



Hon Jay Weatherill MP
Premier of South Australia

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Senator Richard Di Natale
Chair, Senate Select Committee into the
Abbott Government's Commission of Audit
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Senator Di Natale

Thank you for the opportunity to provide a submission to the Senate Select Committee's Inquiry into the Abbott Government's Commission of Audit (the Commission).

The South Australian Government has a number of concerns with the potential outcomes from the Commission, which we outlined in a submission to the Commission in November last year.

In particular, the South Australian Government has observed a number of Audit Commissions which have recommended reductions in services to citizens. We would be concerned if the Commission saw that a reduction in services to the citizens of Australia were part of its remit.

We are also concerned that the Commission will contemplate the shifting of obligations from the Commonwealth to the States. All jurisdictions are facing budgetary pressures and so shifting burdens to the States, in the absence of the provision of more stable revenue streams, would simply shift the fiscal burden of delivering services to the States. Any transfer of functions ought not to be contemplated without a corresponding transfer of the revenue base required to fund those services.

The Commission's Terms of Reference invite it to look at the current architecture of Commonwealth/State relations and we are particularly concerned that the Commission will comment on, and re-open debates about, horizontal fiscal equalisation (HFE). Every Australian citizen has the right to receive the same level of government services, regardless of which state they live in. HFE ensures that each jurisdiction has the fiscal capacity to provide the same level of government services. An Independent Review in late 2012 found that the current HFE system is well-established, internally consistent and works satisfactorily. We strongly consider that the Commission should not disturb that position.

I have attached for your information a copy of our full submission to the Commission which includes more detail on these matters. I trust that it will be useful in the Select Committee's deliberations.

Yours sincerely 

Jay Weatherill
PREMIER

9/1/2014

Enc

South Australian Government Submission to the National Commission of Audit

The South Australian Government provides the following comments to the National Commission of Audit (the Commission), which relate in particular to the *Scope of Government* and *Efficiency and Effectiveness of Government Expenditure* sections of the Commission's Terms of Reference.

The submission is focused on the following core themes:

- Commonwealth-State architecture
 - Ensuring financial pressures are not shifted
 - Vertical fiscal imbalance
 - Support for horizontal fiscal equalisation
- Duplication of Commonwealth and State service delivery
- Intergovernmental Agreement on Federal Financial Relations
 - Increased service levels via National Partnerships
 - Expiring National Partnerships
 - Proliferation of agreements and reporting mechanisms
- Co-payment arrangements and user-charging
- Social housing and homelessness funding
- Infrastructure funding
 - Privatisation
 - Productive transport infrastructure
- Areas of disproportionate impact

Summary

The South Australian Government has observed a number of Audit Commissions which have recommended reductions in services to citizens. We are concerned that the Terms of Reference of the Audit Commission permit, and even encourage, such an outcome. We would be concerned if the Commission saw that a reduction in services to the citizens of Australia were part of its remit.

We are also concerned at those elements of the Terms of Reference that contemplate the shifting of obligations from the Commonwealth to the States. All jurisdictions are facing budgetary pressures, and so shifting burdens to the States, in the absence of the provision of more stable revenue streams, would simply shift the fiscal burden of delivering services to the States. Any transfer of functions ought not be contemplated without a corresponding transfer of the revenue base required to fund those services.

The Terms of Reference invite the Audit Commission to comment on the current architecture of Commonwealth-State relations. Every Australian citizen has the right to receive the same level of government services, regardless of which state that they live in. Horizontal fiscal equalization ensures that each jurisdiction has the fiscal capacity to provide the same level of government services. As an independent review conducted by Hon. John Brumby, Mr Bruce Carter and the Hon. Nick Greiner AC found late last year:

The current HFE system — requiring material equality and being guided by internally referenced principles and pillars, standards and capacities — is well established and internally consistent. It works satisfactorily if the goal and definition of equalisation as currently set out is accepted and one accepts (as we do) that the CGC does a good job of making its judgements and producing its numbers in the circumstances.¹

The Audit Commission should not disturb that position.

