

2

The Framework

Introduction

2.1 This chapter will provide details of the Intergovernmental Agreement on Federal Financial Relations (IGA FFR) before discussing responses to the overall reforms to federal financial relations. The significance of the reforms are considered in the context of the changing dynamics of financial relations between the Commonwealth and the states and territories. The benefits of the IGA FFR are identified before looking at specific issues with national funding agreements. Finally the chapter examines some of the suggestions the Committee has received to improve the existing framework.

The Intergovernmental Agreement on Federal Financial Relations

2.2 The overall objective of the IGA FFR is the 'improvement of the well-being of all Australians'.¹ This is to be achieved through:

- collaborative working arrangements, including clearly defined roles and responsibilities and fair and sustainable financial arrangements, to facilitate a focus by the Parties on long term policy development and enhanced government service delivery;
- enhanced public accountability through simpler, standardised and more transparent performance reporting by all

¹ Council of Australian Governments (COAG), *Intergovernmental Agreement on Federal Financial Relations* (2008), Council of Australian Governments website <http://www.coag.gov.au/intergov_agreements/federal_financial_relations/docs/IGA_federal_financial_relations.pdf> viewed 23 November 2011.

- jurisdictions, with a focus on the achievement of outcomes, efficient service delivery and timely public reporting;
- reduced administration and compliance overheads;
 - stronger incentives to implement economic and social reforms;
 - the on-going provision of Goods and Services Tax (GST) payments to the States and Territories equivalent to the revenue received from the GST; and
 - the equalisation of fiscal capacities between States and Territories.²
- 2.3 The IGA FFR consolidates and simplifies policy development and service delivery arrangements between the Commonwealth and the states and territories, providing the foundation for collaboration in these areas and facilitating the implementation of economic and social reforms ‘in areas of national importance’.³
- 2.4 The principles underpinning the IGA FFR include flexibility for the states and territories to deliver services, reducing Commonwealth prescription, and a commitment to cooperative working arrangements. Accountability to the Australian people for results and value for money are central to the new arrangements.⁴
- 2.5 The IGA FFR provides for three categories of funding transfer between the Commonwealth and the states and territories:
- general revenue assistance, including the on-going provision of GST payments, to be used by the States for any purpose;
 - National Specific Purpose Payments (SPPs) to be spent in the key service delivery sectors; and
 - National Partnership payments to support the delivery of specified outputs or projects, to facilitate reforms or to reward those jurisdictions that deliver on nationally significant reforms.⁵

2 COAG, *Intergovernmental Agreement on Federal Financial Relations* (2008), COAG website <http://www.coag.gov.au/intergov_agreements/federal_financial_relations/docs/IGA_federal_financial_relations.pdf> viewed 23 November 2011.

3 COAG, *Intergovernmental Agreement on Federal Financial Relations* (2008), COAG website <http://www.coag.gov.au/intergov_agreements/federal_financial_relations/docs/IGA_federal_financial_relations.pdf> viewed 23 November 2011.

4 COAG, *Intergovernmental Agreement on Federal Financial Relations* (2008), COAG website <http://www.coag.gov.au/intergov_agreements/federal_financial_relations/docs/IGA_federal_financial_relations.pdf> viewed 23 November 2011.

5 COAG, *Intergovernmental Agreement on Federal Financial Relations* (2008), COAG website <http://www.coag.gov.au/intergov_agreements/federal_financial_relations/docs/IGA_federal_financial_relations.pdf> viewed 23 November 2011.

- 2.6 National Specific Purpose Payments (SPPs) and National Partnership (NP) payments are facilitated under National Agreements (NA) and NPs respectively.

Goods and Services Tax and general revenue

- 2.7 The Commonwealth makes Goods and Services Tax (GST) payments to the states and territories equivalent to the revenue received from the GST. This revenue is untied and can be used by the states and territories for any purpose.⁶
- 2.8 The amount of GST payable to the states and territories is determined by the Commonwealth Treasurer. The Commonwealth Grants Commission makes recommendations to the Treasurer on the distribution of the GST in accordance with the principle of horizontal fiscal equalisation (HFE).⁷
- 2.9 The amount of revenue from the GST to the states and territories in a financial year is defined as:
- the sum of GST collections, voluntary and notional payments made by government bodies, and amounts withheld from any local government authority representing the amount of unpaid voluntary or notional GST;
reduced by:
 - the amounts paid or applied under a provision of a Commonwealth law that requires the Commonwealth to refund some or all of an amount of GST that has been paid.⁸
- 2.10 The Commonwealth makes payments of other general revenue assistance to the states and territories that can be used for any purpose, including:
- revenue sharing arrangements other than GST—for example, offshore petroleum royalty revenues;
 - compensation payments for Commonwealth policy decisions;
or
 - payments for national capital influences.⁹

6 COAG, *Intergovernmental Agreement on Federal Financial Relations* (2008), COAG website <http://www.coag.gov.au/intergov_agreements/federal_financial_relations/docs/IGA_federal_financial_relations.pdf> viewed 23 November 2011.

