



Inquiry into Commonwealth Payments to Victoria

Final Report
November 2012

Legislative Council

Economy and Infrastructure
References Committee

Report No. 2



Inquiry into Commonwealth Payments to Victoria
Final Report

Legislative Council

Economy and Infrastructure References Committee

November 2012

Ordered to be Printed

By Authority
Government Printer for the State of Victoria

No. 202 Session 2010-12

Legislative Council Economy and Infrastructure References Committee

Inquiry into Commonwealth Payments to Victoria

ISBN: 978-0-9872446-6-6

Table of contents

Economy and Infrastructure References Committee	1
Committee Members	1
Committee Staff	1
Chair’s Foreword	3
Findings and Recommendations	5
Acronyms	11
1. Introduction	13
1.1 <i>Terms of reference</i>	13
1.2 <i>Inquiry Process</i>	13
1.3 <i>Scope of the Committee’s Inquiry</i>	14
2. Federal-State Financial Relations	15
2.1 <i>Australia’s Federal Financial Relations</i>	15
2.2 <i>Federal Financial Relations Framework</i>	18
2.2.1 General Revenue Assistance	20
2.2.2 National Specific Purpose Payments	20
2.2.3 National Partnership Payments	20
2.2.4 Commonwealth Own Purpose Expenditure and Direct Outlays	21
2.2.5 Financial Assistance Grants to Local Government	21
2.3 <i>Victoria and its contribution to the Australian economy</i>	21
2.3.1 Land Area	21
2.3.2 Population	22
2.3.3 Gross State Product	24
2.3.4 Revenue	24
2.3.5 Road Network	26
2.4 <i>Local Government revenue and expenditure</i>	26
3. National Partnership Payments	29
3.1 <i>Overview of National Partnership Payments</i>	29
3.1.1 Funding for National Partnership Payments	29
3.2 <i>Victoria’s share of National Partnership Payments</i>	31
3.2.1 Historical analysis of the states’ share of Commonwealth funding	31
3.2.2 Funding provided to Victoria through NPPs	33
3.2.3 Differences in NPP funding across areas of government service delivery	35
3.2.3.1 Health NPPs	35
3.2.3.2 Education NPPs	36
3.2.3.3 Skills and Workforce Development NPPs	38
3.2.3.4 Community Services NPPs	39
3.2.3.5 Affordable Housing NPPs	40
3.2.3.6 Infrastructure NPPs	40
3.2.3.7 Environment NPPs	42
3.2.3.8 Contingent NPPs	43
3.2.3.9 Other NPPs	43
3.2.3.10 Summary	44
3.3 <i>Victoria’s fair share</i>	45
3.3.1 Distribution of NPP funding between states and territories	46
3.3.2 The current basis of the distribution of NPP funding	46
3.3.3 Impact of implementing per capita funding for NPPs	48
3.3.4 NPPs and their relationship to other Commonwealth payments	49

3.3.5 Committee view	51
3.4 <i>Reporting on National Partnership Payments</i>	52
3.4.1 National Partnership Payments Reporting Framework	52
3.4.2 Compliance with reporting guidelines	53
3.4.3 Reviews of NPP reporting arrangements	54
3.4.4 Increasing number of National Partnerships	56
3.4.5 Committee view	57
3.5 <i>Requirements placed on National Partnership Payments</i>	58
3.5.1 Commonwealth guidelines on input and financial controls	59
3.5.2 Compliance with guidelines on input and financial controls	60
3.5.3 Reviews of National Partnership funding requirements	62
3.5.4 Committee view	62
3.6 <i>Future of programs funded by National Partnership Payments</i>	63
3.6.1 Impact of expiring National Partnerships on states' budgets	63
3.6.2 Service delivery impacts of expiring National Partnerships	64
3.6.3 Current treatment of expiring National Partnerships	66
3.6.4 Future treatment of expiring National Partnerships	68
3.6.5 Committee view	69
4. Financial Assistance Grants to Local Government	71
4.1 <i>History of Financial Assistance Grants to Local Government</i>	71
4.2 <i>Funding provided through Financial Assistance Grants</i>	72
4.2.1 Distribution of funding between states and territories	74
4.3 <i>Framework for distribution of Financial Assistance Grants within Victoria</i>	76
4.4 <i>Victoria's Share of General Purpose Grants</i>	77
4.4.1 Cost pressures on local government	77
4.4.2 Importance of Financial Assistant Grants to rural local governments	79
4.4.3 Commonwealth review of Financial Assistance Grants	81
4.4.4 Committee view	82
4.5 <i>Victoria's Share of Local Road Grants</i>	83
5. Commonwealth Own Purpose Expenditure	87
5.1 <i>Definitions of Commonwealth Own Purpose Expenditure and Direct Outlays</i>	87
5.2 <i>Matters to be examined under the Terms of Reference</i>	88
5.3 <i>Estimating Commonwealth Own Purpose Expenditure</i>	88
5.4 <i>Victoria's share of Commonwealth Own Purpose Expenditure</i>	89
5.4.1 Victoria's share of COPE across expenditure areas	90
5.4.2 Changes in Victoria's share of Commonwealth direct expenditure over time	91
5.4.3 Impact of Indigenous population on COPE	92
5.4.4 Commonwealth Public Service	94
5.5 <i>Measuring outcomes as opposed to expenditure</i>	94
Appendix A: List of Written Submissions Received	99
Appendix B: Schedule of Public Hearings	101
Appendix C: National Partnership Payments Questionnaire	103

Economy and Infrastructure References Committee

Committee Members

Ms Jaala Pulford – Chair
Member for Western Victoria Region

Mrs Andrea Coote – Deputy Chair
Member for Southern Metropolitan Region

Mr Greg Barber
Member for Northern Metropolitan Region

Ms Candy Broad
Member for Northern Victoria Region

Mr Damian Drum
Member for Northern Victoria Region

Mr Bernie Finn
Member for Western Metropolitan Region

Mr Simon Ramsay
Member for Western Victoria Region

Mr Adem Somyurek
Member for South Eastern Metropolitan Region

Committee Staff

Mr Robert McDonald – Secretary to the Committee

Ms Vicky Delgos – Research Officer (*until 3 August 2012*)

Mr Sean Marshall – Research Assistant

Mr Anthony Walsh – Research Assistant

Address all correspondence to –

Economy and Infrastructure References Committee
Department of the Legislative Council
Parliament of Victoria
Spring Street
MELBOURNE VIC 3002

Telephone: (03) 8682 2817
Facsimile: (03) 9651 8799
Email: eic@parliament.vic.gov.au
Web: www.parliament.vic.gov.au/standing-committee-on-economy-and-infrastructure
Twitter: @VicParlCtees #eictee

Chair's Foreword

I am pleased to present the report of the Economy and Infrastructure References Committee on its Inquiry into Commonwealth payments to Victoria.

Victoria is heavily reliant on payments from the Commonwealth due to the high level of vertical fiscal imbalance in Australia. The Commonwealth is the major collector of revenue, through income tax and GST, whereas the states are the principal providers of services, particularly in the areas of health and education, which requires significant expenditure. In order for the states to be able meet these expenditure responsibilities, the Commonwealth transfers a large proportion of the revenue it collects to the states. Ever since Federation, the level of financial assistance provided by the Commonwealth to the states has been an area of contention between the two levels of government. Given approximately half of Victoria's income is generated from grants from the Commonwealth, the adequacy of these payments is crucial to Victoria's finances.

The Committee was asked to undertake this Inquiry at a time of considerable financial uncertainty throughout the world. Following the Global Financial Crisis, all national governments have been required to review their income and expenditure to safeguard their financial stability. In Australia, the Commonwealth undertook significant additional expenditure from 2008 to 2011 in order to stimulate the Australian economy and protect it from recession. The stimulus program resulted in substantial increases to grants to the states, enabling them to undertake numerous infrastructure projects. Although the stimulus spending is now being gradually wound down, the Commonwealth continues to provide significant funding to the states, with \$90.4 billion due to be paid to the states in 2012-13, of which \$21 billion is provided to Victoria.

The Terms of Reference required the Committee to examine two specific types of Commonwealth grants — National Partnership Payments (NPPs) and Local Government Financial Assistance Grants — as well as Commonwealth Own Purpose Expenditure undertaken within Victoria. The Terms of Reference did not include an examination of General Revenue Assistance (principally GST payments) and National Specific Purpose Payments (NSPPs) which are the two major sources of Commonwealth funding to Victoria. GST payments and NSPPs accounted for 80 per cent of Commonwealth payments to Victoria in 2011-12 and Commonwealth Budget Papers predict Victoria's share of these payments will rise from \$17.1 billion in 2011-12 to \$21.7 billion by 2015-16. As these payments were outside the Terms of Reference, the Committee's Inquiry was restricted and it was difficult for the Committee to draw meaningful conclusions regarding Victoria's share of Commonwealth funding.

The major focus of the Inquiry was NPPs, which are time limited agreements between the Commonwealth and the states and territories enabling them to deliver large projects and undertake significant reforms. The level of funding provided through NPPs is predicted to decrease in coming years, due to the expiration of a number of stimulus programs. Despite the level of funding decreasing, the number of agreements has risen, with numerous NPPs targeted at lower value programs and projects.

The Committee discovered that even for lower value NPPs, the related National Partnership Agreements are often complex and require extensive reporting to the Commonwealth on how money is spent. In some cases, agreements are also placing an unnecessary burden on the Victorian Government agencies and departments and reducing Victoria's ability to deliver projects innovatively and efficiently. The Committee concluded there is an overuse of these agreements, and many are overly burdensome. We encourage the Victorian Government to work with the Commonwealth to reduce the number of these agreements and the related administrative requirements.

The Committee also investigated the level of funding provided to Victoria through NPPs and examined whether Victoria is receiving its fair share of these payments. This proved a difficult task, as a number of NPPs are targeted at specific programs to address areas of Indigenous disadvantage, meaning comparisons to state population shares are not appropriate. Further complexity is added as some NPPs are later included in equalisation calculations to determine GST distributions and others are not. The Committee believes the relationship between NPPs and GST funding adds complexity to the current system of Commonwealth payments to the states and

reduces transparency. The Committee encourages the Victorian Government to advocate for a simplified and more transparent system of payments to the states.

The final aspect of NPPs examined by the Committee was expiring agreements. The Committee discovered that there is currently no consistent process for considering expiring NPPs to determine whether further funding is required. The Committee noted a small number of expiring NPPs are currently assisting to fund improved service delivery to Victorians and these programs may be put at risk without further Commonwealth funding. This issue is currently being examined by the Council of Australian Governments (COAG), and the Committee urges the Victorian Government to advocate through COAG for an effective system of reviewing expiring NPPs.

The second major area examined by the Inquiry was Financial Assistance Grants to Local Government. The Committee found that a number of Victorian local governments, particularly those in regional areas, are heavily reliant on these grants due to their limited ability to raise own source revenue. Unfortunately, the value of these grants has increased at a rate well below local government expenditure and well below the growth in Commonwealth revenue. This has placed significant financial pressure on some councils. The Committee believes the Commonwealth must review the way it calculates the level of funding provided through these grants, so that they increase at a rate more in line with local government's expenditure responsibilities.

General Purpose Financial Assistance Grants are distributed between states on a per capita basis. However, within Victoria, the Victorian Grants Commission divides these grants between individual local governments using an equalisation formula. This formula aims to provide each Council with the same capacity to deliver services. Smaller councils and rural councils are therefore given larger grants in order to meet the higher cost of service delivery in their local government area. This is a logical approach and should be continued. However, it is interesting to note the inconsistency between this equalisation method used within Victoria and the repeated argument by the Victorian Government that Commonwealth funding should be allocated on a per capita basis.

The final area examined by the Inquiry was Commonwealth Own Purpose Expenditure (COPE), which is an expense made by the Commonwealth Government in the conduct of its own activities. The Committee attempted to quantify Victoria's share of COPE and found it is broadly in line with its population share, particularly if expenditure is adjusted for demographic factors. However, the Committee feels a focus on ensuring Victorians receive equitable outcomes from Commonwealth expenditure is also important, and encourages the Victorian Government to do further work in this area and advocate for additional resources for Victoria in areas where this is not currently being achieved.

I would like to express my gratitude to all those who provided evidence to the Committee. I would also like to thank my fellow Committee members for their contribution to this Inquiry: Mrs Andrea Coote (Deputy Chair), Mr Greg Barber, Ms Candy Broad, Mr Damian Drum, Mr Bernie Finn, Mr Simon Ramsay and Mr Adem Somyurek. Finally, on behalf of my colleagues on the Committee, I acknowledge the hard work of the Secretariat over the course of this Inquiry and towards the preparation of this report: Mr Robert McDonald, Ms Vicky Delgos, Mr Sean Marshall and Mr Anthony Walsh.

I commend this report to the Parliament.

**JAALA PULFORD
CHAIR**

Findings and Recommendations

Chapter 2 — Federal-State Financial Relations

Finding 1

Due to the high level of vertical fiscal imbalance in Australia, Victoria is heavily reliant on transfers from the Commonwealth to meet its expenditure obligations. The adequacy of these payments directly impacts the State Government's capacity to meet the needs of Victorians and deliver services.

[page 18]

Chapter 3 — National Partnership Payments (NPPs)

Victoria's share of National Partnership Payment funding

Finding 2

In 2009 and 2010, the Commonwealth provided significant additional funding to the states through NPPs to undertake major projects as a stimulus measure in response to the global financial crisis. The majority of these projects have now been completed, resulting in a reduction in NPP funding.

[page 34]

Finding 3

Victoria's share of NPPs varies significantly across each of the different areas of government service delivery.

[page 45]

Finding 4

Given the varied nature and objectives of NPPs, it is not always appropriate to measure Victoria's share of NPP funding against its per capita population share or contribution to the national economy. Where a National Partnership Agreement provides funding for multiple states, the funding should be allocated in accordance with criteria relevant to the individual agreement.

[page 51]

Finding 5

The Commonwealth currently provides financial assistance to states to address areas of disadvantage (such as indigeneity, remoteness and socio-economic factors) through both equalisation of GST payments and NPPs. The overlap in the role of these two types of payments adds complexity to Federal-State financial relations and reduces transparency.

[page 51]

Recommendation 1

The Committee recommends that the Victorian Government continue to advocate for improvements to the current GST distribution system to ensure a more transparent system of Commonwealth payments to the States and enable NPP funding to achieve its stated purposes.

[page 51]

Reporting on National Partnership Payments

Finding 6

Although there have been significant improvements to the systems for reporting on Commonwealth payments to Victoria since the introduction of the 2008 Intergovernmental Agreement on Federal Financial Relations, some National Partnership Agreements continue to impose onerous and unnecessary reporting requirements on Victoria.

[page 58]

Finding 7

The rising number of National Partnerships is increasing the administrative burden placed on Victoria and preventing the objectives of the Intergovernmental Agreement on Federal Financial Relations from being fully realised.

[page 58]

Recommendation 2

The Committee recommends that the Victorian Government actively engage with the working group established by the Council of Australian Governments (COAG) to review the proliferation of National Partnership Agreements and advocate for a reduction in the number of agreements and a rationalisation of the reporting arrangements.

[page 58]

Requirements placed on National Partnership Payments

Finding 8

Progress towards the commitment in the 2008 Intergovernmental Agreement on Federal Financial Relations to reduce Commonwealth prescriptions on service delivery by the states has been slow. Input controls and financial controls are still included in a number of current National Partnership Agreements and in some instances these requirements have reduced the ability of Victorian Government departments to deliver services efficiently and innovatively.

[page 63]

Expiring National Partnerships

Finding 9

A number of National Partnerships due to expire on or before 30 June 2013 require ongoing Commonwealth funding in order to continue programs and services currently funded through those agreements. If further funding is not provided, services to Victorians will be negatively impacted.

[page 66]

Recommendation 3

The Committee recommends the Victorian Government continue to monitor expiring National Partnerships and annually report on the potential service delivery impacts of those agreements not being renewed through the Budget Papers.

[page 66]

Finding 10

There is no consistent mechanism for evaluating expiring National Partnership Agreements to determine whether ongoing funding is needed to maintain improved service delivery standards. The absence of such a process creates uncertainty and imposes significant risks on the budgets of the states.

[page 69]

Recommendation 4

The Committee recommends that the Victorian Government actively engage with the working group established by COAG to review expiring National Partnership Agreements to ensure all such agreements are identified and that appropriate levels of ongoing funding are provided to maintain improved service delivery standards.

[page 69]

Recommendation 5

The Committee recommends that the Victorian Government advocate through COAG for an ongoing working group to be established to regularly review expiring National Partnership Agreements to ensure early identification of agreements where ongoing funding will be required to improve budget certainty for the states.

[page 70]

Chapter 4 — Financial Assistance Grants to Local Government

General Purpose Grants

Finding 11

General purpose Financial Assistance Grants (FAGs) are distributed between states on a per capita basis which ensures all states receive an appropriate share relative to their populations.

[page 79]

Finding 12

The current level of funding provided through FAGs, which is indexed based on population growth and the consumer price index (CPI), has not kept pace with the expenditure responsibilities of local governments, meaning they must increasingly rely on own source revenue.

[page 79]

Finding 13

The revenue raising capacity of local governments varies significantly across Victoria. Due to their limited ability to raise own source revenue, some smaller rural councils are heavily dependent on grants, which puts at risk their ongoing financial sustainability.

[page 81]

Recommendation 6

The Committee recommends that the Victorian Government advocate to the Commonwealth Government for changes to the method of calculating the escalation factor of the FAG pool so that FAGs increase at a rate in line with local government's expenditure responsibilities and that all such grants remains untied.

[page 83]

Local Roads Grants

Finding 14

Victoria's share of local road grants is fixed at 20.6 per cent, a substantially smaller proportion than Victoria's population share of 24.8 per cent. The basis for distributing these road grants is out-dated and in need of review.

[page 84]

Recommendation 7

The Committee recommends that the Victorian Government respond to the Road Safety Committee's September 2010 Report on Federal-State Road Funding Arrangements.

[page 85]

Chapter 5 — Commonwealth Own Purpose Expenditure (COPE)

Finding 15

The allocation of COPE between states and territories is influenced by demographic factors, including the size of the Indigenous population and geographic remoteness. COPE therefore cannot be accurately compared to overall per capita shares.

[page 93]

Finding 16

Victoria has a lower proportion of the Australian Indigenous population and is geographically compact compared to other states and the Northern Territory, therefore Victoria's share of COPE is expected to be slightly lower than a strict per capita share.

[page 93]

Finding 17

The quantity of COPE within Victoria is not a reliable measure of whether Victoria receives its fair share of Commonwealth resources in all circumstances. It is more appropriate to measure outcomes, as opposed to outputs, to determine whether Victorians are receiving equal benefit from Commonwealth expenditure and outlays.

[page 96]

Recommendation 8

The Committee recommends the Victorian Government review Commonwealth Government and Productivity Commission performance reporting on Commonwealth Government activities and advocate for additional resources to be allocated to Victoria where equitable outcomes for Victorians are not currently being achieved.

[page 97]

Acronyms

ALGA – Australian Local Government Association

CPI – Consumer Price Index

CGC – Commonwealth Grants Commission

COAG – Council of Australian Governments

COPE – Commonwealth Own Purpose Expenditure

DEEWR – Department of Education, Employment and Workplace Relations

FAGs – Financial Assistance Grants

FaHCSIA – Department of Families, Housing, Community Services and Indigenous Affairs

GSP – Gross State Product

GST – Goods and Services Tax

HoTs – Heads of Treasuries

HFI – Horizontal Fiscal Imbalance

HFE – Horizontal Fiscal Equalisation

IGAFFR – Intergovernmental Agreement on Federal Financial Relations

IPs – Implementation Plans

JCPAA – Commonwealth Parliament's Joint Committee of Public Accounts and Audit

LSOPs – Long Stay Older Patients

MAV – Municipal Association of Victoria

NPs – National Partnerships

NPPs – National Partnership Payments

NSPPs – National Specific Purpose Payments

RoGS – Report on Government Services

VFI – Vertical Fiscal Imbalance

VGC – Victoria Grants Commission

1. Introduction

1.1 Terms of reference

On 28 February 2012, the Legislative Council agreed to the following resolution:

That this House —

- (1) notes that Australia experiences one of the highest mismatches of expenditure responsibilities and revenue raising capacity (vertical fiscal imbalance) of any federation in the world which means the States are heavily reliant on Commonwealth financial transfers; and
- (2) requires the Economy and Infrastructure References Committee to inquire into, consider and report by 30 November 2012 on the level and nature of the following Commonwealth recurrent funding —
 - (i) National Partnership Payments – time limited funding that is provided for a specific project, program or reform.
 - (ii) Financial Assistance Grants to Local Government – provided through the state to local governments as general purpose revenue.
 - (iii) Commonwealth Own Purpose Expenditure – payments made by the Australian Government in the conduct of its own general government sector activities, and includes expenses for the purchase of goods and services and associated transfer payments.
 - (iv) Direct Outlays – the Commonwealth’s operations or activities undertaken in Victoria.
 and in respect of each —
 - (a) whether the current share of funding Victoria is receiving is satisfactory relative to its population share and its contribution to the Australian economy, and the extent and nature of changes in that share over time;
 - (b) whether the adequacy of Victoria’s share varies across each of the different areas of government service delivery and economic activity;
 - (c) if the requirements imposed on funding are reducing the scope for innovation and service delivery efficiencies;
 - (d) whether the costs of administration and associated reporting under funding agreements are appropriate; and
 - (e) the future of programs at the expiry of funding agreements.

1.2 Inquiry Process

Upon receiving this Inquiry, the Committee held a private briefing on 18 April 2012 with the Assistant Treasurer, Hon. Gordon Rich-Phillips, and Mr Brendan Flynn, Deputy Secretary, Economic and Financial Policy Division, Department of Treasury and Finance, who provided an overview of the Terms of Reference. Following the briefing, a discussion paper was prepared and on 23 April 2012, the Committee advertised the Inquiry in *The Australian* and *The Australian Financial Review*, seeking written submissions. The Committee also wrote to 133 individuals and organisations, including all local governments within Victoria, all Victorian Government Departments, interstate treasuries and a number of academics, providing a copy of the discussion paper and seeking a written submission.

Submissions closed on Friday, 8 June 2012. At the close of submissions, the Committee had a total of five written submissions. The Committee received a late sixth submission, from the Victorian Government, on 28 June 2012. Regrettably, the Government submission was released to the media and details were published in *The Australian* on 2 July 2012, prior to it being accepted by the Committee. A list of submissions received is provided in Appendix A.

As part of the Inquiry process, the Committee also sought information from Victorian Government Departments on National Partnership Payments via a questionnaire. A copy of the questionnaire is reproduced in Appendix C. The questionnaire was sent on Thursday, 21 June 2012 and requested a response by Friday, 27 July 2012, providing each Department with five weeks to respond. The

Department of Business and Innovation and the Department of Planning and Community Development responded by the due date stating they do not receive any National Partnership Payments. The Department of Justice returned the surveys on the due date for the two National Partnership Payments it receives. The Department of Treasury and Finance elected to collate the responses from the remaining Departments. These responses were provided to the Committee as a group on 15 August 2012.

The delays by the Victorian Government, both in providing a submission and in returning surveys, have hampered the Committee's ability to effectively undertake the reference. Despite advertising and a significant direct mail-out, the reference has also failed to generate significant interest in the community and with other organisations, resulting in a low number of submissions being received. Given the limited evidence provided to the Committee, extensive research and analysis of budget papers has been undertaken to enable the Committee to effectively respond to the Terms of Reference.

The Committee held one public hearing on 10 October 2012 with the Assistant Treasurer and representatives from the Department of Treasury and Finance. A full list of witnesses who appeared before the Committee is provided in Appendix B. The hearing expanded on the Victorian Government's written submission and provided further information about current Commonwealth reviews being undertaken into matters relevant to the Committee's Terms of Reference.

The Committee gratefully acknowledges the valuable contributions made by all submitters and the public hearing witnesses.

1.3 Scope of the Committee's Inquiry

The scope of the Committee's Inquiry is narrowed to four types of Commonwealth funding:

- National Partnership Payments (NPPs);
- Financial and Assistance Grants to Local Government;
- Commonwealth Own Purpose Expenditure; and
- Direct Outlays.

The scope of the Inquiry does not include Goods and Services Tax (GST) revenue or National Specific Purpose Payments, which comprise a large proportion of Victoria's annual revenue, totalling 62 per cent of Commonwealth grants to Victoria in 2011-12. National Partnership Payments and Financial and Assistance Grants to Local Government comprise the remaining 38 per cent.¹ Commonwealth Own Purpose Expenditure and Direct Outlays are not paid to Victoria, but are expenses for the acquisition of goods and services and associated transfer payments by the Commonwealth Government in the conduct of its own general government activities.²

¹ Commonwealth Government, *Final Budget Outcome 2011-12, Part 3: Australia's Federal Relations*, p. 66.

² Commonwealth Government, *Federal Finance Circular No. 2010/02*, 9 December 2011, p. 2. <http://www.federalfinancialrelations.gov.au/content/circulars/circular_2011_02.pdf>, accessed 29 August 2012.

2. Federal-State Financial Relations

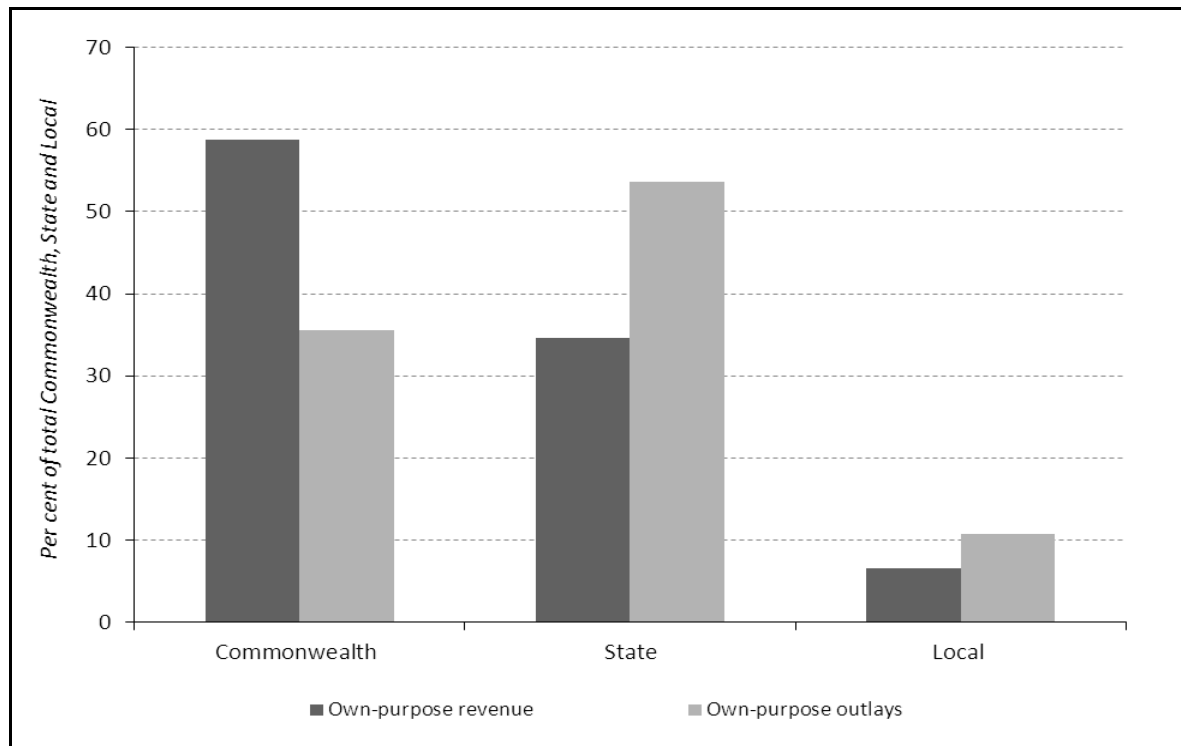
2.1 Australia's Federal Financial Relations

Financial relations between the Commonwealth and the states and territories have undergone a number of significant changes since Australia became a federation in 1901. Soon after Federation, it became apparent that the financial capacities varied substantially among states. From 1910, the Commonwealth Government used its powers under section 96 of the Commonwealth Constitution³ to make special grants to financially weaker states. Initially the grants were provided using various ad hoc processes and varying criteria, however, in 1933 the Commonwealth Grants Commission (CGC) was established to devise consistent principles for the distribution of grants to the states.⁴

The processes used by the Commonwealth to determine the level of financial assistance given to states have always been contentious. Numerous reviews have been undertaken since Federation with different states and territories seeking a greater share of Commonwealth payments. The distribution of payments by the Commonwealth is of heightened importance in Australia due to its high level of vertical fiscal imbalance (VFI).

VFI refers to the difference between the relative revenue and spending responsibilities of the Commonwealth and the states. In Australia, the Commonwealth collects the vast majority of taxes, and in particular has exclusive power to impose duties of customs and of excise, and has been solely responsible for collection of income tax since 1942. The states and territories on the other hand are responsible for delivering a majority of services, such as in the areas of education and health. Chart 2.1 shows the difference between the revenue raising and service delivery responsibilities of the three levels of government in Australia.

Chart 2.1: Shares of national revenue raised and service delivery responsibilities 2011-12



Source: Victorian Government Submission, p. 5.

³ Section 96 of the Commonwealth Constitution states: During a period of ten years after the establishment of the Commonwealth and thereafter until the Parliament otherwise provides, the Parliament may grant financial assistance to any State on such terms and conditions as the Parliament thinks fit.

⁴ Commonwealth Grants Commission, *The Commonwealth Grants Commission: The Last 25 years*, p. 31.

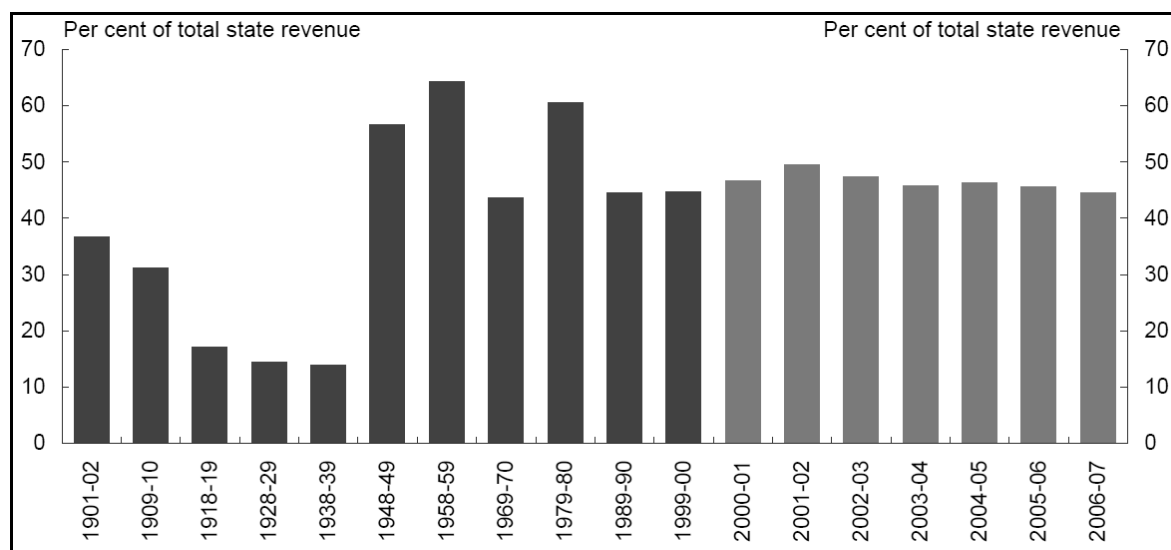
The level of vertical fiscal imbalance in Australia has varied significantly over the 111 years since Federation, particularly following major changes to the taxation system. In 1901-02, 41 per cent of revenue was collected by the Commonwealth. This increased to 85 per cent in 1946-47 following the discontinuation of state income tax in 1942. Payroll taxes were transferred to the states in 1971-72, which provided the states with an additional tax base, and a number of other state taxes were gradually introduced, which meant by 1981-82 the Commonwealth's share of revenue had reduced to 64 per cent. However, following the introduction of the Goods and Services Tax (GST) in 2001, which involved a commitment by the states to remove a number of state taxes, by 2006-07, 81 per cent of revenue was again collected by the Commonwealth.⁵ Table 2.1 and Chart 2.2 show the changes in revenue raising responsibilities over time.

Table 2.1: Proportion of revenue collected under Commonwealth and State legislation

Year	Proportion collected under Commonwealth legislation	Proportion collected under State legislation	Proportion transferred to states	Final proportion in state hands
1901-02	41%	59%	34%	93%
1909-10	41%	59%	27%	86%
1946-47	85%	15%	13%	28%
1981-82	64%	36%	18%	54%
2006-07	81%	19%	21%	40%

Source: Commonwealth Grants Commission, *The Commonwealth Grants Commission: The Last 25 years*, p. 31.

Chart 2.2: Vertical fiscal imbalance since Federation



Source: Australian Treasury, *Architecture of Australia's tax and transfer system*, p. 301.

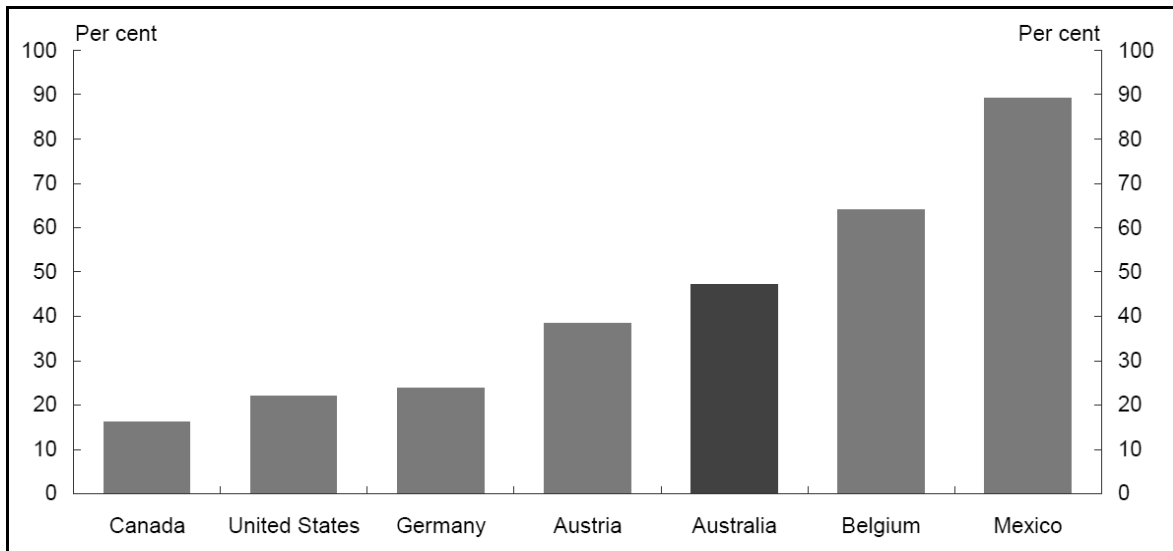
As shown in Chart 2.2 approximately 45 to 50 per cent of state revenue has been derived from grants from the Commonwealth for the majority of the last 60 years. Given Australia's system of federal finances is principally a result of the Australian Constitution, which provides significant revenue raising powers to the Commonwealth, and comparatively limited revenue raising ability to the states, it is unlikely the level of VFI will change significantly in the future. The states will therefore continue to be heavily reliant on Commonwealth transfers, and the level of funding provided through these payments will directly impact the states' capacity to meet their expenditure obligations and deliver services. This issue was highlighted by the Assistant Treasurer at a public hearing:⁶

⁵ Commonwealth Grants Commission, *The Commonwealth Grants Commission: The Last 25 years*, p. 31.
⁶ Hon. G. Rich-Phillips, Assistant Treasurer, *Transcript of Evidence*, 10 October 2012, p. 13.

The reality is that the states — all the states and territories — have spending obligations which substantially exceed their revenue raising capacity ... there is limited capacity for states and territories to raise additional revenue through other means, so we are reliant upon Commonwealth transfers ...

Vertical fiscal imbalance is not unique to Australia. Most federations around the world have a degree of vertical fiscal imbalance due to the divisions of responsibilities between the federal and state governments in their respective constitutions. Chart 2.3 shows the comparative levels of vertical fiscal imbalance in Australia and several other countries with a federal system.

Chart 2.3: Vertical fiscal imbalance in selected OECD countries⁷



Source: Australian Treasury, *Architecture of Australia's tax and transfer system*, p. 301.

Different federations have taken different approaches to federal financial relations. The United States of America, Canada and Switzerland have developed a more competitive system of federal finances with both states and the federal government imposing income tax, and different states taxing at different levels. This results in some states being higher taxing states with higher levels of service delivery, and others being lower taxing and providing fewer services.⁸ Australia has instead adopted a more co-operative model of federalism, with the same level of taxation across the country and the CGC aiming to distribute funds so that all states have the same capacity to provide the same level of services. This principle was espoused in a 1936 report of the CGC which stated:⁹

Special grants are justified when a State through financial stress from any cause is unable to efficiently discharge its functions as a member of the federation and should be determined by the amount of help found necessary to make it possible for that State by reasonable effort to function at a standard not appreciably below that of other States.

This principle is known as horizontal fiscal equalisation (HFE). Whilst this principle has essentially remained unchanged since the establishment of the CGC, the way in which it has been applied has been adapted and refined. The CGC currently aims to achieve HFE through adjustments to the distribution of GST revenue. The current definition of HFE applied by the CGC is:¹⁰

State governments should receive funding from the pool of GST revenue such that, after allowing for material factors affecting revenues and expenditures, each would have the fiscal capacity to provide services and the associated infrastructure at the same standard, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency.

⁷ Data are for 2003, except Australia which uses data for 2005-06.

⁸ James Allan, *The Case for Federalism*, Policy, Vol. 28, No. 2, p. 16.

⁹ Commonwealth Grants Commission, Third Report, 1936, p75.

¹⁰ Commonwealth Grants Commission, *About Fiscal Equalisation*, <http://www.cgc.gov.au/fiscal_equalisation/navigation/2>, accessed 24 September 2012.

The distribution of the GST has recently been reviewed by an independent Panel appointed by the Commonwealth Government.¹¹ Whilst the GST is not within the scope of this Inquiry, it is the largest component of Commonwealth payments to Victoria, therefore the Committee has considered the Terms of Reference in the context of the broader Federal Financial Relations Framework.

