Chapter 3

The Natural Disaster Relief and Recovery Arrangements and the states' GST share

3.1 The terms of reference for this inquiry direct the committee to examine the appropriateness of fiscal arrangements for natural disaster reconstruction efforts. The remaining chapters of the report consider these issues in the context of:

- the Commonwealth's policy of disaster relief assistance to the states and proposals to tighten eligibility for this assistance;
- the Commonwealth Grants Commission's adjustment of GST shares based on the states' net expenses on disaster relief; and
- claims that Queensland's failure to reinsure its assets represents a 'moral hazard' given the generosity of the Commonwealth's disaster relief payments.

The Natural Disaster Relief and Recovery Arrangements (NDRRA)

3.2 This chapter provides an overview of the Commonwealth Government's arrangements to subsidise states' and territories' recovery costs through the Natural Disaster Relief and Recovery Arrangements (NDRRA). The NDRRA is a program of Commonwealth government financial assistance to the states in the form of partial reimbursement of the states' actual expenditure on disaster relief, recovery payments and infrastructure restoration. As the introduction to the 2011 NDRRA Determination notes:

> Natural disasters often result in large-scale expenditure by state governments in the form of disaster relief and recovery payments and infrastructure restoration. To assist with this burden, the Commonwealth has made arrangements to provide financial assistance to the states in some circumstances. Usually the assistance is in the form of partial reimbursement of actual expenditure.
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> The Commonwealth's assistance is intended to be directed to state measures that complement other strategies in relation to natural disasters, such as insurance and disaster mitigation planning and implementation.[1]

3.3 Paragraph 4.1 of the 2011 NDRRA Determination states:

> In carrying out, or contributing to the cost of, eligible measures, the state must act consistently with the general policy that:

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1 Attorney-General's Department, *2011 NDRRA Determination*, http://www.ema.gov.au/www/emaweb/rwpattach.nsf/VAP/(689F2CCBD6DC263C912FB74B15BE8285)~NDRRA+-+Determination+2011+-+Version+1+(PDF)+-+Web+update.pdf/$file/NDRRA+-+Determination+2011+-+Version+1+(PDF)+-+Web+update.pdf (accessed 20 June 2011).

> a) its assistance is not to supplant, or operate as a disincentive for, self-help by way of either insurance or appropriate strategies of disaster mitigation.[2]

3.4 The Attorney-General's Department administers the NDRRA policy to ensure that the states' arrangements are adequate. Following these checks, Treasury transfers the money to the states.[3] As Treasury explained to the committee:

> The way the system normally works is that the states and territories do recovery and relief activities. They then have some administrative processes they go through which include their state auditors, as I understand it, to certify that the things that they have paid for are eligible under the NDRRA, and they then send in information to the Attorney-General's Department that says, 'Here's what we've spent; here's what we've spent it on,' and we then say, 'Above certain thresholds we pay half then three-quarters of those amounts and pass it on to you or you the states.'[4]

3.5 The severity of recent natural disasters in Australia has raised questions about the purpose and the incentives within the NDRRA. Treasury noted that while reliance on NDRRA payments for this and future years will be at historically high levels, the principle of the NDRRA remains that the assistance is there to supplement the states' expenditures:

> In the last 15 years there has only really been one year where there has been more than $200 million paid out under the NDRRA, and it is going to be many times that over this year and probably the next few years.[5]
>
> ...
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> We think it [the NDRRA] is there as a mechanism to help relieve significant financial burdens placed on states, it is not there to relieve all financial burdens and it is not there to replace other sensible things that should be done to either minimise damage in the first place or meet costs after things have been damaged.[6]

3.6 Some of the recent public debate has queried whether the NDRRA payments by the Commonwealth has led some states to underinsure their assets. Treasury responded:

> That is one of the issues that is being considered by the disaster insurance review, I think, under that, and I suspect we will have a look at that same question as the states put in their assessments under the new NDRRA requirements. I don't think we have enough information, or have had

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2 Attorney-General's Department, *2011 NDRRA Determination*, p. 7.