7 COAG, *Intergovernmental Agreement on Federal Financial Relations* (2008), COAG website <http://www.coag.gov.au/intergov_agreements/federal_financial_relations/docs/IGA_federal_financial_relations.pdf> viewed 23 November 2011.
HFE is discussed in more detail in Chapter 2.

8 COAG, *Intergovernmental Agreement on Federal Financial Relations* (2008), COAG website <http://www.coag.gov.au/intergov_agreements/federal_financial_relations/docs/IGA_federal_financial_relations.pdf> viewed 23 November 2011.

- 2.11 There is currently a review underway of the distribution of revenue from the GST to the states and territories. This review was commissioned by the Australian Government in March 2011. A Review Panel comprised of the Hon Nick Greiner AC, the Hon John Brumby and Mr Bruce Carter will prepare an interim report by February 2012 and a final report by September 2012.¹⁰

National Agreements

- 2.12 Under the new framework six NAs have been developed to cover key areas of national importance. These NAs are in the areas of health, education, skills and workforce development, disability services, affordable housing and Indigenous reform.
- 2.13 NAs define the objectives, outcomes, outputs and performance indicators and clarify the roles and responsibilities of the various levels of government to facilitate the delivery of services across a particular sector.¹¹
- 2.14 National SPPs are provided under NAs to states and territories and although the funds must be spent within a particular sector, states and territories have 'full budget flexibility to allocate funds within that sector'.¹²

National Partnership agreements and payments

- 2.15 NP agreements 'define the objectives, outputs and performance benchmarks related to the delivery of specified projects, to facilitate reforms or to reward those jurisdictions that deliver on national reforms or achieve service delivery improvements'.¹³
- 2.16 NP payments are a central element of the new framework. There are three types of NP payments:

9 COAG, *Intergovernmental Agreement on Federal Financial Relations* (2008), COAG website <http://www.coag.gov.au/intergov_agreements/federal_financial_relations/docs/IGA_federal_financial_relations.pdf> viewed 23 November 2011.

10 Commonwealth Grants Commission, <http://www.cgc.gov.au/gst_distribution_review> viewed 23 November 2011.

11 COAG, *Intergovernmental Agreement on Federal Financial Relations* (2008), COAG website <http://www.coag.gov.au/intergov_agreements/federal_financial_relations/docs/IGA_federal_financial_relations.pdf> viewed 23 November 2011.

12 COAG Reform Council (CRC), *Submission 11*, p. 3.

13 COAG, *Intergovernmental Agreement on Federal Financial Relations* (2008), COAG website <http://www.coag.gov.au/intergov_agreements/federal_financial_relations/docs/IGA_federal_financial_relations.pdf> viewed 23 November 2011.

1. project payments - which support the delivery of specified outputs or projects;
 2. facilitation payments - designed to drive reform in areas considered to be a national priority; or
 3. incentive payments - to reward those jurisdictions that deliver on nationally significant reforms.
- 2.17 Currently there are 51 NPs in key areas such as health, education, housing, Indigenous affairs, infrastructure, environment, and community services. NPs are also used to address other areas of national priority such as the national economy and local government and regional development.
- 2.18 Although evidence to the inquiry touched on national funding agreements under both NAs and NPs, the focus tended to be on funding arrangements under NPs.