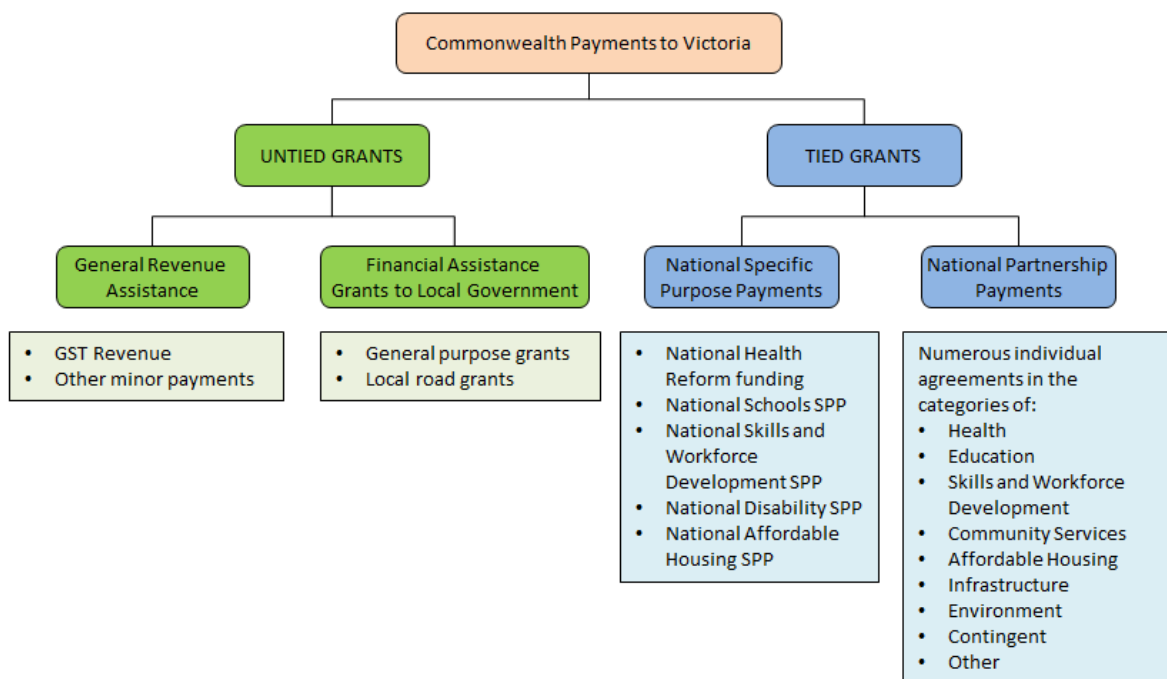
Finding 1

Due to the high level of vertical fiscal imbalance in Australia, Victoria is heavily reliant on transfers from the Commonwealth to meet its expenditure obligations. The adequacy of these payments directly impacts the State Government’s capacity to meet the needs of Victorians and deliver services.

2.2 Federal Financial Relations Framework

The Commonwealth provides assistance to states and territories through four main categories of payments:

- General revenue assistance;
- National Specific Purpose Payments (NSPPs);
- National Partnership Payments (NPPs); and
- Local Government Financial Assistance Grants (FAGs).



These payments can be classified as tied or untied grants. Untied grants mean the Commonwealth does not direct how the funds may be used. Almost half of funds provided to the states and territories are untied in the form of general revenue assistance and FAGs. Tied grants mean that money is provided for a specific purpose or must be spent in a particular way. Tied grants include NSPPs, which are allocated to a general area of expenditure, such as health or education, with states and territories free to determine how the funds are used provided performance benchmarks are met; and NPPs, which are tied to specific projects or initiatives.

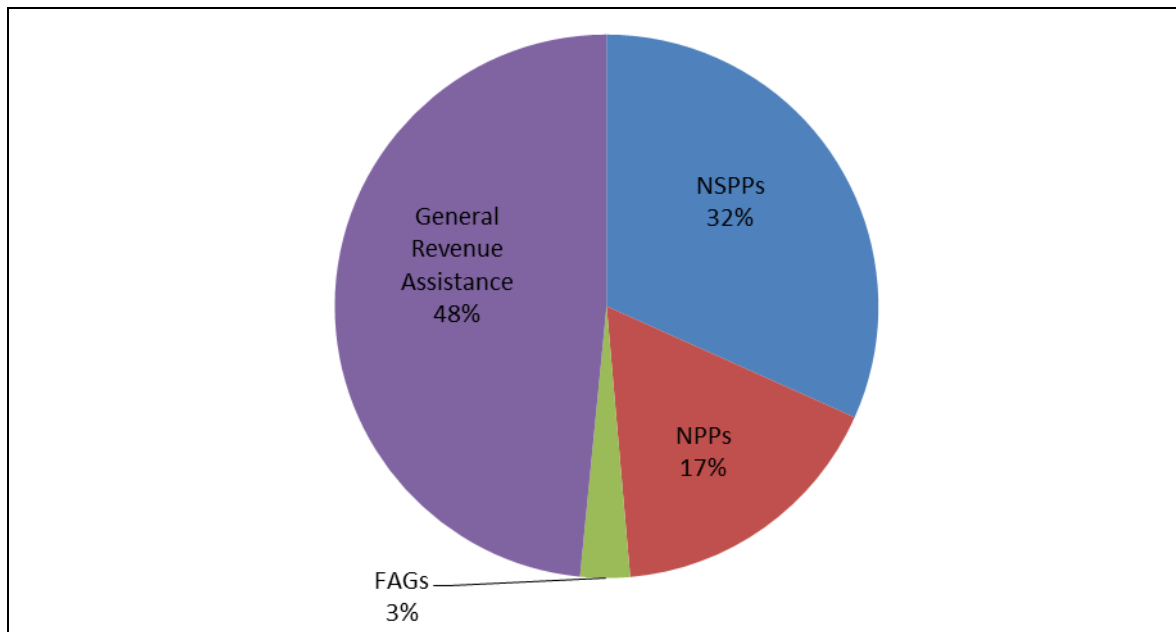
¹¹ GST Distribution Review, <<http://www.gstdistributionreview.gov.au/>>, accessed 24 September 2012.

Prior to 2009, the states received more than 90 different payments for specific purposes.¹² In 2008, the Commonwealth, State and Territory Governments agreed to a new Intergovernmental Agreement on Federal Financial Relations (IGAFFR), which took effect from 1 January 2009. The intent of the parties in implementing the financial framework was to improve the well-being of all Australians through improvements in the quality, efficiency and effectiveness of government service delivery by:¹³

- reducing Commonwealth prescriptions on service delivery by the states and territories;
- clarifying the roles and responsibilities of the parties in the delivery of government services that are the subject of national agreements; and
- enhancing accountability to the public for the outcomes achieved or outputs delivered under national agreements or partnerships.

In 2010-11, 75 per cent of revenue was collected under Commonwealth legislation compared to 25 per cent under state legislation.¹⁴ In this same period, 50 per cent of state revenue came from transfers from the Commonwealth, with \$98.5 billion being transferred from the Commonwealth to the states.¹⁵ Chart 2.4 shows the breakdown of Commonwealth funding provided to Victoria.

Chart 2.4 – Total Commonwealth Payments to Victoria 2011-12



Source: Commonwealth Budget Final Budget Outcome 2011-12.

¹² Commonwealth Grants Commission, *Report on GST Revenue Sharing Relativities — 2012 Update*, p. 22.

¹³ Council of Australian Governments, *Intergovernmental Agreement on Federal Financial Relations*, p. 8.

¹⁴ Commonwealth Grants Commission, *Report on GST Revenue Sharing Relativities 2012 Update*, p. 22.

¹⁵ Commonwealth Grants Commission, *Report on GST Revenue Sharing Relativities 2012 Update*, pp. 22, 25.

2.2.1 General Revenue Assistance

General revenue assistance is funding provided by the Commonwealth to the states and territories for them to spend according to their own budget priorities. Since 2001, these funds are derived mainly from GST revenue. GST revenue is currently distributed on the recommendation of the CGC, which must divide the revenue between states in accordance with a formula aimed to achieve full horizontal equalisation.

As stated earlier, the Commonwealth Government appointed an independent panel to review the distribution of GST revenue,¹⁶ which presented its final report to the Commonwealth Government at the start of November 2012¹⁷ but the report is yet to be publicly released. Given this recent review at a Commonwealth level, and as GST payments are outside the scope of this Inquiry, this report does not comment on funding provided to Victoria through general revenue assistance.

2.2.2 National Specific Purpose Payments

NSPPs are focused on the following service delivery sectors:

- National Healthcare;
- National Schools;
- National Skills and Workforce Development;
- National Disability Services; and
- National Affordable Housing.

Under the IGAFRR, NSPPs are a perpetual source of funding with agreed indexation rates. A shift towards equal per capita distribution of NSPPs between states is being phased in over five years from 2009-10.¹⁸ The only condition attached to these payments is that the state or territory must spend them in the relevant sector. This expenditure is reported by each state or territory's Treasurer within six months of the end of the financial year to the Ministerial Council for Federal Financial Relations. These reports outline how much funding was spent in each sector and seek to explain any discrepancies in amounts provided and expended.

Each NSPP is associated with a National Agreement which contains the objectives, outcomes and performance indicators. The Commonwealth and the state and territory governments determine and agree on the outcomes the NSPPs will achieve.

NSPPs comprised 32 per cent of Commonwealth payments to Victoria in 2011-12. NSPPs are therefore the principal means through which the Commonwealth provides funding to Victoria to fulfil its key responsibilities in a number of areas including health, education and training. Whilst the adequacy of other smaller payments (such as NPPs) can impact the success of specific projects and programs, NSPPs have a significant role in assisting States to meet their major service delivery responsibilities. State Governments have considerable flexibility in the way in which they spend NSPPs and the decisions they make when allocating this funding directly impact service delivery outcomes.

NSPPs are excluded from the Terms of Reference, therefore the Committee has not further examined these payments. However, the Committee believes it is important to note the role of NSPPs within the Federal Financial Relations framework.

2.2.3 National Partnership Payments

NPPs are time limited agreements which allow states and territories to deliver large projects and undertake significant reforms. NPPs encompass the five NSPP sectors plus four additional areas of infrastructure, environment, contingent and other.

NPPs can be provided to multiple states and/or territories or a single state or territory. The funds must be used for a specified purpose and the state/territory government must report back to the Commonwealth on how the money has been spent to meet the agreed outcomes in the National

¹⁶ GST Distribution Review, <<http://www.gstdistributionreview.gov.au/>>, accessed 24 September 2012.

¹⁷ GST key to tax reform: Greiner, *Weekend Australian*, 3 November 2012, p. 1.

¹⁸ Commonwealth Government, *Budget Papers 2012-13, Budget Paper No. 3: Australia's Federal Relations*, p. 20.

Partnership Agreement. Further details of reporting and administrative arrangements associated with NPPs are discussed in Chapter 3.

NPPs can also include reward payments to states or territories that successfully deliver nationally significant reforms. Reward payments occur when a state or territory achieves certain performance benchmarks detailed in the National Partnership Agreement as assessed by the COAG Reform Council. Reward payments can be used for any purpose.

2.2.4 Commonwealth Own Purpose Expenditure and Direct Outlays

Commonwealth Own Purpose Expenditure (COPE) is expenditure undertaken by the Commonwealth for its own purposes. This includes Commonwealth Government expenses, Medicare and unemployment benefits paid to individuals and defence expenditure. Some COPE payments are also provided to state/territory agencies to deliver services on behalf of the Commonwealth. COPE is discussed further in Chapter 5.

2.2.5 Financial Assistance Grants to Local Government

Financial Assistance Grants (FAGs) are grants provided by the Commonwealth directly to local governments. These grants are provided under the *Local Government (Financial Assistance) Act 1995* (Cth). FAGs were first introduced in 1974-75 as a means of distributing tax revenue to local government.

FAGs consist of two components, a general purpose grant distributed according to population, and a local road grant which is distributed according to fixed historical shares. FAGs are paid in quarterly instalments to the Local Government Grants Commission in each state/territory, which also recommends how to distribute the funds. The primary objectives of FAGs are to:

- enable local government to provide an equitable level of services;
- improve the financial capacity of local government and provide certainty of funding; and
- improve the efficiency and effectiveness of local government.

FAGs are distributed by Grants Commissions in each state or territory to address issues of horizontal fiscal imbalance, ensuring that all local government areas in a state/territory are able to provide services to a similar level. The Victoria Grants Commission (VGC) has been established to allocate funds to local governments within Victoria. When allocating these funds the VGC is guided by the principles in the Commonwealth legislation, such as ensuring HFE between local government areas and that grants are allocated according to need. Local Government FAGs are discussed further in Chapter 4.

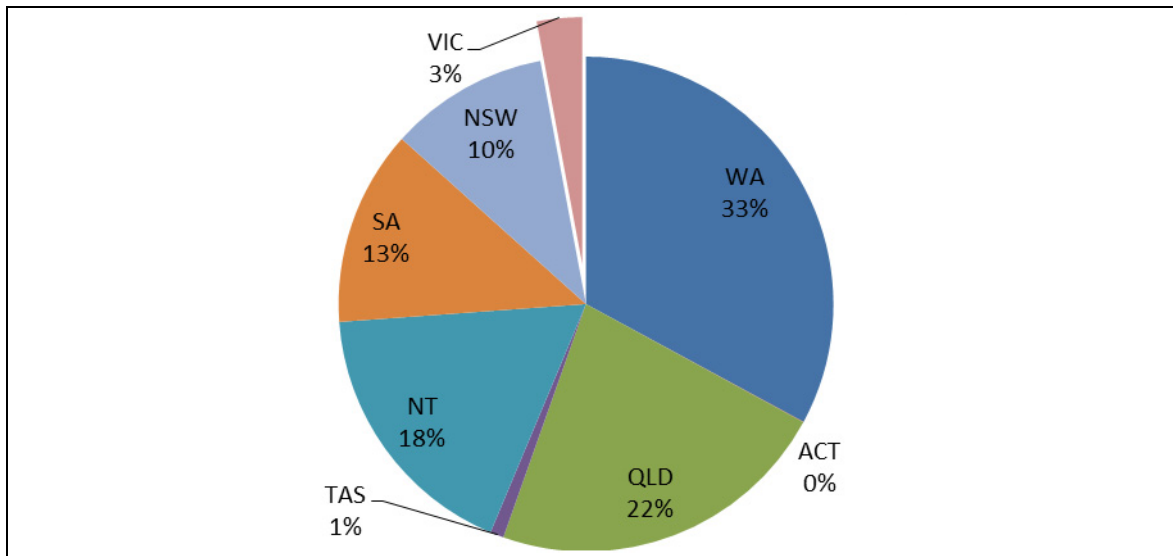
2.3 Victoria and its contribution to the Australian economy

The Committee's Terms of Reference require it to determine if Victoria receives its 'fair share' of Commonwealth funding. This section provides background information about Victoria and examines its relationship to the other states and territories within the Australian Federation, which necessarily impact on Victoria's share of Commonwealth funding.

2.3.1 Land Area

Geographically, Victoria is Australia's second smallest state. Chart 2.5 shows Victoria comprises approximately 3 per cent of Australia's land area.

Chart 2.5 – Australian states and territories by land area

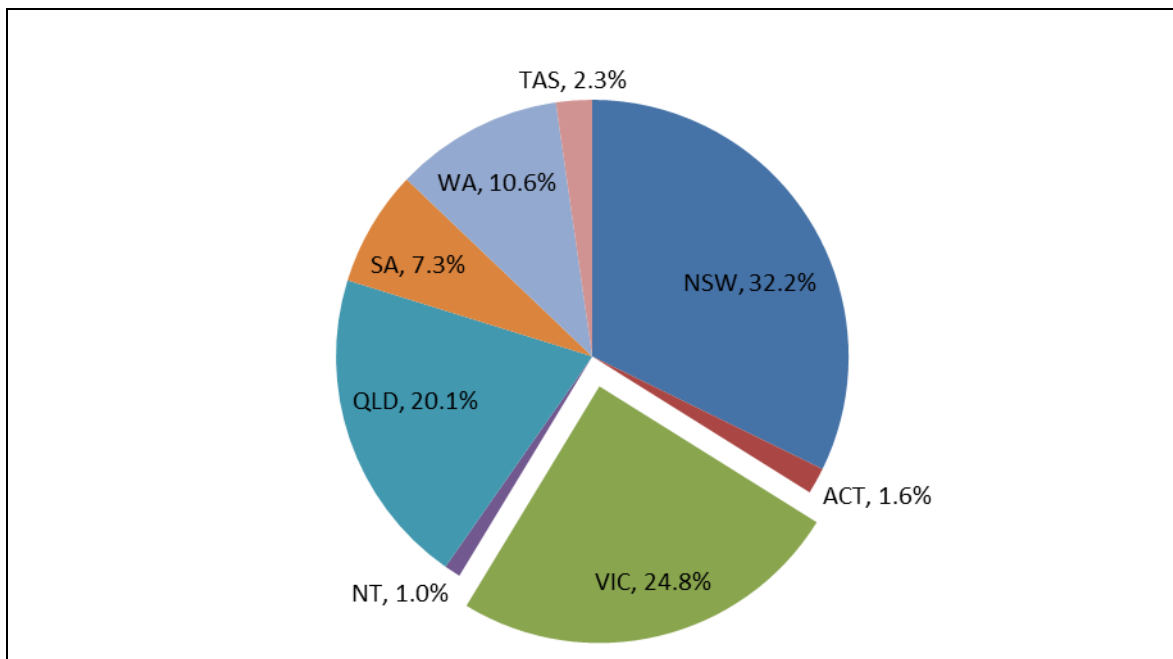


Source: Geoscience Australia¹⁹

2.3.2 Population

In contrast to the geographical comparison above, Victoria is Australia's second most populous state, being home to almost a quarter of Australia's population. Chart 2.6 shows the distribution of the Australian population between states and territories as at December 2011.

Chart 2.6 – Australian states and territories by population

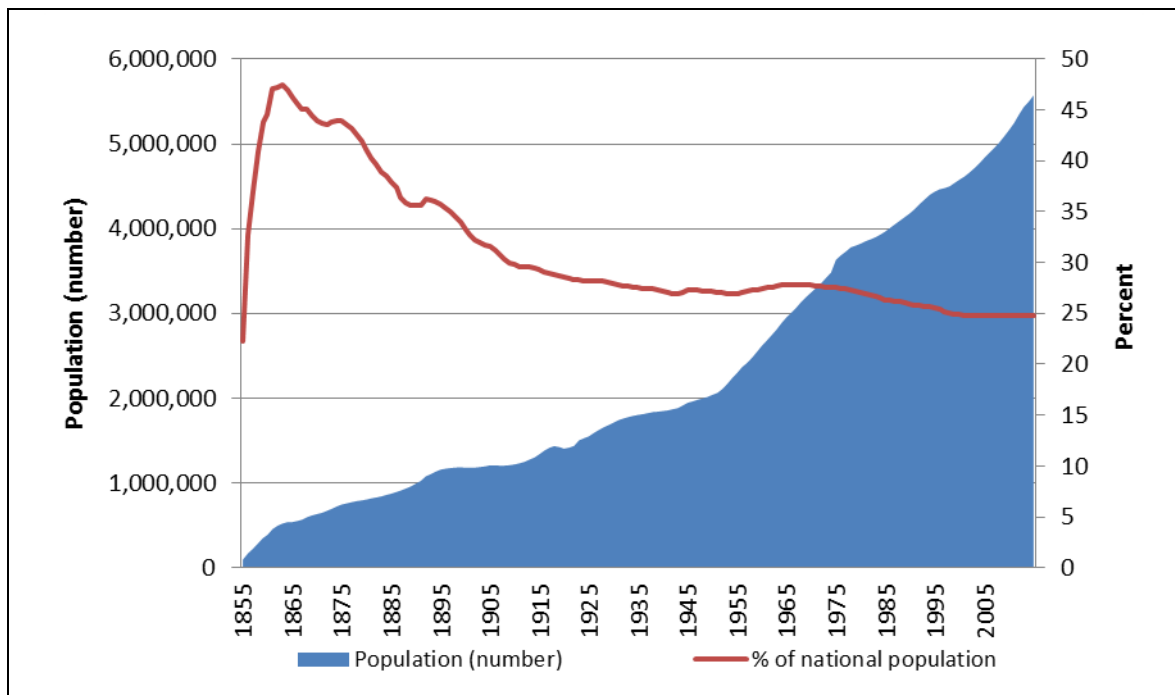


Source: ABS 3101.0 - Australian Demographic Statistics, Dec 2011

Although Victoria's population has increased over time, as shown by Chart 2.7, when taken as a percentage of the national population, it has remained relatively stable at approximately 24 to 27 per cent for the last hundred years. According to the preliminary results of the 2011 Census, Victoria is currently home to 24.8 per cent of the national population.

¹⁹ Geoscience Australia, *Area of Australia - States and Territories*, <<http://www.ga.gov.au/education/geoscience-basics/dimensions/area-of-australia-states-and-territories.html>>, accessed 24 September 2012.

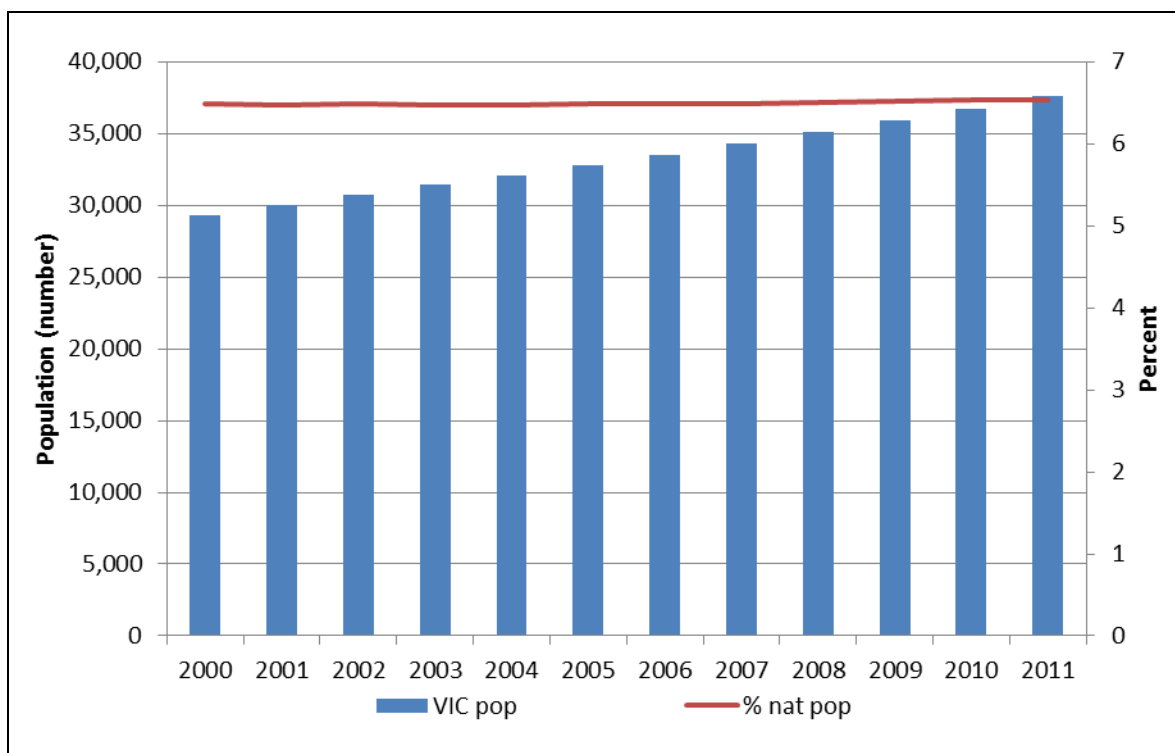
Chart 2.7 – Victoria’s total population and as a percentage of the national population



Source: ABS 3105.0.65.001 - Australian Historical Population Statistics, 2008

Commonwealth funding to the states and territories is also impacted by the distribution of Australia’s Indigenous population. As with the total population, Victoria’s Indigenous population has also increased over time, however, when this is taken as a percentage of the national Indigenous population, it has remained relatively stable. Chart 2.8 shows Victoria’s total Indigenous and Victoria’s share of the national Indigenous population. Victoria is currently home to approximately 37,600 Indigenous Australians, comprising 6.5 per cent of the national Indigenous population.

Chart 2.8: Victoria’s total Indigenous population and as a percentage of the national Indigenous population

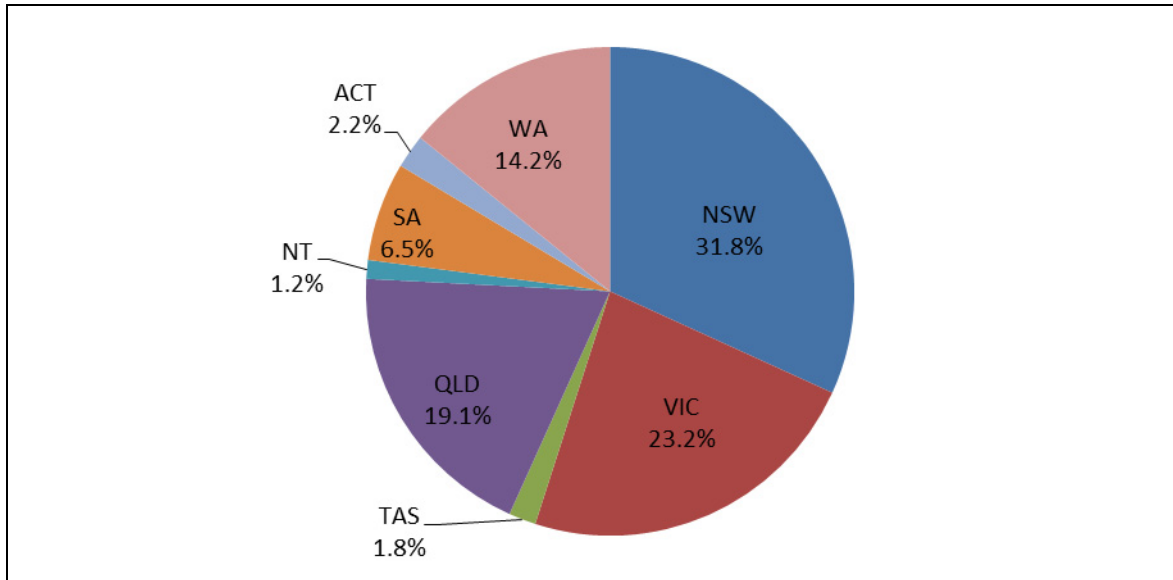


Source: ABS 3101.0 - Australian Demographic Statistics, Dec 2011

2.3.3 Gross State Product

In 2011, Victoria recorded the second highest Gross State Product (GSP) of all Australian states and territories, meaning it was a significant contributor to the national economy. Chart 2.9 shows Victoria’s GSP contributed 23 per cent of GDP, slightly lower than Victoria’s 24.8 per cent population share. By contrast, Western Australia is home to 10.6 per cent of the national population, but contributed 14 per cent of GDP.

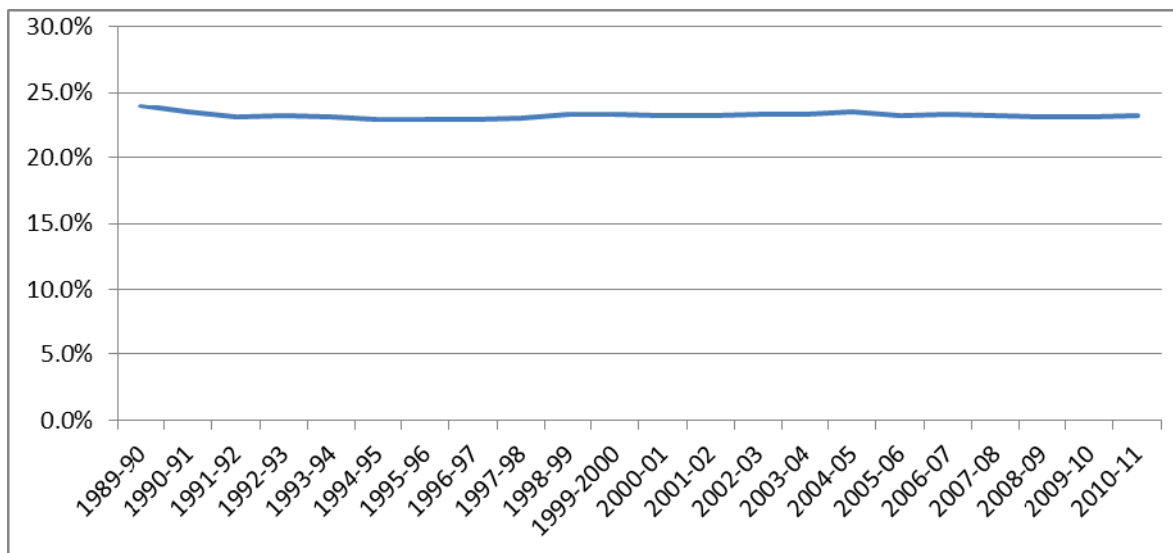
Chart 2.9 – Gross State Product by state and territory 2011



Source: ABS 5220.0 - Australian National Accounts: State Accounts, 2010-11

When compared to that of the other states and territories, Victoria’s GSP has been fairly stable. Chart 2.10 shows that although Victoria’s economy has grown over the last 20 years, the proportion Victoria contributed to the national economy has remained approximately the same.

Chart 2.10: Victoria’s Gross State Product as a percentage of Gross Domestic Product 1992 to 2011



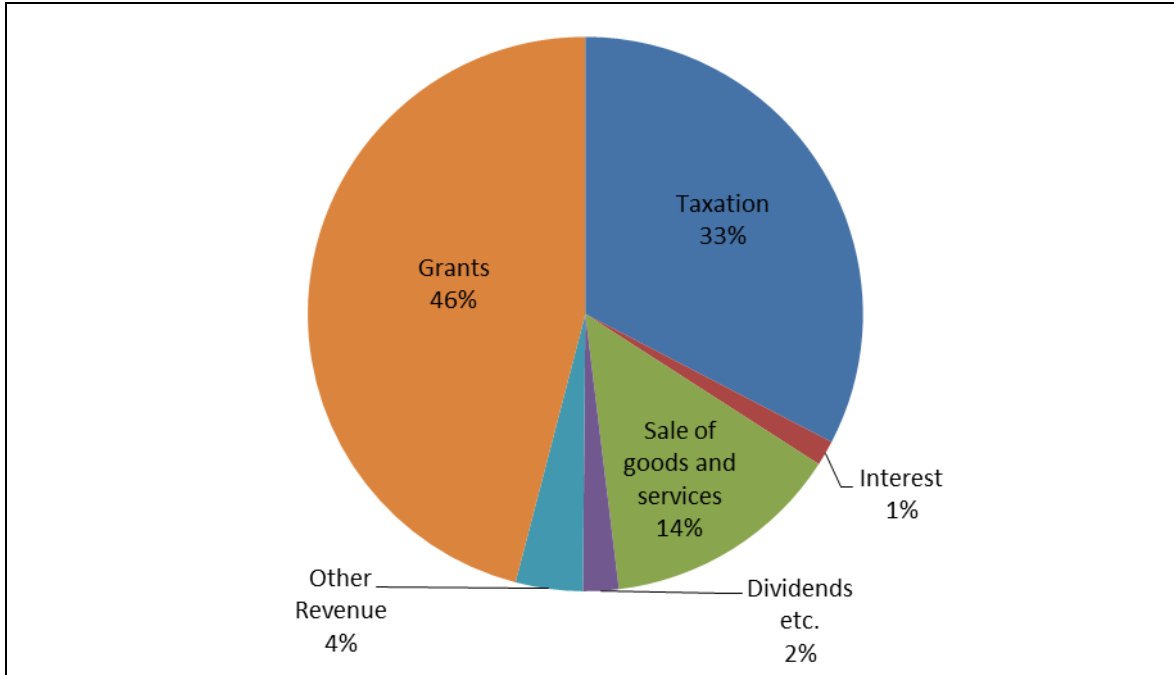
Source: ABS 5206.0 - Australian National Accounts: National Income, Expenditure and Product — Table 1. Gross State Product, Chain volume measures and current prices

2.3.4 Revenue

Chart 2.11 shows Victorian Government revenue is derived from a variety of sources. The five main revenue sources are:

- Grants from the Commonwealth;
- Taxation revenue;
- Sale of goods and services;
- Dividends, income tax and rate equivalent revenue; and
- Interest.

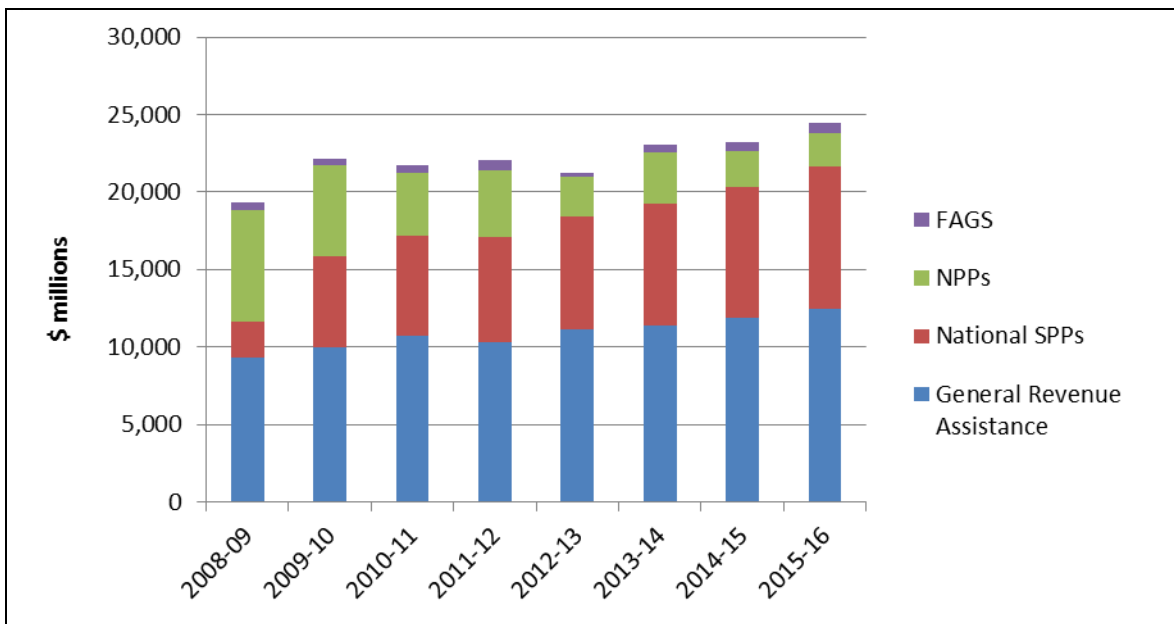
Chart 2.11: Estimated Victorian Government Revenue 2012-13



Source: 2012-13 Victorian Budget Paper No. 5, Chapter 4, p 161.

As shown in Chart 2.11, the largest source of revenue for the Victorian Government in 2012-13 is expected to be grants derived from the Commonwealth Government. In Chart 2.11, Grants include FAGs, NPPs, NSPPs and GST. Chart 2.12 breaks down the grant revenue received/predicted to be received by Victoria from 2008-09 until 2015-16.

Chart 2.12: Commonwealth Payments to Victoria 2008-09 to 2015-16



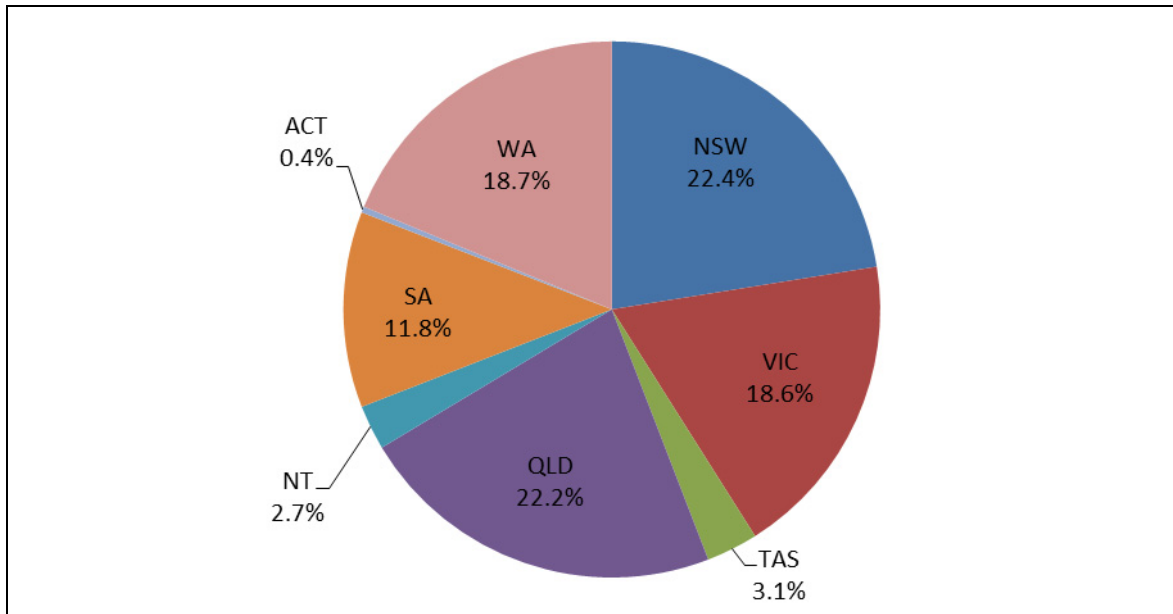
Source: Commonwealth Final Budget Outcome 2008-09 to 2010-11 and Commonwealth Budget Papers 2012-13.

Chart 2.12 shows that while there will be an increase in funding between 2008-09 and 2015-16, the amount received from NPPs is declining, the amount received from NSPPs is increasing, while the amounts received from FAGS and general revenue assistance is increasing slightly.

2.3.5 Road Network

Despite its small land area in comparison to other states and territories, Victoria has one of the larger road networks with approximately one fifth of Australia's roads. Chart 2.13 provides a breakdown of the road network by state and territory, measured by road length.