3 Mr Damien White, Treasury, *Proof Committee Hansard*, 13 May 2011, p. 3.

4 Mr Damien White, Treasury, *Proof Committee Hansard*, 13 May 2011, p. 10.

5 Mr Damien White, Treasury, *Proof Committee Hansard*, 13 May 2011, p. 7.

6 Mr Damien White, Treasury, *Proof Committee Hansard*, 13 May 2011, p. 7.

enough information in Treasury to date to make an assessment of whether we would believe that to be true.[7]

How is the level of state government assistance calculated?

3.7 The 2011 NRRDA Determination sets out how the level of state government assistance is to be determined. The level of federal assistance in a financial year is based on the state's actual expenditure (or what is expected to be spent within six months) on eligible disasters. This expenditure includes non monetary assistance.

Thresholds

3.8 If Commonwealth assistance is payable on this basis, the rate of assistance is worked out on the basis of the state's two thresholds for that financial year and the amount of its expenditure in that year on all eligible disasters.[8] The states pick up the full amount of the cost up to a first threshold. Above that threshold and up to a second threshold, the cost is shared, and above the second threshold, the cost is again shared, but the proportion that the Commonwealth picks up is greater than between thresholds one and two. The first threshold is .225 per cent of the state's total general government sector revenue and grants in the financial year two years prior to the relevant financial year. The second threshold is equal to the state's first threshold multiplied by 1.75.

Table 3.1: NDRRA State and Territory Expenditure Thresholds

	State revenue	*.225	1st threshold	*1.75	2nd threshold
NSW	$53,206,000,000		$119,713,500		$209,498,625
Vic	$39,283,000,000		$88,386,750		$154,676,813
Qld	$37,008,000,000		$83,268,000		$145,719,000
WA	$19,399,000,000		$43,647,750		$76,383,563
SA	$13,531,000,000		$30,444,750		$53,278,313
Tas	$4,286,000,000		$9,643,500		$16,876,125
NT	$4,187,000,000		$9,420,750		$16,486,313
ACT	$3,420,000,000		$7,695,000		$13,466,250

Source: Natural Disaster Relief and Recovery Arrangements, 'State and Territory Expenditure Thresholds', 2010–11 http://www.ag.gov.au/www/emaweb/rwpattach.nsf/VAP/(9A5D88DBA63D32A661E63698597393 56)~EMA+-+RR+-+NDRRA+-+2010-11+NDRRA+State++Territory+Threshold.PDF/$file/EMA+-+RR+-+NDRRA+-+2010-11+NDRRA+State++Territory+Threshold.PDF

Categories of expenditure

3.9 There are three categories of expenditure: A, B and C. Category A is a form of emergency assistance that is given to individuals to alleviate their personal hardship or distress arising as a direct result of a natural disaster. Category B is the restoration

7 Mr Damien White, Treasury, *Proof Committee Hansard*, 13 May 2011, p. 9.

8 Attorney-General's Department, *2011 NDRRA Determination*, p. 12.

or replacement of certain essential public assets damaged as a direct result of a natural disaster. Category C is a community recovery package designed to support a holistic approach to the recovery of regions, communities or sectors severely affected by a natural disaster. It comprises a community recovery fund and recovery grants for primary producers and small businesses.[9]

How the system works in practice

3.10 Based on the 2011 NDRRA Determination (see Table 3.1), the thresholds for Queensland are $83.3 million and $145.7 million. Where the Queensland Government's expenditure has not exceeded the first threshold of $83.3 million, the Commonwealth reimburses Queensland on a dollar for dollar basis. However, this only applies to categories A and C measures, not B.

3.11 Where the Queensland Government's expenditure has exceeded the first threshold of $83.3 million but is less than the second threshold of $145.7 million, the Commonwealth reimburses Queensland again on a dollar for dollar basis for all three categories.