Governance and accountability

Council of Australian Governments

- 2.19 The Council of Australian Governments (COAG) is the peak intergovernmental body in Australia. It is comprised of the Prime Minister, State Premiers, Territory Chief Ministers and the President of the Australian Local Government Association (ALGA).¹⁴
- 2.20 COAG was established in 1992 and is supported by a Secretariat located in the Department of the Prime Minister and Cabinet.¹⁵ Its role is to initiate, develop, endorse and monitor the 'implementation of policy reforms that are of national significance and which require cooperative action by Australian Governments'.¹⁶
- 2.21 COAG meets at the Prime Minister's discretion as needed and releases communiqués detailing the outcomes of each meeting.¹⁷

14 Council of Australian Governments (COAG), <<http://www.coag.gov.au/>> viewed 23 November 2011.

15 COAG, <http://www.coag.gov.au/about_coag/index.cfm> viewed 23 November 2011.

16 COAG, *Intergovernmental Agreement on Federal Financial Relations* (2008), see COAG website.

17 COAG, <http://www.coag.gov.au/about_coag/index.cfm> viewed 23 November 2011.

- 2.22 COAG negotiates and signs intergovernmental agreements after the various jurisdictions have committed to implement decisions reached by COAG.¹⁸ The IGA FFR was agreed to by COAG in November 2008 and came into effect on 1 January 2009.

Ministerial Council for Federal Financial Relations

- 2.23 The Ministerial Council for Federal Financial Relations has general oversight of the IGA FFR on behalf of the COAG. The Council is made up of the Treasurers of the Commonwealth, states and territories and is chaired by the Treasurer of the Commonwealth.

COAG Reform Council

- 2.24 The COAG Reform Council (CRC) is an independent non-statutory body established by COAG to drive its reform agenda. The CRC monitors, assesses and publicly reports on the performance of the Commonwealth and states and territories in achieving the outcomes and performance benchmarks specified in the six National Agreements. The CRC provides reports to COAG which:
- publish the performance data and provide a comparative analysis of the performance of governments in meeting the agreement's objectives, including highlighting relevant contextual differences between jurisdictions;
 - highlight examples of good practice and performance so that, over time, innovative reforms or methods of service delivery may be adopted by other jurisdictions (from second year of reporting); and
 - reflect the contribution of both levels of government to achieving performance benchmarks and to achieving continuous improvement against the outcomes, outputs and performance indicators (from second year of reporting).¹⁹

Productivity Commission

- 2.25 The Steering Committee for the Review of Government Service Provision, which is supported by a Secretariat within the Productivity

18 COAG, <http://www.coag.gov.au/intergov_agreements/index.cfm> viewed 23 November 2011.

19 COAG Reform Council, <<http://www.coagreformcouncil.gov.au/about.cfm>> viewed 23 November 2011.

Commission (PC), provides agreed performance information to the CRC to enable reporting on NAs.²⁰

2.26 Additionally, in March 2008, COAG requested that the PC report to COAG on the impact and benefits of the reform agenda every two to three years. The PC's role is to assess:

- the economic impacts and benefits of COAG reforms
- where practicable, whether Australia's reform potential is being achieved and the opportunities for improvement.

The focus of the Commission's reporting will be on the realised and prospective effects of COAG reforms. It will complement COAG Reform Council reporting on the implementation of reforms agreed to by COAG.²¹

2.27 The first report is to be provided to COAG by 31 December 2011.

Perspectives on the overall reforms

2.28 Throughout the inquiry the Committee heard that there was general support for the IGA FFR. However, while the underlying principles and intent of the framework are seen as positives there have been problems translating the theory into practice with regard to national funding agreements.

2.29 This section will examine the:

- significance of the reforms;
- changing dynamics of federal financial relations;
- benefits of the IGA FFR; and
- issues with national funding agreements.

The significance of the reforms

2.30 Throughout the inquiry the Committee heard that the IGA FFR has provided significant reform to the financial relations system between the

20 Productivity Commission (PC), 'Review of Government Service Provision', <<http://www.pc.gov.au/gsp/review>> viewed 23 November 2011.

21 PC, 'Impacts and Benefits of COAG Reforms', <<http://www.pc.gov.au/projects/study/coag-reporting>> viewed 23 November 2011.