Chart 2.13 – Road Network Size



Source: Australian Infrastructure Statistics Yearbook 2012²⁰

2.4 Local Government revenue and expenditure

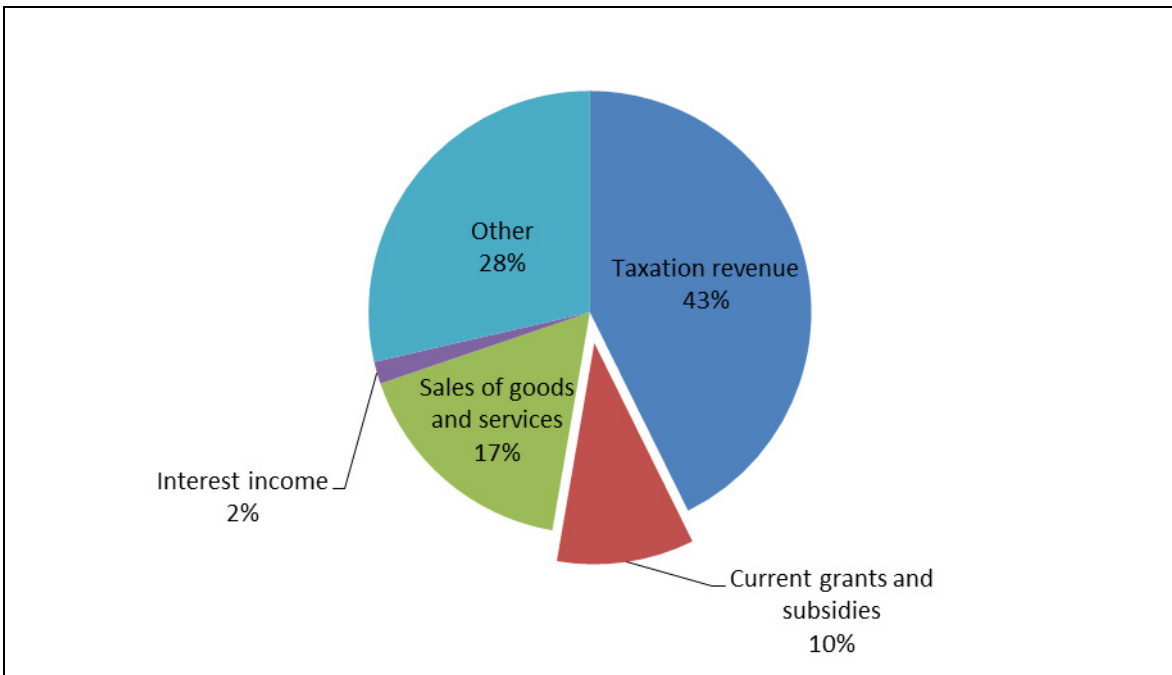
Local government in Victoria has five principal sources of revenue:

- Taxation revenue;
- Grants and subsidies;
- Sale of goods and services;
- Interest; and
- Other revenue.

The majority of local government income in 2010-11 came from taxation revenue, principally through council rates. Chart 2.14 shows the percentage of revenue derived from each of these sources.

²⁰ Australian Dept. of Infrastructure and Transport, Bureau of Infrastructure, Transport and Regional Economics, Table T 1.3, p. 43, <http://www.bitre.gov.au/publications/2012/stats_002.aspx>

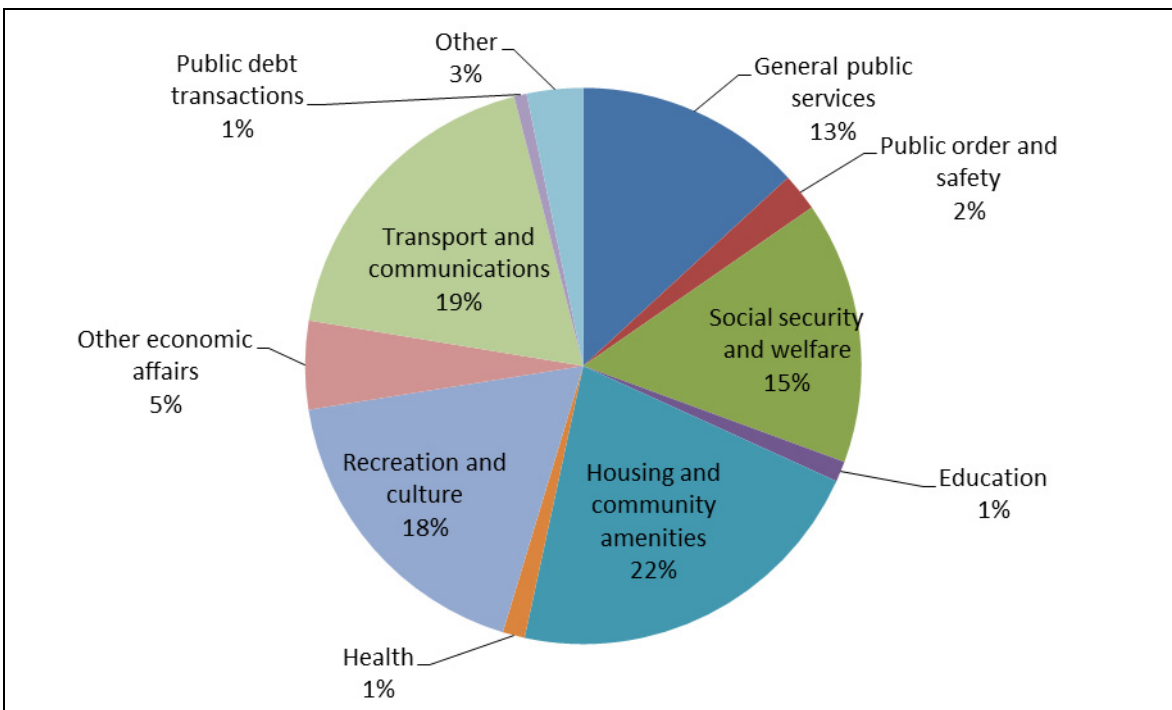
Chart 2.14 – Victorian Local Government Revenue, 2010-11



Source: ABS 5512.0 - Government Finance Statistics, Australia, 2010-11

Local governments provide a significant number of services and have a variety of different responsibilities. Chart 2.15 provides a breakdown of the expenditure by Victorian local governments in 2010-11.

Chart 2.15 – Victorian Local Government Outlays, 2010-11



Source: ABS 5512.0 - Government Finance Statistics, Australia, 2010-11

3. National Partnership Payments

3.1 Overview of National Partnership Payments

National Partnership Payments (NPPs) are tied grants. The aim of NPPs is to:²¹

- support the delivery of specified outputs or projects;
- facilitate reform; or
- reward those jurisdictions that deliver nationally significant reforms.

Payments made by the Commonwealth from Nation-building Funds for state infrastructure projects are also treated as NPPs.²²

There are three types of payments made under National Partnerships (NPs):²³

- Project payments – which are for specific purposes and election commitments and support national objectives or provide funds to states to deliver specific projects;
- Facilitation payments – for areas considered a national priority, facilitation payments assist states to improve service delivery or to encourage the states to implement ambitious reforms;
- Reward payments – for providing encouragement to states for achieve ambitious performance targets.

The COAG Reform Council assesses NPs against an agreed set of performance benchmarks. These are publicly reported. The Commonwealth then uses this information from COAG to determine reward payments made to the states and territories.

There are nine categories of NPs, with a range of agreements, either with individual, all or select states and territories. The categories of the agreements are:

- Health;
- Education;
- Skills and workforce development;
- Community services;
- Affordable housing;
- Infrastructure;
- Environment;
- Contingent; and
- Other.

3.1.1 Funding for National Partnership Payments

The Commonwealth Treasury is responsible for making payments to the states under NPs. Payments are made in accordance with Commonwealth legislation and the Intergovernmental Agreement. Financial transfers are made for NPPs on the seventh day of each month to the Victorian State Treasury. They are divided into one twelfth of the annual payment, unless other

²¹ Intergovernmental Agreement on Federal Financial Relations, p. 6, <http://www.federalfinancialrelations.gov.au/content/intergovernmental_agreements.aspx> accessed 9 October 2012.

²² National partnership payments, <http://www.federalfinancialrelations.gov.au/content/national_partnership_agreements/default.aspx>, accessed 18 October 2012. Nation-building Funds include the Building Australia Fund, the Education Investment Fund and the Health and Hospitals Fund.

²³ National partnership payments, <http://www.federalfinancialrelations.gov.au/content/national_partnership_agreements/default.aspx>, accessed 18 October 2012.

financial arrangements are agreed to.²⁴ Table 3.1 outlines the budgeted amount for NPPs for 2011-12 to 2014-15, excluding Financial Assistance Grants to Local Government.

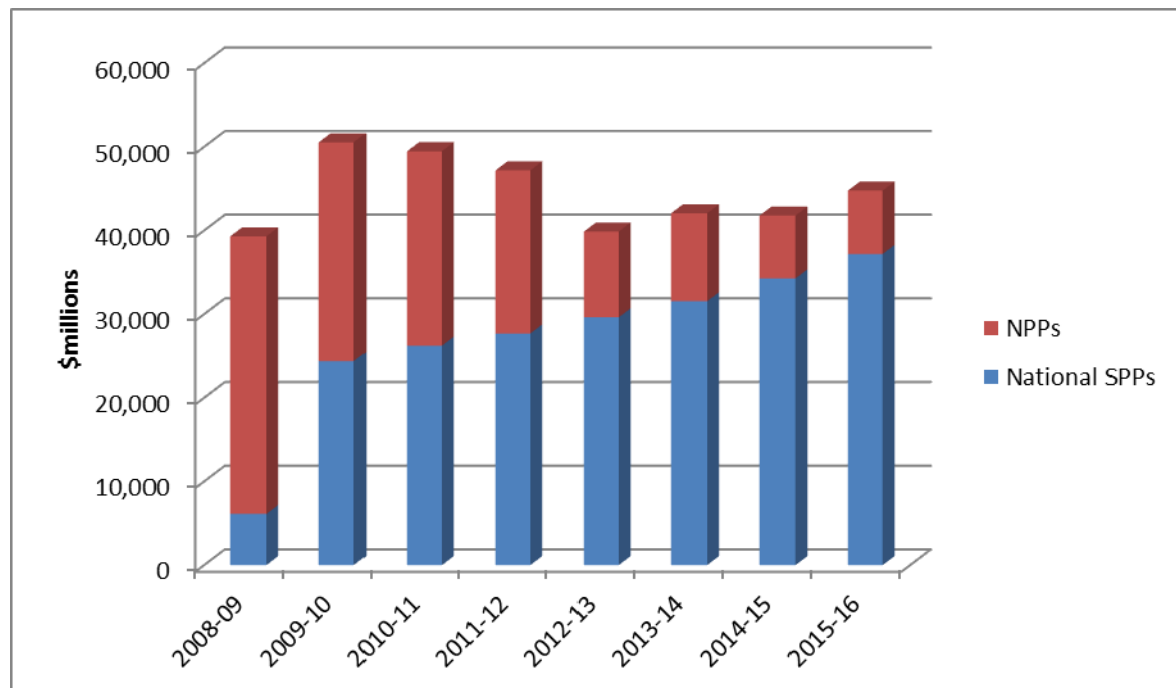
Table 3.1: National partnership payments by state and territory 2011-12 to 2015-16

State/territory	2011-12 (\$million)	2012-13 (\$million)	2013-14 (\$million)	2014-15 (\$million)	2015-16 (\$million)	Total (\$million)
NSW	5,197	2,741	2,674	1,674	1,428	13,715
VIC	3,619	2,326	2,764	1,768	1,557	12,033
QLD	5,348	2,140	2,054	1,187	1,110	11,839
WA	1,931	1,314	1,351	717	605	5,918
SA	1,841	818	232	346	576	3,813
TAS	518	272	198	126	171	1,285
ACT	210	88	105	128	78	609
NT	823	507	268	181	185	1,964
Unallocated	0	41	866	1375	1850	4,132
Total	19,488	10,247	10,512	7,501	7,561	55,308

Source: Commonwealth Final Budget Outcome 2011-21; Commonwealth Budget Papers 2012-13, Part 3: Australia's Federal Relations.

As a percentage of total payments provided by the Commonwealth, NPP funding is decreasing. In 2009-10, NPP funding made up approximately 54 per cent of total funding provided to states and territories by the Commonwealth. By 2014-15, NPP funding is expected to be around 21 per cent of total funding, with Specific Purpose Payments and National Health Reform Funding making up 79 per cent of funding.²⁵ Charts 3.1 and 3.2 show the estimated change in NPP funding since NPPs were introduced in 2009.

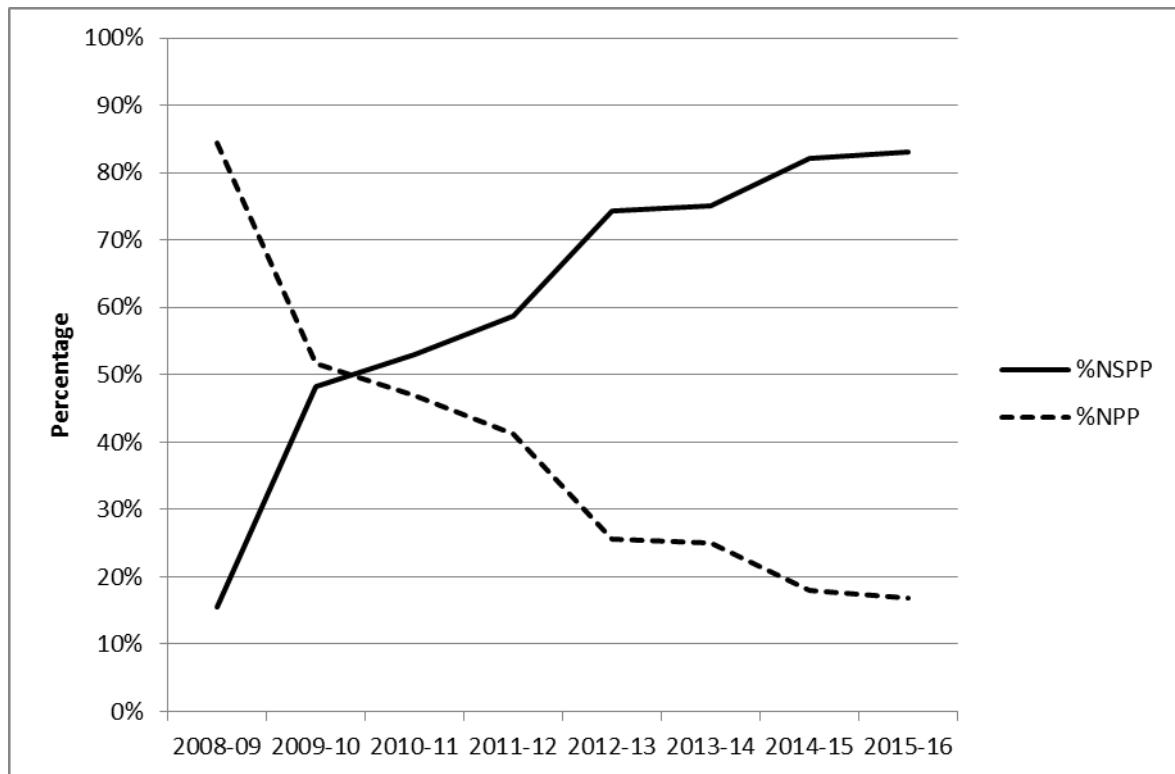
Chart 3.1: Commonwealth Funding to the states through National SPPs and NPPs 2008-09 to 2015-16²⁶



²⁴ Council of Australian Governments, *Intergovernmental Agreement on Federal Financial Relations: Schedule D – Payment Arrangements*, p. D-2.

²⁵ Commonwealth Government, *Budget Papers 2011-12, Part 3: Australia's Federal Relations*, p. 21.

²⁶ Excludes Financial Assistance Grants to Local Government.

Chart 3.2: NPPs and NSPPs as a percentage of Commonwealth grants to states 2008-09 to 2015-16²⁷

The Victorian Government notes in its submission to the Committee:²⁸

[NPPs] will represent 14 per cent of Commonwealth funding to Victoria in 2012-13. [NPP] funding as a share of total payments for specific purposes will substantially decrease as economic stimulus measures are progressively wound down.

NSPPs are transitioning to a system where they are provided on a per capita basis, whereas Victoria currently receives less than its per capita share of NPPs. The trend towards a greater proportion of grants being made through NSPPs guarantees that Victoria will receive a higher overall share of Commonwealth payments to the states.

3.2 Victoria's share of National Partnership Payments

The Terms of Reference require the Committee to examine whether the current share of funding Victoria is receiving is satisfactory relative to its population share and its contribution to the Australian economy, and the extent and nature of changes in that share over time. The Terms of Reference further ask the Committee to consider whether the adequacy of Victoria's share varies across each of the different areas of government service delivery and economic activity.

The Committee has first examined the share of NPPs Victoria has received over time, and secondly examined whether this varies across the eight categories of NPPs. As stated above, NPPs were introduced as a specific category of payment under the IGAFRR which took effect on 1 January 2009. Prior to that date, these payments were included in numerous SPPs. It is therefore not possible to analyse Victoria's share of NPPs prior to 2009. The Committee has therefore briefly examined Victoria's share of SPPs prior to 2009.

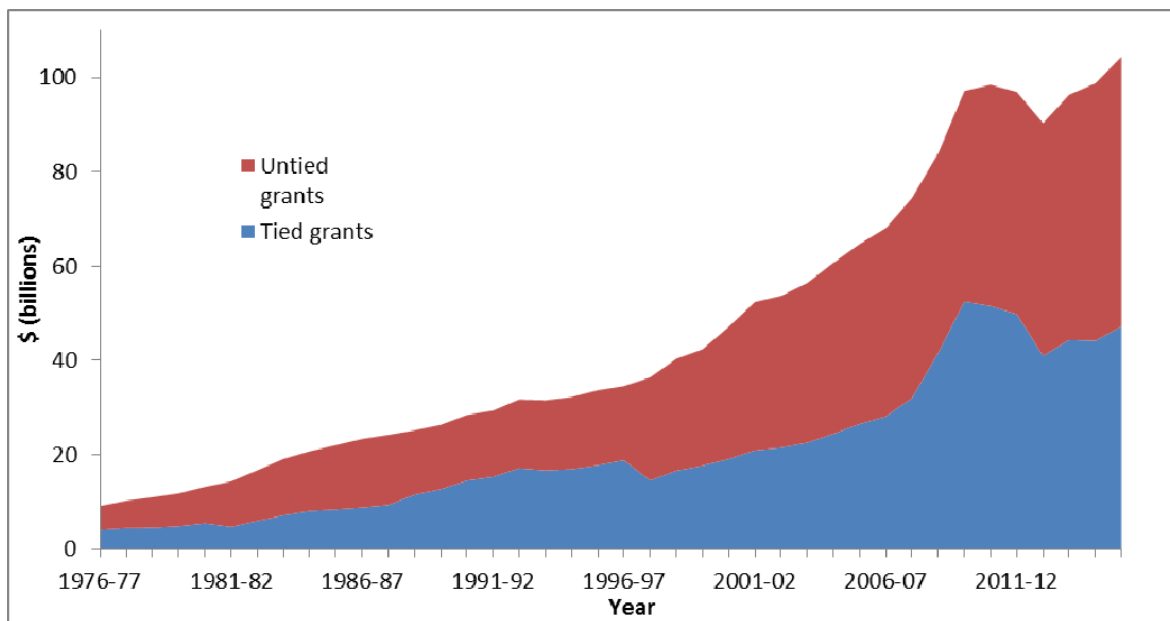
3.2.1 Historical analysis of the states' share of Commonwealth funding

Specific Purpose Payments were first used in 1923-24 and grew rapidly in the 1960s.²⁹ Chart 3.3 shows the trend in the use of Specific Purpose Payments (tied grants) compared to general revenue assistance (untied grants) since 1976.

²⁷ Excludes Financial Assistance Grants to Local Government.

²⁸ Victorian Government, Submission No. 6, p. 7.

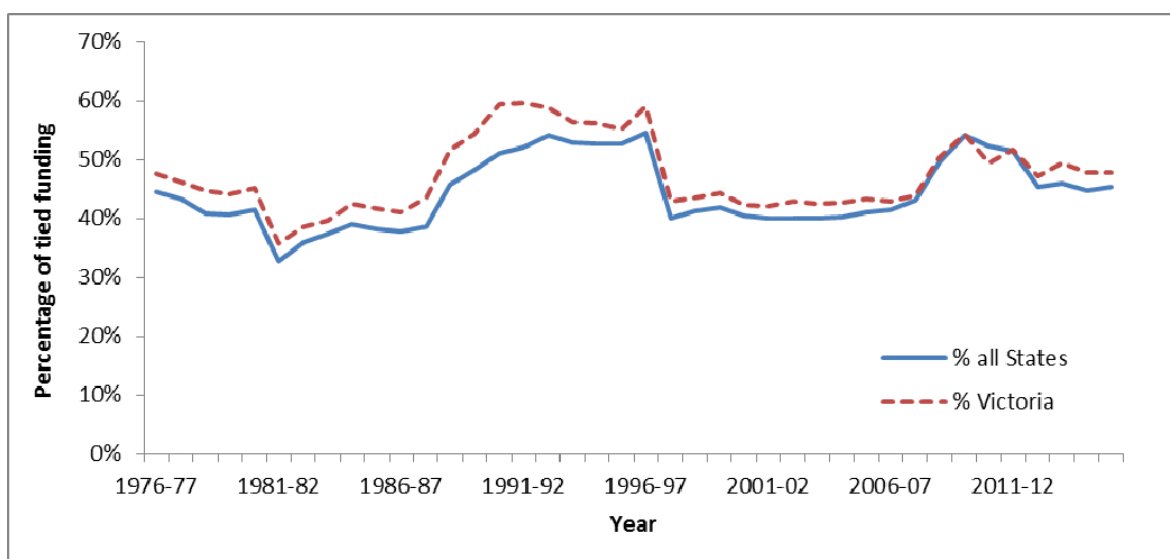
Chart 3.3: Commonwealth funding to the states 1976-77 to 2015-16 (estimated)



As demonstrated by Chart 3.3, the amount of funding provided by the Commonwealth to the states has steadily increased since the 1970s. Following the introduction of the GST in 2000, which replaced a number of state taxes, Commonwealth transfers to the states have increased at a faster rate to compensate for the reduction in State generated revenue. However, this has further contributed to vertical fiscal imbalance, making the states further reliant on these payments from the Commonwealth.

Chart 3.4 shows in percentage terms the breakdown of funding provided to all states and Victoria through tied and untied grants. Over the 40 years from 1976-77, the percentage of funding provided to the states through tied grants has fluctuated between a low of 33 per cent in 1981-82 and a high of 54 per cent in 2009-10. This fluctuation is mainly due to the Federal stimulus spending being provided through NPPs. Over this period an average of 44 per cent of funding provided to the states each year is provided as tied grants.

Chart 3.4: Percentage of Commonwealth funding to all states and Victoria provided as tied grants 1976-77 to 2015-16 (estimated)



²⁹ Federal State Relations Committee, *Specific Purpose Payments received by Victoria*, p. 19.

The Victorian Government notes in its submission that the operation of the current GST system results in Victoria receiving a higher proportion of its Commonwealth grants as tied funding than smaller states.³⁰ This is also evident from Chart 3.4.

A significant proportion of tied grants are now provided to states as NSPPs. Although these funds are classified as tied grants given they must be spent in specific categories, the way in which the funds are spent within each category is at the discretion of the states. NSPPs will transition to a system of equal per capita funding distribution under the IGAFRR and as stated in Chapter 2, these payments are outside the Terms of Reference for this Inquiry.³¹

The remaining tied grants are comprised of NPPs, which are much more prescriptive and are required to be spent on specific projects or initiatives. These payments are discussed further in the next section.

3.2.2 Funding provided to Victoria through NPPs

NPPs were first introduced as a specific type of payment in 2009. From 2008-09, the Commonwealth has reported in its Final Budget Outcome the total amount allocated to each State through NPPs. Table 3.2 shows the percentage of these payments received by Victoria.

Table 3.2: National Partnership Payments for Victoria 2008-09 to 2011-12

	Total allocated to Victoria (\$million)	Total allocated to all states and territories (\$million)	Percentage received by Victoria
2008-09	7,453	33,188	22.46%
2009-10	5,372	26,141	20.55%
2010-11	3,612	23,234	15.55%
2011-12	3,618	19,488	18.57%
Total	20,055	102,050	19.65%

Source: Commonwealth Final Budget Outcome 2008-09 to 2011-12.

As shown in Table 3.2, Victoria has received approximately 19.7 per cent of NPP funding in the last four financial years. In its forward estimates, the Commonwealth also estimates the amount of funding it anticipates providing to the states for the next four financial years. The NPP funding to be provided to Victoria from 2012-13 to 2015-16 is shown in Table 3.3.

Table 3.3: National Partnership Payments for Victoria 2012-13 to 2015-16

	Total allocated to Victoria (\$million)	Total allocated to all states and territories (\$million)	Percentage to be received by Victoria
2012-13	2,326	10,206	22.78%
2013-14	2,764	9,646	27.79%
2014-15	1,768	6,126	28.81%
2015-16	1,557	5,711	27.27%
Total	8,415	31,689	26.55%

Source: Commonwealth Budget Papers 2012-13, Part 3: Australia's Federal Relations.

As show in Table 3.3, the overall funding provided to the states through NPPs is decreasing (see also Chart 3.2). The decrease in NPP funding is due to a number of factors. Firstly, the Commonwealth Government has moved towards providing the majority of funding to states through NSPPs. The more recent decrease in NPPs has been due to the expiry of the Commonwealth Government stimulus measures.

³⁰ Victorian Government, Submission No. 6, p. 5.

³¹ Victorian Government, Submission No. 6, p. 3.

The Nation Building – Economic Stimulus Plan was announced by the Commonwealth Government on 3 February 2009 in response to the global financial crisis and was a key component of its stimulus strategy. It provided \$27 billion towards nearly 50,000 short and medium term building and construction projects. Key elements of the plan included:³²

- the Building the Education Revolution program investing \$16.2 billion in building and refurbishing primary and secondary school infrastructure;
- \$5.9 billion to boost the number of social and defence houses by around 20,000 and to fast-track repairs and maintenance of existing social housing;
- \$1.7 billion for investment in higher and vocational education as well as trade training centres;
- \$800 million to enhance local community facilities and infrastructure; and
- \$2.3 billion to improve road and rail infrastructure and safety including repairs to regional roads and improvements at safety black spots and the installation of boom gates at rail crossings.

The majority of these projects were funded through NPPs to the states. The 2011 Progress Report on the Nation Building - Economic Stimulus Plan states:³³

The Plan was designed so that the impact and benefits of the various programs would be felt across several financial years while also ensuring there would be an immediate impact through targeted initiatives. Short term programs such as minor repairs and maintenance to schools and social housing were incorporated to quickly bolster the economy from the beginning of 2009 and give businesses in the construction industry the confidence to keep workers employed. The medium term building and construction projects were designed to support the building, construction and infrastructure sectors from early 2009 until 2011-12. These important sectors will continue to benefit from some support in 2011-12 as the last of the funding is fed into the economy.

Most economic stimulus NP agreements included clauses requiring the money to be spent by particular dates in order to achieve immediate effects from the stimulus measures. As the majority of the projects funded through these stimulus measures were completed by 30 June 2010, NPP funding has progressively been reduced. NSPP funding, however, has continued to increase in accordance with the agreed the indexation rates.

The increase in funding provided through NSPPs and reduction in NPPs provides a number of advantages for the states. Most significantly, it provides increased budget certainty as NSPPs are ongoing funding indexed each year by a growth factor that is specified in the Intergovernmental Agreement.³⁴ There are also less prescriptive requirements on the way in which NSPP funding is spent, as the funds need only be spent in the broad area to which they are allocated. This gives state governments greater flexibility as to how funds are spent.

Finding 2

In 2009 and 2010, the Commonwealth provided significant additional funding to the states through NPPs to undertake major projects as a stimulus measure in response to the global financial crisis. The majority of these projects have now been completed, resulting in a reduction in NPP funding.

³² Commonwealth Government, *Nation Building - Economic Stimulus Plan – Commonwealth Coordinator-General's Two Year Progress Report to 31 January 2012*, p. 8.

³³ Commonwealth Government, *Nation Building - Economic Stimulus Plan – Commonwealth Coordinator-General's Two Year Progress Report to 31 January 2012*, p. 6.

³⁴ Intergovernmental Agreement on Federal Financial Relations, <http://www.federalfinancialrelations.gov.au/content/intergovernmental_agreements.aspx>, accessed 9 October 2012.

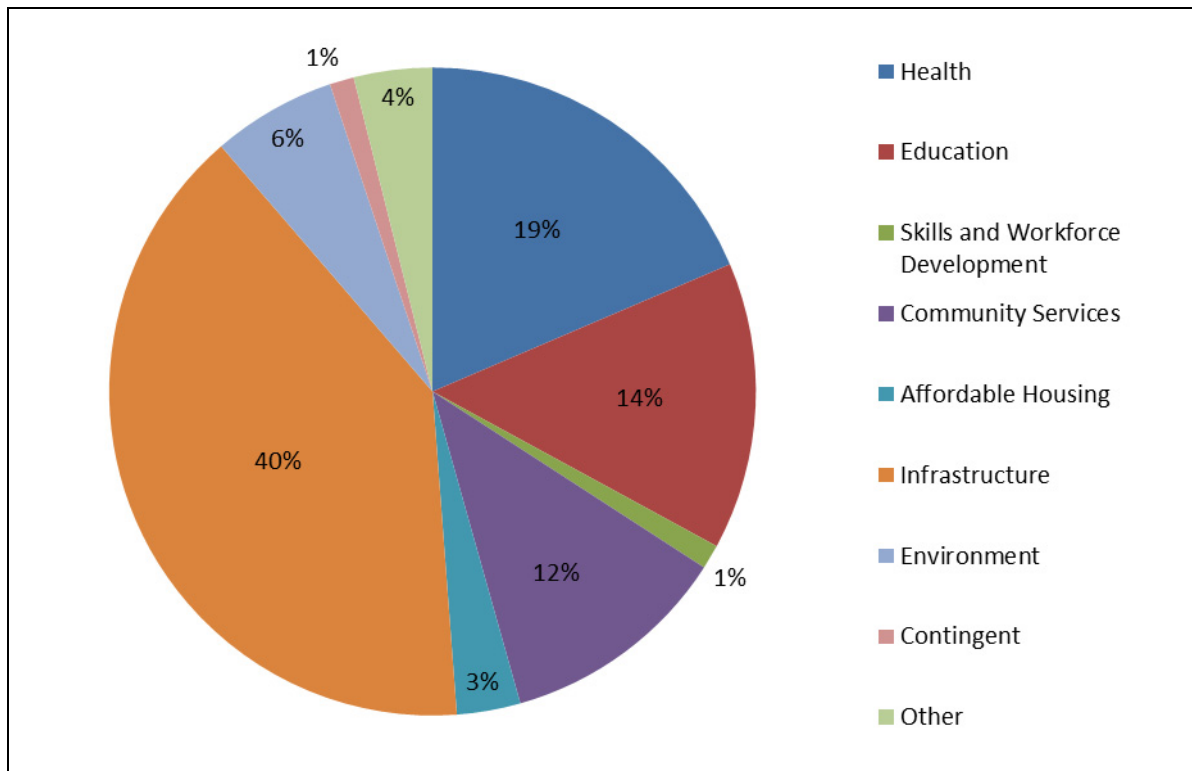
3.2.3 Differences in NPP funding across areas of government service delivery

The Terms of Reference require the Committee to examine whether Victoria's share of NPP funding varies across each of the different areas of government service delivery and economic activity. In the Commonwealth Budget Papers, NPPs are grouped into nine areas:

- Health;
- Education;
- Skills and workforce development;
- Community services;
- Affordable housing;
- Infrastructure;
- Environment;
- Contingent; and
- Other.

Chart 3.5 shows the division of NPP funding by category in 2011-12. Infrastructure funding makes up the largest proportion of NPP funding at 40 per cent. Health, Education and Community Services are also significant categories of NPP funding.

Chart 3.5: Commonwealth NPP funding by category 2011-12



Source: Commonwealth Final Budget Outcome 2011-12.

3.2.3.1 Health NPPs

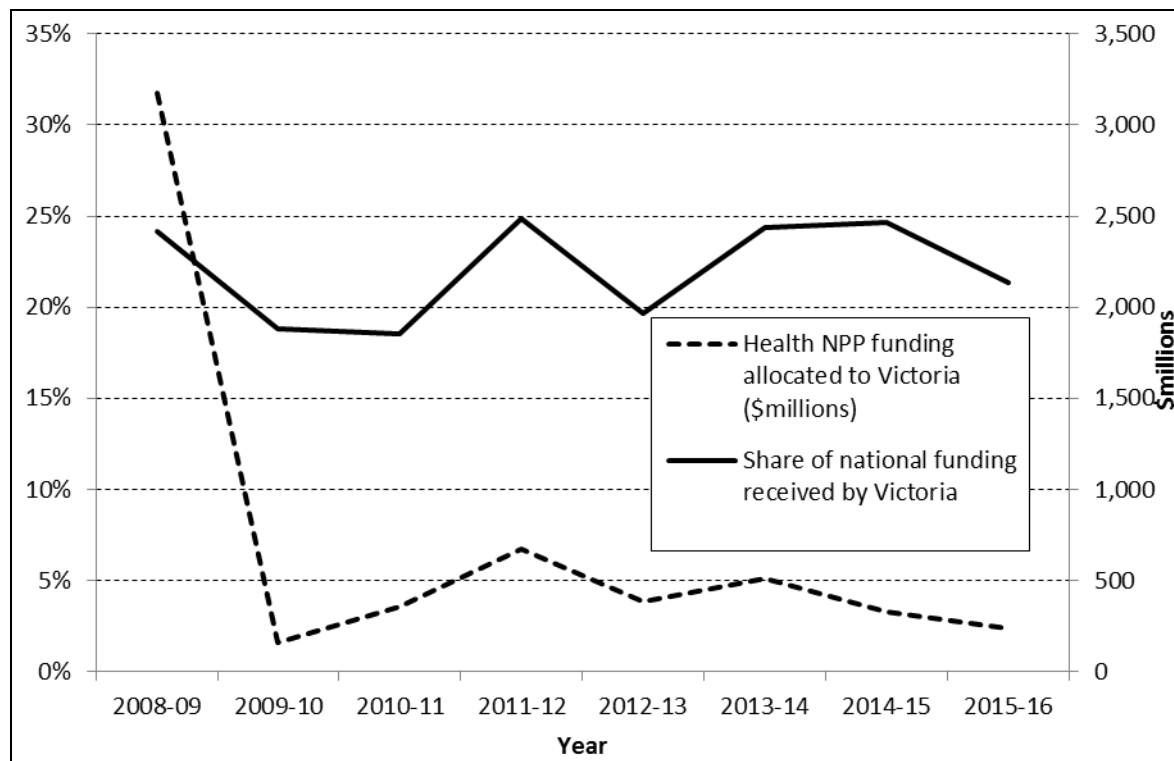
Major reforms of Commonwealth-State funding arrangements for health have occurred over the past eight years. In 2008-09, a substantial proportion of health funding provided to the states was delivered through an NPP. From 1 July 2009, a number of payments previously provided as NPPs were rolled into the National Healthcare SPP.³⁵ This resulted in significant reduction in NPP funding from 2008-09 to 2009-10, although the overall funding given to the states for health services continued to increase.

³⁵ Commonwealth Government, *Budget Papers 2008-09, Budget Paper No. 3: Australia's Federal Relations*, pp. 36-37.

On 2 August 2011, the Council of Australian Governments (COAG) signed a new National Health Reform Agreement. This agreement is intended to deliver major reforms to the organisation, funding and delivery of health and aged care.³⁶ As a result of this agreement, in 2012-13, the National Healthcare SPP has been replaced with National Health Reform Funding, totalling \$13.5 billion for all states.³⁷ National Health Reform Funding is provided to the states on a per capita basis, with Victoria receiving \$3.4 billion of this funding.

In addition to National Health Reform Funding, the Commonwealth continues to provide additional funding through NPPs. The amount and share of NPP funding for health provided to Victoria is shown in Chart 3.6. Although over time some NPPs have been rolled into the National Healthcare SPP and now National Health Reform Funding, health remains the area with the largest number of NPPs. It is estimated that there will be 58 different NPPs in force at different stages from 2010-11 to 2015-16 in the health category.³⁸ These payments are grouped into sub-categories of National Health Reform, Health Infrastructure, Health Services, Preventative Health and Other Health NPPs.

Chart 3.6: Victorian Health NPP funding 2008-09 to 2015-16



Source: Commonwealth Final Budget Outcome 2008-09 to 2010-11 and Commonwealth Budget Papers 2012-13, Part 3: Fiscal Strategy and Outlook, p. 22.

Chart 3.6 shows that Victoria’s share of NPP funding varies between just under 19 per cent and 25 per cent. However, the overall amount of funding provided through NPPs is decreasing, as more funding is delivered through other payments and some NPPs expire.

3.2.3.2 Education NPPs

Education is another area where the use of NPPs has significantly reduced over time. This is largely due to the Building the Education Revolution National Partnership, which delivered large amounts of funding to the states between 2008-09 and 2010-11 for school infrastructure projects. As this agreement has now expired, the amount of funding provided through Education NPPs has significantly reduced.

³⁶ COAG Reform Council, Healthcare, <<http://www.coagreformcouncil.gov.au/agenda/healthcare.cfm>>, accessed 10 August 2012.

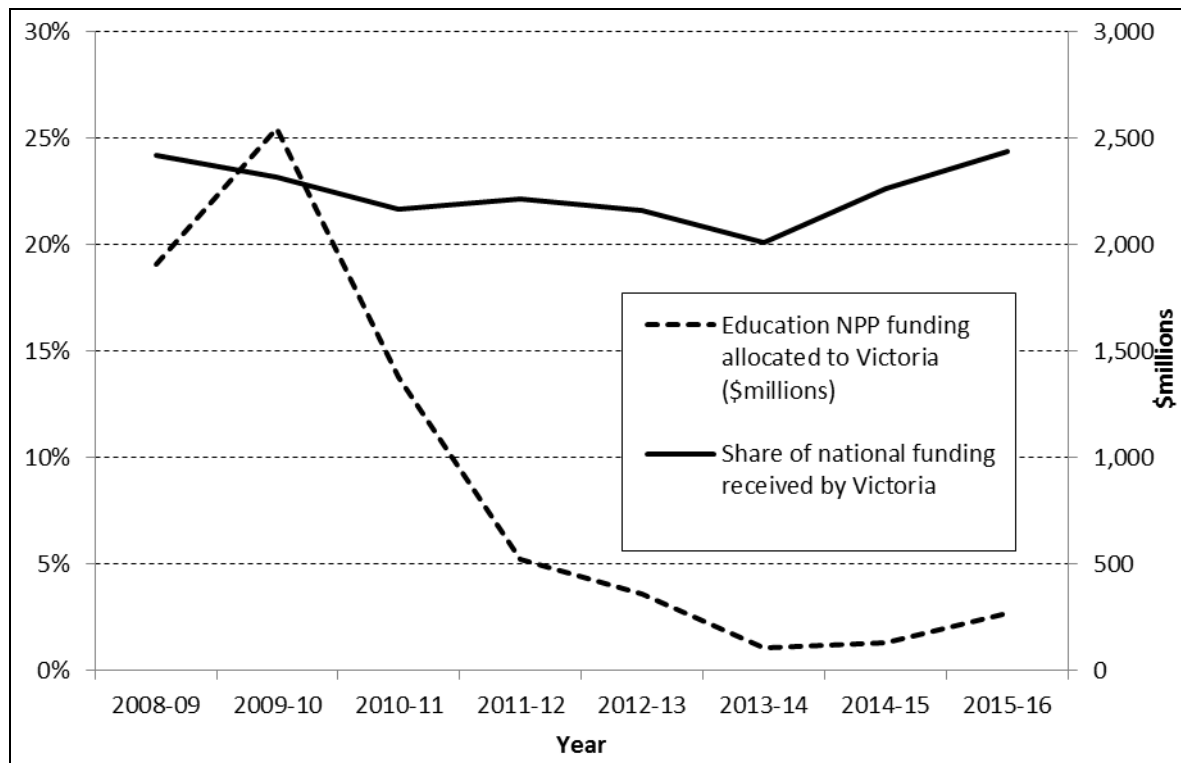
³⁷ Commonwealth Government, Budget Papers 2012-13, Budget Paper No. 3: Australia’s Federal Relations, p. 27.