The South Australian Government accepts there may be benefits to the community in examining issues such as:

- the duplication of some services between the Commonwealth and the States;
- the proliferation of National Partnerships and Intergovernmental Agreements and their associated reporting obligations;
- greater security regarding infrastructure investments – the recent instances of funds committed under a previous Commonwealth Government being reversed under the current Commonwealth Government have no place in a functioning federal system of government.

This Submission comments in more detail on these matters.

Commonwealth-State architecture

Ensuring Financial Pressures are not Shifted

It is vital that the Commission is mindful of not recommending a situation whereby financial pressures and obligations are shifted from the Commonwealth Government onto states and territories. All jurisdictions are facing budgetary pressures and the states and territories lack access to a robust, broad-based tax revenue base.

Vertical Fiscal Imbalance

Vertical fiscal imbalance (VFI), the imbalance between revenue collection and expenditure responsibility within the Australian federation, is often raised as an issue relevant to tax reform. The more important issue is ensuring adequate revenue levels for state governments, whether from assured grants or own source revenues. Some element of fiscal autonomy is required at the margin to allow individual states to deal with their own budgetary circumstances and pressures.

The recent *Australia's Future Tax System* review (the Henry Tax Review) recommended reform of state taxes and proposed that:

¹ GST Distribution Review (2012), *Final Report*, Finding 2.3, p 9.

Reforms to State taxes should be implemented over time through an intergovernmental agreement to allow for revenue stability as taxes are reformed and to facilitate good policy outcomes across the federation.

South Australia supports a cooperative Commonwealth-state approach to national tax reform provided that proposed changes lead to an overall benefit for the South Australian community. It is essential if state taxes are to be reformed, that there is adequate revenue replacement.

Both the states and the Commonwealth are facing significant funding pressures. Growth in GST revenues is not keeping pace with the economy, placing significant strain on state budgets. Over the forward estimates period GST and non-GST grants from the Commonwealth as a proportion of GDP are significantly lower than when the GST was first introduced. This is despite the community expecting improved levels of service which have continued cost pressures for states, including in the areas of health, education, disability support and infrastructure renewal.

In this context, any transfer of functions ought not be contemplated without a corresponding transfer of the revenue base required to fund those services.

While other grants from the Commonwealth are generally tied to funding specific areas, changes to Specific Purpose Payments or National Partnerships grant policy as a result of Commonwealth budget pressures or changes in policy support can exacerbate the budget problems faced by the states, which need to address and manage community expectations in relation to core government services.

Support for Horizontal Fiscal Equalisation

The Intergovernmental Agreement on Federal Financial Relations (IGA) states that GST revenue will be distributed among the states in accordance with the principles of horizontal fiscal equalisation (HFE). HFE aims to give each jurisdiction the same per capita fiscal capacity to provide the national average level of services.

The current, comprehensive, system of fiscal equalisation in Australia is a fundamental strength of the Australian federation and must be retained. This has been supported by research demonstrating the equity and efficiency benefits of the current HFE approach.²

As an independent review conducted by Hon. John Brumby, Mr Bruce Carter and the Hon. Nick Greiner AC found late last year:

The current HFE system — requiring material equality and being guided by internally referenced principles and pillars, standards and capacities — is well established and internally consistent. It works satisfactorily if the goal and definition of equalisation as currently set out is accepted and one accepts (as we do) that the CGC does a good job of making its judgements and producing its numbers in the circumstances.³

² Independent Economics, 2012, *Horizontal Fiscal Equalisation: Modelling the welfare and efficiency effects* - http://www.treasury.sa.gov.au/_data/assets/pdf_file/0011/1181/horizontal-fiscal-equalisation-modelling-welfare-efficiency-effects.pdf

³ GST Distribution Review (2012), *Final Report*, Finding 2.3, p 9.

Equalisation ensures that each jurisdiction has an equal capacity to deliver services to a national average standard through financial transfers between jurisdictions depending on their relative fiscal capacity. Those transfers equalise capacity in terms of relative advantages and disadvantages which are beyond the control of state governments. HFE ensures that otherwise similar households and firms in an integrated national economy, within the Australian federation, are not treated as different class citizens and entities merely on account of the accidents of natural resource location and circumstances of fellow residents within state borders. Fiscal equalisation ensures that all states are placed on an equal footing in this regard.