Commonwealth and states and territories. The Tasmanian Government told the Committee that the new framework was ‘an important evolution in federal financial relations’ and ‘represented a major step forward in Commonwealth-state financial relations’.²²

- 2.31 Likewise, the New South Wales Government in their written submission to the inquiry, commented:

Overall, the changing dynamics of grants brought about by COAG in 2008, through the IGA FFR, are considered a positive step in Commonwealth-State relations due to the increased focus on outcomes and increased public accountability.²³

- 2.32 The Victorian Government called the reform a ‘significant watershed in Australian federalism’ explaining that the IGA FFR has:

...for the first time in Australia’s federal history—established an ongoing policy and administrative framework for intergovernmental transfers. Facilitating these transfers through a single piece of Commonwealth legislation is a dramatic improvement in Commonwealth-level parliamentary accountability. It also provides for a much more coherent and comprehensive approach to these transfers, particularly the outcomes-based policy and reform objectives of the IGA FFR.²⁴

- 2.33 This view was supported by other witnesses to the inquiry. The Commonwealth Auditor-General told the Committee that the IGA FFR ‘represents a significant evolution in Commonwealth, state and territory arrangements’.²⁵ Academic witnesses also confirmed the importance of the framework particularly as it places Commonwealth-state financial relations within a comprehensive legislative framework.²⁶ The Victorian Government’s submission noted that a recent Organisation for Economic Co-operation and Development (OECD) report recognised the

22 Tasmanian Government, *Submission 8*, p. 8.

23 NSW Government, Treasurer, *Submission 10*, p. 3.

24 Victorian Government, *Submission 6*, pp. 7 and 11.

25 Mr Ian McPhee, Auditor-General, Australian National Audit Office (ANAO), *Committee Hansard*, Canberra, 24 June 2011, p. 2.

26 Professor Alexander Jonathan Brown, Professor of Public Law, Griffith University, *Committee Hansard*, Brisbane, 19 July 2011, p. 17; See also Associate Professor Anne Twomey, *Committee Hansard*, Sydney, 19 August 2011, p. 10.

contribution that the IGA FFR is making to Australia's economic performance and social welfare.²⁷

Changing dynamics

- 2.34 Evidence to the inquiry suggests that the IGA FFR addresses ongoing historical issues within Australia's underlying federal structure. The Australian Constitution, which came into force on 1 January 1901, divided power between the newly created Commonwealth Government and the state governments. In terms of fiscal responsibility, this division of power allowed the Commonwealth to collect excise and customs duties, retain a limited amount of these funds for the Commonwealth's own requirements and return the balance to the states.
- 2.35 However, over time the initial arrangements have become increasingly complex, producing a growing discrepancy between revenue collected and expenditure.²⁸ The Commonwealth collects the bulk of the revenue and the states and territories are responsible for most of the expenditure. The Productivity Commission reports that, in 2008–09, the Commonwealth raised 'two-thirds of all government revenue, but only undertook half of all government expenditure'.²⁹ This difference is called vertical fiscal imbalance (VFI).
- 2.36 The states and territories acknowledge that VFI necessitates the transfer of revenue between the Commonwealth and states and territories.³⁰ It is the resulting perceived distortion of the original intent of the Australian federal system that the states and territories take issue with. The Victorian Government submitted that:

[S]ince Federation, the potential for the Commonwealth's fiscal dominance to overwhelm the constitutional division of powers and the policy and budget autonomy of States and Territories has been widely recognised.³¹

27 Victorian Government, *Submission 6*, p. 8. See Organisation of Economic Co-operation and Development (OECD), *OECD Reviews of Regulatory Reform: Australia: towards a seamless national economy* 2010, pp. 3 and 146–147.

28 For a history of the development of vertical fiscal imbalance in Australia see Denis James, 'Federal-State Financial Relations: The Deakin Prophecy', *Research Paper*, no. 17, 1999–2001, Department of the Parliamentary Library.

29 PC, 'Impacts and Benefits of COAG Reforms: Reporting Framework', *Productivity Commission Research Report*, 2010, p. 19.

30 Tasmanian Government, *Submission 8*, pp. 3–4; Victorian Government, *Submission 6*, p. 6.

31 Victorian Government, *Submission 6*, p. 7.

- 2.37 According to the Victorian Government, the IGA FFR provides a solution because it acknowledges and facilitates the role of the states and territories in the federal system:

The IGA FFR does not simply 'allow' States and Territories to determine their own priorities: more fundamentally, it recognises their primary (and constitutional) responsibility for many of the service sectors covered by relevant National Agreements and associated Special Purpose Payments.³²

- 2.38 The CRC explained that the IGA FFR has addressed this issue by removing Commonwealth prescription and providing flexibility to the states and territories by moving to an outcome focused reporting structure.³³ In order to attain this flexibility, the IGA FFR emphasises the need to clearly define the roles and responsibilities of the various levels of government.³⁴