³⁸ Commonwealth Government, Budget Papers 2012-13, Budget Paper No. 3: Australia’s Federal Relations, pp. 25-47.

The amount and share of NPP funding for education provided to Victoria is shown in Chart 3.7. Victoria's share of this funding does not vary greatly over the eight years shown on the chart, peaking at 24 per cent in 2008-09 and gradually reducing to an estimated 20 per cent in 2013-14, before being predicted to rise to 24 per cent again in 2015-16.

There are 25 NPPs in the Education category from 2011-12 to 2015-16. The overall funding provided to Victoria is slightly below its per capita distribution. This is due to several National Partnerships which are specifically targeted at Indigenous disadvantage, particularly in the Northern Territory and Western Australia.³⁹

Chart 3.7: Victorian Education NPP funding 2008-09 to 2015-16



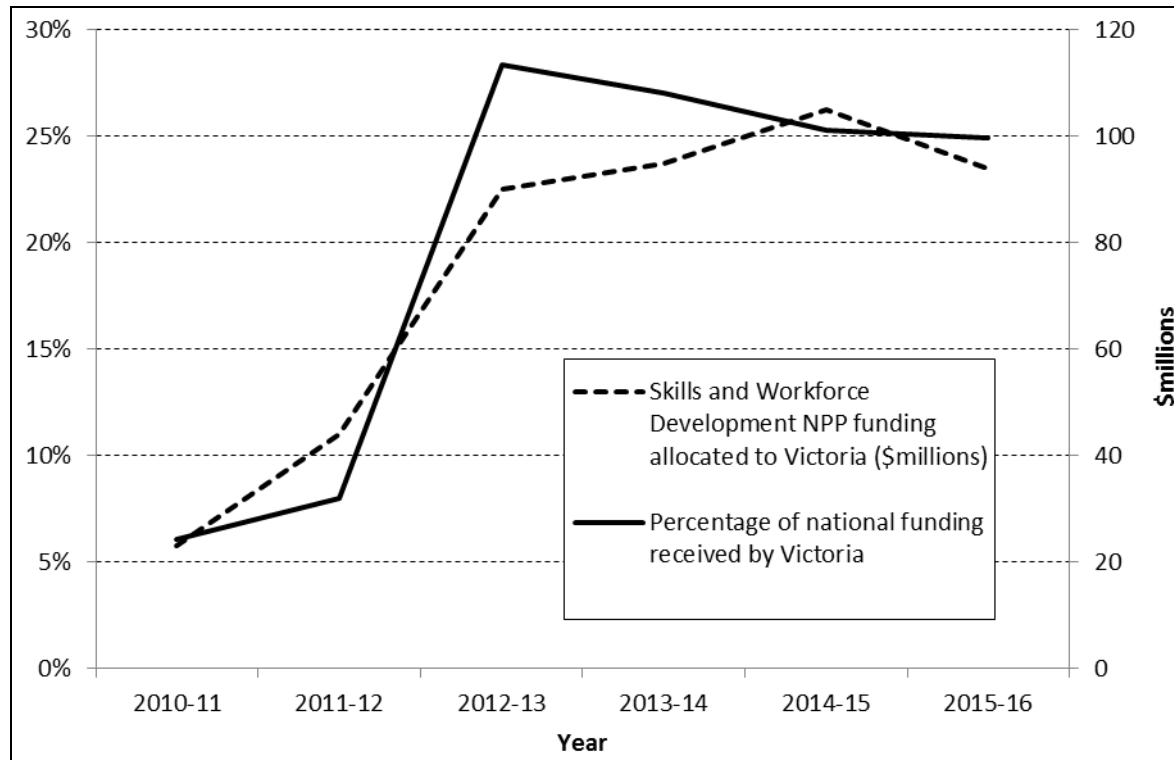
Source: Commonwealth Final Budget Outcome 2008-09 to 2010-11 and Commonwealth Budget Papers 2012-13, Part 3: Fiscal Strategy and Outlook, p. 22.

³⁹ National Partnership on Closing the Gap in the Northern Territory; National Partnership on the East Kimberley development package; National Partnership on Indigenous early childhood development — children and family centres.

3.2.3.3 Skills and Workforce Development NPPs

Skills and Workforce Development was first introduced as a category of NPP in 2010-11, having previously been included under the Education category of NPPs. Chart 3.8 shows the amount and share of funding provided to Victoria under the Skills and Workforce Development NPP.

Chart 3.8: Victorian Skills and Workforce Development NPP funding 2010-11 to 2015-16



Source: Commonwealth Final Budget Outcome 2010-11 and Commonwealth Budget Papers 2012-13, Part 3: Fiscal Strategy and Outlook, p. 22.

For the first two years of funding in this category, Victoria received significantly lower funding than other states. This was due to Victoria not being included in the National Partnership on Productivity Places Program. Instead, Victoria negotiated a separate agreement with the Commonwealth, which provided funding for training delivery as part of the Securing Jobs for Your Future: Skills for Victoria initiative.⁴⁰ This funding was provided as Commonwealth Own Purpose Expenditure (COPE),⁴¹ and is not included as a payment to Victoria.

The National Partnership on Productivity Places Program terminated on 30 June 2012, which means Victoria’s share of funding dramatically increases from 2012-13 onwards, although the level of funding does not increase significantly. In its submission, the Victorian Government acknowledges that Commonwealth funding received in the area of skills is largely commensurate with Victoria’s population share.⁴²

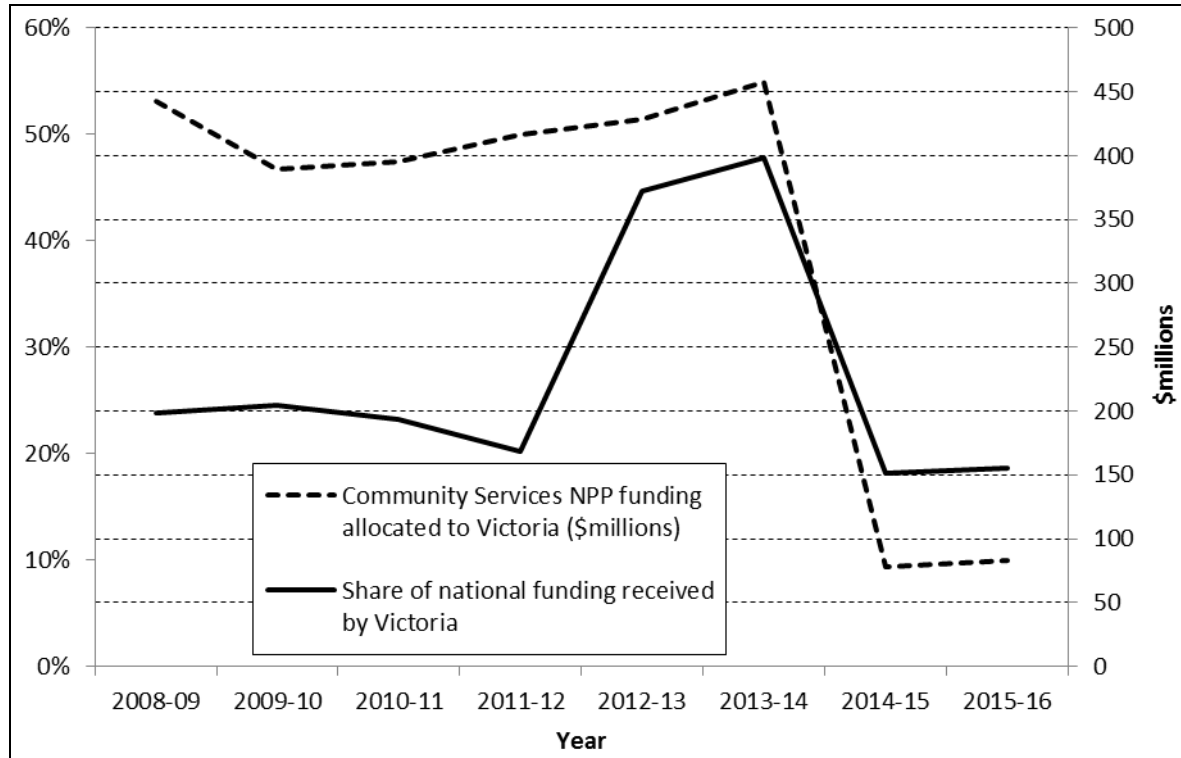
There are nine NPPs in the area of Skills and Workforce Development that will operate from 2011-12 to 2015-16. The most significant of these is the Building Australia’s Future Workforce — National partnership on skills reform, which comprises 62 per cent of NPP funding, and is distributed on a per capita basis.⁴³

⁴⁰ COAG Reform Council, *National Agreement for Skills and Workforce Development: Performance report for 2009*, p. 56.
⁴¹ Victorian Government, Submission No. 6, p. 7.
⁴² Victorian Government, Submission No. 6, p. 7.
⁴³ National Partnership Agreement on Skills Reform, clause 45, p. 10.

3.2.3.4 Community Services NPPs

Chart 3.9 shows the amount and share of funding provided to Victoria through NPPs for community services from 2008-09 to 2015-16. As shown in the chart, Victoria's share of funding is set to increase significantly in 2012-13 and 2013-14.

Chart 3.9: Victorian Community Services NPP funding 2008-09 to 2015-16



Source: Commonwealth Final Budget Outcome 2008-09 to 2010-11 and Commonwealth Budget Papers 2012-13, Part 3: Australia's Federal Relations, p. 22.

In its submission, the Victorian Government explains:⁴⁴

[I]n 2012-13, Victoria will receive approximately 44.7 per cent of national community services NP funding. This is the result of Victoria declining to transfer responsibility for home and community care to the Commonwealth under the National Healthcare agreement. Western Australia and Victoria are now the only states to receive NP funding for home and community care, with Victoria to receive \$352.4 million under this agreement in 2012-13, significantly inflating Victoria's overall share of NP funding in this area.

Current Commonwealth Budget Papers do not include funding past 2013-14 for the National Partnership on transitioning responsibilities for aged care and disability services — Basic community care maintenance and support services component, although they do state that provision has been made in the Contingency Reserve subject to negotiations with the states.⁴⁵ Therefore it is likely that Victoria will continue to receive a significantly higher proportion of Community Services NPP funding than other states.

In total there are 18 NPPs in the Community Services category.⁴⁶ 10 of these provide small amounts of funding solely to the Northern Territory and one solely to Queensland.

⁴⁴ Victorian Government, Submission No. 6, p. 7.

⁴⁵ Commonwealth Government, *Budget Papers 2012-13, Budget Paper No. 3: Australia's Federal Relations*, p. 77.

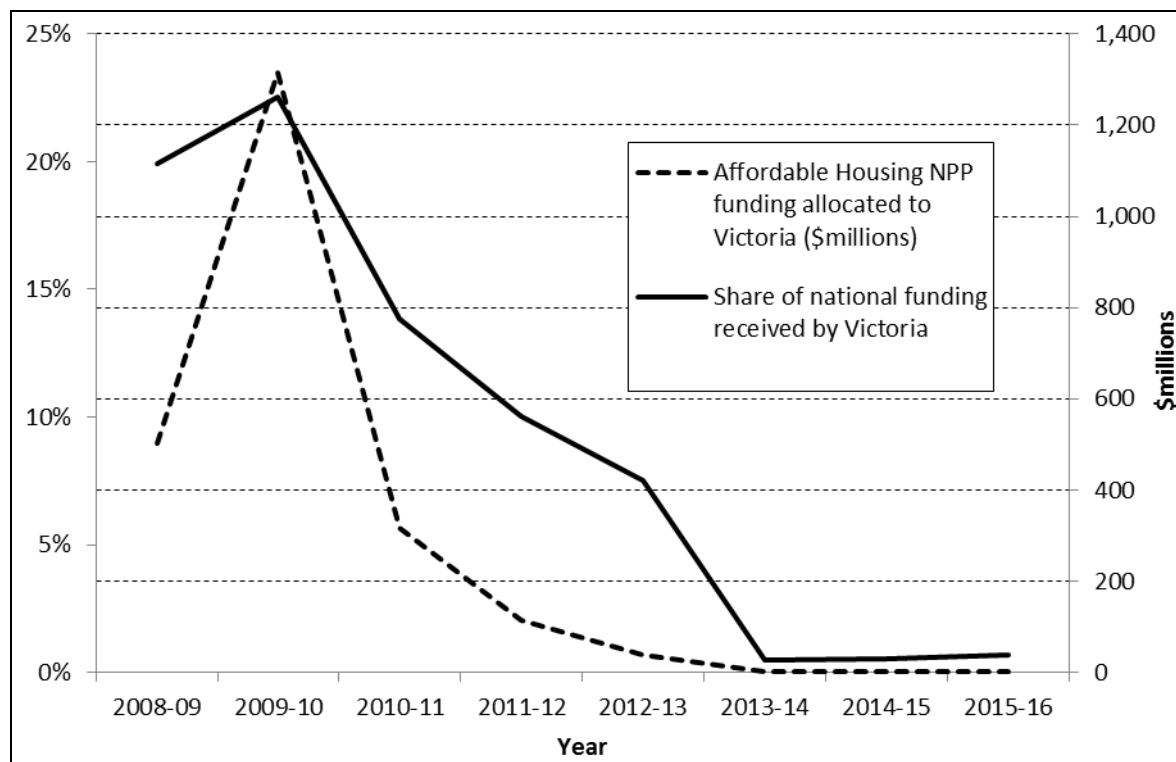
⁴⁶ Commonwealth Government, *Budget Papers 2012-13, Budget Paper No. 3: Australia's Federal Relations*, pp. 76-83.

3.2.3.5 Affordable Housing NPPs

The amount of funding for affordable housing provided through NPPs is set to decrease significantly over the next four financial years. Funding peaked in 2009-10 due to funding provided for the First Home Owners Boost and stimulus spending as part of the Nation Building and Jobs Plan — social housing initiative to build and repair social housing across Australia.⁴⁷

Along with these two NPPs, a number of other national partnerships are due to expire by 30 June 2013, including the national partnership on homelessness. After peaking at \$1,316 million in 2009-10 as part of the economic stimulus program, Victoria will only receive \$2.5 million in affordable housing NPPs in each of 2013-14, 2014-15 and 2015-16. Chart 3.10 shows the funding provided to Victoria through NPPs for Affordable Housing.

Chart 3.10: Victorian Affordable Housing NPP funding 2008-09 to 2015-16



Source: Commonwealth Final Budget Outcome 2008-09 to 2010-11 and Commonwealth Budget Papers 2012-13, Part 3: Australia’s Federal Relations, p. 22.

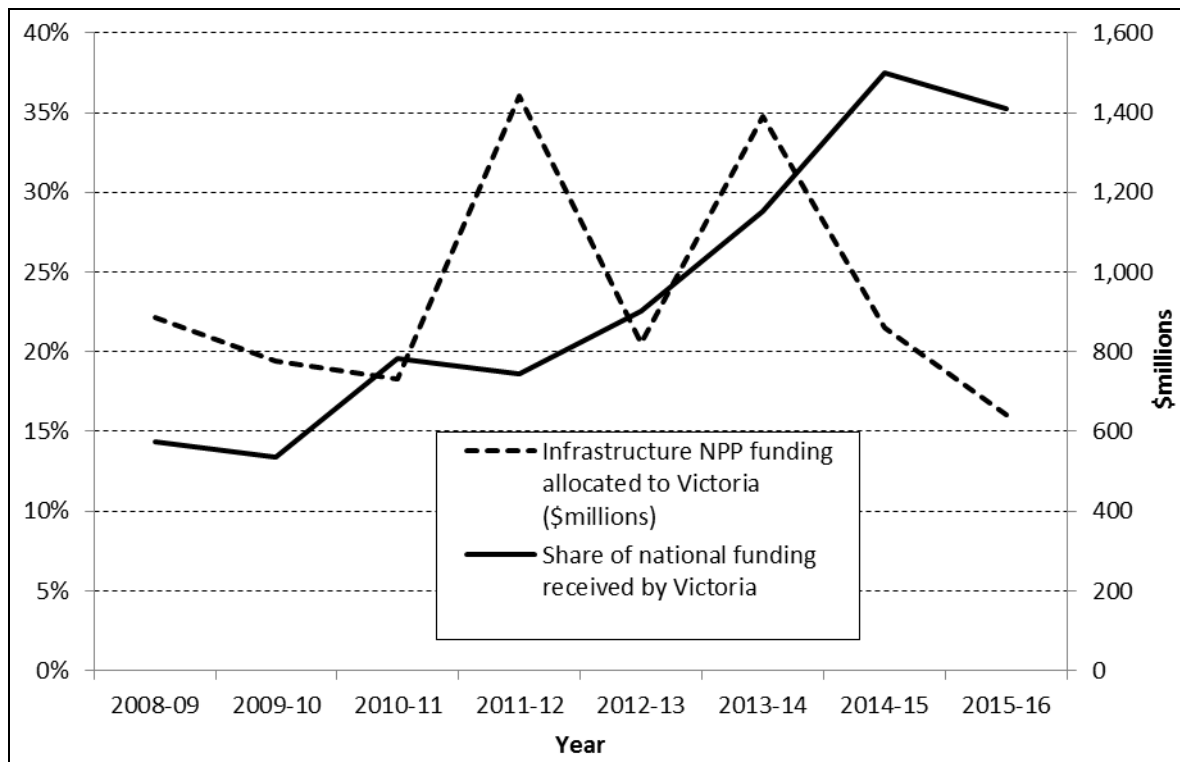
3.2.3.6 Infrastructure NPPs

Commonwealth funding for infrastructure is provided solely through NPPs and there is no ongoing funding provided through a SPP. Payments made to the states for infrastructure projects from the Building Australia Fund are treated as NPPs and included in this funding.

Chart 3.11 shows the amount and share of Commonwealth infrastructure funding for Victoria through NPPs from 2008-09 to 2015-16. As the Commonwealth funds individual projects, the level of funding varies greatly from year to year depending on the commencement and completion dates of projects. Commonwealth Budget Papers have made provision for \$3.6 billion of infrastructure funding for the duplication of the Pacific Highway in NSW as part of the National Partnership on the Nation Building Program. However, this is conditional on the NSW Government matching this funding.⁴⁸ Should the project proceed, Victoria’s share of infrastructure funding will be significantly decreased.

⁴⁷ Commonwealth Government, *Budget Papers 2009-10, Budget Paper No. 3: Australia’s Federal Relations*, pp. 83-84.

⁴⁸ Commonwealth Government, *Budget Papers 2012-13, Budget Paper No. 3: Australia’s Federal Relations*, p. 96.

Chart 3.11: Victorian Infrastructure NPP funding 2008-09 to 2015-16

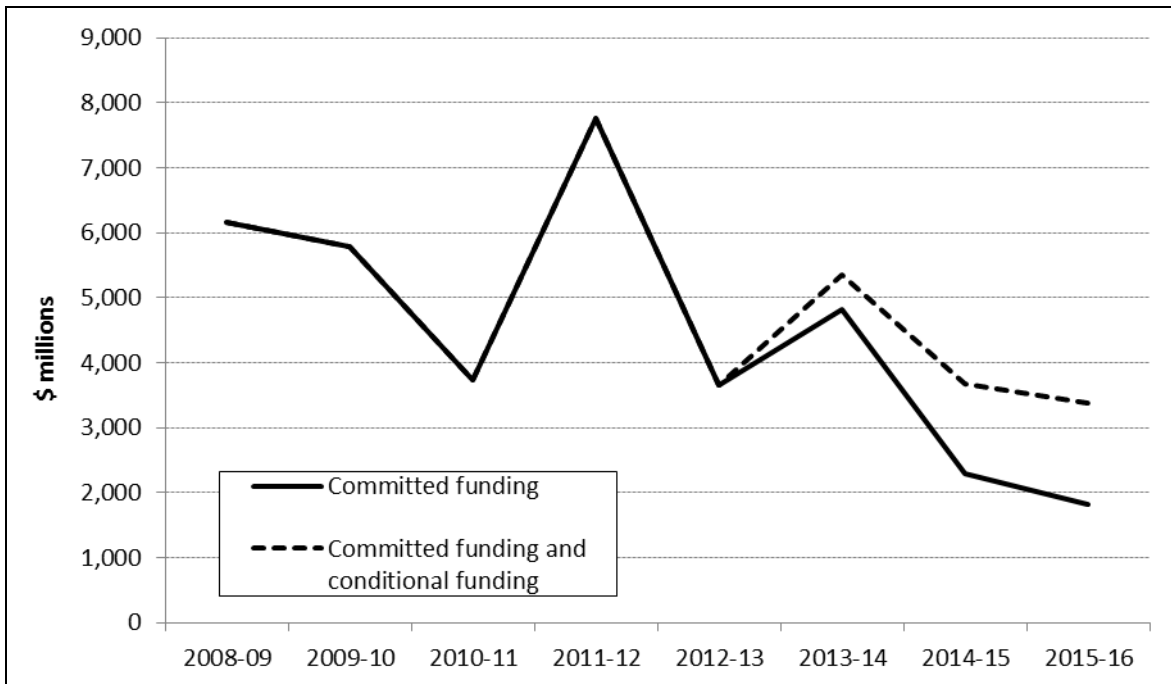
Source: Commonwealth Final Budget Outcome 2008-09 to 2010-11 and Commonwealth Budget Papers 2012-13, Part 3: Australia's Federal Relations, p. 22.

While Victoria's share of funding is predicted to rise from 2011-12 onwards, this is mainly due to Victoria continuing to receive funding for the Regional Rail Link project, and the Commonwealth yet to commit to other major projects over this period. Victoria's share of funding in 2012-13 and 2013-14 is lower than originally stated in the 2011-12 Commonwealth Budget partly due to the Victorian Government requesting that funds for the duplication of the Western Highway be delayed until 2014-15 to provide time for the completion of an Environmental Effects Statement.⁴⁹

Chart 3.12 shows the total amount of funding provided by the Commonwealth through Infrastructure NPPs. Some future NPPs, in particular for the duplication of the Pacific Highway in NSW, are yet to be formally allocated to states, so future NPP funding is shown on the Chart as both committed funding and a higher total which includes the conditional funding. Funding peaked in 2011-12 as part of the stimulus package delivered through the National Partnership on the Nation Building Program. However, from 2013-14, the amount of funding provided by the Commonwealth for infrastructure will significantly decrease.

⁴⁹ Department of Infrastructure and Transport, Nation Building Program - Western Highway - Duplication from Ballarat to Stawell, <http://www.nationbuildingprogram.gov.au/projects/ProjectDetails.aspx?Project_id=032646-08VIC-NP>, accessed 24 September 2012.

Chart 3.12: Total Infrastructure NPP funding 2008-09 to 2015-16

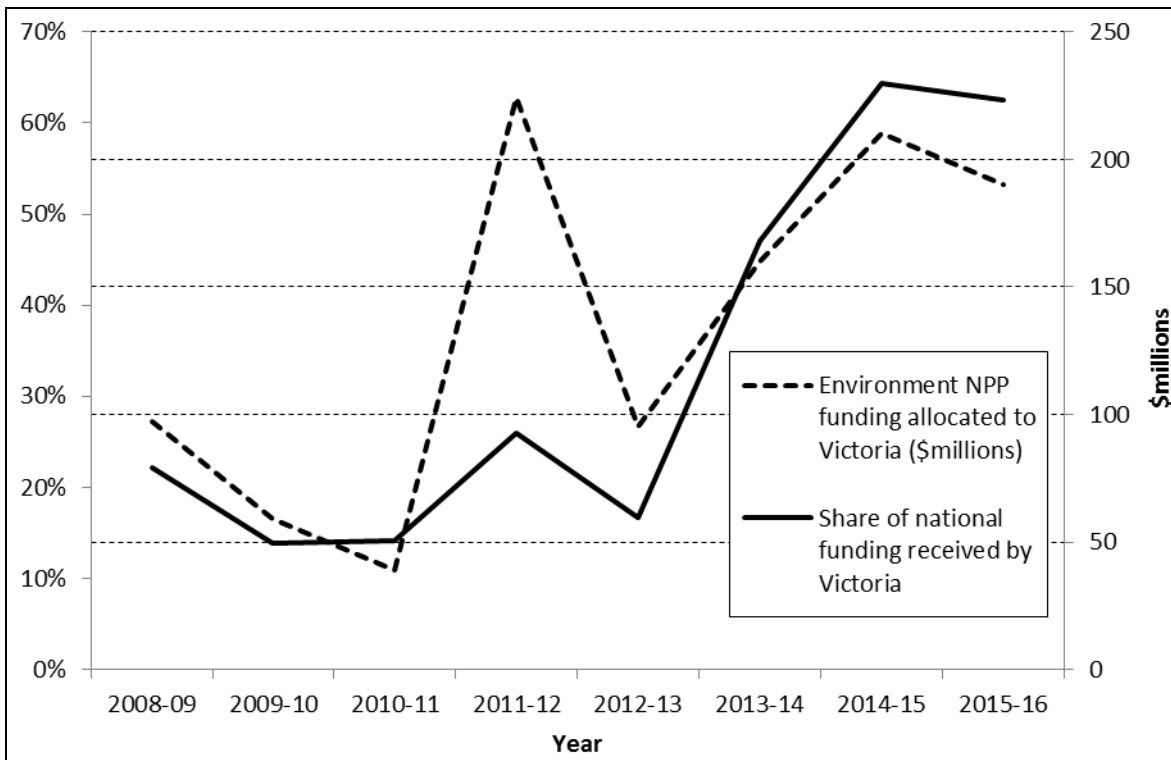


Source: Commonwealth Final Budget Outcome 2008-09 to 2010-11 and Commonwealth Budget Papers 2012-13, Part 3: Australia’s Federal Relations, p. 22.

In total there are 29 Infrastructure NPPs that will operate from 2011-12 to 2015-16. Many of these are for minor infrastructure projects in individual states, such as the redevelopment of the Sydney Cricket Ground and the construction of the Townsville Convention and Entertainment Centre.

3.2.3.7 Environment NPPs

Chart 3.13: Victorian Environment NPP funding 2008-09 to 2015-16



Source: Commonwealth Final Budget Outcome 2008-09 to 2010-11 and Commonwealth Budget Papers 2012-13, Part 3: Australia’s Federal Relations, p. 22.

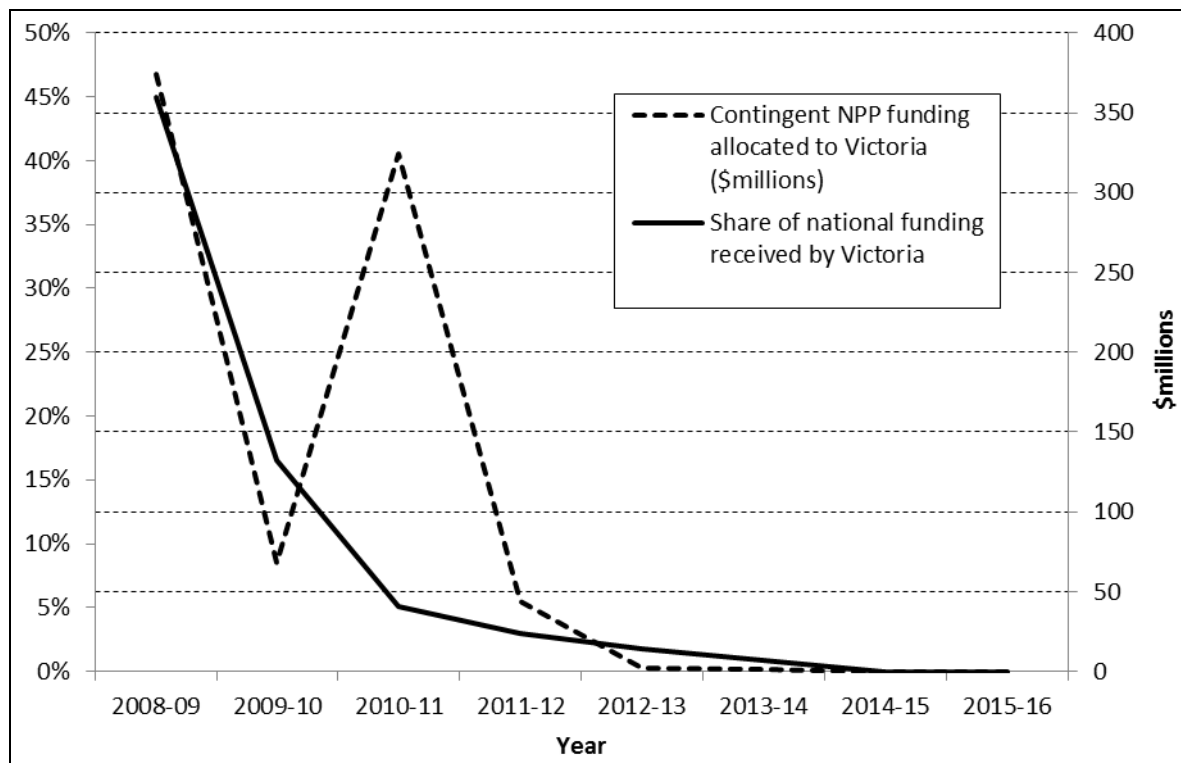
As with funding for infrastructure, Commonwealth environment funding is provided solely through NPPs and there is no ongoing funding provided through a SPP. Environment is one of the smaller categories of NPPs, which results in significant fluctuation of funding when larger projects are funded. Victoria is receiving significant funding under the Sustainable Rural Water Use and Infrastructure component of the Water for the Future National Partnership, which will result in Victoria's share of funding exceeding 50 per cent of the national pool in 2014-15 and 2015-16.

In total, there are 16 NPPs that will operate from 2011-12 to 2015-16. Very few of these are allocated on a per capita basis as they target specific environmental initiatives.

3.2.3.8 Contingent NPPs

Contingent payments arise where the Commonwealth has committed to provide compensation when an event occurs or otherwise guarantees a states' financial position.⁵⁰ The most substantial area of Contingent payments is natural disaster relief funding. Significant funding is being paid to Queensland in this category due to the November 2010 to February 2011 floods and Tropical Cyclone Yasi. Victoria received funding in 2011-12 due to the floods in the summer of 2010-11. Due to the nature of these payments, they are very variable from year to year. Chart 3.14 shows the amount and share of funding provided to Victoria through Contingent NPPs.

Chart 3.14: Victorian Contingent NPP funding 2008-09 to 2015-16



Source: Commonwealth Final Budget Outcome 2008-09 to 2010-11 and Commonwealth Budget Papers 2012-13, Part 3: Australia's Federal Relations, p. 22.

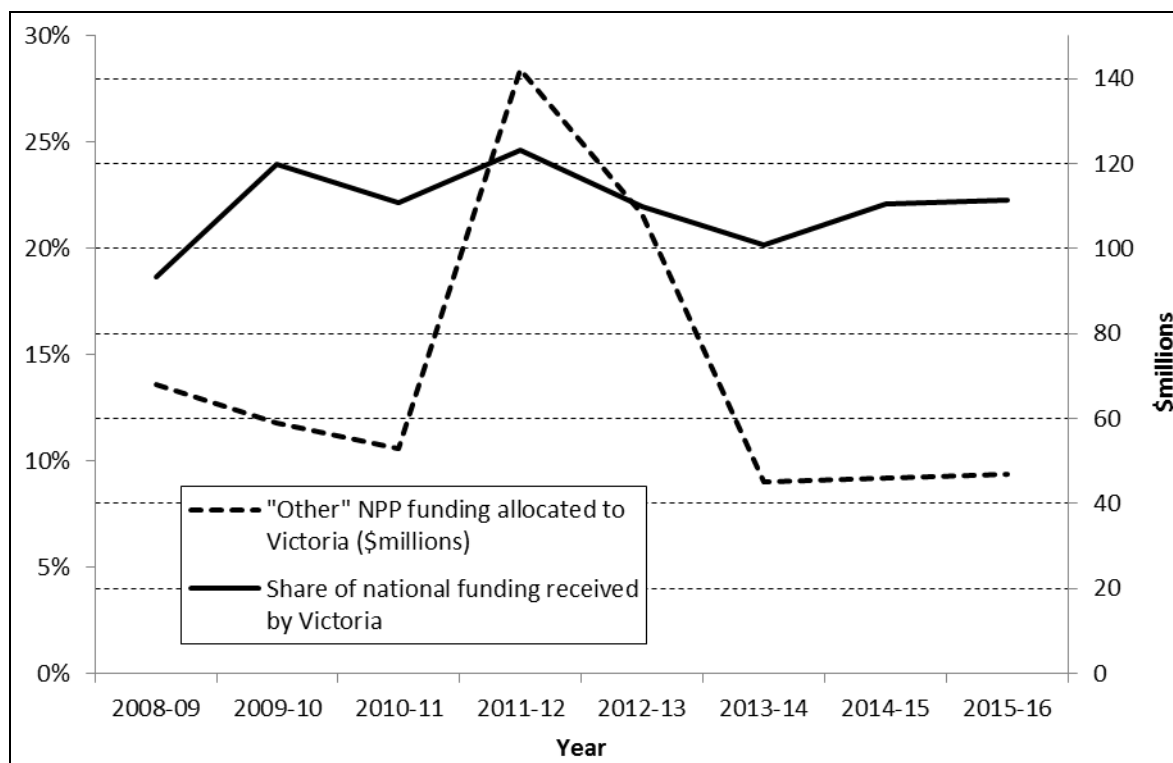
3.2.3.9 Other NPPs

The "Other" category of NPPs captures payments to the states that do not fall into the first eight categories. These can include payments in respect of agriculture, forestry and fishing; fuel and energy; public order and safety; and recreation and culture.⁵¹

⁵⁰ Commonwealth Government, *Budget Papers 2012-13, Budget Paper No. 3: Australia's Federal Relations*, p. 110.

⁵¹ Commonwealth Government, *Budget Papers 2012-13, Budget Paper No. 3: Australia's Federal Relations*, p. 112.

Chart 3.15: Victorian “Other” NPP funding 2008-09 to 2015-16



Source: Commonwealth Final Budget Outcome 2008-09 to 2010-11 and Commonwealth Budget Papers 2012-13, Part 3: Australia’s Federal Relations, p. 22. Excludes Financial Assistance Grants to Local Government.

Chart 3.15 demonstrates the level of funding provided to Victoria in the “Other” category. Financial Assistance Grants to Local Government have been excluded from these figures as they are examined separately in Chapter 4. There are approximately 14 NPPs in the “Other” category from 2011-12 to 2015-16. A number of these are for one off events, such as the Centenary of Canberra in 2013 or the pilot of drought reform measures in Western Australia.

The two highest value NPPs in this category are the National Partnership to deliver a seamless national economy, which is provided on a per capita basis, and the National Partnership on legal assistance services, which uses population size, demographic characteristics and socio-economic variables to provide a distribution based on the incidence and risk of disadvantage.⁵² As shown in Chart 3.15, Victoria consistently receives between 20 and 25 per cent of overall funding in this category.

3.2.3.10 Summary

As shown in the previous sections, Victoria’s share of funding varies across the nine categories of NPPs.

- In the Health and Education categories, Victoria has received a fairly consistent share of funding, varying between approximately 20 and 25 per cent.
- In the Skills and Workforce Development and Community Services categories, due to the different arrangements that apply in different jurisdictions, each state’s share of funding varies significantly from year to year.
- Affordable Housing NPP funding is predicted to decrease significantly due to the winding down of economic stimulus programs.
- Infrastructure funding is one of the least predictable categories of NPP, with funding varying greatly from year to year depending on the specific projects funded in a particular year.

⁵² National Partnership Agreement on Legal Assistance Services, pp. 8 to 9.

- Environment funding and “Other” funding is generally targeted at individual initiatives in particular states, as opposed to national programs, which means Victoria’s share of funding fluctuates.
- Contingent NPP funding is principally targeted at natural disaster relief, with Queensland receiving the majority of recent funding due to floods and cyclones in that state.

Finding 3

Victoria’s share of NPPs varies significantly across each of the different areas of government service delivery.

3.3 Victoria’s fair share

As discussed in section 3.2.3, Victoria’s share of funding varies across the nine categories of NPPs and in some categories, Victoria’s share varies considerably from year to year. The Terms of Reference ask the Committee to examine whether this share is satisfactory relative to Victoria’s population share and its contribution to the Australian economy, and whether the adequacy of Victoria’s share varies across each of the different areas of government service delivery and economic activity.

The Victorian Government states in its submission to the Committee.⁵³

Between 2008-09 and 2011-12, Victoria has received significantly less than its per capita share of NP funding. In 2011-12, Victoria received approximately 19.8 per cent of total available NP funding based on 2012-13 Commonwealth Budget data, compared with a population share of 24.9 per cent. It is anticipated, based on this data, that Victoria’s share of NP funding will increase to 22.9 per cent in 2012-13, remaining less than the State’s per capita share.