With full HFE, no fiscal incentives for population migration arise - whereas they would if there were a requirement that revenues in an area matched expenditures in the same area. HFE ensures that location decisions in a federation are independent of the fiscal effects that arise from accidental variations in regional physical and human resource endowments, and that those location decisions instead are driven by inter-regional variations in marginal productivity for particular resources.

HFE is not detrimental to national economic growth and does not undermine incentives for states to pursue growth enhancing reforms. Similarly, states have incentives to pursue greater efficiency in service delivery under HFE.

There is a strong case on grounds of both equity and efficiency for HFE. HFE transfers are needed to allow the same efficient and equitable result as is obtained with implicit area equalisation from uniform tax rates and equal service standards for comparable cost locations in a national or unitary setting. Implicit area fiscal equalisation occurs automatically within the scope of the Commonwealth Budget. HFE attacks, at source, the effects of the arbitrary location of sub-national government boundaries in a federation as compared with the outcomes which arise implicitly in a unitary nation.

Duplication of Commonwealth and State Service Delivery

A lack of clear delineation of roles and responsibilities between tiers of government can lead to inefficiency in administration and service delivery, and confusion or lack of optimal service for service recipients. A more robust approach is required to ensure that in those areas involving dual responsibility, clarity is established.

The following are indicative examples in the health and skills domains of the challenges present where duplication exists:

- While cross-government support is required in the area of Indigenous health, the current arrangements under the National Partnership on Closing the Gap in Indigenous Health Outcomes, where Commonwealth and state own purpose funding is used, is an example of the type of situation that can result in the duplication of some services (such as smoking initiatives).
- The interaction between the Commonwealth and the states on training and skills matters. The Commonwealth operates in this field as a policy maker and as a direct funder of training and other services. The direct involvement of both the state and the Commonwealth in provision of training complicates matters for the users (industry and students) of the system because it creates

multiple programs with similar objectives, but different designs and access processes.

- The Commonwealth funded Industry Skills Councils (ISCs) can fulfil a useful role providing information on industry needs. However, some of the ISCs' activities and expectations have grown and require significant Commonwealth funding. ISCs are responsible for developing the training packages and qualifications used nationally. This has led to the current position where there are well over 2,500 accredited qualifications available in the national VET sector (Some of these are of questionable value to employers and only about half of these qualifications have ever had an enrolment in South Australia).

An example where the split in state-Commonwealth funding responsibilities has been made more clear is in aged care and disability services for older people, where the service funding responsibility is determined by age. Approaches like this could be considered in other areas to address duplication issues.

South Australia wishes to emphasise to the Commission that, in developing any recommendations to address areas of potential overlap, the impact on states and citizens needs to be given due consideration, especially if the Commonwealth were to vacate an area of service provision. There is certainly no capacity for states to assume additional functions or responsibilities without appropriate funding to deliver the relevant services.

Intergovernmental Agreement on Federal Financial Relations

South Australia was actively involved in the development of the Intergovernmental Agreement on Federal Financial Relations (IGA FFR) in 2008. The IGA FFR represented a significant reform of Commonwealth-state relations and has delivered many process improvements that have genuinely improved federal-financial relations.

The key principles of the IGA FFR remain appropriate and relevant, in particular:

- the distribution of the GST based on horizontal fiscal equalisation principles;
- clear roles and responsibilities;
- a strong framework of accountability;
- the focus on outcomes; and
- simplified intergovernmental fiscal transfers (including Treasury-to-Treasury payment arrangements).

South Australia supports the retention of these principles, which provide a firm basis for collaborative policy development, decision-making about reforms in service delivery and efficient governance.

There are some operational aspects of the IGA FFR and federal-financial relations more broadly, that could be improved. Comments on some of the more significant of these issues are set out below.

Increased Service Levels via National Partnerships

Expiring National Partnerships have created a high degree of funding uncertainty for states and territories in circumstances where service levels have increased as

a result of the National Partnership and there is an expectation in the community that they will continue.

National Partnerships should not be used for increases in service levels unless they are specifically designed to be short-term interventions to create local skills and/or capacity that offer a level of ongoing sustainability. Service level increases should be supported through specific-purpose payments or similar, with National Partnerships generally reserved for temporary one-off funding arrangements. This reflects the original intention for National Partnerships.