- 2.39 However, the Committee heard that to date the clarification of roles and responsibilities in both NAs and NPs 'has been inadequate'.³⁵ The NSW Government told the Committee that, despite the original intention of the IGA FFR, roles and responsibilities are defined broadly and:

Across the NAs, a total of 63 responsibilities are defined as "shared", with just 45 listed as Commonwealth and 36 listed as State responsibilities.³⁶

- 2.40 Identifying the roles and responsibilities of the different levels of government has been a perennial problem for Commonwealth-state financial relations. Professor Brown from Griffith University drew the Committee's attention to the 'historical confusion' inherent in the Australian system.³⁷ He likened the problem to the difference between a layered cake and a marbled cake:

It is the old idea—which to some extent is an idea which informed the design of the Australian Constitution—that you can separate out the roles and responsibilities of different levels of government quite clearly, like a layered cake, but in reality what you get is all

32 Victorian Government, *Submission 6*, p. 10.

33 CRC, *Submission 11*, p. 5.

34 COAG, *Intergovernmental Agreement on Federal Financial Relations* (2008), COAG website <http://www.coag.gov.au/intergov_agreements/federal_financial_relations/docs/IGA_federal_financial_relations.pdf> viewed 23 November 2011.

35 NSW Government, Treasury, *Submission 10*, p. 6.

36 NSW Government, Treasury, *Submission 10*, p. 6.

37 Professor Brown, Griffith University, *Committee Hansard*, Brisbane, 19 July 2011, p. 17.

levels of government getting involved in all sorts of things, even if one level of government has different roles or different leadership roles, and you end up with a marbled cake rather than a layered cake.³⁸

- 2.41 Professor Brown went on to explain that the lack of clear roles and responsibilities is a symptom of the ‘inescapable’ tension between the centralised and decentralised power of the Australian federation and ongoing efforts to reconcile the two.³⁹ He added that the ambiguous position of local government within the federation and subsequently within the Commonwealth-state financial relations framework caused further difficulties.⁴⁰

Benefits of the new framework

- 2.42 The Committee heard that the underlying principles and intent of the IGA FFR provided a solid foundation to improve financial relations between the Commonwealth and the states and territories. Previous financial arrangements between the Commonwealth and the states and territories were dominated by Specific Purpose Payments (SPP), which are tied grants with an inputs focus rather than an outcomes focus. An inputs focus enabled the Commonwealth to exert control through imposing conditions on states and territories: it focused attention on *how* objectives were achieved. In contrast, the IGA FFR facilitates an outcomes focus, primarily concerned with *what* is being achieved.
- 2.43 The shift from an inputs focus to an outcomes focus was seen as a positive step by witnesses. In both oral and written evidence to the Committee, witnesses identified features within the IGA FFR that should improve the funding process:
- a less prescriptive role for the Commonwealth;
 - increased flexibility for the states and territories; and
 - the clarification of the roles and responsibilities of the various levels of government.
- 2.44 All of these benefits are interlinked and cannot be separated. The less prescriptive role for the Commonwealth in service delivery has allowed

38 Professor Brown, Griffith University, *Committee Hansard*, Brisbane, 19 July 2011, p. 17.

39 Professor Brown, Griffith University, *Committee Hansard*, Brisbane, 19 July 2011, p. 20.

40 Professor Brown, Griffith University, *Committee Hansard*, Brisbane, 19 July 2011, p. 18.

greater flexibility to the states and territories. To enable this change the focus has shifted from measuring inputs and outputs to measuring outcomes. In turn, this shift has required clarification of the roles and responsibilities of the various levels of government.

- 2.45 Referring to the significant change in the dynamic of Commonwealth-state relations under the IGA FFR, the Victorian Government explained the benefits of the new arrangements:

...an outcomes based framework that provides states and territories with flexibility delivers better value for money than where funding conditions are tightly prescribed by the Commonwealth.⁴¹

- 2.46 The Victorian Government identified two reasons why better value for money could be achieved through this increased flexibility:

Firstly, the state and territory governments can tailor policies to their local conditions, which improves the responsiveness, efficiency and effectiveness of policy. Secondly, the flexibility allows states to innovate and find new and better ways of delivering services. This kind of innovation cannot happen when inputs are tightly prescribed.⁴²

- 2.47 This point was reiterated by several witnesses. The Auditor-General told the Committee that states and territories were in the best position to meet the needs of their population, having the 'on-the-ground experience' that enables them to best 'deliver services in their own jurisdictions'.⁴³ He indicated that the move to an outcomes focus and flexibility is part of a wider shift in public administration:

In many ways the new approach reflects national and international developments in public sector management. By consolidating payments, giving greater emphasis to expected outcomes and looking to enhance accountability for performance, it is expected that the quality and effectiveness of government services will be improved.⁴⁴

41 Mr Donald Speagle, Deputy Secretary, Federalism, Citizenship and Climate Change Group, Department of Premier and Cabinet, Victoria, *Committee Hansard*, Canberra, 16 September 2011, p. 13.