Given the varied nature of NPPs, the Committee believes it is unhelpful to make assessments about whether the current division of NPP funding between states and territories is appropriate based on these aggregate figures. Aggregate figures can be misleading as a significant number of NPPs are directed towards initiatives targeted at the Indigenous population. The Victorian Government also noted in its submission that Victoria’s share of Skills and Workplace Reform funding is significantly lower than a per capita share and its share of Community Services funding will be significantly higher than a per capita share due to special administrative arrangements associated with particular agreements.⁵⁴ These variations distort aggregate figures. When questioned about this issue at a public hearing, the Assistant Treasurer acknowledged this difficulty:⁵⁵

We certainly recognise that there are differences in terms of need and in terms of disadvantage across different jurisdictions, and that is going to be reflected in individual national partnerships. But equally the aggregate numbers are important because ... we do rely on the Commonwealth for around 50 per cent of our funding and we do need to be receiving a fair share here in Victoria. But I certainly take your point that there are differences in need and that will be reflected in various partnerships. We accept that, but the aggregate remains important.

The underlying assumption in the Terms of Reference that the distribution of NPP funding should in most circumstances relate to population distribution or contribution to the economy is problematic. As shown in Chart 2.8, Victoria has consistently contributed approximately 23 per cent of Gross Domestic Product for the past 20 years despite being home to approximately 25 per cent of the national population. Furthermore, NPPs are not designed to provide money to states in recognition of the money they have contributed to Commonwealth taxation revenue. The purpose of NPPs is to:

⁵³ Victorian Government, Submission No. 6, p. 7.

⁵⁴ Victorian Government, Submission No. 6, p. 7.

⁵⁵ Hon. G. Rich-Phillips, Assistant Treasurer, *Transcript of Evidence*, 10 October 2012, p. 6

- support the delivery of specified outputs or projects;
- facilitate reform; or
- reward states that deliver nationally significant reforms.

Rather than providing funding on a per capita basis, it could be argued that the funding should be allocated to achieve these NPP outcomes.

In the following section, the Committee has examined how funding is divided between states and territories within existing National Partnership Agreements to assess whether the funding distribution is appropriate.

3.3.1 Distribution of NPP funding between states and territories

Current Commonwealth Budget Papers estimate that between 2011-12 and 2015-16 there will be funding provided to states and territories through 180 National Partnerships. This does not include potential new NPPs that will be developed over this period. Some of these NPPs provide funding to all six states and both territories, and are therefore divided between 8 jurisdictions, but the majority do not. Table 3.4 shows the number of states/territories receiving funding under NPPs for each category of NPP.

Table 3.4: Distribution of NPPs between states and territories 2011-12 to 2015-16

Category	Number of states/territories receiving funding under National Partnerships in that category									
	UA	1	2	3	4	5	6	7	8	Total
Health	1	24	1	1		2	1	1	27	58
Education		8	1			1			15	25
Skills and Workforce Development		1	1					2	5	9
Community Services		11					1	1	4	17
Affordable Housing	1	3						3	1	8
Infrastructure	1	13	1	2	1	1	1	2	7	29
Environment		4	3	2		3		1	3	16
Contingent			1		1			2		4
Other	2	7				1		1	3	14
Total	5	71	8	5	2	8	3	13	65	180

UA = funds have not yet been allocated between states and territories.

Source: Commonwealth Budget Papers 2012-13, Part 3: Australia's Federal Relations.

As shown in Table 3.4, 71 current NPPs provide funding to only one individual state or territory. Of these, 29 are allocated exclusively to the Northern Territory, totalling \$346.1 million over the 5 year period. Most of these are targeted toward Indigenous health and education programs. Only 65 out of 180 NPPs (36 per cent) provide funding to all 8 jurisdictions.

3.3.2 The current basis of the distribution of NPP funding

The Committee has examined a number of NPPs that provide funding to all 8 jurisdictions to determine the basis on which the funding is divided. The majority of funding agreements contain clear statements about the basis on which the break up between states and territories is calculated.

In the Health category, 27 NPPs include all 8 jurisdictions. Of these, very few are allocated on a per capita basis according to the population of the state. Instead, funding is distributed on criteria specific to the agreement, for example:

- National Partnership on Financial Assistance for Long Stay Older Patients (LSOPs) — funding distributed on the basis of the LSOP census (Victoria receives 12 per cent of funding);
- National Partnership Agreement on Hospital and Health Workforce Reform — activity based funding — \$10 million was subtracted from the total and split equally between the

states and territories and the remaining funds were distributed using rurally weighted admitted separations (Victoria receives 26.5 per cent of funding);

- National Partnership Agreement Supporting National Mental Health Reform — states and territories are invited to bid for funds from a competitive funding pool of \$200 million over five years (2011-12 to 2015-16) to implement reforms that address priority service gaps.

Similarly, in the Education category, funding is divided on criteria related to the nature of the National Partnership agreement:

- National Partnership on the digital education revolution — funding distributed on the basis of school census data (Victoria receives 23.8 per cent of funding);
- National Partnership Agreement on Early Childhood Education — universal access to early education — funding allocated on the basis of projected four year old populations (Victoria receives 22.1 per cent of funding);
- National Partnership Agreement for More Support for Students with Disabilities — funding allocated according to estimated proportion of students with disabilities (Victoria receives 24.2 per cent of funding);
- National Partnership Agreement on Improving Teacher Quality — facilitation funding distributed based on share of the national FTE for teaching staff according to ABS data (Victoria receives 25.4 per cent of funding).

For Skills and Workforce Education:

- National Partnership on Skills Reform — funding distributed on a per capita basis (Victoria receives 24.9 per cent of funding);
- National Partnership on TAFE fee waivers for childcare qualifications — funding is provided based on demand with the Commonwealth reimbursing states for all fee revenue foregone for eligible courses (Victoria is estimated to receive 48 per cent of funding).

The Committee believes that although the funding under these agreements is not always provided on a per capita basis, the funding is appropriately distributed in accordance with criteria relevant to the individual NPP.

In its submission, the Victorian Government contends that Environment NPPs are one area where Victoria is not receiving its fair share:⁵⁶

Analysis of the NP component of the *Caring for Our Country* program shows that Victoria receives approximately 20 per cent of the total available funding pool, well below an equitable distribution of available funding. Victoria's share of competitive funding is significantly lower than this figure; over the past four years the average of funds received by Victoria represented just 13 per cent of the national pool.

The submission further argues:⁵⁷

Victoria is placed at a significant funding disadvantage relative to other jurisdictions and penalised for our earlier investment in managing resources.

The Committee notes the concerns of the Victorian Government, but does not hold the view that this share is inequitable. The purpose of the Caring for our Country initiative is to improve biodiversity and sustainable farm practices.⁵⁸ As noted in Chapter 2, although Victoria is home to 24.8 per cent of the Australian population, Victoria comprises only 3 per cent of Australia's land area. Given one of the priority areas of Caring for our Country is natural resource management in northern and remote Australia, it is not surprising Victoria receives less than 24.8 per cent of available funding.

⁵⁶ Victorian Government, Submission No. 6, p. 9.

⁵⁷ Victorian Government, Submission No. 6, p. 9.

⁵⁸ Commonwealth Department of Agriculture, Fisheries and Forestry and Commonwealth Department of Sustainability, Environment, Water, Population and Communities, *Caring for Our Country*, <<http://www.nrm.gov.au/about/caring/index.html>>, accessed 24 August 2012.

When the National Partnership on Financial Assistance for Long Stay Older Patients was announced, the Victorian Government similarly criticised the allocation of funding. In a press release the Premier stated:⁵⁹

Victoria will receive \$33.2 million over three years under the National Partnership (NP) on financial assistance for long-stay older patients, representing a 12 per cent share of the available funding. ... The new funding share is based on a census of long stay older patients. Victoria has a relatively low number of long-stay older patients due to significant state investment to reduce length of stay. Victoria is effectively being penalised for investing to improve the performance of our hospital system.

The Committee notes the Victorian Government's concerns that it is receiving less funding due to its own earlier investment in related initiatives. However, given the purpose of NPPs is to support the delivery of specified outputs or projects or facilitate reform, the Committee does not feel it would be effective to give states money if they have already achieved the target outcomes. It is also problematic to look at NPP funding in isolation. For example, although Victoria only receives 12 per cent of the National Partnership on Financial Assistance for Long Stay Older Patients funding (240 out of 2,000 places), as Victorians are transferred to residential aged care more quickly, Victoria receives a higher share of Commonwealth funded residential aged care beds. According to the 2010-11 Annual Stocktake of Aged Care Places, as at 30 June 2011, 25.7 per cent of operational residential aged care beds were in Victoria, totalling 1,611 more beds than a per capita share.⁶⁰ Therefore, although Victoria misses out on some NPP funding, Victorians recover that funding through other avenues.

3.3.3 Impact of implementing per capita funding for NPPs

In its submission, the Victorian Government makes a number of comparisons between the level of funding Victoria currently receives and the level of funding it would receive if funding were distributed on a per capita basis.

Over the first four years of NPPs, Victoria received 19.7 per cent of NPP funding. Table 3.5 demonstrates Victoria would have received significantly higher funding if funding was allocated on a per capita basis.

Table 3.5: National partnership payments for Victoria 2008-09 to 2011-12 if provided on a per capita basis

	Allocated to Victoria in Commonwealth budget (\$millions)	Total allocated (\$millions)	Allocated to Victoria if capita share (24.8%) applied (\$millions)	Change in amount received by Victoria (\$millions)
2008-09	7,453	33,188	8,231	778
2009-10	5,372	26,141	6,483	1,111
2010-11	3,612	23,234	5,762	2,150
2011-12	3,619	19,488	4,833	1,214
Total	20,056	102,051	25,309	5,253

Source: Commonwealth Final Budget Outcome 2008-09 to 2011-12

From 2008-09 and 2011-12, Victoria's per capita share of 19.7 per cent was impacted by significant level of funding provided to the Northern Territory through NPPs. Despite only being home to 1 per cent of Australia's population, the Northern Territory received 3.1 per cent of NPP funding. If funding to the Northern Territory is excluded from calculations, Victoria received 20.3 per cent.

⁵⁹ Minister for Health, Media Release: Additional Commonwealth-State funding for Victorian health services, 17 May 2011, <<http://www.premier.vic.gov.au/media-centre/media-releases/960-additional-commonwealth-state-funding-for-victorian-health-services.html>>, accessed 31 August 2012.

⁶⁰ Department of Health and Ageing, *Operational Places and Ratios by State/Territory - Stocktake 2010-11*, <<http://www.health.gov.au/internet/main/publishing.nsf/Content/ageing-rescare-aac-stats-stocktake-2010-11-attachmentb>>, accessed 15 October 2012.

Over the next four years, Victoria's share of NPP funding is due to increase. In fact, based on funding that has been allocated to states and territories in the 2012-13 Commonwealth Budget, Victoria is due to receive over 26 per cent of NPP funding from 2012-13 to 2015-16. As shown in Table 3.6, if per capita funding were introduced from 2012-13 onwards, Victoria would lose \$478 million in NPP funding over the next four financial years.

Table 3.6: National partnership payments for Victoria 2012-13 to 2015-16 if provided on a per capita basis

	Allocated to Victoria in Commonwealth budget (\$millions)	Total allocated (\$millions)	Allocated to Victoria if capita share (24.8%) applied (\$millions)	Change in amount received by Victoria (\$millions)
2012-13	2,325	10,206	2,531	206
2013-14	2,764	9,946	2,467	-297
2014-15	1,765	6,126	1,519	-246
2015-16	1,557	5,711	1,416	-141
Total	8,411	31,987	7,933	-478

Source: Commonwealth Budget Papers 2012-13, Part 3: Australia's Federal Relations, p. 22; Committee calculations. Excludes funding yet to be allocated between states and territories.

Not only would a per capita methodology result in less money for Victoria, as shown by Table 3.7, the Northern Territory would lose over \$800 million of funding over 4 years, which would be a 72 per cent reduction in NPP funding.

Table 3.7: National partnership payments for the Northern Territory 2012-13 to 2015-16 if provided on a per capita basis

	Allocated to NT in Commonwealth budget (\$millions)	Total allocated (\$millions)	Allocated to NT if capita share (1.0%) applied (\$millions)	Change in amount received by NT (\$millions)
2012-13	507	10,206	102	-405
2013-14	268	9,646	96	-171
2014-15	181	6,126	61	-119
2015-16	185	5,711	57	-128
Total	1,141	31,689	317	-824

Source: Commonwealth Budget Papers 2012-13, Part 3: Australia's Federal Relations, p. 22; Committee calculations. Excludes funding yet to be allocated between states and territories.

Given the income generating capacity of the Northern Territory, a loss of \$800 million would be a substantial reduction to its revenue and would significantly impact on the services it could deliver.

3.3.4 NPPs and their relationship to other Commonwealth payments

The Commonwealth Government makes payments to the states in three main categories: General Revenue Assistance, National Specific Purpose Payments and NPPs. In order to determine the adequacy of Victoria's share of NPP funding, it is also necessary to examine the role of NPPs within this system of Commonwealth payments.

GST Revenue is currently divided between states by the CGC using a complicated formula which aims to achieve horizontal fiscal equalisation (HFE). As part of its calculations, the CGC considers each state's fiscal capacity and as part of this process it takes into account the amount of revenue it receives though some NPPs, but not all NPPs. If a State receives a greater share of certain NPP

funding, its GST share is reduced. In its 2012 Update on GST Revenue Sharing Relativities, the CGC stated:⁶¹

The above average increase in receipts of Commonwealth payments reduced Western Australia's, South Australia's and Tasmania's shares of GST. On the other hand, the Commonwealth payments for Victoria, Queensland and the Northern Territory fell relative to the average, resulting in greater GST shares for these states.

This interaction between NPPs and GST further complicates matters when trying to determine whether Victoria receives its fair share of Commonwealth funding. According to the CGC 2012 Update, Victoria received an extra \$96.5 million of GST payments due to receiving a below average share of other Commonwealth payments.⁶² The CGC further stated:⁶³

Mining and Indigeneity are the largest single influences on State fiscal capacities. Most states that have a strong mining sector also have a large Indigenous population, and states without a strong mining sector tend to have relatively small Indigenous populations. So these drivers tend to counteract each other. This is most notable in Victoria, which requires \$2.3 billion more GST due to its low mining revenue capacity, but needs \$1.6 billion less GST to deliver services to Indigenous people.

In its submission to this Inquiry, the Victorian Government argues against the current system of GST distribution stating:⁶⁴

Victoria considers that specific, large policy challenges and initiatives should be excluded from GST arrangements and addressed through separate, tied and targeted programs from the Commonwealth.

The Committee notes that "specific, large policy challenges" are currently achieved through NPPs. In March 2011, the Commonwealth Treasurer issued Terms of Reference for a Review of GST Distribution.⁶⁵ The Victorian Government expanded on its position in its third submission to the GST Distribution Review in which it advocates for a per capita distribution of GST revenue and a greater use of NPPs to address issues such as Indigenous disadvantage.⁶⁶

Significant, unpredictable changes to revenue pose challenges for all jurisdictions. This could be avoided for both the Commonwealth and States by using only tied grants (NP payments) to address inherent disabilities and policy challenges of national significance. While donor States would likely see a fall in their tied grants, there would be a corresponding increase in their (untied) GST. This would partially address the current anomaly whereby States with fewer specific disabilities receive relatively more of their revenue from the Commonwealth as tied funding.

Tied grants are the best way to compensate States for disability factors such as low socio-economic status, Indigeneity and remoteness, and they are already used for this purpose. Their benefit (compared with untied funding) is their transparency against specific outcomes, and their focus on actual rather than relative disadvantage.

The Victorian Government further states:⁶⁷

Any assistance provided in the form of tied grants must be included in the HFE assessment, to avoid double compensation. The consistent treatment of capital payments is even more important. Because these are usually large, their treatment (by inclusion or exclusion) can significantly affect GST relativities over several years. While consistency is Victoria's main objective, on balance it may be preferable to treat all Commonwealth payments by inclusion.

⁶¹ Commonwealth Grants Commission, *Report on GST Revenue Sharing Relativities 2012 Update*, p. 8.
⁶² Commonwealth Grants Commission, *Report on GST Revenue Sharing Relativities 2012 Update*, p. 80.
⁶³ Commonwealth Grants Commission, *Report on GST Revenue Sharing Relativities 2012 Update*, p. 14.
⁶⁴ Victorian Government, Submission No. 6, p. 5.
⁶⁵ GST Distribution Review, *Terms of Reference*, <<http://www.gstdistributionreview.gov.au/content/Content.aspx?doc=tor.htm>>, accessed 5 September 2012.
⁶⁶ Victorian Government, *Third Submission to the GST Distribution Review*, p. 3.
⁶⁷ Victorian Government, *Third Submission to the GST Distribution Review*, p. 4.

Currently both GST distribution and NPPs are both being used to address equalisation issues such as remoteness and Indigenous disadvantage. Given this overlap, it is difficult for the Committee to determine whether the current allocation of NPP funding is appropriate, or whether some states are receiving both additional GST payments and payments through NPPs (some of which are directed by the Commonwealth to be excluded from GST calculations) to address the same area of disadvantage.

3.3.5 Committee view

The aim of NPPs is to support the delivery of specified outputs or projects, facilitate reform, or reward states that deliver nationally significant reforms. Given the purpose of NPPs, and that each Australian state is different in geographic size and has a different population, a different population distribution and a different level of disadvantage, the Committee does not believe that NPP payments should be distributed on a per capita basis or based on a state's contribution to the economy in all circumstances. As shown in section 3.3.2, where NPP funding is divided between jurisdictions, the funding is typically allocated on criteria relevant to the purpose of the NPP. The Committee supports a continuation of this approach.

However, the Committee believes the objectives of some NPPs are currently being undermined as some, but not all, are later included in GST distribution calculations, which aim to achieve full horizontal fiscal equalisation. A significant number of NPPs are currently focussed on health, education and housing initiatives for remote and Indigenous communities, many of which are excluded from GST calculations. Therefore jurisdictions such as the Northern Territory receive additional NPP funding and increased GST revenue to address the same disadvantage. This system is not transparent as adjustments for indigeneity and remoteness are mixed with other factors in complex calculations under the current GST distribution system.

Whilst GST payments are outside the scope of this Inquiry, the Committee believes the true purpose of NPPs cannot be achieved unless the system for GST distribution is improved and the relationship between GST payments and NPPs clarified. The Committee notes the Victorian Government made three submissions to the Commonwealth GST Distribution Review raising these concerns and encourages it to continue to advocate for changes to the GST distribution system to ensure a more transparent system of Commonwealth funding to the states.

Finding 4

Given the varied nature and objectives of NPPs, it is not always appropriate to measure Victoria's share of NPP funding against its per capita population share or contribution to the national economy. Where a National Partnership Agreement provides funding for multiple states, the funding should be allocated in accordance with criteria relevant to the individual agreement.

Finding 5

The Commonwealth currently provides financial assistance to states to address areas of disadvantage (such as indigeneity, remoteness and socio-economic factors) through both equalisation of GST payments and NPPs. The overlap in the role of these two types of payments adds complexity to Federal-State financial relations and reduces transparency.

Recommendation 1

The Committee recommends that the Victorian Government advocate for improvements to the current GST distribution system to ensure a more transparent system of Commonwealth payments to the states and enable NPP funding to achieve its stated purposes.

3.4 Reporting on National Partnership Payments

The Terms of Reference require the Committee to examine whether the costs of administration and associated reporting under funding agreements are appropriate.

3.4.1 National Partnership Payments Reporting Framework

Improving performance reporting arrangements for national agreements was identified as one of the objectives of the 2008 IGAFRR:⁶⁸

The accountability of governments to the public will be enhanced through simpler, standardised and more transparent public performance reporting for all jurisdictions, underpinned by clearer roles and responsibilities.

The new framework for federal financial relations replaces Commonwealth prescriptions on state and territory service delivery with a new focus on the achievement by all levels of government of mutually agreed objectives and outcomes.

There are no uniform reporting arrangements for NPPs. Each National Partnership Agreement contains the reporting requirements for that individual agreement.

The Commonwealth Government has issued guidelines that set out how performance indicators and benchmarks should be set and how performance reporting should be managed. Federal Finances Circular No. 2010/01 states that performance indicators should inform the community about how governments are progressing towards achieving objectives, outcomes and outputs. The indicators should be few in number and reflect the most relevant information about progress in achieving objectives.⁶⁹ According to the guidelines, the performance indicators should be:⁷⁰

- meaningful;
- understandable;
- timely;
- measurable;
- comparable;
- administratively simple and cost effective;
- accurate;
- hierarchical; and
- technically correct.

Performance benchmarks are target levels that states must meet for respective performance indicators to be eligible for further funding or reward payments, if the agreement provides for such payments. The COAG Reform Council assesses the achievement of performance benchmarks and makes recommendations about reward payments.

Federal Finances Circular No. 2010/01 also provides guidance about reporting arrangements. It states that performance reporting should be designed to maximise the public understanding of what outcomes have been achieved under the National Partnership and that the amount of information provided should be limited to the effective assessment of performance.⁷¹

⁶⁸ Intergovernmental Agreement on Federal Financial Arrangements, , Schedule C, p. 1, <http://www.federalfinancialrelations.gov.au/content/intergovernmental_agreements.aspx > accessed 9 October 2012.

⁶⁹ Commonwealth Government, *Federal Finances Circular No. 2010/01*, 18 March 2010, p. 22, <http://www.federalfinancialrelations.gov.au/content/circulars/circular_2010_01.pdf>, accessed 29 August 2012.

⁷⁰ Commonwealth Government, *Federal Finances Circular No. 2010/01*, 18 March 2010, pp. 23-4, <http://www.federalfinancialrelations.gov.au/content/circulars/circular_2010_01.pdf>, accessed 29 August 2012.

⁷¹ Commonwealth Government, *Federal Finances Circular No. 2010/01*, 18 March 2010, p. 22, <http://www.federalfinancialrelations.gov.au/content/circulars/circular_2010_01.pdf>, accessed 29 August 2012.

Federal Finances Circular No. 2011/02 states that:⁷²

- the frequency and scope of performance reporting should match the policy goals and the amount of funding allocated to the National Partnership;
- accurate, timely and relevant performance reporting to support public accountability needs to be balanced against administrative efficiency; and
- reporting cycles should generally be on a financial year basis (except for the education sector where reporting on a calendar year basis is more informative) and in general, should not be more frequently than six monthly.

3.4.2 Compliance with reporting guidelines

The Victorian Government submission states that key issues for Victoria include that:⁷³

- A growing number of agreements are placing a large administrative burden on Victoria, and distracting attention from reforms of national significance.
- Some small agreements impose disproportionately high reporting requirements relative to the level of funding provided.

In evidence to the Committee the Assistant Treasurer stated:⁷⁴

[T]here are some examples in the submission where the reporting requirements have been over the top given the size of the partnerships or the complexity and risk of the partnerships.

These overly burdensome reporting requirements appear to be contrary to the intent of the 2008 IGAFRR and the statements in the Federal Finances Circulars. The Committee is therefore concerned that the guidelines are not always being complied with when National Partnership Agreements are drafted.

Given it is not always evident from reading a written National Partnership Agreement what resources will be required to comply with the reporting requirements, the Committee decided to write to all Victorian Government Departments seeking information about the cost of reporting on the NPPs they administer. The Committee requested each Department to complete a one page survey about each NPP, including information on the resources involved to report to the Commonwealth. A copy of the questionnaire is included in Appendix C.

The Committee received 27 survey responses in total, one of which related to a COPE payment, not an NPP. From the 26 responses received that related to NPPs, there was a large variation in the time required and costs involved in reporting under the agreement.

The surveys highlighted several inconsistencies between the reporting guidelines in Federal Finances Circular No. 2011/02 and the provisions of some NPPs:

- Several NPPs required quarterly reporting⁷⁵ or monthly reporting⁷⁶ and one required fortnightly reporting,⁷⁷ well in excess of the guidelines which recommend reporting no more frequently than six monthly;
- Some NPPs require high levels of detail in reporting, which adds to the administrative burden on Victorian Government Departments — for example, requiring monthly financial

⁷² Commonwealth Government, *Federal Finances Circular No. 2011/02*, 9 December 2011, p. 16, <http://www.federalfinancialrelations.gov.au/content/circulars/circular_2011_02.pdf>, accessed 29 August 2012.

⁷³ Victorian Government, Submission No. 6, p. 6.

⁷⁴ Hon. G. Rich-Phillips, Assistant Treasurer, *Transcript of Evidence*, 10 October 2012, p. 14.

⁷⁵ Survey Responses provided by Victorian Government Departments — National Partnership Agreement on Indigenous Early Childhood Development; National Partnership Agreement on Social Housing

⁷⁶ Survey Response provided by Victorian Government Departments — National Partnership on the First Home Owners Boost; National Partnership on the Nation Building and Jobs Plan — Building the education revolution — Primary schools for the 21st century

⁷⁷ Survey Response provided by Victorian Government Departments — National Partnership on the Nation Building and Jobs Plan — social housing — second stage construction

data which is manually intensive as Commonwealth requirements do not match existing Victorian systems,⁷⁸

- Collating data for reporting on some national partnerships can require significant resources. Reporting on the Smarter Schools National Partnership requires involvement of multiple units within the Department, takes over 700 hours of staff time to prepare and costs over \$50,000 annually. Reporting on the Literacy and Numeracy National Partnership has involved 1,440 hours of staff time to date, costing just under \$100,000.⁷⁹

A number of responses also made comments about reporting required by National Partnerships that was seen as inappropriate. Comments included:

- the reporting templates provided by [the Commonwealth] focus on activity and tend to underplay broader strategies around areas such as professional learning;⁸⁰
- the level of information sought does not always reflect the value of the investment, for example, the same level of information is often requested on investments that are in the order of \$10-\$20million as the investments in the order of hundreds of millions to a billion dollars;⁸¹
- while it is considered important for progress against the aims of the project to be monitored ... this reporting needs to be in proportion to the funding and reforms being delivered ... Reporting on how the money is spent by jurisdictions to achieve these outcomes is considered an unnecessary burden and it is not clear how this information is used;⁸²
- it is now generally recognised that the performance reporting framework under the agreement is not well aligned with the objectives of and desired outputs and outcomes under the agreement and does not enhance understanding of the value or impact of [the] services or the actual performance of agencies involved in delivering these services;⁸³
- reporting is very high level and completed in differing ways by other jurisdictions.⁸⁴

3.4.3 Reviews of NPP reporting arrangements

Under clause A11(d) of the Intergovernmental Agreement of Federal Financial Relations, the COAG Reform Council has an ongoing role to monitor the aggregate pace of activity in progressing COAG's agreed reform agenda. As part of this role, it produces an annual report on progress. In the Report on progress 2011, the COAG Reform Council found:⁸⁵

... the framework for federal financial relations is fundamentally sound and that it is an effective system worthy of ongoing support. It promotes strong principles to support collaboration on economic, environmental and social reforms and is a significant step forward from the previous system. COAG and governments should therefore stay the course on institutional reform.

⁷⁸ Survey Response provided by Victorian Government Departments — National Partnership on the Nation Building and Jobs Plan — social housing — second stage construction

⁷⁹ Survey Response provided by Victorian Government Departments — Smarter Schools National Partnership; Literacy and Numeracy National Partnership.

⁸⁰ Survey Response provided by Victorian Government Departments — Smarter Schools National Partnership

⁸¹ Survey Response provided by Victorian Government Departments — National Partnership Agreement on Implementation of Major Infrastructure Projects in Victoria

⁸² Survey Response provided by Victorian Government Departments — National Partnership Agreement on the Elective Surgery Waiting List Reduction Plan

⁸³ Survey Response provided by Victorian Government Departments — National Partnership Agreement on Legal Assistance Services.

⁸⁴ Survey Response provided by Victorian Government Departments — National Partnership Agreement on Closing the Gap in Indigenous Health Outcomes.

⁸⁵ COAG Reform Council, *COAG reform agenda: Report on progress 2011*, p. 41.

The Council also found:⁸⁶

There are some positive examples of an appropriate level of reporting requirements for National Partnerships. The council believes that the reporting burden associated with the seamless national economy reforms is manageable for an agreement that deals with some 39 streams of business regulation and competition reform. The reporting requirements for some of the major reform National Partnerships in health, housing, skills and workforce development and Indigenous reform also appear reasonable. ...

Four issues which have been raised by States include: unnecessarily detailed reporting requirements, unnecessarily frequent reporting requirements, ad hoc requests and inconsistent application of the principle of reduced reporting burden when negotiating implementation plans. ... On balance, the council concludes that this feature is being largely realised in the case of National Agreements but only partially realised in the case of National Partnerships.

In particular:⁸⁷

Those institutional features that the council has determined are not being fully realised at this time, and for which there are no current processes, are:

- reduced administration and compliance costs (National Partnerships);
- timely performance reporting (non-reward National Partnerships); and
- performance reporting focussed on efficient service delivery (National Partnerships).

The COAG Reform Council recommended that COAG agree to address the concerns raised by some states and territories about excessive administrative and compliance burden in some National Partnerships.⁸⁸ In its response COAG agreed:⁸⁹

that there should not be an excessive administrative and compliance burden: there has been significant work undertaken to address concerns through the implementation of the recommendations of the Heads of Treasuries review under the [IGAFFR]. In particular, the finalisation of the Federal Finances Circular on the development of Implementation Plans and the Drafters' toolkit are intended to address concerns about administrative and compliance burden. More, however, still needs to be done through First Ministers Departments and Treasuries to minimise the excessive administrative and compliance burden in some [National Partnerships].

The issue of reporting requirements attached to National Partnership Agreements was also recently examined by the Federal Parliament's Joint Committee of Public Accounts and Audit. In its 2011 Inquiry into National Funding Agreements the Committee found:⁹⁰

[W]hile the underlying principles and intent of the [IGAFFR] have been acknowledged as providing an excellent foundation for federal financial relations, in practice the implementation has not fulfilled the promised potential of the framework.

The Victorian Government provided evidence to that Committee which supported their view:⁹¹

The cultural challenge that we have is one where some people in some of the relevant line agencies ...are taking a while to absorb what is a really marked conceptual shift. ...The challenge that we have is persuading some of those who for many years in line agencies

⁸⁶ COAG Reform Council, *COAG reform agenda: Report on progress 2011*, p. 29.

⁸⁷ COAG Reform Council, *COAG reform agenda: Report on progress 2011*, p. 42.

⁸⁸ COAG Reform Council, *COAG reform agenda: Report on progress 2011*, p. 43.

⁸⁹ COAG Response to the COAG Reform Council, *COAG reform agenda: Report on progress 2011*, p. 2.

⁹⁰ Joint Committee of Public Accounts and Audit (Cth), *Report 427 - Inquiry into National Funding Agreements*, p. 35.

⁹¹ Joint Committee of Public Accounts and Audit (Cth), *Report 427 - Inquiry into National Funding Agreements*, p. 47.

and both levels of government have been dealing with these very prescriptive SPPs to realise that the world has changed fundamentally

In its report, the Joint Committee of Public Accounts and Audit recommended:⁹²

that a structured approach be developed and implemented by the Department of the Prime Minister and Cabinet and other central agencies to ensure relevant staff receive specific training to enhance understanding of the Intergovernmental Agreement on Federal Financial Relations and develop the skills required to meet outcomes focused performance reporting requirements.

It further recommended:⁹³

that the Commonwealth works through the Council of Australian Governments to ensure that states and territories develop and implement a similarly structured approach to foster cultural change throughout departments and agencies and ensure all staff receive relevant training to enhance understanding of the framework and develop the skills required to meet outcomes focused performance reporting requirements.

In August 2012, the Commonwealth Government tabled provided its response to the Committee's report. The Commonwealth Government stated it has developed a Drafters' Toolkit which incorporates the relevant Federal Finances Circulars, A Conceptual Framework for performance reporting and other related information.⁹⁴

3.4.4 Increasing number of National Partnerships

The Victorian Government submission noted that since the introduction of the 2008 IGAFRR the number of National Partnership Agreements continues to rise, increasing the potential for agreements to overlap, and collectively imposing a significant administrative and reporting burden on states through duplication.⁹⁵ In its Report on progress 2011, the COAG Reform Council also commented that since the new IGAFRR arrangements commenced there has been a proliferation of National Partnerships.⁹⁶

Current Commonwealth Budget Papers identify 180 payments to be made under National Partnerships over the next five financial years. A significant number of these payments are for low value projects. Chart 3.16 provides a breakdown of the quantum of funding provided to Victoria through NPPs.

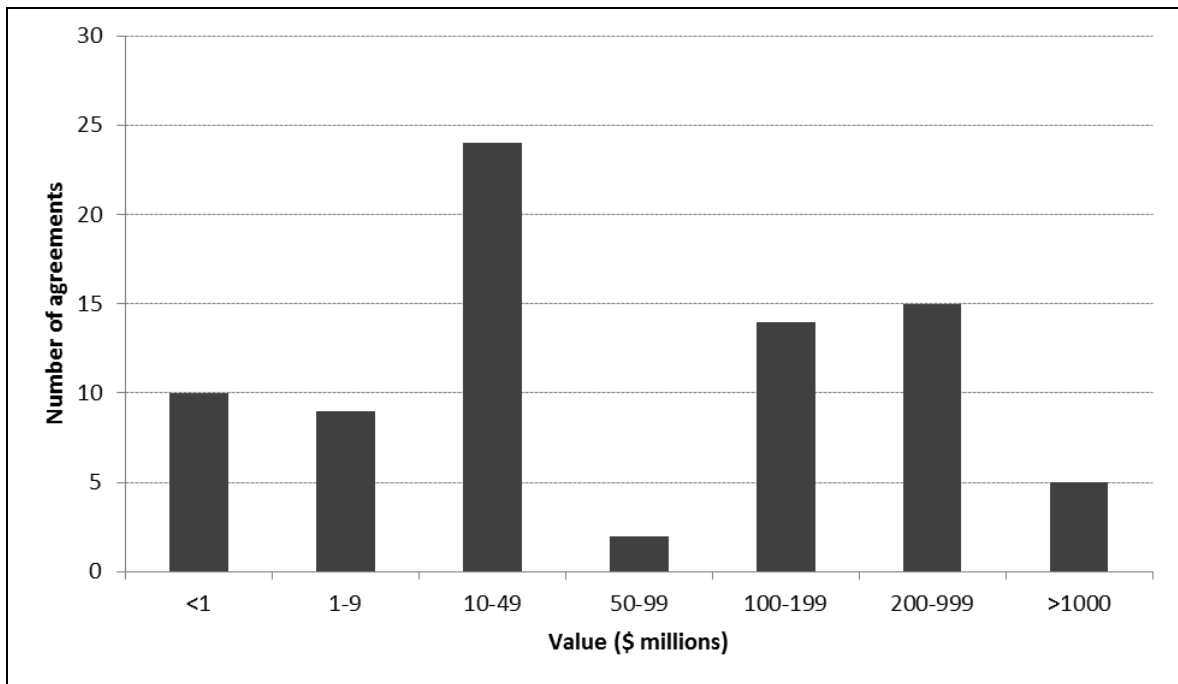
⁹² Joint Committee of Public Accounts and Audit (Cth) , *Report 427 - Inquiry into National Funding Agreements*, Recommendation No. 5, p. 67.

⁹³ Joint Committee of Public Accounts and Audit (Cth), *Report 427 - Inquiry into National Funding Agreements*, Recommendation No. 8, p. 68.

⁹⁴ Government Response to Joint Committee of Public Accounts and Audit (Cth), *Report 427 - Inquiry into National Funding Agreements*, p. 5.

⁹⁵ Victorian Government, Submission No. 6, p. 10.

⁹⁶ COAG Reform Council, *COAG reform agenda: Report on progress 2011*, p. 29.

Chart 3.16: National Partnership Agreements by funding amount to Victoria

Source: Victorian Budget 2012-13: Budget Information Paper No. 3, p. 14.

At its July 2012 meeting COAG recognised the need to take action on this issue. The meeting communique states:⁹⁷

COAG discussed ongoing concerns about the proliferation of National Agreements, National Partnership Agreements and Project Agreements. COAG is committed to ensuring that only matters of truly national significance will be progressed as new multilateral National Partnership Agreements, with consideration of existing or alternative funding mechanisms before any new funding agreements are entered into. To support this, the working group which will consider expiring agreements will also consider and recommend measures to streamline the development and administration of selected funding agreements, for reporting to COAG at its December 2012 meeting.

This review was supported by the Assistant Treasurer in evidence to the Committee:⁹⁸

My understanding is that the working group has been established and has met a number of times, and that work will go back to COAG soon ... obviously the proliferation of NPs is something that Victoria has raised, and it was raised in the submission to the committee. How that is dealt with will be a matter for COAG's consideration.

3.4.5 Committee view

The Committee supports the aims of the IGAFRR to achieve simpler, standardised and more transparent public performance reporting. The Committee notes that significant progress has been made towards streamlining the reporting and administration of Commonwealth payments to states since the introduction of the IGAFRR in 2008.

However, evidence provided to the Committee indicates that the intent of the IGAFRR is yet to be fully realised in the area of NPPs. A number of agreements continue to impose unnecessarily frequent reporting, require more information than is required for public accountability and involve detailed output reporting, which results in Victoria devoting additional resources to the reporting process.

The Committee is also concerned at the growing number of NPPs, the cumulative effect of which can result in an unreasonable administrative burden being placed on the states. The Committee is

⁹⁷ Council of Australian Governments, *Meeting Communiqué*, 25 July 2012, p. 4.

⁹⁸ Hon. G. Rich-Phillips, Assistant Treasurer, *Transcript of Evidence*, 10 October 2012, p. 7.

pleased to note COAG recently announced a review of the number of NPPs. The Committee looks forward to the outcomes of the review and encourages the Victorian Government to continue to engage in this process and advocate for reduction in the number of agreements and a rationalisation of the reporting arrangements.

Finding 6

Although there have been significant improvements to the systems for reporting on Commonwealth payments to Victoria since the introduction of the 2008 Intergovernmental Agreement on Federal Financial Relations, some National Partnership Agreements continue to impose onerous and unnecessary reporting requirements on Victoria.

Finding 7

The rising number of National Partnerships is increasing the administrative burden placed on Victoria and preventing the objectives of the Intergovernmental Agreement on Federal Financial Relations from being fully realised.

Recommendation 2

The Committee recommends that the Victorian Government actively engage with the working group established by the Council of Australian Governments (COAG) to review the proliferation of National Partnership Agreements and advocate for a reduction in the number of agreements and a rationalisation of the reporting arrangements.

3.5 Requirements placed on National Partnership Payments

The Terms of Reference require the Committee to examine whether the requirements imposed on National Partnership funding are reducing the scope for innovation and service delivery efficiencies. The Standing Council on Federal Financial Relations website states:⁹⁹

The federal financial relations framework gives the States greater flexibility to direct resources to areas where they will produce the best results in each State. In the Intergovernmental Agreement, the Commonwealth has committed to move away from prescriptions on service delivery in the form of financial or other input controls, which inhibit state service delivery and priority setting. Rather than dictating how things should be done, the framework focuses on the achievement of mutually agreed outcomes, providing the States with increased flexibility in the way they deliver services to the Australian people.

