fund specific projects in areas of joint responsibility, such as transport, environment and water. National Partnership payments will also be the mechanism by which the Commonwealth provides incentive payments to the states to drive nationally significant reforms or to fulfil its election commitments. Incentive payments will be additional to current SPP funding levels.

The outcomes from the reform to Commonwealth-state financial relations will be incorporated in a new intergovernmental agreement expected to be finalised at the COAG meeting in December 2008. The new arrangements are expected to commence in 2009 and be fully operational by 2009-10.