Expiring National Partnerships

Aside from the importance of the appropriate use of National Partnerships as outlined above, the process for considering the future of expiring National Partnerships is an area which requires further attention. Currently, the Commonwealth Government is under no obligation to provide any advance notice of its future funding intentions at the expiry of an agreement.

For the last three years, the states and Territories have prepared a detailed annual submission to the Commonwealth recommending future treatments for expiring National Partnerships. The Commonwealth has not formally responded to these submissions and funding decisions by the Commonwealth have often been left until the release of its Budget.

This leaves states in the difficult position of not knowing whether programs can continue, especially in cases where service levels and community expectations have been raised. It also causes difficulty in employment arrangements for contract staff working on a program that is funded by a time-limited agreement.

State Government inefficiencies would be reduced if there is greater engagement and commitment from the Commonwealth on expiring agreements with advance notice of Commonwealth funding intentions. When National Partnerships raise service levels, policy discussions between the Commonwealth and states should be concluded ahead of state Budget processes.

Inefficiencies have also been introduced to both Commonwealth and state governments through the re-negotiation of short term agreements. For example, in 2012-13, rather than rolling over existing agreements for a limited period, the Commonwealth Government re-negotiated the National Partnership Agreement on Homelessness for one year and the National Partnership Agreement on Early Childhood Development for 18 months.

Proliferation of Agreements and Reporting Mechanisms

There is a significant administrative burden on government agencies, arising from the proliferation of intergovernmental agreements and reporting mechanisms.

While one of the intentions of the IGA FFR was to reduce the overall number of agreements and the associated red tape, the number of agreements has grown significantly over the years since the IGA FFR was agreed. As at June 2013 there were more than 130 active agreements, many of which are worth less than \$10 million annually. These agreements often require extensive negotiations.

In addition, the structure of funding agreements has often been at odds with the IGA FFR, requiring frequent and detailed reporting against outputs or, in some cases, inputs. This results in protracted negotiations and costly overheads.

South Australia recognises that public reporting which compares performance among states and territories is important in ensuring that the benefits of competitive federalism can be realised, particularly by identifying superior outcomes and model approaches in one jurisdiction that others might seek to emulate. However, in many cases the detailed and frequent reporting required under agreements gives rise to a significant administrative burden without benefit in terms of true accountability.

Further opportunities to streamline data collection across governments would be welcomed. We consider the ethos under the National Health Reform Agreement for collecting data once but using multiple times has been successful and should be considered more broadly.

South Australia notes, and is encouraged by, recent discussions with Commonwealth representatives which have indicated a willingness to address some of these concerns.

Co-payment Arrangements and User-charging

South Australia notes that the Commission has been asked to review and report on savings and appropriate price signals such as the use of co-payment arrangements.

South Australia considers that any Commonwealth decisions to improve its budget position should not be achieved by simply reducing direct benefits or increasing Commonwealth user charges or co-payments, without consideration of, and attention to, the wider ramifications. Such changes would directly impact on the cost of living for South Australians. It could also ultimately lead to more South Australians turning to both government and non-government organisation for assistance.

In recognition of the cost of living pressures faced by many households, ensuring that South Australia is *An Affordable Place to Live* is one of the South Australian Government's seven strategic priorities. As such, a number of initiatives have been implemented over recent years with a view to keeping South Australia an affordable place to live, work, do business and raise a family.

The Commonwealth contributes significantly in assisting South Australians address cost of living pressures through a wide range of support mechanisms and initiatives, such as the Commonwealth Rental Assistance payments, the Pharmaceutical Benefits Scheme, and Medicare.

Social Housing and Homelessness Funding

The long term viability of the social housing system is a critical issue, which South Australia encourages the Commission to give due consideration.

Increases in operational and maintenance costs, reduction in net rental revenue, and increased demand for services are straining the system. Furthermore, non-housing services are also increasingly provided by public housing authorities to support vulnerable tenants.

The existing funding arrangements for social housing, facilitated through grants, rental subsidies (i.e. Commonwealth Rental Assistance - CRA) and rental revenue are not sustainable in the context of the growing community need for affordable housing.