However, in its submission to the Committee, the Victorian Government states this objective is not being achieved in practice:¹⁰⁰

Contrary to the intent of the 2008 [IGAFFR], input controls are still forming part of intergovernmental agreements. This represents a shift by the Commonwealth from cooperative federalism to a more coercive approach, with the Commonwealth seeking to exercise considerable influence over Victorian policy. ...

By preventing States from flexibly tailoring their approaches to local needs and priorities, input controls significantly reduce the scope for States that are parties to an agreement to drive innovation and service delivery efficiencies. As noted by the Ministerial Council for Federal Financial Relations Report to COAG on the Implementation of the 2008 [IGAFFR],

⁹⁹ Standing Council on Federal Financial Relations, *Federal Financial Relations Framework*, <<http://www.federalfinancialrelations.gov.au/>>, accessed 10 October 2012.

¹⁰⁰ Victorian Government, Submission No. 6, pp. 9-10.

“The continued use of input controls is impeding the shift towards giving States and Territories greater flexibility in how they deliver outcomes coupled with greater accountability for outcomes.”

3.5.1 Commonwealth guidelines on input and financial controls

National Partnership Agreements are drafted by Commonwealth portfolio agencies. Federal Finances Circular No. 2010/01 outlines the process for developing national partnerships and states:¹⁰¹

The Intergovernmental Agreement provides explicit direction that National Partnerships must focus on outcomes and outputs rather than inputs. To the fullest extent possible, payments should be aligned with the achievement of outcomes and outputs, as measured through clearly specified performance indicators in National Partnerships, and avoid the use of financial and other input controls.

Federal Financial Relations Circular No. 2011/02 expands on the reasons National Partnership Agreements should not include input controls, stating they:¹⁰²

- undermine the outcomes focus of the Intergovernmental Agreement and proper consideration of outcomes and/or outputs and their measurement;
- limit States’ flexibility to determine how to achieve outcomes and/or outputs efficiently according to the needs of their community and the nature of their service delivery systems, including through innovation and continuous improvement;
- limit States’ budget flexibility in responding to community needs;
- obscure accountability as States are accountable for the achievement of outcomes and/or outputs, but through input controls, are constrained in how those outcomes and/or outputs are achieved;
- transfer risk to the Commonwealth as by imposing input controls, the Commonwealth is assuming a degree of responsibility for the achievement of outcomes and/or outputs for which States are responsible; and
- can add to administration and reporting costs.

Appendix B to Federal Financial Relations Circular No. 2011/02 identifies 14 types of input controls that are to be avoided when drafting National Partnership Agreements:

1. Maintenance of effort — States are required to maintain pre-NP levels of investment (financial and non-financial) during and/or after the term of the NP.
2. Cost matching and cost sharing — States are required to provide a prescribed level of own source funding as a condition of Commonwealth funding. This can include existing or redirected State investments, or new effort.
3. Income and/or expenditure reporting — States are required to provide evidence that funding has been received and expended.
4. Acquittals — States are required to report how much Commonwealth funding received has been expended.
5. Auditing (financial) — State expenditure of SPP and NP funding is subject to the Commonwealth audit process. This requires that States provide financial or non-financial information to Commonwealth auditors.
6. Statement of purchasing activity States are required to provide evidence that certain goods or services have been purchased.

¹⁰¹ Commonwealth Government, *Federal Finances Circular No. 2010/01*, 18 March 2010, p. 22, <http://www.federalfinancialrelations.gov.au/content/circulars/circular_2010_01.pdf>, accessed 29 August 2012.

¹⁰² Commonwealth Government, *Federal Finances Circular No. 2011/02*, 9 December 2011, p. 12, <http://www.federalfinancialrelations.gov.au/content/circulars/circular_2011_02.pdf>, accessed 29 August 2012.

7. Prescribing how funds are to be allocated/spent — The Commonwealth directs how existing and/or new State or Commonwealth funding is to be allocated or expended during and/or after the term of the NP.
8. Return of unspent funds, savings quarantining, interest quarantining — Commonwealth funding not expended, or interest earned from Commonwealth funding, is required to be either returned to the Commonwealth, or expended in a particular area/way.
9. Quarantining of reward funding — The Commonwealth requires that any reward funding achieved is allocated for expenditure in a particular sector.
10. Sanctions (financial) — A financial penalty to the State that is incurred when certain terms and conditions of the agreement are not met.
11. Prescribing implementation method, including through over specification of outputs or activities — The Commonwealth directs the terms and actions that States must undertake to achieve outcomes and/or outputs.
12. Prescribing procurement method — The Commonwealth directs the activities and processes as to how the States will obtain goods and services.
13. Prescription of staffing arrangements and costs — The Commonwealth directs States to use a certain level of staff/non-financial resources in the delivery of the outcomes and outputs and/or report such levels of resources during and after delivery of the National Partnership.
14. Prescription of implementation method, process and/or delivery method through competitive bidding processes — The Commonwealth directs the terms, actions and/or processes that States must undertake, or the resources that States must allocate, to achieve outcomes and/or outputs, as a condition of approving competitive funding bids.

3.5.2 Compliance with guidelines on input and financial controls

The Victorian Government submission states:¹⁰³

The 2010 [Heads of Treasuries (HoTs)] review of NPs and associated agreements found that financial controls exist in approximately one third of NPs, and other input controls in approximately one quarter of NPs. Input controls exist where the Commonwealth controls, or seeks to control how an output is delivered by the States. Financial controls exist where NPs make Commonwealth funding contingent on State financial expenditure, most commonly by requiring matching contributions.

The Committee has been unable to verify these statements as the 2010 HoTs review is not a public document. The Commonwealth Parliament's Joint Committee of Public Accounts and Audit (JCPAA) recommended that the Commonwealth Government make the recommendations and a summary of the findings of the HoTs Review public, along with the associated Government response and implementation strategies.¹⁰⁴ The Committee notes, however, this recommendation was not agreed to.¹⁰⁵

As part of its survey of Victorian Government Departments that administer NPPs (see Appendix C), the Committee asked each Department to identify whether the requirements in each NPP Agreement they administer had impacted on potential innovation and service delivery efficiencies. Of the 26 survey responses received relating to NPPs:

- 14 stated the requirements of the NPP did not impact on potential innovation and service delivery efficiencies;
- 8 identified alternative uses for the funding or different ways in which a project could have been delivered if Commonwealth funding requirements were less prescriptive;
- 3 stated the timelines imposed by stimulus funding meant decisions had to be made quickly and did not allow for full consideration of potential service delivery improvements and innovation options; and

¹⁰³ Victorian Government, Submission No. 6, p. 9.

¹⁰⁴ Joint Committee of Public Accounts and Audit (Cth), *Report 427 - Inquiry into National Funding Agreements*, Recommendation No. 5, p. 43.

¹⁰⁵ Government Response to Joint Committee of Public Accounts and Audit (Cth), *Report 427 - Inquiry into National Funding Agreements*, p. 4.

- 1 made no comment.

These responses correlate with the statement in the Victorian Government submission that between one quarter and one third of National Partnership Agreements still contain an unnecessary level of prescription of how projects are delivered by the states. Comments regarding the requirements contained in National Partnership Agreements included:

- the time frame pressures (deadlines) particularly of the early phases of the [project] have ... proven to be one of the most restrictive aspects of the initiative;¹⁰⁶
- lack of certainty of ongoing funding for service delivery beyond the life of the agreement is inhibiting service providers' willingness to commit to longer term innovation;¹⁰⁷
- Victoria was required to renegotiate the [Implementation Plan], which took considerable time and effort;¹⁰⁸
- the reward element, with its focus on activity and effort, tended to distort investment away from reform to short term gain.¹⁰⁹

The surveys also identified a number of input controls in existing National Partnership Agreements, contrary to the Commonwealth guidelines, including:

- specifying the size of grants that can be provided to individual schools;¹¹⁰
- restricting which Aboriginal housing organisations are eligible for funding;¹¹¹
- requiring a number of individual audits, reviews and workshops and Project Proposal Reports for variations to the project;¹¹² and
- limiting expenditure to eligible project costs¹¹³ or excluding certain uses of funding such as the construction or extension of buildings.¹¹⁴

In contrast, a number of other surveys stated the requirements in the National Partnership Agreement were supporting reform and innovation, as intended by the IGAFRR. Comments included:

- The states have a good degree of flexibility in determining how they will utilise funding to achieve the objectives. The NPA's requirements do not negatively affect potential innovation or service deliver efficiencies;¹¹⁵
- The agreement provided a must needed funding boost ..., with some additional flexibility as to how Commonwealth funds could be allocated;¹¹⁶
- Innovation and efficiency derived from ... information management are not impacted by NPP.¹¹⁷

¹⁰⁶ Survey Response provided by Victorian Government Departments — Digital Education Revolution National Partnership

¹⁰⁷ Survey Response provided by Victorian Government Departments —National Partnership on Early Childhood Education

¹⁰⁸ Survey Response provided by Victorian Government Departments —National Partnership on Remote Indigenous Housing

¹⁰⁹ Survey Response provided by Victorian Government Departments — Smarter Schools National Partnerships

¹¹⁰ National Partnership Agreement on Empowering Local Schools, clause 47, p. 10.

¹¹¹ Survey Response provided by Victorian Government Departments —National Partnership on Remote Indigenous Housing

¹¹² Survey Response provided by Victorian Government Departments —National Partnership Agreement on Implementation of Major Infrastructure Projects in Victoria

¹¹³ Survey Response provided by Victorian Government Departments —National Partnership Agreement on Implementation of Major Infrastructure Projects in Victoria

¹¹⁴ National Partnership Agreement for More Support for Students with Disabilities, clause 25, p. 6.

¹¹⁵ Survey Response provided by Victorian Government Departments —National Partnership Agreement on National Disaster Resilience

¹¹⁶ Survey Response provided by Victorian Government Departments —National Partnership Agreement on Legal Assistance Services

3.5.3 Reviews of National Partnership funding requirements

The issue of unnecessarily prescriptive requirements being included in National Partnership Agreements has been examined by a number of previous reviews at the Commonwealth level. The JCPAA stated:¹¹⁸

Contrary to the intention of the [IGAFFR], ... the implementation process has impeded the ability of states and territories to maintain their flexibility. Witnesses repeatedly spoke of the return to a prescriptive approach by the Commonwealth, particularly through the proliferation of the NP payments.

The JCPAA noted several of the same issues that were raised through the surveys of Victorian Government departments undertaken by this Committee, including inflexibility, micromanagement and input and financial controls included in agreements or implementation plans. It recommended:¹¹⁹

that the Department of the Prime Minister and Cabinet and central agencies investigate whether additional measures are needed to encourage and enforce the application of the Intergovernmental Agreement on Federal Financial Relations' principles and associated guidelines, and that the findings of the investigation be publicly released

In its response, the Commonwealth Government stated that it was continuing to pursue a range of measures to promote the application of the IGAFFR principles, through its Drafters' Toolkit and Federal Finances Circulars.¹²⁰

This issue has also been examined by the COAG Reform Council, which noted:

Work is ... underway to address concerns about financial or other input controls or prescriptions on service delivery in certain National Partnerships. These review processes are expected to fulfil the commitments to ongoing reform to the framework for federal financial relations and continuous improvement of performance reporting. Governments plan to complete this work over the next nine months.¹²¹

In its response to the COAG Reform Council report, COAG affirmed its commitment to ensuring the full intent of the IGAFFR is realised:¹²²

COAG is committed to the changes needed to embed fully key features of the framework for federal financial relations, noting there is already significant work underway to drive this cultural change.

The Committee looks forward to the outcome of this further work to be undertaken by the Commonwealth Government.

3.5.4 Committee view

The Committee endorses the intent of the IGAFFR to move away from prescriptions on service delivery and provide greater flexibility for states to direct resources to areas where they will produce the best results. However, the Committee is concerned that progress towards achieving this aim has been slow.

Evidence provided to the Committee shows that input controls and financial controls are still included in a number of current National Partnership Agreements. In some instances, these requirements have reduced the ability of Victorian Government departments to deliver services efficiently and innovatively.

¹¹⁷ Survey Response provided by Victorian Government Departments —Project Agreement for Emergency Pest and Disease Response Programs

¹¹⁸ Joint Committee of Public Accounts and Audit (Cth), *Report 427 - Inquiry into National Funding Agreements*, Recommendation No. 5, p. 28.

¹¹⁹ Joint Committee of Public Accounts and Audit (Cth), *Report 427 - Inquiry into National Funding Agreements*, Recommendation No. 5, p. 43.

¹²⁰ Government Response to Joint Committee of Public Accounts and Audit (Cth), *Report 427 - Inquiry into National Funding Agreements*, p. 5.

¹²¹ COAG Reform Council, *COAG reform agenda: Report on progress 2011*, p. 42.

¹²² COAG Response to the COAG Reform Council, *COAG reform agenda: Report on progress 2011*, p. 2.

The Committee is encouraged by the statements made by COAG that further work will be undertaken to ensure cultural change to achieve the objectives stated in the 2008 IGAFRR. The detailed guidance provided in the Federal Financial Relations Circulars is a step towards achieving these aims and the Committee hopes the guidelines are more strictly followed when drafting National Partnership agreements in future.

Finding 8

Progress towards the commitment in the 2008 Intergovernmental Agreement on Federal Financial Relations to reduce Commonwealth prescriptions on service delivery by the states has been slow. Input controls and financial controls are still included in a number of current National Partnership Agreements and in some instances these requirements have reduced the ability of Victorian Government departments to deliver services efficiently and innovatively.

3.6 Future of programs funded by National Partnership Payments

The Terms of Reference require the Committee to examine the future of programs funded by NPPs at the expiry of the current funding agreements.

As discussed in 3.1, NPPs are time limited funding which aim to support the delivery of specified outputs or projects, facilitate reform, or reward states that deliver nationally significant reforms. Although most National Partnerships provide money for one-off projects that will not require ongoing funding, a number of National Partnerships implement reforms or raise service delivery levels that require further funding to maintain.

Schedule E of the IGAFRR states:¹²³

National Partnerships are generally expected to have limited time horizons. On delivery of the particular initiative which is subject to a National Partnership payment:

- (a) funding would cease because the project, output or reform has been delivered; or
- (b) where on-going funding is required to maintain a new level of output, such funding may more appropriately be provided through the relevant National SPP Agreement or general revenue assistance.

Finances Circular No. 2010/01 states:¹²⁴

The Ministerial Council for Federal Financial Relations will assess expiring National Partnership agreements as to whether they should be rolled into SPPs or general revenue assistance.

Although there is an acknowledgement in the IGAFRR that on-going funding may be needed to continue some programs established through expiring NPPs, there is currently no clear process through which this is assessed.

3.6.1 Impact of expiring National Partnerships on states' budgets

NPPs will provide over \$10 billion to the states in 2012-13 and approximately \$2.3 billion to Victoria.¹²⁵ Given this is a significant source of revenue for the states, expiring National

¹²³ Intergovernmental Agreement on Federal Financial Relations, Schedule E, Clause E23, p. E-4, <http://www.federalfinancialrelations.gov.au/content/intergovernmental_agreements.aspx> accessed 9 October 2012.

¹²⁴ Commonwealth Government, *Federal Finances Circular No. 2010/01*, 18 March 2010, p. 22, <http://www.federalfinancialrelations.gov.au/content/circulars/circular_2010_01.pdf>, accessed 29 August 2012.

¹²⁵ Commonwealth Government, *Budget Papers 2011-12, Part 3: Australia's Federal Relations*, pp. 22, 114. Excludes Financial Assistance Grants to Local Government.

Partnerships can have a significant impact on a State's Budget. The Queensland Commission of Audit recently raised expiring NPs as a source of significant Budget uncertainty for the State.¹²⁶

Budget uncertainty arises when there is insufficient notice or unclear advice on Australian Government plans for expiring NPs. Often, states can be unaware of Australian Government intentions until its budget is delivered in early May. This creates uncertainty about how to manage programs, and can make it difficult to manage if funding is not confirmed in the Australian Government Budget.

For example, the Australian Government has advised states that the funding decisions for the Digital Education Revolution, Early Childhood Education, Homelessness, and Indigenous Economic NPs will be considered in the 2013-14 Budget, which will be less than eight weeks before these NPs expire. If a decision on future funding is not announced until this time, this leaves the states with limited flexibility to consider their own funding options.

The Victorian Government raised similar concerns in its submission to the Committee.¹²⁷

The 2012-13 Commonwealth Budget did not provide commitment to ongoing support of significant agreements expiring in the next two years, including the Digital Education Revolution NP (expiring 30 June 2013), Homelessness NP (expiring 30 June 2013) and Literacy and Numeracy NP (expiring 31 December 2012).

Without commitment from the Commonwealth on the future of expiring NPs, Victoria bears all of the financial and policy risk for continuing or cutting funding to these programs.

The 2012-13 Commonwealth Budget Papers state:¹²⁸

National Partnership payments are expected to decrease from \$21.6 billion in 2011-12 to \$11.4 billion in 2012-13. This primarily reflects the timing of infrastructure payments, with funding for a number of large infrastructure projects being made available in 2011-12 to assist the States in progressing essential infrastructure projects, thereby supporting future economic growth. ...

Expiring National Partnerships account for \$424.3 million, and are attributable to the expiry of completed programs, the majority of which are small-scale agreements and primarily relate to completed infrastructure projects. Part of this funding is attributable to programs that have, or are being, renegotiated, for example Skills Reform and Certain Concessions for Pensioners and Seniors Card Holders. This amount is markedly small in the context of State Government expenditure which is expected to total approximately \$209.0 billion in 2011-12.

Although the Commonwealth views the \$424.3 million of funding it attributes to expiring National Partnerships as a small figure, requiring the states to find the funds to continue the programs and initiatives currently funded by these National Partnerships can have a significant impact on a state's budget. Furthermore, the uncertainty created by expiring NPPs can expose the states to significant financial risk and impede the states' budget planning processes. The Committee also believes the Commonwealth's valuation of \$424.3 million for expiring NPPs may not reflect the true cost of these programs as a number of NPPs are "front loaded" — meaning that the majority of funding is paid up front through a facilitation payment in earlier financial years.¹²⁹

3.6.2 Service delivery impacts of expiring National Partnerships

Victorian Budget Information Paper No. 3: Federal Financial Relations examines a number of expiring National Partnerships and the potential impacts on service delivery of the Commonwealth failing to provide further funding once the agreements expire. The Budget Information Paper identifies five National Partnerships due to expire on or before 30 June 2013 that have achieved

¹²⁶ Queensland Commission of Audit, *Interim Report June 2012*, p. 89.

¹²⁷ Victorian Government, Submission No. 6, p. 12.

¹²⁸ Commonwealth Government, *Budget Papers 2011-12, Part 3: Australia's Federal Relations*, p. 4.

¹²⁹ See for example: National Partnership Agreement on Improving Teacher Quality; National Partnership Agreement on Hospital and Health Workforce Reform — Taking Pressure off Public Hospitals and Subacute care components.

increases in service standards that the Victorian Government believes should be rolled in to National SPP:¹³⁰

- Digital Education Revolution NP;
- Improving Teacher Quality NP;
- Literacy and Numeracy NP;
- Homelessness NP; and
- Hospital and Health Workforce Reform NP.

According to Commonwealth Budget Papers, these five National Partnerships will provide \$195.7 million to Victoria in 2012-13.¹³¹ This does not include funding for the Taking Pressure off Public Hospitals and Subacute care components of the Hospital and Health Workforce Reform NP, which were provided in advance in 2008-09. If divided evenly over the five years of the agreement, this potentially provided an additional \$61.3 million to Victoria in 2013-13, making the total value of these expiring agreements \$257 million. Budget Information Paper No. 3 notes that a number of other expiring agreements have served their purpose and will appropriately expire.¹³²

Budget Information Paper No. 3 makes the following comments about the service delivery impact of National Partnership Agreements due to expire on 30 June 2013:¹³³

Non-renewal of these agreements will negatively impact on the Victorian community, for example:

- A winding back or cessation of Commonwealth funding for the **Digital Education Revolution NP** would disadvantage future student cohorts because unlike current Year 9 to 12 students they would not receive computers.
- Reduced funding under the **Smarter Schools NP Improving Teacher Quality** Initiative would see Victoria's teachers not rewarded for delivering better educational outcomes for disadvantaged and Indigenous students and for working in rural/remote and hard-to-staff schools.
- Discontinued funding under the **Hospital and Health Workforce Reform NP** could leave 170 sub-acute care beds across Victoria (59 000 bed days this represents approximately 2 360 patients that would not receive care) unfunded.

Commonwealth Budget Papers state that provision has been made in the Contingency Reserve subject to negotiations with the states for a continuation of the Digital Education Revolution National Partnership,¹³⁴ which will hopefully ensure future Year 9 students receive computers. Since the 2012-13 Budget, the Commonwealth has announced an additional \$241.2 million will be provided to the states for an extension of the Literacy and Numeracy NP until 30 December 2013.¹³⁵ However, announcements are yet to be made regarding the other three expiring National Partnerships, and \$175 million of reward funding (potentially \$44.5 million for Victoria) for the Improving Teacher Quality NP has been re-profiled from 2012-13 to 2013-14 due to likely delays in the COAG Reform Council's assessment of performance milestones.¹³⁶

Survey responses provided to the Committee identified three additional NPs that will expire in 2013 that may require further funding. Two of these were low value NPs — the Improving ear health services for Indigenous Australian children NP (\$612,407 for Victoria over the life of the

¹³⁰ Victorian Government, *Budget Paper 2012-13: Budget Information Paper No. 3, 2012-13 Federal Financial Relations*, p. 11. Budget Information Paper No. 3 states it is also appropriate to consider the National partnership on low socio-economic status school communities together with other Smarter Schools National Partnerships. Funding has been provided for the National partnership on low socio-economic status school communities NP until 30 June 2015.

¹³¹ In total \$306.4 million was provided to Victoria for the five year agreement.

¹³² Victorian Government, *Budget Paper 2012-13: Budget Information Paper No. 3, 2012-13 Federal Financial Relations*, p. 12.

¹³³ Victorian Government, *Budget Paper 2012-13: Budget Information Paper No. 3, 2012-13 Federal Financial Relations*, p. 11.

¹³⁴ Commonwealth Government, *Budget Papers 2009-10, Budget Paper No. 3: Australia's Federal Relations*, pp. 83-84.

¹³⁵ Commonwealth Government, *Budget Papers 2012-13, Mid-Year Economic and Fiscal Outlook*, p. 76.

¹³⁶ Commonwealth Government, *Budget Papers 2012-13, Mid-Year Economic and Fiscal Outlook*, p. 76.

agreement)¹³⁷ and the NP on Helping Our Kids Understand Finances — Professional Learning and MoneySmart schools (\$400,00 for Victoria over the life of the agreement).¹³⁸ The NP on more support for students with disabilities is due to expire on 31 December 2013 and will provide \$19.2 million to Victoria in 2012-13. Commonwealth Budget Papers state:¹³⁹

The major focus of this short-term initiative is to build the capacity of Australian schools and teachers to better support students with disabilities, contributing to improved student learning experiences, educational outcomes and transitions to further education or work.

Although this NP was initially funded as a fixed-term initiative, the survey response provided to the Committee states that ongoing funding will be required to maintain increased service delivery levels.¹⁴⁰ Significant work is currently being undertaken at a national level in the area of disability services, particularly in relation to the National Disability Insurance Scheme, however, if further funding is not provided through new initiatives or a continuation of the agreement, service delivery improvements achieved through the NP may be impacted.

2012-13 was the first year that the Victorian Government has published Budget Information Paper No. 3. The Committee believes the new Budget Information Paper is a useful tool to monitor expiring National Partnerships as it outlines the practical effects on service delivery to Victorians that will result if the Commonwealth Government does not provide further funding for these programs. The Committee encourages the Victorian Government to continue to monitor expiring National Partnerships and publicly report on these through the Budget Papers.

Finding 9

A number of National Partnerships due to expire on or before 30 June 2013 require ongoing Commonwealth funding in order to continue programs and services currently funded through those agreements. If further funding is not provided, services to Victorians will be negatively impacted.

Recommendation 3

The Committee recommends the Victorian Government continue to monitor expiring National Partnerships and annually report on the potential service delivery impacts of those agreements not being renewed through the Budget Papers.

3.6.3 Current treatment of expiring National Partnerships

As part of its survey of Victorian Government departments (see Appendix C), the Committee asked each Department to identify whether further funding would be required at the conclusion of each National Partnership Agreement. Of the 26 survey responses received relating to NPPs:

- 15 stated further funding would be required; and
- 11 stated the funding was for a one-off project and further funding would not be required.

The surveys identified a range of ways in which expiring National Partnerships are currently being treated. Of the NPPs that did not require further funding, survey comments included:

¹³⁷ Survey Response provided by Victorian Government Departments — National Partnership on Improving ear health services for Indigenous Australian children.

¹³⁸ Survey Response provided by Victorian Government Departments — National Partnership on Helping Our Kids Understand Finances — Professional Learning and MoneySmart schools.

¹³⁹ Commonwealth Government, *Budget Papers 2011-12, Part 3: Australia's Federal Relations*, p. 62.

¹⁴⁰ Survey Response provided by Victorian Government Departments — National Partnership on more support for students with disabilities.

- funding is now provided through a new National Partnership;¹⁴¹
- funding is now provided through a National SPP;¹⁴²
- some reforms have led to increased operational costs, which are being funded through increased fees and charges on industry, new government funding or internal reprioritisation;¹⁴³ and
- the funding is one off project funding.¹⁴⁴

Others stated that further funding was required to continue programs under the NPPs, but that it was unclear if funds would be provided. Observations included:

- the Commonwealth Government recently announced a commitment to fund a further five years ... At this stage the Commonwealth has provided no indication of funding levels for Victoria or the process by which this will be determined.¹⁴⁵
- funding was “based on clear expectation of continued funding beyond the current National Partnership which expires in June 2013. As at July 2012 there is no clarity around the form and quantum of future funding for this area of service delivery, which present financial and policy risks for Victoria as service level expectations have been raised”,¹⁴⁶
- funding “will be reviewed in 2014. The intention is that following the implementation phase ... ongoing commitment of all parties to the NP will be reflected in a National Agreement on Early Childhood Development. Commonwealth funding contributions are intended to extend from 2016- 2020”,¹⁴⁷ and
- further funding will be required if programs currently delivered under the [National Partnership] are to continue post 2013.¹⁴⁸

These comments reveal the inconsistent way in which expiring National Partnerships are treated. They also demonstrate that the timeframe and manner in which expiring National Partnerships are considered is largely at the discretion of the Commonwealth. Other examples of the treatment of expiring NPPs include:

- shortly before the Commonwealth Budget was released, the Federal Minister for School Education announced further funding to continue literacy and numeracy programs under the Literacy and Numeracy National Partnership until December 2013, with “negotiations with the states and territories to decide how the money will be allocated”,¹⁴⁹
- although 2012-13 Commonwealth Budget Papers state that provision has been made in the Contingency Reserve for further funding of the National Partnership on the digital education revolution subject to negotiations with the states, no details have been announced on the quantum of funding put aside or the timeline or process for the negotiations;¹⁵⁰ and
- despite the Commonwealth stating the National Partnership on Homelessness “represents a significant first step to reduce homelessness”¹⁵¹, there is yet to be an announcement of further funding and the agreement is due to expire in June 2013.

¹⁴¹ Survey Response provided by Victorian Government Departments — National Partnership on the Elective Surgery Waiting List Reduction Plan .

¹⁴² Survey Response provided by Victorian Government Departments — National Partnership on Social Housing

¹⁴³ Survey Response provided by Victorian Government Departments — National Partnership to Deliver a Seamless National Economy.

¹⁴⁴ Survey Response provided by Victorian Government Departments — National Partnership on Water for the Future.

¹⁴⁵ Survey Response provided by Victorian Government Departments — Caring for our Country.

¹⁴⁶ Survey Response provided by Victorian Government Departments — National Partnership on Early Childhood Education.

¹⁴⁷ Survey Response provided by Victorian Government Departments — National Partnership on the National Quality Agenda (NQA) for Early Childhood Education and Care.

¹⁴⁸ Survey Response provided by Victorian Government Departments — National Partnership on Youth Attainment and Transitions.

¹⁴⁹ Minister for School Education, Media Release: Literacy and numeracy schemes receive \$243 million boost, 5 May 2012, <<http://ministers.deewr.gov.au/garrett/literacy-and-numeracy-schemes-receive-243-million-boost>>, accessed 10 September 2012.

¹⁵⁰ Commonwealth Government, *Budget Papers 2011-12, Part 3: Australia's Federal Relations*, pp. 59.

¹⁵¹ Commonwealth Government, *Budget Papers 2011-12, Part 3: Australia's Federal Relations*, p. 87.

The Committee is concerned the inconsistent manner in which NPPs are treated can lead to decisions being made in compressed timeframes, which may not result in a well-considered agreements. The Committee believes there would be great value in implementing a consistent and transparent process for early identification of expiring NPPs to ensure decisions are made regarding ongoing funding in a timely manner.

3.6.4 Future treatment of expiring National Partnerships

The Victorian Government stated in its submission that the issue of expiring NPs has previously been explored at a national level.¹⁵²

The 2010 Heads of Treasuries Review of National Agreements and National Partnerships (the HoTs Review) identified options and refined the criteria for determining how expiring NPs should be treated.

In January 2011, the Ministerial Council for Federal Financial Relations agreed ... that the State and Territory Treasurers would provide a submission about the future of expiring NPs and IPs to the Commonwealth Treasurer for his consideration. This HoTs Review was endorsed by COAG in February 2011.

In 2011, on behalf of all State treasuries, NSW co-ordinated a report that was submitted to the Commonwealth Treasurer in October 2011 on the treatment of expiring NPs against the agreed criteria. The timing of the provision of the report was at the request of the Commonwealth so as to inform the formulation of jurisdictions' budgets. However, the Commonwealth failed to provide a response to the report and only provided a partial response to states on Commonwealth budget night - a week after the Victorian budget was handed down.

As previously noted, the HoTs Review is not a public document, so the Committee has been unable to examine its recommendations. The Commonwealth has recently issued guidelines to assist in the consistent treatment of expiring National Partnerships. Federal Finances Circular No. 2011/02 states:¹⁵³

To assist consideration of the appropriate treatment of expiring National Partnerships, provision for a review of the National Partnership should be incorporated in the agreement.

The Standing Council on Federal Financial Relations has also issued a Short Guide to Reviewing National Partnerships, which states:¹⁵⁴

As far as practicable, reviews should allow sufficient time for any policy or budget decisions, and further time to allow for the possible need to negotiate an extended or new agreement, prior to the expiry of the agreement. For example, if a National Partnership is due to expire on 30 June 2014, the review should ideally report by no later than the end of October 2013, so that its conclusions and recommendations can inform consideration of any future policy and funding arrangements, including as part of the Commonwealth Budget, for the 2014-15 financial year.... Particular attention should be given to National Partnerships that deal with large, sensitive or complex issues, or involve significant financial risk, to ensure that they are reviewed no later than 12 months prior to expiry.

This approach was supported by the Assistant Treasurer in evidence to the Committee:¹⁵⁵

What is important around expiring partnerships is to have certainty as to future arrangements, particularly where partnerships have raised the level of service delivery and have raised community expectations around particular areas of service delivery to ensure

¹⁵² Victorian Government, Submission No. 6, p. 12.

¹⁵³ Commonwealth Government, *Federal Finances Circular No. 2011/02, 9 December 2011*, p. 25, <http://www.federalfinancialrelations.gov.au/content/circulars/circular_2011_02.pdf>, accessed 24 September 2012.

¹⁵⁴ Standing Council on Federal Financial Relations, *A Short Guide to Reviewing National Partnerships*, p. 2, <http://www.federalfinancialrelations.gov.au/content/guidelines/Short-Guide_review.pdf>, accessed 24 September 2012.

¹⁵⁵ Hon. G. Rich-Phillips, Assistant Treasurer, *Transcript of Evidence*, 10 October 2012, p. 14.

that we have ongoing funding to continue to deliver service delivery at that raised level or raised level of expectation. That is really the key to expiring partnerships.

COAG recently followed up this issue at its July 2012 meeting. Its meeting communique stated:¹⁵⁶

COAG noted that a number of programs under National Partnerships have supported increased service levels. COAG recognised the importance of a coordinated approach to the consideration of ongoing funding for National Partnerships. It endorsed the criteria developed by Heads of Treasuries to determine the treatment of expiring National Partnerships. COAG also agreed to establish a working group to report back to COAG in September, to provide early identification of those agreements expiring on or before 30 June 2013 that have led to increased service levels, and options for their treatment if they were continued, noting that any Commonwealth funding decisions are contingent on Commonwealth Budget processes.

The Committee welcomes the new Commonwealth guidelines and the establishment of the working group and looks forward to the outcomes of its work. The Committee believes it is important for reviews of National Partnerships to be an ongoing process within the Federal Financial Relations Framework, as indicated by the recently issued Federal Finances Circular. The Committee encourages the Victorian Government to continue to advocate for timely reviews of expiring NPs to provide greater certainty to programs funded through such agreements.

3.6.5 Committee view

The Committee believes National Partnerships are an important vehicle for achieving national reforms and raising service delivery standards across Australia. A number of initiatives currently funded through NPPs have improved outcomes for Victorians and enhanced health and education programs by implementing nationally consistent processes.

The Committee commends the intent in the IGAFRR that where ongoing funding is required to maintain a new level of service delivery achieved through an NPP, such funding should be rolled into an ongoing NSPP. However, the Committee is concerned that there is currently no system in place to regularly review expiring NPPs to ensure this aim is achieved.

The Committee welcomes the recent announcement by COAG of a Working Group to identify expiring NPPs where additional funding may be required. The Committee encourages the Victorian Government to actively engage with the COAG Working Group to ensure all such NPPs are identified and that appropriate levels of ongoing funding are provided to ensure improved service delivery standards can be maintained. The Committee also urges the Victorian Government to advocate for the Working Group to have an ongoing role, to ensure decisions regarding expiring National Partnerships are made in an efficient and timely manner in the future.

Finding 10

There is no consistent mechanism for evaluating expiring National Partnership Agreements to determine whether ongoing funding is needed to maintain improved service delivery standards. The absence of such a process creates uncertainty and imposes significant risks on the budgets of the states.

Recommendation 4

The Committee recommends that the Victorian Government actively engage with the working group established by COAG to review expiring National Partnership Agreements to ensure all such agreements are identified and that appropriate levels of ongoing funding are provided to maintain improved service delivery standards.

¹⁵⁶ Council of Australian Governments, *Meeting Communique*, 25 July 2012, p. 4.

Recommendation 5

The Committee recommends that the Victorian Government advocate through COAG for an ongoing working group to be established to regularly review expiring National Partnership Agreements to ensure early identification of agreements where ongoing funding will be required to improve budget certainty for the states.

4. Financial Assistance Grants to Local Government

4.1 History of Financial Assistance Grants to Local Government

The Commonwealth has provided financial assistance to local governments since 1974-75. The initial aim of these payments was to 'promote equality among regions, and to ensure adequate services and the development of resources at local and regional levels'.¹⁵⁷ The funding was in recognition of the additional range of services provided by local government over time including health, regulatory functions and infrastructure.

Since their introduction there have been a number of reviews and adjustments to the allocation of financial assistance grants (FAGs) including a review in the mid-1980s that resulted in the Commonwealth Government enacting the *Local Government (Financial Assistance) Act 1986*. A key feature of the legislation was that from 1989-90, grants would be distributed to states on an equal per capita basis, which currently remains the basis for general purpose grants. In 1993, a further review of funding arrangements was undertaken and found that:¹⁵⁸

- there had been a shift in the share of funding to rural councils in all states and the Northern Territory except Victoria;
- State Grants Commissions were following two models of fiscal equalisation: in one, an increasing share of funds was allocated to local governments with increasing populations whereas in the other model, the reverse was true;
- in most states, an increasing share of assistance went to local governments with the greatest socio-economic disadvantage;
- the need for a uniform national reporting framework was urgent;
- absorbing local road funding into financial assistance grants and hence distributing road funding on an equal per capita basis would be disruptive and was not recommended; and
- additional measures to encourage efficiency in local government should be implemented.

In 1994 the Victorian Government embarked on major reforms in local government which resulted in 210 municipalities being amalgamated into 79. Larger councils now benefit from economies of scale and additional resources to provide a wider range of services. However, as discussed later in this Chapter, many local councils remain reliant on Commonwealth financial assistance, with a greater reliance in regional municipalities.

The 1993 review led to further reforms and the introduction of the *Local Government (Financial Assistance) Act 1995* ('the Act'), under which the current financial grants are provided. The grants comprise two components:

- a general purpose payment, distributed based on population (a per capita basis); and
- an identified local roads component, distributed according to fixed historical shares.¹⁵⁹

Section 3(2) of the Act states that the financial assistance is provided to the states for the purposes of improving:

- a) the financial capacity of local governing bodies; and

¹⁵⁷ Parliament of Australia, *Commonwealth General Purpose Financial Assistance to Local Government*, Parliamentary Library Research Paper 19, 2000-01, p. 4
<http://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/rp0001/01RP19>, accessed 10 October 2012.

¹⁵⁸ Parliament of Australia, *Commonwealth General Purpose Financial Assistance Grants to Local Government*, Parliamentary Library Research Paper 9, Sept 2007, p.7
<<http://www.aph.gov.au/binaries/library/pubs/rp/2007-08/08rp09.pdf>>, accessed 10 October 2012.

¹⁵⁹ Department of Regional Australia, Local Government, Arts and Sports,
<www.regional.gov.au/local/assistance/index.aspx>, accessed 16 February 2012.

- b) the capacity of local governing bodies to provide their residents with an equitable level of services; and
- c) the certainty of funding for local governing bodies; and
- d) the efficiency and effectiveness of local governing bodies; and
- e) the provision by local governing bodies of services to Aboriginal and Torres Strait Islander communities.

The decision not to allocate the roads component on a per capita basis was to not disadvantage states and territories with smaller populations. The 1995 Premiers' Conference agreed that local road funds would continue to be distributed on the basis of the criteria in the *Australian Land Transport Development Act 1988*. Accordingly, interstate distribution of identified road grants has been frozen at the historical shares that applied in 1991-92 when grants were untied.

In 1999, when the introduction of the GST was being negotiated by the Commonwealth Government with minor parties in the Senate, a plan was put forward for the states to take responsibility for providing financial assistance to local government. It was proposed the states would fulfil this responsibility through the proceeds of GST revenue. However, following the agreement to exempt basic food from the GST, which consequently reduced the size of the GST pool, the Commonwealth Government agreed to retain the responsibility for the payment of Financial Assistance Grants to local government, rather than transfer this responsibility to the states.¹⁶⁰ As a result, the Commonwealth Government has continued to provide FAGs until the present day.