42 Mr Speagle, Department of Premier and Cabinet, Victoria, *Committee Hansard*, Canberra, 16 September 2011, p. 13.

43 Mr McPhee, ANAO, *Committee Hansard*, Canberra, 24 June 2011, p. 2.

44 Mr McPhee, ANAO, *Committee Hansard*, Canberra, 24 June 2011, p. 2.

Issues with national funding agreements

2.48 While there was overall support for the IGA FFR witnesses also identified a number of problems with national funding agreements, including:

- proliferation of agreements;
- implementation of agreements; and
- reporting requirements.

These issues are outlined briefly in the following paragraphs but will be discussed in more detail in Chapters 3 and 4.

Proliferation of agreements

2.49 The IGA FFR reduced the existing 92 specific purpose payments (SPPs) to six NAs. The Committee heard that despite the reduction in SPPs and contrary to the original intention of the IGA FFR, NPs and the more proscriptive payments they provide, have grown to 51.⁴⁵ Both the Tasmanian Government and the NSW Government expressed disappointment at the subsequent proliferation of funding agreements.⁴⁶

2.50 Specifically the NSW Government identified that the new arrangements no longer cater for small, less complex projects without developing a full NP. Previously these types of fund transfers could be completed with a 'simple exchange of letters' between relevant parties.⁴⁷ The NSW Government maintained that the need for a NP in such circumstances contributes to the proliferation of such agreements.

2.51 Associate Professor Anne Twomey told the Committee that the proliferation of funding agreements under NPs had seriously jeopardised the new reforms and left the way open for the problems with the previous system to re-emerge.⁴⁸ In their written submission to the inquiry, the Business Council of Australia (BCA) summarised the concerns over this proliferation expressed by many witnesses, singling out the return of Commonwealth control of the system and the consequent loss of state and territory flexibility.⁴⁹

45 Business Council of Australia (BCA), *Submission 9*, p. 1.

46 Tasmanian Government, *Submission 8*, p. 9; NSW Government, Treasurer, *Submission 10*, p. 7.

47 NSW Government, Treasury, *Submission 10*, p. 7.

48 Association Professor Twomey, *Committee Hansard*, Sydney, 19 August 2011, p. 10.

49 BCA, *Submission 9*, p. 1.

Implementation of agreements

2.52 The Committee was told that the reassertion of Commonwealth control over funding was evident in the Implementation Plans (IPs) developed for funding agreements. Contradictory to the principles of the IGA FFR, witnesses pointed out that the IPs were often prescriptive and focused on inputs rather than outcomes.⁵⁰ The NSW Government identified the increased administrative burden created by the IPs.⁵¹ The Tasmanian Government expressed concern over the ‘onerous reporting requirements’ entailed in the IPs, a feature confirmed by the NSW Government.⁵²

Reporting requirements

2.53 With regard to reporting requirements, the Committee heard evidence that there were two areas of concern: the reporting burden and the quality and timeliness of data. The Northern Territory Legislature referred to ‘irrelevant reporting mechanisms’⁵³ and the NSW Government detailed the difficulties faced by states and territories in meeting the reporting demands for NPs:

Most NPs (or associated Implementation Plans) require line agencies to furnish milestone and/or progress reports to the relevant Commonwealth line agency. These may or may not be linked to the release of milestone/progress payments to the States. The frequency of reporting varies among agreements from annual to monthly. There are also ad hoc requests by the Commonwealth which can be difficult to accommodate, especially where the information sought is detailed, not otherwise collated in the requested manner and/or is sought at short notice. In some areas, there are also separate reporting requirements on related issues to different bodies.⁵⁴

2.54 The quality and timeliness of data required to fulfil reporting requirements was a recurring theme throughout the inquiry. There were overarching issues with the limitations of the data available, not only to the states and territories but to the CRC and the PC in their broader reporting roles. Once again, the NSW Government’s written submission summed up the difficulties, describing the problems, including:

50 NSW Government, Treasurer, *Submission 10*, p. 5; Tasmanian Government, *Submission 8*, pp. 8–9.

51 NSW Government, Treasurer, *Submission 10*, p. 5.

52 Tasmanian Government, *Submission 8*, p. 9; NSW Government, Treasurer, *Submission 10*, p. 5.

53 Legislative Assembly of the Northern Territory, *Submission 17*, p. [1].

54 NSW Government, Treasurer, *Submission 10*, p. 8.

...data that are poor quality, unreliable or infrequent; data that are not comparable over time or between jurisdictions; and data that cannot be sufficiently disaggregated by Indigenous or socio-economic status where appropriate.⁵⁵

Goods and Services Tax revenue

2.55 The IGA FFR also covers the provision of GST revenue to the states and territories. Although the distribution of the GST revenue was not the focus of this inquiry, the Committee heard evidence of a degree of dissatisfaction with the GST arrangements. GST revenue is distributed according to the principles of HFE.⁵⁶ The Commonwealth Grants Commission (CGC), which recommends levels of GST revenue paid to the states and territories, defines HFE as:

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.⁵⁷

2.56 In general, smaller states and territories support the current arrangements for the GST redistribution and larger states and territories express some reservations about the system. The Tasmanian Government 'strongly supports the existing principle and practice of HFE on the basis that it is fair and equitable for all states'.⁵⁸ Whereas the NSW Government maintains that:

The consequences of Australia's HFE are: large cross-subsidies paid by the larger to the smaller States; a complex and data intensive method of equalisation yet one which still relies on large measures of judgement; and a method of equalisation which

55 NSW Government, Treasurer, *Submission 10*, p. 6.

56 COAG, *Intergovernmental Agreement on Federal Financial Relations* (2008), COAG website <http://www.coag.gov.au/intergov_agreements/federal_financial_relations/docs/IGA_federal_financial_relations.pdf> viewed 23 November 2011.

57 Commonwealth Grants Commission (CGC), 'About Fiscal Equalisation', <http://www.cgc.gov.au/fiscal_equalisation/navigation/2> reviewed 23 November 2011.

58 Tasmanian Government, *Submission 8*, p. 5.

potentially has significant adverse impacts on resource allocation in Australia.⁵⁹

- 2.57 With regard to this inquiry, the Committee was particularly concerned to hear suggestions that the current distribution process may provide a disincentive to productivity and reward poor administration. The NSW Government submitted that:

Above average revenues may be partially equalised away and this can reduce the incentive to improve efficiency. There is a disincentive against expanding the revenue base, either through increasing activity in the State or through undertaking additional expenditure to fund economic development, as some of the increased revenue capacity will be equalised away through lower GST revenue.⁶⁰

- 2.58 The CGC was asked if GST distribution did affect efficiency and quality of administration. The CGC denied that this was the case and maintained, that on the contrary, '[m]icro service level efficiency is absolutely rewarded'.⁶¹

- 2.59 The Committee also sought clarification regarding the affect that payments under NAs and NPs have on the distribution of GST. The CGC told the Committee that the majority of such payments did affect GST distribution but that each payment was assessed individually before a decision was made:

You cannot say all of them will [affect the GST distribution], because the Treasurer might tell us that one should not and the commission might itself decide that a particular payment should not. The presumption is that, because there is money available to the states to fund services, it will affect the GST distribution. The bulk of them do.⁶²

Changes to improve the framework

- 2.60 The Committee received a number of suggestions to improve the perceived inadequacies of the IGA FFR. The Victorian Government
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59 NSW Government, Treasurer, *Submission 10*, p. 4.

60 NSW Government, Treasurer, *Submission 10*, p. 4.

61 Mr John Spasojevic, Secretary, Commonwealth Grants Commission (CGC), *Committee Hansard*, Canberra, 16 September 2011, p. 9.