This is critical in the context of the findings of the Housing Supply and Affordability Reform Report, prepared in response to a request from COAG.⁴ The Report highlighted challenges for lower-income households, with an increasing number having difficulty meeting their housing costs. In the absence of sufficient growth in the supply of affordable housing, increased homelessness is a likely outcome, as already reflected in increases in homelessness at the last Census (105,237 people classified as homeless on Census night in 2011, up from 89,728 in 2006).⁵

Reform to housing funding must be driven by a rational structural framework designed to meet outcomes and redress the structural inequalities and inefficiencies of the current model, including the role of CRA regardless of which sector owns the housing (consistent with the Henry Review recommendations). The framework could also be used to clarify roles and responsibilities between different levels of government, and potentially with other partners in the private and not-for-profit sector.

Housing supply alone will not adequately address the challenges facing people who are homeless. Ongoing and specialist support is required, including crisis support and longer-term services to help people both achieve and sustain housing.

The Commonwealth has an important role in funding and supporting social housing and homelessness services and South Australia welcomes the opportunity to work collaboratively to ensure long-term viability is achieved. South Australia would welcome the opportunity to explore ways to maximise, in a socially responsible manner, private sector involvement to increase social housing provision.

Infrastructure Funding

Privatisation

South Australia notes that the Commission's terms of reference provide for the consideration of the potential privatisation of Commonwealth assets. South Australia also notes the linkage to the recently announced Productivity Commission Inquiry into infrastructure costs.

While the terms of reference of the National Commission of Audit do not refer to state-owned assets, we note recent media which has reported the Commonwealth Government's interest in mechanisms to incentivise states to sell more assets to help fund infrastructure spending.

Infrastructure Australia also noted in its 2012 report titled "*Part of the answer to removing the infrastructure deficit*" that

there is considerable scope to fund critically required new infrastructure in Australia by transferring publicly owned infrastructure assets to the private sector.....Many assets in the energy, ports, airports and freight rail sectors

⁴ HSAR Working Party, 2012, Housing Supply and Affordability Reform Report
<http://www.coag.gov.au/sites/default/files/Final%20Report%20-%20Housing%20Supply%20and%20Affordability%20Reform.pdf>

⁵ ABS Catalogue 2049.0 - Census of Population and Housing: Estimating homelessness, 2011
<http://abs.gov.au/AUSSTATS/abs@.nsf/Latestproducts/2049.0Main%20Features22011?opendocument&tabname=Summary&prodno=2049.0&issue=2011&num=&view=>

could be transferred relatively quickly. Some other sectors require structural and regulatory change before this would be recommended. (p 5)

In that context, we draw to the Commission's attention that the South Australian Government has ruled out further privatisation of any significant government assets. The South Australian Government notes that our formerly state-owned electricity and ports utilities were already privatised under a previous government.

South Australia is concerned that states that have already transferred publicly owned assets to the private sector could be disadvantaged for future infrastructure provision if the Commonwealth Government provides incentives, or co-funds infrastructure, for those states that have not yet privatised assets in the energy, ports, airports and freight rail sectors but do so in the future.

Productive Transport Infrastructure

As our cities grow, our populations demand improved transport infrastructure. In many cases the most appropriate solutions involve public transport, either road-based (buses) or rail (heavy or light rail). The size of many important public transport projects makes it difficult for state governments to fund these solely from their own revenue streams. It is important that state governments can partner with the Commonwealth Government in an appropriate mix of road and rail projects in our cities.

The Commonwealth Government should play an active role in assisting the funding of critical infrastructure that contributes to productivity across both road and rail.

An essential part of delivering quality transport infrastructure is long-term planning and stability in investment by both Commonwealth and state governments. Recent instances of projects which were committed under the previous Commonwealth Government which have seen funding withdrawn under the new Government - in some cases where projects have already commenced - undermine the certainty which is required to deliver large infrastructure projects. These reversals have no place in a functioning federal system of government.

Areas of Disproportionate Impact

In the event that the Commission gives consideration to make recommendations about potential geographical consolidation, re-location or reduction of existing Commonwealth functions and activities as part of its deliberations, South Australia encourages the Commission to consider also the potential economic impacts at a local and state level and to ensure these are not disproportionate in their effect.

November 2013