4.2 Funding provided through Financial Assistance Grants

The amount of funding provided through FAGs each year is calculated by taking the previous year's total funding and multiplying it by an escalation factor. Section 8 of the Act specifies the formula the Federal Treasurer is to apply each year for calculating the escalation factor and determining the level of local government financial assistance grants. Commonwealth documentation states that the escalation factor "compensates for changes in CPI and population, so that the value of the grants is maintained in real per capita terms".¹⁶¹

The Act provides the Treasurer with discretion to increase or decrease the escalation factor in special circumstances. In applying this discretion, the Treasurer is required to have regard to the objects of the Act and any other matters the Treasurer thinks relevant. The same escalation factor is applied to both the general purpose and local road grant. Table 4.1 shows the funding provided through FAGs and the relevant escalation factor since they were introduced in 1974-75. Prior to 1991-92 local road grants were provided as tied grants under different legislation.

Table 4.1: Local Government Financial Assistance Grants 1974-75 to 2015-16 (estimated)

Year	General purpose grants	Local road grants	Total grants	Escalation factor
1974-75	56,345,000	n/a	56,345,000	n/a
1975-76	79,978,000	n/a	79,978,000	1.42
1976-77	140,070,131	n/a	140,070,131	1.75
1977-78	165,327,608	n/a	165,327,608	1.18
1978-79	179,426,870	n/a	179,426,870	1.09
1979-80	222,801,191	n/a	222,801,191	1.24
1980-81	302,226,347	n/a	302,226,347	1.36
1981-82	352,544,573	n/a	352,544,573	1.17
1982-83	426,518,330	n/a	426,518,330	1.21

¹⁶⁰ Prime Minister, Hon. John Howard MP, Media Release, *Changes to the Goods and services tax (GST)*, 31 May 1999.

¹⁶¹ Commonwealth Department of Regional Australia, Local Government, Arts and Sport, *Local Government National Report 2007-08*, p. 25, <<http://www.regional.gov.au/local/publications/reports/index.aspx>> accessed 10 October 2012.

Year	General purpose grants	Local road grants	Total grants	Escalation factor
1983–84	461,531,180	n/a	461,531,180	1.08
1984–85	488,831,365	n/a	488,831,365	1.06
1985–86	538,532,042	n/a	538,532,042	1.10
1986–87	590,427,808	n/a	590,427,808	1.10
1987–88	636,717,377	n/a	636,717,377	1.08
1988–89	652,500,000	n/a	652,500,000	1.02
1989–90	677,739,860	n/a	677,739,860	1.04
1990–91	699,291,988	n/a	699,291,988	1.03
1991–92	714,969,488	303,174,734	1,018,144,222	1.46
1992–93	730,122,049	318,971,350	1,049,093,399	1.03
1993–94	737,203,496	322,065,373	1,059,268,869	1.01
1994–95	756,446,019	330,471,283	1,086,917,302	1.03
1995–96	806,748,051	357,977,851	1,164,725,902	1.07
1996–97	833,693,434	369,934,312	1,203,627,746	1.03
1997–98	832,859,742	369,564,377	1,202,424,119	1.00
1998–99	854,180,951	379,025,226	1,233,206,177	1.03
1999–2000	880,575,142	390,737,104	1,271,312,246	1.03
2000–01	919,848,793	408,163,979	1,328,012,772	1.04
2001–02	965,841,233	428,572,178	1,394,413,411	1.05
2002-03	1,007,855,328	447,215,070	1,455,070,398	1.04
2003-04	1,039,703,554	461,347,062	1,501,050,616	1.03
2004-05	1,077,132,883	477,955,558	1,555,088,441	1.04
2005-06	1,121,079,905	497,456,144	1,618,536,049	1.04
2006-07	1,168,277,369	518,399,049	1,686,676,418	1.04
2007-08	1,234,986,007	547,999,635	1,782,985,642	1.06
2008-09	1,621,289,630	719,413,921	2,340,703,551	1.31
2009-10	1,371,300,000	608,500,000	1,979,800,000	0.85
2010-11	1,424,936,889	632,286,432	2,057,223,321	1.04
2011-12	1,495,256,846	663,489,464	2,158,746,310	1.05
2012-13	1,548,400,000	687,000,000	2,235,400,000	1.04
2013-14	1,609,900,000	714,400,000	2,324,300,000	1.04
2014-15	1,674,200,000	742,900,000	2,417,100,000	1.04
2015-16	1,739,600,000	771,900,000	2,511,500,000	1.04

Sources: Local Government National Report 2008-09; Department of Regional Australia, Local Government, Arts and Sport; Commonwealth Budget Papers 2012-13, Part 3: Australia's Federal Relations, p. 114.

Allocations for 2009-10 to 2011-12 are approximate based on Commonwealth Budget Papers and information from the Department of Regional Australia, Local Government, Arts and Sport. Final allocations are yet to be published in the Local Government National Reports. Grant allocations for 2012-13 to 2015-16 in Table 4.1 are estimated figures based on 2012-13 Commonwealth Budget Papers. Final allocations may differ once a final escalation factor is determined by the Commonwealth Treasurer.

As Table 4.1 demonstrates, the funding provided by the Commonwealth through FAGs has increased by between 3 and 5 per cent most years, in line with CPI and population increases. In 2008-09, there was a one-off increase of FAGs by 31 per cent as a result of the Australian

Government's decision to bring forward one-quarter of the budgeted allocation for 2009–10.¹⁶² Commonwealth Budget Papers stated that the aim of accelerating the provision of funding to local government was to assist the Government's strategy of supporting economic growth and jobs, allowing local governments to bring forward their delivery of some services into 2008-09 or early 2009-10, when they may otherwise have been provided later in 2009 or in 2010.¹⁶³ The adjustment factor for 2009-10 was determined to be 0.85 to adjust for the greater than usual increase in 2008-09. The financial years stated in Table 4.1 are the years to which payments are related under the Act. As the Commonwealth prepays some entitlements, the amounts reported in Commonwealth Final Budget Outcomes vary from these figures.

The 2012-13 Commonwealth Budget indicates that half of the 2012-13 FAGs, totalling \$1.1 billion nationally (Victoria's share is \$263.3 million), were paid in the 2011-12 year. The stated reason for this was to provide local governments with additional flexibility and assist them in responding to the widespread natural disasters and other pressures.¹⁶⁴

4.2.1 Distribution of funding between states and territories

In 2011-12, FAGs to local government throughout Australia totalled \$2,158.7 million, made up of \$1,495.2 million in general purpose assistance grants and \$663.5 million in local roads funding. Table 4.2 lists the FAG payments to each State and Territory for 2011-12.

Table 4.2: Local Government Financial Assistance Grants 2011-12

State/Territory	General Purpose Grants (\$millions)	Local Roads Grants (\$millions)	Total (\$millions)
New South Wales	483.8	192.5	676.3
Victoria	371.7	136.8	508.5
Queensland	302.5	124.3	426.8
Western Australia	153.9	101.5	255.3
South Australia	109.9	36.5	146.4
Tasmania	33.9	35.1	69.1
Northern Territory	15.3	15.5	30.9
ACT	24.0	21.3	45.3
Total	1,495.2	663.5	2,158.7

Source: Department of Regional Australia, Local Government, Arts and Sport.¹⁶⁵

General Purpose grants continue to be divided between states according to population shares. Road grants continue to be allocated based on historical shares from over 20 years ago, under which Victoria receives 20.6 per cent of national funding. As illustrated above, in 2011-12, Victoria received a total of \$508.5 million in FAGs, comprising \$371.7 million in a general purpose payment and a further \$136.8 million on local roads funding.

Victoria's share of FAGs has remained fairly constant, in line with Victoria's share of the national population. Charts 4.1 and 4.2 show the level of FAG funding provided to Victoria.

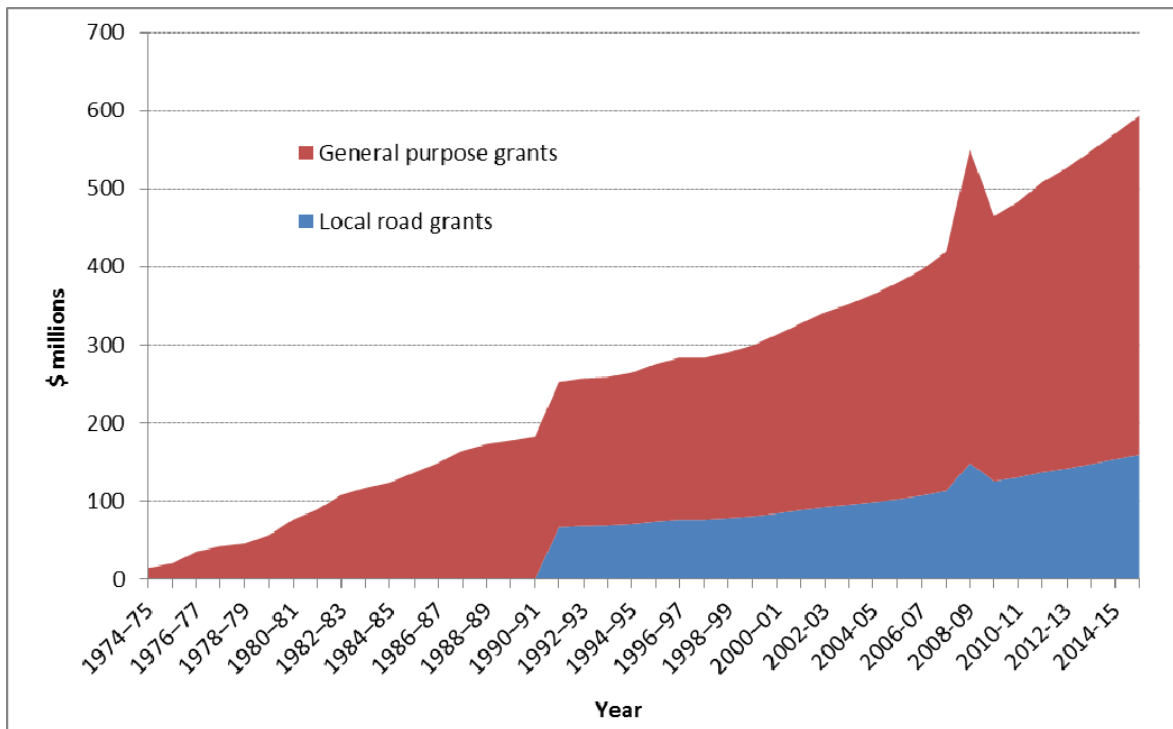
¹⁶² Commonwealth Department of Regional Australia, Local Government, Arts and Sport, *Local Government National Report 2008-09*, p. 20, <<http://www.regional.gov.au/local/publications/reports/index.aspx>> accessed 10 October 2012.

¹⁶³ Commonwealth Government, *Budget Papers 2011-12, Part 3: Australia's Federal Relations*, p. 105.

¹⁶⁴ Commonwealth Government, *Budget Papers 2011-12, Part 3: Australia's Federal Relations*, p. 115.

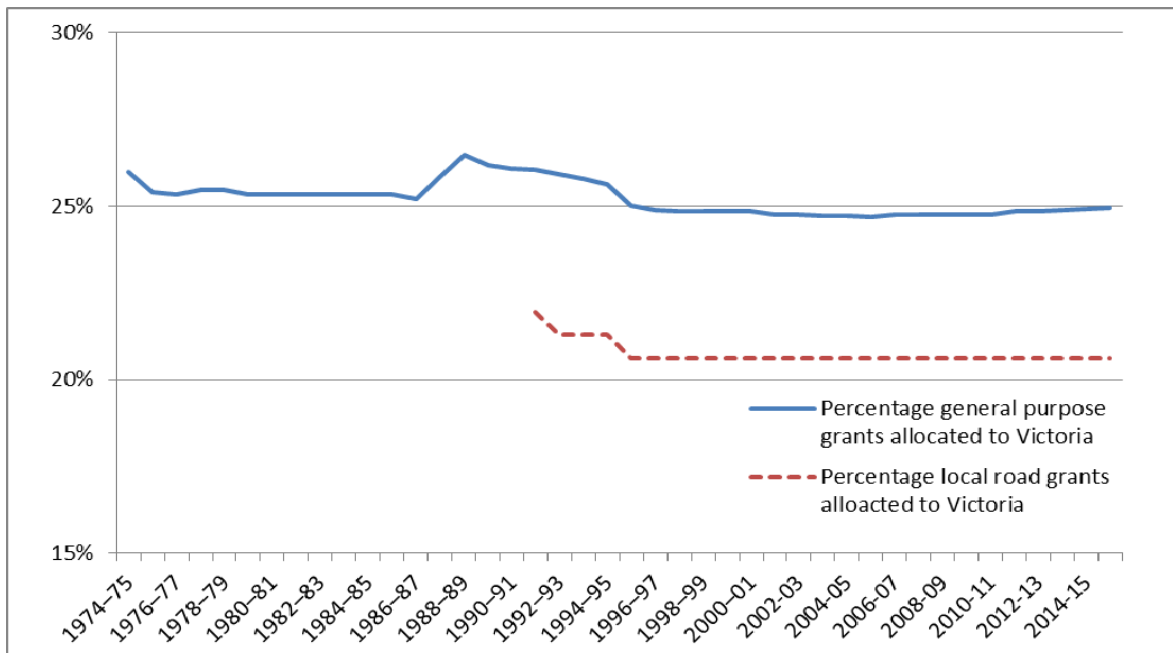
¹⁶⁵ Department of Regional Australia, Local Government, Arts and Sport, *Financial Assistance Grants to Local Government*, <<http://www.regional.gov.au/local/assistance/index.aspx>>, accessed 25 September 2012.

Chart 4.1: Local Government Financial Assistance Grants to Victoria 1974-75 to 2015-16



Sources: Local Government National Report 2005-06; Department of Regional Australia, Local Government, Arts and Sport; Commonwealth Budget Papers 2012-13, Part 3: Australia's Federal Relations, p. 114.

Chart 4.2: Victoria's share of national Local Government Financial Assistance Grants 1974-75 to 2015-16¹⁶⁶



Sources: Local Government National Report 2005-06; Department of Regional Australia, Local Government, Arts and Sport; Commonwealth Budget Papers 2012-13, Part 3: Australia's Federal Relations, p. 114.

¹⁶⁶ Charts 4.1 and 4.2 — Grant allocations for 2011-12 to 2015-16 are estimated figures based on Commonwealth Budget Papers. Final allocations may differ. Financial years relate to years for which payments relate under the Act, not years in which payments are actually made. Since 2008-09, the Commonwealth has prepaid some entitlements so amounts received will vary.

As shown in Chart 4.2, Victoria's share of general purpose grants has remained reasonably consistent around 25 per cent in line with Victoria's population. Since 1995-96, Victoria's share of local road grants has been fixed at 20.62 per cent.

4.3 Framework for distribution of Financial Assistance Grants within Victoria

Distribution of Financial Assistance Grants between individual Victorian local governments is determined by the Victoria Grants Commission (VGC). The VGC allocates grants on the basis of nationally agreed principles, as enumerated in the Act, and consistent with the roles and responsibilities of the Commonwealth and states outlined in the *Commonwealth of Australia Constitution Act 1900* (Cth).

This basis of the distribution is a horizontal fiscal equalisation formula. The Victorian Grants Commission must apply the Commonwealth's national distribution principles to the funding amount to determine what each local government receives. The national principles for the general purpose grant are listed below:¹⁶⁷

- **Horizontal equalisation** – General purpose grants are to be allocated to councils, as far as practicable, on a full horizontal equalisation basis. This aims to ensure that each council is able to function, by reasonable effort, at a standard not lower than the average standard of other councils in the State/Territory.
- **Effort neutrality** – In allocating general purpose grants, an effort or policy neutral approach is to be used in assessing the expenditure requirements and revenue raising capacity of each council. This means as far as practicable, the policies of individual councils in terms of expenditure and revenue efforts will not affect the grant determination.
- **Minimum grant** – The minimum general purpose grant for a council is to be not less than the amount to which it would be entitled if 30 per cent of the total amount of general purpose grants were allocated on a per capita basis.
- **Other grant support** – In allocating general purpose grants, other relevant grant support provided to local governing bodies to meet any of the expenditure needs assessed is to be taken into account.
- **Aboriginal Peoples and Torres Strait Islanders** – Financial assistance is to be allocated to councils in a way which recognises the needs of Aboriginal peoples and Torres Strait Islanders within their boundaries.
- **Council Amalgamation** – Where two or more local governing bodies are amalgamated into a single body, the general purpose grant provided to the new body for each of the four years following amalgamation

In its submission to the Inquiry, the VGC outlined the methodology for allocating FAGs.¹⁶⁸

The VGC's methodology for allocating general purpose grants takes into account each council's assessed relative expenditure needs and relative capacity to raise revenue. For each council, a raw grant is obtained which is calculated by subtracting the council's standardised revenue from its standardised expenditure. The available general purpose grants pool is then allocated in proportion to each council's raw grant, taking into account the requirement in the Commonwealth legislation and associated national distribution principles to provide a minimum grant to each council.

Under the VGC's general purpose grants methodology, standardised expenditure is calculated for each council on the basis of nine expenditure functions. Between them, these expenditure functions include virtually all council recurrent expenditure. A number of cost adjusters are used in various combinations against each function. These allow the VGC to take account of the particular characteristics of individual councils which impact on the cost of service provision on a comparable basis.

The structure of the model ensures that the gross standardised expenditure for each function equals aggregate actual expenditure by councils, thus ensuring that the relative importance

¹⁶⁷ Victorian Grants Commission, *Annual Report 2010-11*, October 2011, p. 12.

¹⁶⁸ Victorian Grants Commission, Submission No. 3, pp. 1-2

of each of the nine expenditure functions in the VGC's model matches the pattern of actual council expenditure. Standardised rate revenue, or a council's capacity to raise revenue from its community, is calculated for each council by multiplying its valuation base (on a capital improved value basis) by the average rate across all Victorian councils over three years. The payments in lieu of rates received by some councils for major facilities such as power stations and airports are added to the standardised revenue to ensure that all councils are treated on an equitable basis.

The revenue raising capacity assessment also takes account of council's capacity to raise revenue from user fees and charges (given size of population and local characteristics). For each council, for each of the nine functional areas, the relevant driver (such as population) is multiplied by the State median revenue from user fees and charges. For some functions, this is then modified by a series of "revenue adjustors" to take account of differences between municipalities in their capacity to generate fees and charges, due to their characteristics. The assessed capacity to generate user fees and charges for each council is added to its standardised rate revenue to produce total standardised revenue. It is the relative gap between the assessment of standardised expenditure and standardised revenue (the raw grant) that determines the share of the available funding that each council receives.

The VGC also has its own set of 14 cost adjustors it considered when allocating funds for 2011-12. They include population demographics, the amount of kerbed roads, the size of the area and tourism.¹⁶⁹

No council may receive a general purpose grant of less than 30 per cent of the per head of population average, which in 2011-12 was \$20.04.

For the local roads grants, the allocation of funding by the VGC is again based on a formula designed to calculate the needs of Victorian councils. There are five cost modifiers used by the VGC to determine funding. These are:¹⁷⁰

- volume of freight in an area;
- climate;
- availability of road making materials;
- sub-grade conditions; and
- strategic routes.

The calculation also takes into account the length of roads, the standard asset preservation cost as well as the amount and number of bridges.¹⁷¹

4.4 Victoria's Share of General Purpose Grants

As general purpose grants are divided between states on a per capita basis, it is self-evident that Victoria receives a satisfactory share of funding relative to its population share compared to other states. However, some submissions to the Committee raised concerns that the overall level of funding provided through these grants is too low, and the quantum of funding is not increasing at an appropriate rate.

4.4.1 Cost pressures on local government

In its submission to the Inquiry, the VGC notes that aggregate local government expenditure is growing at a faster rate than the funding provided through FAGs. FAGs provided to Victoria have increased 38 per cent from \$342 million in 2002-03 to \$472 million in 2011-12. In the same period, aggregate local government expenditure has increased by a much faster rate from \$3.901 billion in 2002-03 to \$6.381 billion in 2010-11, a 64 per cent increase.¹⁷² Chart 4.3 demonstrates the increasing gap between local government expenditure and funds received through FAGs, which local governments must meet from other revenue sources.

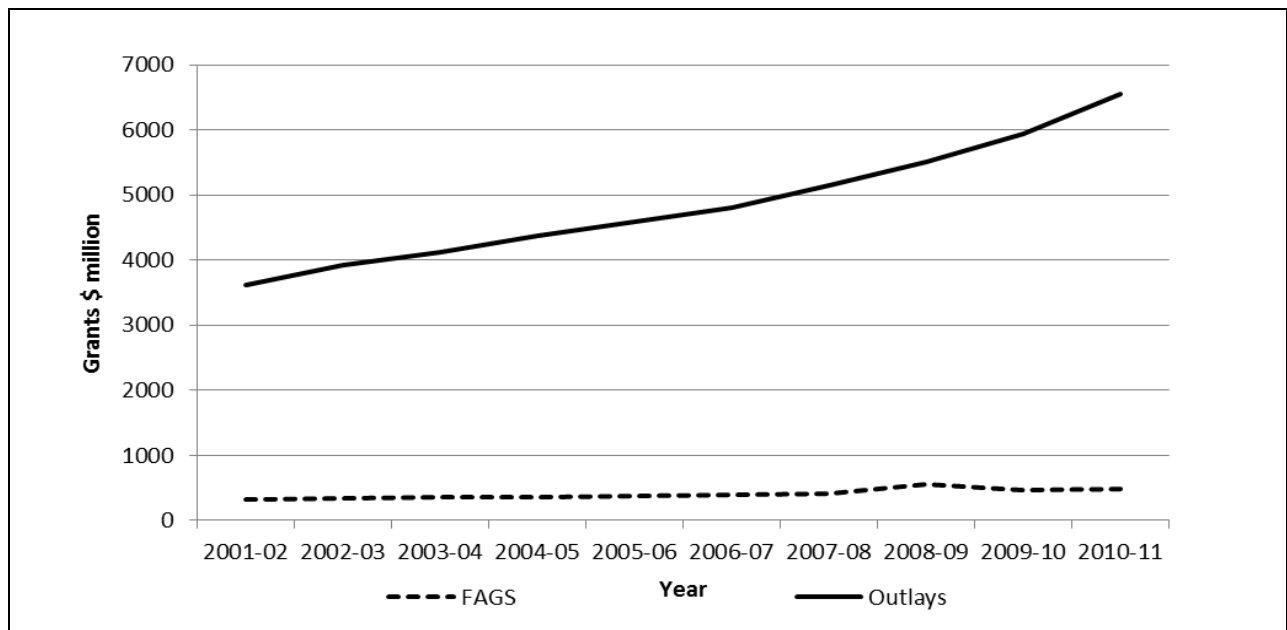
¹⁶⁹ Victorian Grants Commission, *Annual Report 2010-11*, October 2011, p.22.

¹⁷⁰ Victorian Grants Commission, *Annual Report 2010-11*, October 2011, p.28.

¹⁷¹ Victorian Grants Commission, *Annual Report 2010-11*, October 2011, p.28.

¹⁷² Victorian Grants Commission, Submission No. 3, p. 4

Chart 4.3 – Victorian Local Government Revenue and Outlays



Source: ABS 5512.0 - Government Finance Statistics, Australia, 2010-11

At the public hearing the Assistant Treasurer commented on the relatively slow increase in FAGs compared to Commonwealth revenue.¹⁷³

The other point I would make is that financial assistance grants to local government have declined substantially as a share of Commonwealth spending over the last 15 or so years. Fifteen years ago financial assistance grants comprised around 1 per cent of total Commonwealth spending. It is now down to around 0.6 of 1 per cent of Commonwealth spending. We have seen in relative terms a decline in the proportion of the Commonwealth budget spent on financial assistance grants. I guess what is important from a Victorian perspective and a local government perspective is that those financial assistance grants actually have regard to cost pressures and demand pressures within local government.

The City of Port Phillip's submission supported this view and noted that FAG funding has not grown in line with councils' costs and have provided insufficient funding for 'cost push pressures' such as:¹⁷⁴

- peak oil prices;
- child care infrastructure and service costs;
- global financial crisis; and
- regulatory costs and levies (e.g. landfill fees and EPA levies).

The City of Port Phillip further stated that:¹⁷⁵

Over the past 10 years Victoria's share of the Financial Assistance Grants program has increased from \$327 million in 2001/2002 to \$508 million in the current 2011/12 financial year. This represents a compound growth rate of 4.5% per annum. The population in Victoria has also grown significantly over the same period from 4.612 million in 2001 to 5.624 million today. This represents a compound growth rate of 2.0% per annum. This means that the allocation to the State assuming an average inflation rate of 2.5% over the same period has on a per capita basis been stagnant in real terms. The local government sector has over this period been subjected to a number of factors that are largely outside its control and this has required the sector as a whole to increase rates revenue by more than the prevailing inflation rate as measured by the movement in the Consumer Price Index (CPI).

¹⁷³ Hon. G. Rich-Phillips, Assistant Treasurer, *Transcript of Evidence*, 10 October 2012, pp. 6-7.

¹⁷⁴ City of Port Phillip, Submission No. 4, p. 3.

¹⁷⁵ City of Port Phillip, Submission No. 4, p. 2.

The East Gippsland Shire Council's submission stated that local government's share of untied Commonwealth funding has continued to decrease in real terms while expenses have risen at a faster rate than CPI.¹⁷⁶ The Council noted that it is highly dependent on FAGs because of low average incomes in the area.¹⁷⁷

The City of Whittlesea raised a similar concern about the way the Commonwealth Government indexes FAGs, which currently takes into account population growth and CPI.¹⁷⁸

There is ... a strong case to argue that CPI as a consumer related pricing index does not reflect the commercial pricing changes relevant to Councils. A commercial pricing inflator would better represent the increase in cost for Councils.

The Council also noted that the VGC's allocation disadvantages municipalities with the fastest growing populations, such as the City of Whittlesea, which 'desperately needs funding for greenfield development areas that need capital infrastructure like sports facilities, community centres, libraries etc.'¹⁷⁹

Finding 11

General purpose Financial Assistance Grants (FAGs) are distributed between states on a per capita basis which ensures all states receive an appropriate share relative to their populations.

Finding 12

The current level of funding provided through FAGs, which is indexed based on population growth and the consumer price index (CPI), has not kept pace with the expenditure responsibilities of local governments, meaning they must increasingly rely on own source revenue.

4.4.2 Importance of Financial Assistant Grants to rural local governments

In its submission to this Inquiry, the VGC noted that financial assistance grants are of varying importance to Victorian councils.¹⁸⁰ The 2010-11 allocation of FAGs as a percentage of total expenditure for each council throughout Victoria indicated that for most metropolitan and some interface councils the Financial Assistance Grants met only 5 per cent of their total expenditure. The VGC noted in its submission that in contrast, ten rural councils are heavily reliant on FAGs, these being: West Wimmera, Towong, Loddon, Hindmarsh, Pyrenees, Ararat, Northern Grampians, Gannawarra, Buloke, and Moira. For these councils, FAGs meet more than 20 per cent of total expenditure.¹⁸¹

As a comparison, inner city councils including Melbourne (0.5 per cent), Port Phillip (1.5 per cent), Yarra (1.6 per cent) and Stonnington (2.0 per cent) have significant revenue raising through rates and parking fines and as a result FAGs meet less than 2 per cent of their expenditure. Whereas, regional councils such as West Wimmera (30.5 per cent), Towong (27.8 per cent) and Loddon (26.5 per cent) do not possess such strong self-revenue raising opportunities and over a quarter of expenditure is met by FAGs.

¹⁷⁶ East Gippsland Shire, Submission No. 5, p. 2.

¹⁷⁷ East Gippsland Shire, Submission No. 5, p. 2.

¹⁷⁸ City of Whittlesea, Submission No. 2, p. 2.

¹⁷⁹ City of Whittlesea, Submission No. 2, pp. 2-3

¹⁸⁰ Victorian Grants Commission, Submission No. 3, p. 4.

¹⁸¹ Victorian Grants Commission, Submission No. 3, p. 4.

In a submission to the Commonwealth Grants Commission review of the Local Government (Financial Assistance) Act 1995, the Municipal Association of Victoria (MAV) commented that.¹⁸²

The provision of financial assistance to Victorian local government in the form of General Purpose Grants and Road Funding is critical to the future sustainability of local government in this State. In fact many small rural councils are dependent on grant funding to provide a basic level of service to the community.

In April 2008, the Productivity Commission released a review into the revenue raising capacity of local government. The review found that the capacity of local governments to raise revenue is important to their financial sustainability and their ability to promote the well-being of their local communities.¹⁸³ The Productivity Commission highlighted that local governments have increasingly been providing services beyond their traditional roles of the provision of local roads and other services to property.¹⁸⁴ Many councils now have a substantial involvement in the delivery of human services, and in planning and regulatory functions.

Key findings relevant to this Inquiry included:¹⁸⁵

- Local governments in urban areas are predominantly funded from their own sources of revenue, particularly rates, fees and charges. For most rural and remote councils, grants are also a substantial source of their revenue;
- The revenue raising capacity of local governments depends partly on their fiscal capacity, which differs by class of local government;
- Most councils could do more to help themselves, but a small number will remain highly dependent on grants, despite high levels of revenue raising effort;
- State governments impose legislative and regulatory constraints on the raising of revenue by local governments that affect the ways in which councils raise revenue, but the overall impact on revenue raising capacity is unclear.

The Committee has been asked to examine FAGs in the context of vertical fiscal imbalance. Increased reliance by local governments on own source revenue, as opposed to FAGs, decreases vertical fiscal imbalance as local governments have greater control over their own source revenue. However, the Committee is concerned that some local governments have limited ability to increase their own source revenue to meet their increased spending responsibilities and the slower growth rate of FAGs compared to expenditure is placing considerable budgetary pressures on some local governments, particularly those in rural areas.

At the public hearing the Assistant Treasurer confirmed that funding local government through a share of the GST is not supported by the Victorian Government, as a number of state taxes have been removed on the understanding that all GST revenue would flow to the states.¹⁸⁶ Given the slow growth rate of FAGs, and few alternative sources of revenue, a number of councils have raised rates by percentages well above CPI to meet their additional costs. The Victorian Farmers Federation has been critical of the burden that rate increases have placed on rural ratepayers, particularly farmers.¹⁸⁷

The municipal rating system is no longer viable for Victorian farmers, the cost of production is on the increase and some farmers just can't cope with the constant increases in their rates bills. We need a fairer system ... The time has come for local councils to stop collecting unreasonable rates from farmers.

¹⁸² Municipal Association of Victoria, *Submission to the Commonwealth Grants Commission review of the Local Government (Financial Assistance) Act 1995*, p. 1, <http://www.cgc.gov.au/__data/assets/pdf_file/0003/4656/Municipal_Association_of_Victoria.pdf>, accessed 10 October 2012.

¹⁸³ Productivity Commission, *Assessing Local Government Revenue Raising Capacity*, August 2008, p. XIX.

¹⁸⁴ Productivity Commission, *Assessing Local Government Revenue Raising Capacity*, August 2008, p. XIX.

¹⁸⁵ Productivity Commission, *Assessing Local Government Revenue Raising Capacity*, August 2008, p. XVIII.

¹⁸⁶ Hon. G. Rich-Phillips, Assistant Treasurer, *Transcript of Evidence*, 10 October 2012, p. 9.

¹⁸⁷ Victorian Farmers Federation, Media Release, *Get fair dinkum on rates- says VFF*, 26 September 2012, <http://www.vff.org.au/newsite/media_centre/detail.php?id=1393&order=9>, accessed 15 October 2012.

The Committee supports this view and is concerned that increasing gap between FAG funding and local government expenditure is placing the financial sustainability of some rural councils at risk.

Finding 13

The revenue raising capacity of local governments varies significantly across Victoria. Due to their limited ability to raise own source revenue, some smaller rural councils are heavily dependent on grants, which puts at risk their ongoing financial sustainability.

4.4.3 Commonwealth review of Financial Assistance Grants

In its Report on Assessing Local Government Revenue Raising Capacity, the Productivity Commission noted the imbalance in the revenue raising capacity of local governments and concluded:¹⁸⁸

Given the differences in the scope to raise additional revenue across different classes of councils, there is a case to review the provision of Australian Government general purpose grants to local governments.

Despite this recommendation being made in 2008, it was not until the end of August 2012 that the Federal Minister for Local Government announced a review into the Local Government Financial Assistance Grants program to be conducted by the Commonwealth Grants Commission. In announcing the review, the Minister advised “the review will identify tangible measures for improving the impact of Financial Assistance Grants on the effectiveness of local governments and their ability to provide an equitable level of service to their residents”.

Stage 1 of the review will examine the policy and administration of the Financial Assistance Grants program to make the most of existing funding. This will include making sure the national principles that guide the distribution of FAGs to local governments are still valid and assessing the relative need of local governments in each state and territory with a particular focus on those that service regional and remote communities. The input of all states, territories and local governments will be sought as part of the review process. The Commonwealth Grants Commission is expected to report to Government in December 2013.¹⁸⁹ Details of Stage 2 of the review are yet to be announced.

The Committee believes there is a need to review FAGs, but is concerned the Terms of Reference include “valuating the economic and financial benefits of untied vs tied funding for enhancing the effectiveness of local governments and their ability to ensure effective services for their residents”. At the public hearing, the Assistant Treasurer stated:¹⁹⁰

[The] terms of reference also raise the issue of tied and untied grants ... which obviously is introducing a new element — the concept of the tied grant — in terms of those financial assistance grants. ... [T]hat goes back to the point I made before about tied grants versus untied grants at a state level, but that would be at a local government level.

As discussed in Chapter 3 on National Partnerships, tied funding can often have unintended consequences by placing conditions on the way in which the services are provided and reducing scope for innovations and efficiencies. The Committee believes that local governments are best placed to decide how services should be delivered for their municipalities and is concerned that providing part of the general purpose grants as a tied grant could result in the Commonwealth placing unnecessary reporting and administrative burdens on local councils.

¹⁸⁸ Productivity Commission, *Assessing Local Government Revenue Raising Capacity*, August 2008, p. 94.

¹⁸⁹ Hon. Simon Crean MP, Media Release, *Review of Financial Assistance Grants*, 31 August 2012, <http://www.minister.regional.gov.au/sc/releases/2012/august/sc164_2012.aspx>, accessed 10 October 2012.

¹⁹⁰ Hon. G. Rich-Phillips, Assistant Treasurer, *Transcript of Evidence*, 10 October 2012, pp. 8-9.

The Committee also notes that the Terms of Reference for Stage 1 of the review only cover intrastate distribution of grants,¹⁹¹ not the amount of funding provided. At the public hearing the Assistant Treasurer stated:¹⁹²

[Stage 1 of the review] ... does not go to the issue of the level of financial assistance grants being paid to local government. It goes to the issue of how they are disbursed, but it does not actually go to the issue of the pool itself and the level of that pool. ... The issue I raised before related to the decline in the share of Commonwealth expenditure on financial assistance grants. That issue is not picked up in those terms of reference.

The Australian Local Government Association (ALGA) have raised similar concerns, stating:¹⁹³

ALGA has long argued that the amount of funding provided by the Federal Government to councils is not adequate. While we welcome the Government's decision to undertake a review of this funding, we believe it should include an assessment of the adequacy of the amount of grants and whether the current approach to indexation is effective, given the annual cost increases faced by councils do not reflect CPI...

The inquiry is a two-stage process and while the initial stage is looking at policy and administration of the program we are calling on the Government to make sure the key issues of indexation and the total amount of the grants are addressed in the second stage which is due for completion by December 2013.

This review is vital because the whole question of adequate and certain federal funding for local services is of great concern to councils and communities alike. It must be remembered that the key reason local government is working so hard to gain full recognition in the Australian Constitution is to ensure that federal funding of local government is secure and effective.

The MAV has similarly stated:¹⁹⁴

Councils don't deliver a common basket of household goods and services. Their biggest input cost is staff to deliver people-based services such as child care, parks and gardens maintenance, food safety inspections, home care, public libraries, school crossings, maternal and child health visits and much more.

Their second largest cost driver is labour, construction and material costs to maintain \$60 billion of local roads, community assets and facilities. These costs are simply not reflected in CPI movements.

Reform is needed to better match core funding to local government cost movements so councils don't have to go cap-in-hand to ratepayers every time grants decline and service demands rise.

4.4.4 Committee view

General purpose grants from the Commonwealth to local government are critically important to the continued financial viability of local governments within Victoria. Given the significant revenue raising capacity of the Commonwealth, and the increasing role of local governments in service delivery, it is important that FAGs keep pace with the cost pressures on local government.

The Committee notes the growth of FAGs has been significantly lower than the growth of Commonwealth revenue. This modest growth rate of FAGs has forced most local governments to increase rates, their principal source of revenue, at a rate well above CPI. The Committee does not

¹⁹¹ Hon. Simon Crean MP, Media Release, *Review of Financial Assistance Grants*, 31 August 2012, <http://www.minister.regional.gov.au/sc/releases/2012/august/sc164_2012.aspx>, accessed 10 October 2012.

¹⁹² Hon. G. Rich-Phillips, Assistant Treasurer, *Transcript of Evidence*, 10 October 2012, p. 9.

¹⁹³ Australian Local Government Association, *Local Government Welcomes Review of Financial Assistance Grants*, <<http://alga.asn.au/?ID=7633>>, accessed 27 September 2012.

¹⁹⁴ Municipal Association of Victoria, *Surprise \$24 million financial blow to council budgets*, <[http://www.mav.asn.au/News/Pages/surprise-\\$24-million-financial-blow-to-council-budgets-22-Aug.aspx](http://www.mav.asn.au/News/Pages/surprise-$24-million-financial-blow-to-council-budgets-22-Aug.aspx)>, accessed 27 September 2012.

believe that this is sustainable. While some larger inner-city councils are able to offset some of these cost pressures through increases to other charges, such as parking fees and fines, smaller rural councils do not have this option. The Committee believes it is essential that the overall size of the FAG funding pool be increased in light of the rapidly increasing expenditure responsibilities of local governments.

Although the Commonwealth has recently announced a review of FAGs, the Committee is concerned the scope of the review is too narrow. A redistribution of the existing FAG pool is unlikely to properly address the funding issues currently faced by local governments and may simply transfer these issues between councils. The proposition in the Terms of Reference for the CGC's review of FAGs that part of the grants could become tied is also of concern and the Committee urges the Victorian Government to advocate for all FAG funding to remain untied.