62 Mr Spasojevic, CGC, *Committee Hansard*, Canberra, 16 September 2011, p. 11.

re-iterated the importance of the framework and suggested that 'a key national priority should be to ensure that these reforms are properly implemented *prior* to considering other far-ranging reform options'.⁶³

2.61 The Australian National Audit Office (ANAO) suggested that another area needing attention was the interaction between the IGA FFR and the recently enhanced framework for the administration of grant programs.⁶⁴ The ANAO explained that under the legislation the Commonwealth Grant Guidelines (CGGs) do not apply to national funding agreements.⁶⁵ The ANAO is of the opinion that the exemption of these agreements from the CGGs could lead to a number of inconsistencies, including:

- ...complex administrative arrangements whereby any grants awarded to state and territory governments may be subject to governance arrangements that are different to those applying to grants awarded, under the same program, to other types of applicants;
- ...a funding agreement might be signed with an intermediary in respect to a project actually being delivered by a state government, rather than a National Partnership Agreement being negotiated with the state; and
- ...the time required to negotiate a National Partnership Agreement with the various states and territories, rather than signing a standardised funding agreement, can present challenges to the achievement of intended outcomes.⁶⁶

2.62 The ANAO suggests that the interaction between the grants under the two new frameworks should be re-examined in order to remove these inconsistencies and improve governance arrangements.⁶⁷

Committee comment

2.63 The Committee is pleased with the strength of the consensus that the underlying principles and intent of the IGA FFR are seen as addressing the previous problems underpinning federal financial relations. The Committee notes the general recognition, including international recognition, of the significance of the IGA FFR reforms. The Committee

63 Victorian Government, *Submission 6*, p. 9.

64 ANAO, *Submission 1*, p. 4.

65 ANAO, *Submission 1*, p. 4.

66 ANAO, *Submission 1*, p. 4.

67 ANAO, *Submission 1*, p. 4.

agrees that the reforms were a substantial milestone in federal financial relations, one which is based on sound principles and provides a robust framework for the future.

- 2.64 However, the Committee is aware that the potential benefits of this framework will only be fully realised if the principles and intention of the IGA FFR are actually followed in practice. For example, the Committee is particularly concerned with the proliferation of NPs and the potential for this trend to distract from the reform process. A broader discussion of the disconnect between the underlying intention of the IGA FFR and its current operation is explored further in Chapter 3.
- 2.65 The Committee recognises the place of NPs within the overall IGA FFR. However, the Committee supports a more strategic use of NPs to drive reform, particularly as the principles of the IGA FFR promote a move away from tied payments. The Committee believes that where NPs are operationally justified reward payments should only be made when performance benchmarks have been clearly achieved. Payments should be a genuine reward for effort, not a default. The Committee recognises that there are times where reward payments have not been made but wants to emphasise that payments must be earned not expected.
- 2.66 The Committee is particularly concerned with the continuing blurring of the roles and responsibilities between the levels of government. The Committee notes that the CRC has highlighted this issue in its recent report and understands that at times 'shared responsibilities are unavoidable'.⁶⁸ While the Committee recognises that governments will need to collaborate in certain areas, the Committee shares the CRC's concern that 'shared responsibilities lead to confusion about which level of government is accountable' in some cases.⁶⁹ The Committee believes action must be taken to immediately reduce, where appropriate, the number of responsibilities defined as 'shared' in NAs and clarify existing ambiguities to promote accountability.

68 CRC, *COAG reform agenda: Report on progress 2011: Report of the Council of Australian Governments*, COAG Reform Council, 2011, p. 22.

69 CRC, *COAG reform agenda: Report on progress 2011: Report of the Council of Australian Governments*, COAG Reform Council, 2011, p. 22.

- 2.67 The Committee acknowledges that some states hold concerns expressed over the redistribution of the GST, but notes that there is currently a review underway which may address the issues raised.⁷⁰
- 2.68 The Committee shares the concerns of the Auditor-General regarding the interaction between the IGA FFR and the enhanced framework for the administration of grant programs. The Committee recommends that the Department of Finance and Deregulation re-examine the interaction of the two frameworks and take steps to address any inconsistencies.

Recommendation 1

- 2.69 The Committee recommends that the Department of Finance and Deregulation examine the interaction between the new grants framework and grant payments delivered under the Intergovernmental Agreement on Federal Financial Relations. The report should propose options to remove inconsistencies and improve governance arrangements for all grants provided to states and territories.**

A copy of the report should be provided to the Joint Committee of Public Accounts and Audit, with the Government's Response to this recommendation - and both should be made publicly available.

⁷⁰ This review was commissioned by the Australian Government in March 2011. A Review Panel made up of The Hon Nick Greiner AC, The Hon John Brumby and Mr Bruce Carter will prepare an interim report by February 2012 and a final report by September 2012. (CGC, <http://www.cgc.gov.au/gst_distribution_review> reviewed 23 November 2011.)