Recommendation 6

The Committee recommends that the Victorian Government advocate to the Commonwealth Government for changes to the method of calculating the escalation factor of the FAG pool so that FAGs increase at a rate in line with local government's expenditure responsibilities and that all such grants remains untied.

4.5 Victoria's Share of Local Road Grants

The Committee's Terms of Reference require an examination of 'Financial Assistance Grants to Local Government – provided through the state to local governments as general purpose revenue.' The Reference does not specifically refer to local road grants however the Committee sees this as an important component of FAGs.

Local road grants have been divided between states based on fixed historical shares since 1995-96. Evidence put to the Committee and similar evidence presented to previous reviews suggests this allocation of grants is inequitable as it is based on out-dated methodology and does not take into account the population and road usage of each State.

In October 2005 the Commonwealth Government asked the Commonwealth Grants Commission to undertake a review of the interstate distribution of local roads grants. The Commission was asked to make recommendations on possible changes to the distribution between the states and territories of the local roads grants and how this distribution could be updated in future years.¹⁹⁵ In its submission to that review, the Victoria Grants Commission argued that the Commonwealth Grants Commission should adopt a simple formula for the interstate distribution of the local roads grants, which could be easily understood and readily updated and reflected the relative needs of the states in maintaining local roads.¹⁹⁶ The Commonwealth Grants Commission's report on the Review of the Interstate Distribution of Local Roads Grants was released on 8 May 2007.¹⁹⁷

The Commonwealth Government decided not to accept the recommendations of the report and to maintain the status quo, due to problems with the quality and consistency of the local roads data across the states. It did not accept the proposal for an interim distribution recommended by the Commonwealth Grants Commission and, instead, indicated that the existing interstate distribution will be continued, along with the provision of supplementary funding to South Australia. This additional funding for South Australia is recorded as a National Partnership payment in Commonwealth Budget Papers,¹⁹⁸ but if included as part of local road grant funding, Victoria's share for 2012-13 is effectively reduced from 20.6 per cent to 20.1 per cent.

¹⁹⁵ Commonwealth Grants Commission, *Report on the review of the interstate distribution of local road grants*, 2006, p. vi.

¹⁹⁶ Victorian Grants Commission, *Submission to Commonwealth Grants Commission Review of Interstate Distribution of Local Road Grants*, p. 7, <http://www.cgc.gov.au/__data/assets/pdf_file/0014/4424/VGC_Submission_to_CGC_January_2006_.pdf>, accessed 10 October 2012.

¹⁹⁷ Commonwealth Grants Commission, *Report on the review of the interstate distribution of local road grants*, 2006.

¹⁹⁸ Commonwealth Government, *Budget Papers 2012-13, Part 3: Australia's Federal Relations*, p. 115.

In 2010, the Victorian Parliamentary Road Safety Committee tabled a report into Federal-State Road Funding. The Committee's Reference required a review of the economic efficiency and equity of the then current arrangements and recommendations for improvement.

The Committee's concluded that there is an inequitable distribution of the local roads grant amongst the states. The Committee found that:¹⁹⁹

- The level of Federal road funding has grown over time, particularly in recent years with the establishment of the Nation Building Program and Infrastructure Australia. However, the contribution that the Federal government makes to total national road funding remains the least of Australia's three tiers of government. This arrangement is inequitable given that the Federal government raises significantly greater revenue, and has significantly greater capacity to raise revenue, than state and local governments.
- Vertical fiscal imbalance has had a particularly negative effect on roads in rural, regional and remote areas where many roads are literally crumbling as a result of years of inadequate funding. While local governments are responsible for managing more than 80 per cent of the entire road network by length, they have faced mounting cost pressures in recent years and a simultaneous real reduction in Federal funding.
- The current road funding arrangements also undermine economic efficiency. Economic efficiency requires that any finite pool of funding – such as total Federal funding for all expenditure purposes – should be allocated towards those areas of expenditure that represent the highest priorities for society and which deliver the greatest economic and social returns.
- Although roads represent such an area of high priority, this is not reflected in the current level of funding for roads. The states' current shares of the grant have been fixed since 1991 when the grant became untied and the original basis for these shares is now unknown. The current shares of the states no longer reflect relative road funding needs, primarily because they result in under-funding of those states with higher populations.

The Road Safety Committee recommended that the Minister for Roads and Ports, through COAG, advocate a change in the local roads grant allocation methodology. It recommended that the local roads grant should be allocated according to a weighted average of 20 per cent for each state and territory's share of the total national local roads length and 80 per cent for its share of the national population and that this change should also apply to allocations under the Roads to Recovery Program.²⁰⁰

Given this recent comprehensive review by a Victorian Parliamentary Committee, this Committee has decided not to re-examine local road grant funding arrangements in detail. However, the Committee notes that the Government has yet to formally respond to the Road Safety Committee's Report, over two years since it was tabled on 1 September 2010. This is despite a legislative requirement that Government responses to Committee reports be tabled within 6 months.²⁰¹ The Committee supports the Road Safety Committee's recommendation that the Victorian Government advocate for a change in the local roads grant allocation methodology through COAG, and calls on the Government to formally respond to the recommendations in the report.

Finding 14

Victoria's share of local road grants is fixed at 20.6 per cent, a substantially smaller proportion than Victoria's population share of 24.8 per cent. The basis for distributing these road grants is out-dated and in need of review.

¹⁹⁹ Road Safety Committee (Vic), *Inquiry into Federal-State Road Funding Arrangements*, 2010, p. xi.

²⁰⁰ Road Safety Committee (Vic), *Inquiry into Federal-State Road Funding Arrangements*, 2010, p. 80-1.

²⁰¹ *Parliamentary Committees Act 2003*, s. 36.

Recommendation 7

The Committee recommends that the Victorian Government respond to the Road Safety Committee's September 2010 Report on Federal-State Road Funding Arrangements.

5. Commonwealth Own Purpose Expenditure

5.1 Definitions of Commonwealth Own Purpose Expenditure and Direct Outlays

The Terms of Reference require the Committee to examine both:

Commonwealth Own Purpose Expenditure – payments made by the Australian Government in the conduct of its own general government sector activities, and includes expenses for the purchase of goods and services and associated transfer payments; and

Direct Outlays – the Commonwealth’s operations or activities undertaken in Victoria.

The Committee has struggled to differentiate between the two terms “Commonwealth Own Purpose Expenditure” (COPE) and “Direct Outlays”. According to Commonwealth Finance Circular No. 2010/02, a Commonwealth Own Purpose Expense is:²⁰²

an expense made by the Australian Government in the conduct of its own general government sector activities, and includes expenses for the purchase of goods and services and associated transfer payments. Such funds are open to all sectors of the economy and therefore they may be paid to other levels of governments, in which case the payments are made and reported by the responsible Australian Government agency; and not reported in Budget Paper No. 3.

COPE is distinguished from Commonwealth payments to other governments (state and local), which are often referred to as grants or revenue assistance. These are provided to State or local governments who are responsible for the service delivery. Such payments include GST payments, National SPPs, NPPs and Local Government FAGs, all of which are reported in Commonwealth Budget Paper No. 3 - Australia’s Federal Relations.

In its submission, the Victorian Government initially indicates a narrower definition of COPE as a Commonwealth service or program “delivered through state line agencies”. It distinguishes Direct Outlays as other expenditure undertaken by the Commonwealth within Victoria.²⁰³ However, this distinction is confused later in the Victorian Government submission when it states that “COPE payments include Commonwealth special purpose and community grants”²⁰⁴ including the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) grants and Department of Education, Employment and Workplace Relations (DEEWR) grants. These grants are provided from the Commonwealth Department directly to community organisations and other groups, with no involvement of State line agencies. They would therefore fall outside a narrow definition of COPE as a Commonwealth service or program “delivered through state line agencies”.

Given the similarity in the two definitions, it is difficult to classify Commonwealth expenditure as either a COPE or a Direct Outlay. Furthermore, as is discussed later in this Chapter, quantifying Commonwealth expenditure undertaken within a particular state is difficult. If the narrow definition of COPE is chosen, as a Commonwealth service or program “delivered through state line agencies”, this task is made even more difficult.

The Victorian Government argues in its submission that the “effectiveness of the Commonwealth’s direct outlays will necessarily impact on the ability of Victoria to pursue its own policy objectives”.²⁰⁵ The Committee believes this is true regardless of whether the service is delivered through a state line agency. For the purposes of this Inquiry, the Committee has therefore chosen to use the broader definition of COPE, as described in Commonwealth Finance Circular No. 2010/02. This definition includes Direct Outlays under the definition of COPE, and the term COPE is used for the remainder of this Chapter.

²⁰² Commonwealth Government, *Federal Finance Circular No. 2010/02*, 9 December 2011, p. 2. <http://www.federalfinancialrelations.gov.au/content/circulars/circular_2011_02.pdf>, accessed 29 August 2012.

²⁰³ Victorian Government, Submission No. 6, p. 3.

²⁰⁴ Victorian Government, Submission No. 6, p. 17.

²⁰⁵ Victorian Government, Submission No. 6, p. 18.

5.2 Matters to be examined under the Terms of Reference

The Terms of Reference require the Committee to consider four categories of Commonwealth expenditure and in respect of each —

- (a) whether the current share of funding Victoria is receiving is satisfactory relative to its population share and its contribution to the Australian economy, and the extent and nature of changes in that share over time;
- (b) whether the adequacy of Victoria's share varies across each of the different areas of government service delivery and economic activity;
- (c) if the requirements imposed on funding are reducing the scope for innovation and service delivery efficiencies;
- (d) whether the costs of administration and associated reporting under funding agreements are appropriate; and
- (e) the future of programs at the expiry of funding agreements.

The Committee notes that the considerations listed in paragraphs (c) to (e) of the Terms of Reference are not relevant to COPE. As COPE is not provided to the State Government, but is expenditure undertaken by the Commonwealth Government in the conduct of its own general government sector activities, there are no funding agreements, therefore no reporting requirements, and no funding agreements that can expire exposing the states to financial risk. Where Victorian Government agencies receive COPE payments, they do so in a service provider capacity (delivering a service on behalf of the Commonwealth Government, for example administering highly specialised drugs on a fee for service basis²⁰⁶), as opposed to being the agency in charge of the service delivery program. Should funding issues arise, the responsibility and financial risk for programs delivered through COPE falls to the Commonwealth not the State Government.

The Committee has therefore focussed on paragraphs (a) and (b) of the Terms of Reference, whether Victoria receives a satisfactory share of COPE and whether this has varied over time and across different areas of government service delivery.

5.3 Estimating Commonwealth Own Purpose Expenditure

It is not a simple task to quantify COPE within Victoria. Financial reporting undertaken by the Commonwealth generally does not distinguish between the State or territory in which money is spent.

In its submission to the Committee, the Victorian Government attempted to quantify expenditure by the Commonwealth using ABS national accounts data:

Table 5.1: National government expenditure 2010-11

	Victoria		Australia		Victoria: share of national (%)
	\$ million	% GSP	\$ million	% GDP	
Consumption	18,515	5.8	96,544	6.9	19.2
Investment	4,489	1.4	19,603	1.4	22.9
Total	23,004	7.3	116,147	8.3	19.8

Source: Victorian Government, Submission No. 6, p. 19; ABS Cat No. 5220.0.

The Committee feels this estimation method has limitations as it only includes expenditure where final consumption or investment is undertaken by the Commonwealth Government. It does not include Commonwealth payments, such as unemployment benefits and education payments, which are provided to individuals or households who then undertake the final consumption expenditure. In 2010-11, Commonwealth Budget Papers estimate total Commonwealth expenditure was approximately \$356 billion²⁰⁷ of which almost \$99 billion was payments to the states,²⁰⁸ leaving

²⁰⁶ Medicare Australia, *Highly Specialised Drugs (HSD) program*, <<http://www.medicareaustralia.gov.au/provider/pbs/highly-specialised-drugs/index.jsp>>, accessed 13 November 2012.

²⁰⁷ Commonwealth Government, *Final Budget Outcome 2010-11, Part 2: Australian Government Financial Statements*, p. 16.

approximately \$257 billion of own purpose expenditure. The estimates provided by the Victorian Government based on ABS accounts data (Table 5.1) only capture \$116 billion, or approximately 45 per cent, of that expenditure.

Whilst Commonwealth Budget Papers and Commonwealth Department annual reports do not provide information on Commonwealth expenditure by State, the Productivity Commission analyses all government expenditure as part of its biannual Indigenous Expenditure Report. Whilst the aim of the report is to estimate expenditure by each level of government to gain a clearer picture of the efficiency of government services provided to Indigenous Australians,²⁰⁹ the report includes estimates of all Australian Government expenditure by state and territory, geographical region and by expenditure area. Whilst the estimates are not exact,²¹⁰ the Committee believes this is the best source of available data to estimate COPE. The Indigenous Expenditure Reports also largely correlate with Commonwealth and State Budget Papers. These estimate the Commonwealth Government's expenditure was \$356.1 billion in 2010-11²¹¹ and the Victorian State Government's expenditure was \$45.5 billion.²¹²

The Indigenous Expenditure Reports classify Australian Government expenditure into two groups:²¹³

- *direct expenditure* — expenditure on services and programs (including income support) that is provided directly to individuals, non-government service providers or local governments. This also includes the operation of the machinery of the Australian Government.
- *indirect expenditure* — payments 'to' and 'through' the State and Territory governments, including:
 - payments for specific purposes (National Specific Purpose Payments (SPPs) and National Partnership payments provided 'to' or 'through' State and Territory governments for specific purposes such as to pursue policy objectives and delivery of services in major service areas: health, education, community services, housing, infrastructure and environment. Also included are financial assistance grants to local governments
 - general revenue assistance — includes a broad category of payments, such as GST payments, which are provided to State and Territory governments without conditions, to spend according to their own budget priorities

The Commonwealth payments to Victoria examined in the earlier chapters of this report are included in the definition of "indirect expenditure" by the Productivity Commission. In its analysis of COPE and Commonwealth Direct Outlays, the Committee has excluded indirect expenditure and focussed on direct expenditure by the Commonwealth as defined by the Productivity Commission. The Committee believes this provides the best estimate of Commonwealth expenditure for its own purposes.

5.4 Victoria's share of Commonwealth Own Purpose Expenditure

The Productivity Commission's Indigenous Expenditure Report also groups Australian Government expenditure into sixteen expenditure categories. Table 5.2 contrasts Commonwealth direct expenditure within Victoria with total direct expenditure across Australia to get an estimate of Victoria's share of COPE in each of these areas:

²⁰⁸ Commonwealth Government, *Final Budget Outcome 2010-11, Part. 3: Australia's Federal Relations*, p. 63.

²⁰⁹ Productivity Commission, *Indigenous Expenditure Report 2012*, p. 3.

²¹⁰ Further details of the limitations of this data can be found in the Productivity Commission, *Indigenous Expenditure Report 2012 — Expenditure Data Manual and Service Use Measure Definitions Manual*

²¹¹ Productivity Commission, *Indigenous Expenditure Report 2012*, Table W-V.1 and .

²¹² Productivity Commission, *Indigenous Expenditure Report 2012*, Table W-O.1 and .

²¹³ Productivity Commission, *Indigenous Expenditure Report 2012*, Service Use Measure Manual, pp. 43, 44.

Table 5.2: Commonwealth Government direct expenditure 2010-11

Expenditure area	Commonwealth Direct Expenditure within Victoria (\$millions)	Total Commonwealth Direct Expenditure (\$millions)	Percentage of Commonwealth Direct Expenditure within Victoria
Early child development	952	4,236	22.5%
School education	566	2,276	24.9%
Tertiary education	3,150	11,822	26.6%
Hospitals services	621	2,617	23.7%
Public and community health services	915	5,274	17.4%
Health care subsidies & support services	7,812	34,193	22.8%
Labour and employment services	1,435	6,574	21.8%
Social security support	21,806	88,729	24.6%
Housing services	733	3,402	21.5%
Community and environment services	1,876	7,669	24.5%
Transport and communication services	240	1,175	20.4%
Public order and safety	947	4,045	23.4%
Community support and welfare	4,344	17,701	24.5%
Recreation and culture	756	3,203	23.6%
General government services & defence	15,370	62,205	24.7%
Support to industry	566	2,461	23.0%
Total	62,089	257,582	24.1%

Source: Productivity Commission, *Indigenous Expenditure Report 2012*, Table W-J.1.

Table 5.2 shows that in 2010-11, 24.1 per cent of COPE was in Victoria. This is slightly lower than Victoria's 24.8 per cent population share, but higher than Victoria's 23.2 per cent contribution to GDP.²¹⁴ This is contrasted with the Northern Territory which received 1.7 per cent of COPE, compared to its 1.0 per cent population share.

5.4.1 Victoria's share of COPE across expenditure areas

Table 5.2 demonstrates that Victoria's share of COPE does not vary significantly across each of the expenditure categories used by the Productivity Commission.

Victoria's share is lowest in the category of public and community health services. This is largely due to significant investment by the Commonwealth in Indigenous community and public health, with the Northern Territory receiving \$649 million of the total Commonwealth expenditure of \$5.27 billion (12.3 per cent of funding) in this category, which results in Victoria's lower share of 17.4 per cent. By contrast, the Northern Territory receives only 0.4 per cent of funding for hospital services, due to the smaller number of hospitals, whereas Victoria receives 23.7 per cent.

The two largest areas of Commonwealth spending are social security support and general government services and defence. 24.6 per cent of social security spending occurred in Victoria in 2010-11, principally due to Victoria's unemployment rate being slightly lower than the national average for part of the period. 24.7 per cent of general government services and defence funding was in Victoria, almost equal to its 24.8 per cent per capita share.

Victoria received 26.6 per cent of COPE for tertiary education. This largely correlates with 25.9 per cent of tertiary enrolments and 26.9 per cent of equivalent full time student load being at Victorian institutions in 2011.²¹⁵ Victoria received 22.5 per cent of COPE on early child development, lower than its per capita share. This reflects higher enrolment rates in approved childcare services in

²¹⁴ ABS 5220.0 - Australian National Accounts: State Accounts, 2010-11.

²¹⁵ Commonwealth Department of Education, Employment and Workplace Relations, *Higher education statistics*, <<http://www.deewr.gov.au/HigherEducation/Publications/HEStatistics/Publications/Pages/Home.aspx>>, accessed 19 September 2012.

Queensland, meaning only 22.6 per cent of children attending Australian Government approved child care services are in Victoria.²¹⁶

Victoria received 21.8 per cent of COPE for labour and employment services, this number being lower due to expenditure on Indigenous employment programs resulting in the Northern Territory, Queensland and Western Australia receiving more than their per capita share. Victoria also received less than its per capita share on transport and communication services at only 20.4 per cent, with Queensland receiving 24.3 per cent.

5.4.2 Changes in Victoria's share of Commonwealth direct expenditure over time

The Productivity Commission publishes its Indigenous Expenditure Report biannually. The first report was published in 2010, based on financial data for the year 2008-09 and the second report in 2012 based on financial data for 2010-11. The Committee has therefore only been able to examine changes in COPE between 2008-09 and 2010-11. Table 5.3 shows the change in Victoria's share of COPE between these two financial years.

Table 5.3: Victoria's share of COPE 2008-09 and 2010-11

	2008-09	2010-11	Change in share 2008-09 to 2010-11	Change in expenditure 2008-09 to 2010-11
Early child development	21.7%	22.5%	0.8%	36.0%
School education	23.0%	24.9%	1.9%	301.2%
Tertiary education	24.6%	26.6%	2.0%	44.7%
Other education ²¹⁷	24.5%	N/A	N/A	N/A
Healthy lives ²¹⁸	23.6%	22.2%	-1.4%	9.7%
Labour and employment services	21.5%	21.8%	0.3%	25.1%
Social security support	25.1%	24.6%	-0.5%	-6.6%
Housing services	19.9%	21.5%	1.6%	298.3%
Community and environment services	24.6%	24.5%	-0.1%	7.5%
Transport and communication services	23.4%	20.4%	-3.0%	-19.7%
Public order and safety	23.6%	23.4%	-0.2%	19.9%
Community support and welfare	24.6%	24.5%	0.0%	-29.1%
Recreation and culture	24.3%	23.6%	-0.7%	0.5%
General government services & defence	24.8%	24.7%	-0.1%	31.9%
Support to industry	24.8%	23.0%	-1.8%	-45.1%
Total	24.5%	24.1%	-0.4%	5.2%

Source: Productivity Commission, 2010 Indigenous Expenditure Report Supplement and Productivity Commission, Indigenous Expenditure Report 2012, Table W-J.1.

Table 5.3 shows there was an overall 5.2 per cent increase in COPE within Victoria between 2008-09 and 2010-11, although Victoria's national share decreased by 0.4 per cent. This was largely due to a reduction in Victoria's share of health funding (which is one of the largest categories of COPE as it includes Medicare payments) with a 1.4 per cent decrease. The reduction in Victoria's share of health funding is partly explained by significant additional Commonwealth expenditure in the Northern Territory, which resulted in an almost doubling of funding for community and public health services in that jurisdiction. The actual amount of health-related COPE in Victoria increased by 9.7 per cent (from \$8.52 billion to \$9.35 billion) between 2008-09 and 2009-10, despite the decrease in the national share.

²¹⁶ Productivity Commission, *Report on Government Services 2012*, Table 3A.10.

²¹⁷ Expenses included in the other education category for 2008-09 were included under the early child development, school education and tertiary education categories in 2010-11.

²¹⁸ Expenditure under the categories of hospitals services, public and community health services and health care subsidies and support services have been grouped for the purposes of this table, as health expenditure was grouped differently in the 2010 and 2012 Indigenous Expenditure reports.

Between 2008-09 and 2010-11, there were significant decreases in COPE expenditure within Victoria in the transport and communication services and support to industry categories, although Victoria's national share only decreased slightly. There were increases in all three education categories, partly due to reclassification of expenditure from the Other education category, but also due to increases in Victoria's national share.

5.4.3 Impact of Indigenous population on COPE

The allocation of COPE is significantly influenced by the distribution of the Indigenous population across Australia, as a number of Commonwealth programs specifically target Indigenous disadvantage. The Productivity Commission's Indigenous Expenditure Report notes that the cost of service provision to the Indigenous population can be significantly higher than for non-Indigenous Australians.²¹⁹

Most Indigenous Australians resided in major cities and regional areas in 2006 (75 per cent). However a higher proportion of the Indigenous population (25 per cent) lived in remote and very remote areas compared to non-Indigenous Australians (2 per cent).

The cost of providing services is often higher in remote areas where the challenges of being physically isolated can mean smaller populations, less developed market economies and lack of infrastructure. Also the multiple dimensions of disadvantage increase with remoteness, therefore higher costs of providing services to these geographical areas contribute to overall expenditure data reported in this report.

The Productivity Commission aims to separate Indigenous expenditure from non-Indigenous expenditure in an attempt to quantify this difference. Based on its analysis, it is therefore possible to estimate the amount of COPE spent in each state for Indigenous and non-Indigenous Australians. This is illustrated in Table 5.4.

Table 5.4: Commonwealth Government direct expenditure 2010-11

State	Indigenous expenditure (\$billions)	Indigenous as percentage of national	Non-Indigenous expenditure (\$billions)	Non-Indigenous as percentage of national	Total expenditure (\$billions)	Total as percentage of national
NSW	2.9	25.5%	80.3	32.6%	83.2	32.3%
Vic	0.7	6.0%	61.4	25.0%	62.1	24.1%
Qld	3.0	25.8%	49.4	20.1%	52.4	20.3%
WA	1.6	14.1%	23.4	9.5%	25.0	9.7%
SA	0.7	5.8%	19.4	7.9%	20.1	7.8%
Tas	0.3	2.6%	6.4	2.6%	6.7	2.6%
ACT	0.1	0.9%	3.8	1.5%	3.9	1.5%
NT	2.2	19.4%	2.0	0.8%	4.3	1.7%
Aust	11.5	100.0%	246.1	100.0%	257.6	100.0%

Source: Productivity Commission, *Indigenous Expenditure Report 2012*, Table W-J.1.

By dividing expenditure in this way, COPE related to Indigenous and non-Indigenous Australians can be compared with the per capita share of the Indigenous and non-Indigenous population across Australia.

²¹⁹ Productivity Commission, *2012 Indigenous Expenditure Report*, p. 74.

Table 5.5: Commonwealth Government non-Indigenous direct expenditure 2010-11 and distribution of non-Indigenous Australians between states

State	Percentage Indigenous Population	Percentage Indigenous Expenditure	Percentage Non-Indigenous Population	Percentage Non-Indigenous Expenditure
NSW	31.5%	25.5%	32.2%	32.6%
Vic	6.9%	6.0%	25.4%	25.0%
Qld	28.4%	25.8%	19.9%	20.1%
WA	5.6%	14.1%	7.5%	9.5%
SA	12.7%	5.8%	10.4%	7.9%
Tas	3.6%	2.6%	2.3%	2.6%
ACT	0.9%	0.9%	1.7%	0.8%
NT	10.4%	19.4%	1.5%	0.7%

Sources: Productivity Commission, *Indigenous Expenditure Report 2012*, Table W-J.1; ABS 2075.0 - *Census of Population and Housing - Counts of Aboriginal and Torres Strait Islander Australians, 2011*

As shown in Table 5.5, Victoria received 25.0 per cent of non-Indigenous COPE, which is closely related to its 25.4 per cent share of the non-Indigenous Australian population. Victoria also received 6.0 per cent of Indigenous expenditure, which is near to its 6.9 per cent share of Australia's Indigenous population.

Across Australia, Indigenous expenditure largely correlates with the proportion of the Indigenous population within each state. The exception is the Northern Territory, which is home to 10.4 per cent of Australia's Indigenous population, but received 19.4 per cent of Indigenous related COPE. This can be attributed to the geographic distribution of the Indigenous population within the Northern Territory, with a higher percentage of the Indigenous population living in remote areas (43.78 of Northern Territorians live in a remote or very remote area, compared with 0.08 per cent of Victorians and 0.5 per cent of people in NSW²²⁰), which increases the cost of service delivery.

In its submission, the Victorian Government refers to special purpose and community grants including FaHCSIA grants and DEEWR grants as being an area where Victoria has not received its fair share of funding.²²¹ However, the distribution of these grants is also affected by Indigenous factors, with approximately 15 per cent of FaHCSIA grants and 7 per cent of DEEWR grants being allocated to the Northern Territory, consequently reducing other states' shares.²²²

Finding 15

The allocation of COPE between states and territories is influenced by demographic factors, including the size of the Indigenous population and geographic remoteness. COPE therefore cannot be accurately compared to overall per capita shares.

Finding 16

Victoria has a lower proportion of the Australian Indigenous population and is geographically compact compared to other states and the Northern Territory, therefore Victoria's share of COPE is expected to be slightly lower than a strict per capita share.

²²⁰ Based on 2011 population figures — ABS 3218.0 Regional Population Growth, Australia.

²²¹ Victorian Government, Submission No. 6, p. 17.

²²² Commonwealth Department of Families, Housing, Community Services and Indigenous Affairs, *Grants Funding*, <http://www.fahcsia.gov.au/sites/default/files/documents/09_2012/grants_1.xls>, accessed 21 September 2012; Department of Education, Employment and Workplace Relations, *Grants Awarded up to 30 June 2012*, <http://www.deewr.gov.au/Department/Publications/Documents/GrantFiles/GrantsAnnouncements_upto300612.xls>, accessed 21 September 2012.

5.4.4 Commonwealth Public Service

Another possible measure of Commonwealth direct expenditure is the geographical distribution of the Commonwealth public service. The Victorian Government states in its submission:²²³

The Commonwealth also undertakes direct expenditure within the State of Victoria. This largely takes the form of payments to Commonwealth employees and direct commission of public infrastructure. It is anticipated that the Commonwealth directly expends more per capita in the Northern Territory and Australian Capital Territory due to payments for the Commonwealth public service and the Australian Defence Force.

According to the *Australian Public Service Statistical Bulletin: State of the Service Series 2010–11*, there were 166,195 employees in the Commonwealth Public Service as at 30 June 2011.²²⁴ As would be expected, a large proportion of these employees — 64,759 or 38.9 per cent — are located in the Australian Capital Territory. There are also 1,704 employees located overseas. The remaining 100,032 employees are located with the six Australian states and the Northern Territory.²²⁵ Table 5.6 shows the geographical distribution of these employees.

Table 5.6: Australian Public Service Employees by State as at 30 June 2011 excluding employees based overseas or in the ACT

	Australian Public Service Employees	Percentage of Australian Public Service (excluding ACT and overseas employees)
New South Wales	30,729	30.7%
Victoria	26,510	26.5%
Queensland	18,053	18.0%
South Australia	9,968	10.0%
Western Australia	7,787	7.8%
Tasmania	4,138	4.1%
Northern Territory	2,847	2.8%
Total	100,032	100.0%

Source: *Australian Public Service Statistical Bulletin: State of the Service Series 2010–11, Table 5, p. 26.*

Victoria has 25.2 per cent of the national population if the population of the ACT is excluded. However, Table 5.2 shows that Victoria is home to 26.5 per cent of the Australian Public Service excluding the ACT and overseas employees. This proportion is even higher — 27.0 per cent — if only ongoing employees are counted.²²⁶ The latest report on the State of the Australian Public Service also notes there was a net increase of 384 employees in Victoria in 2010-11 due to promotion or transfer.²²⁷ These figures indicate Victoria has its fair share, if not more than its fair share, of Australian Public Service employees, and therefore the related Commonwealth expenditure on their salaries and related costs.

5.5 Measuring outcomes as opposed to expenditure

The Victorian Government states in its submission:²²⁸

The effectiveness of the Commonwealth’s direct outlays will necessarily impact on the ability of Victoria to pursue its own policy objectives. For example, the effectiveness of Commonwealth investment in achieving job opportunities for the long-term unemployed has a direct impact on how effective Victorian human services agencies can be in building resilience and improving economic and social independence.

²²³ Victorian Government, Submission No. 6, p. 18.

²²⁴ Includes ongoing and non-ongoing employees — *Australian Public Service Statistical Bulletin: State of the Service Series 2010–11, Table 5, p. 26.*

²²⁵ Includes ongoing and non-ongoing employees — *Australian Public Service Statistical Bulletin: State of the Service Series 2010–11, Table 5, p. 26.*

²²⁶ Includes ongoing and non-ongoing employees — *Australian Public Service Statistical Bulletin: State of the Service Series 2010–11, Table 5, p. 26.*

²²⁷ State of the Service 2010-11, p. 104.

²²⁸ Victorian Government, Submission No. 6, p. 18.

It further argues.²²⁹

Considering the level of Commonwealth funding provided to Victoria as COPE payments, the current system lacks the appropriate level of transparency, and requires significant improvement for enhanced accountability and efficient coordination of service delivery.

At the public hearing, the Assistant Treasurer expanded on this, stating:²³⁰

My understanding is that it obviously varies from department to department, depending on what programs they are running, but it is not clear what COPE funding actually exists, particularly by jurisdiction. If that were reported through the Commonwealth budget papers, for example, we would have a far clearer understanding of exactly what level of COPE funding actually exists, where it is geographically and where it is programmatically.

The Committee agrees the effectiveness of COPE within Victoria can impact the Victorian Government's own programs and activities, however the Committee is not convinced further measuring the level of Commonwealth Government expenditure is the best way to ensure Victorians receive an equitable outcome from Commonwealth outlays. The statements in the Victorian Government submission and by the Assistant Treasurer also imply the Commonwealth Government should be accountable to the Victorian Government for expenditure on its own activities and programs.

In 2007 the Senate Standing Committee on Finance and Public Administration tabled a report on Transparency and Accountability of Commonwealth Public Funding and Expenditure which recommended.²³¹

that the State and Territory jurisdictions provide to the Commonwealth comprehensive annual statements of the purposes and expenditures of GST revenues to enable their incorporation into Budget Paper No.3.

The Commonwealth Government responded to the report stating:²³²

Not agreed - The *Federal Financial Relations Act 2009*, which implements financial arrangements of the *Intergovernmental Agreement on Federal Financial Relations*, provides for all GST revenue to be distributed to the States and Territories (the States) and that this revenue can be used by the States for any purpose. Consequently, GST revenue forms part of each State's consolidated revenue from which all state expenditures are funded...

Annual state budgets provide the public with detailed estimates of how each State will allocate its expenditure. State governments are accountable to their parliaments and electorates for these budget decisions.

The Committee supports this view and believes it can similarly be argued that the Commonwealth Government is responsible to the Commonwealth Parliament for its own purpose expenditure. Victorian Members of the Commonwealth House of Representatives and Victorian Senators are responsible for ensuring Commonwealth Budget decisions take into account the interests of Victorians.

At the public hearing, the Assistant Treasurer argued:²³³

One of the disincentives, if we focus the funding at a certain level of outcomes, is that because Victoria is efficient we are actually not benefiting from being efficient. If we are being funded for the efficient delivery of outcomes in Victoria, we are actually getting less Commonwealth funding because we are efficient, whereas if funding is allocated on a people per capita basis and we deliver a program more efficiently in Victoria than it is delivered in other jurisdictions, we actually get a benefit.

²²⁹ Victorian Government, Submission No. 6, p. 18.

²³⁰ Hon. G. Rich-Phillips, Assistant Treasurer, *Transcript of Evidence*, 10 October 2012, p. 8.

²³¹ Senate Standing Committee on Finance and Public Administration, *Report on Transparency and accountability of Commonwealth public funding and expenditure*, p. 36.

²³² Government Response to the Senate Standing Committee on Finance and Public Administration, *Report on Transparency and accountability of Commonwealth public funding and expenditure*, p. 5.

²³³ Hon. G. Rich-Phillips, Assistant Treasurer, *Transcript of Evidence*, 10 October 2012, p. 5.

The Committee agrees with this view in relation to Commonwealth grants provided to Victoria, as where Victoria is able to discharge its responsibilities more efficiently, it should receive the benefit. However, with COPE, the responsibilities discharged through the expenditure belong to the Commonwealth, not the state. Where a state is involved, it is simply a service delivery agency. If the Commonwealth is able to deliver a service it is responsible for more efficiently in one state than another, the benefits of the efficiency would normally rest with the Commonwealth, not the state which was contracted to provide the service.

In relation to COPE, the Committee considers the focus in the Terms of Reference on a satisfactory share of expenditure is less appropriate than a focus on equitable outcomes for Victorians. In areas of Commonwealth responsibility, the aim of the Victorian Government should be to advocate for a share of Commonwealth resources that makes sure Victorians receive an equitable and appropriate outcome compared to the rest of Australia. As discussed earlier in this Chapter, in some circumstances, more or less expenditure is needed in a particular jurisdiction to ensure the same result.

Over time, governments around the world are gradually moving from an outputs to an outcomes focus. A report commissioned by the World Bank, *Moving from Outputs to Outcomes: Practical Advice from Governments Around the World*, noted:²³⁴

One of the major rationales for an outcome-oriented approach is to provide for more rationality to the resource allocation process, so that funds are allocated where they are most likely to maximize the achievement of outcomes. At a minimum, linking outcomes to budgeting can illustrate what benefits arise from expenditures.

The Committee believes the focus should not be on ensuring Victorians receive an equal amount of COPE as other states, but instead the objective should be ensuring sufficient resources are allocated by the Commonwealth where needed to ensure Victorians receive equitable outcomes from that expenditure. A narrow focus on expenditure may result in more important issues being overlooked.

The Commonwealth Government currently undertakes detailed reporting on its activities as part of departmental and agency annual reports. These documents also focus on performance reporting on the achievement of stated objectives, not just financial reporting. The Productivity Commission also annually undertakes a Report on Government Services which aims to provide information on the equity, efficiency and effectiveness of government services in Australia. The data in the report is intended to provide an incentive to improve the performance of government services by helping jurisdictions identify where there is scope for improvement and promoting greater transparency and informed debate about comparative performance.²³⁵

The Committee urges the Victorian Government to advocate for additional Commonwealth expenditure where Victorians are not receiving a sufficient level of service delivery or the same access to programs as other states. By examining the current outcomes for Victorians in areas such as education, health, community services and homelessness, the Government may be able to identify areas where Victorians are not receiving a fair allocation of Commonwealth resources.

Finding 17

The quantity of COPE within Victoria is not a reliable measure of whether Victoria receives its fair share of Commonwealth resources in all circumstances. It is more appropriate to measure outcomes, as opposed to outputs, to determine whether Victorians are receiving equal benefit from Commonwealth expenditure and outlays.

²³⁴ Burt Perrin, *Moving from Outputs to Outcomes: Practical Advice from Governments Around the World*, <<http://siteresources.worldbank.org/CDFINTRANET/Resources/PerrinReport.pdf>>, accessed 24 September 2012.

²³⁵ Productivity Commission, *Report on Government Services 2012*, p. 1.2, <<http://www.pc.gov.au/gsp/rogs/2012>>, accessed 24 September 2012.

Recommendation 8

The Committee recommends the Victorian Government review Commonwealth Government and Productivity Commission performance reporting on Commonwealth Government activities and advocate for additional resources to be allocated to Victoria where equitable outcomes for Victorians are not currently being achieved.

Appendix A: List of Written Submissions Received

1. Australian National Audit Office
2. City of Whittlesea
3. Victoria Grants Commission
4. City of Port Phillip
5. East Gippsland Shire
6. Victorian Government

Appendix B: Schedule of Public Hearings

Wednesday, 10 October 2012

- Hon. Gordon Rich-Phillips, MLC — Assistant Treasurer
- Mr Grant Hehir — Secretary, Department of Treasury and Finance
- Mr Brendan Flynn — Deputy Secretary, Economic and Financial Policy, Department of Treasury and Finance
- Ms Mary Cavar — Director, Tax and Intergovernmental Relations, Department of Treasury and Finance
- Ms Teresa Stewart — Assistant Director, Intergovernmental Relations, Department of Treasury and Finance

Appendix C: National Partnership Payments Questionnaire

Name of NPP Agreement	
Funding Amount	
Term of funding agreement (start date and end date)	

Reporting to the Commonwealth

Frequency of reporting (e.g. monthly, quarterly)	
Average length of report (e.g. number of pages)	
Do you use a template report?	
Which areas of your organisation are involved in producing the report?	
How long does it take to complete each report? Please specify a number of hours for each area.	
What is the estimated cost of producing the report? Please explain the basis for your calculation.	
Where are completed progress reports sent? Does the Department receive feedback?	

Other questions

Do the requirements in the NPP Agreement impact on potential innovation and service delivery efficiencies? If so, please provide examples as to how the project could be delivered differently or more effectively.
Is the NPP funding provided for a one off project or will ongoing funding be required at the end of the NPP?