3.12 Where the Queensland Government's expenditure exceeds the second threshold of $145.7 million, the Commonwealth picks up 75 per cent of the tab for all three categories.

Table 3.2: Payment conditions for the categories of expenditure

	Categories
Up to 1st threshold	AC
Between 1st and 2nd threshold	ABC
Over 2nd threshold	ABC

Source: Based on 2011 NDRRA Determination, p. 4.

3.13 In the case of the Queensland floods, given the extent of damage, the Commonwealth will be funding 75 per cent of almost all of the damage to essential infrastructure. As the House committee report noted: 'In effect, the Commonwealth has become the insurer for state governments for extreme natural disasters'.[10]

States' natural disaster expenditure and their GST share

3.14 The Commonwealth Grants Commission (CGC) assumes for simplicity that because states and territories operate under a common administrative and policy

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9 Attorney-General's Department, *2011 NDRRA Determination*, pp. 2–4.

10 House of Representatives Standing Committee, Inquiry into the *Income Tax Rates Amendment (Temporary Flood Reconstruction Levy) Bill 2011* and the *Tax Laws Amendment (Temporary Flood Reconstruction Levy) Bill 2011*, February 2011, p. 7.

framework, they have the same spending policies in relation to natural disaster relief. Its assessment of states' GST requirements recognises states' actual expenditure on disaster relief, net of payments from the Commonwealth. Accordingly, the burden on State budgets of dealing with the non-Commonwealth funded costs of dealing with recovery from natural disasters is shared between the states through the GST allocation process.[11]

3.15 In its submission to this inquiry, the CGC noted that it ensures that neither the Commonwealth NDRRA funding received by a State nor its related expenditure affects its GST share.[12] State spending on natural disasters in excess of that funded by the Commonwealth through the NDRRA is taken into account in determining a State's GST share. The CGC ensures that a state's spending on natural disaster relief above the state average is partly funded by a reduction in other states' GST shares.

3.16 In other words, to the extent that an individual state spends in excess of the average spent by all states on natural disaster relief, its GST share is increased. The CGC gives the example based on Table 3.3 (below). Queensland's GST share would be increased by $15.39 per person because its net spend of $32.83 is more than the all-state average spend of $17.32.

Table 3.3: Impact of natural disaster relief expenses and NDRRA payments for 2006–07 to 2008–09 on the GST distribution, (2010 Review)

Annual average	**NSW**	**Vic**	**Qld**	**WA**	**SA**	**Tas**	**ACT**	**NT**	**Total**
Gross state expenses ($m)	105.5	168	291.3	17.9	0.4	3.7	0.0	17.3	604.4
NDRRA revenue ($m)	2.6	73.4	151.8	0.0	0.0	0.2	0.0	6.9	234.9
Net expenses ($m)	102.9	94.9	139.5	17.9	0.4	3.5	0.0	10.4	369.5
Net expenses (%)	14.81	17.73	32.83	8.40	0.28	7.08	0.00	47.79	17.32
Impact on GST (%)	-2.62	0.52	15.39	-9.01	-17.08	-10.33	-17.36	30.17	3.55

Source: Commonwealth Grants Commission, *Submission 1*, p. 2.

The all-state average

3.17 The CGC told the committee that it adopts an average of expenditure across all states because it assumes that all states have the same spending policies in regard to natural disaster relief given they all operate under the NDRRA. However, the Secretary of the Commission, Mr John Spasojevic, told the committee that in the case of the recent Queensland floods:

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11 Commonwealth Grants Commission, *Submission 1*, p. 1; Mr John Spasojevic, *Proof Committee Hansard*, 13 May 2011, p. 12.

12 Commonwealth Grants Commission, *Submission 1*, p. 1.

> ...the commission will have to assure itself that the numbers that we are seeing provided by the states do represent an average policy. If not, the commission will have to think about how it adjusts those numbers to make sure they are comparable.[13]

3.18 It does appear that at least some state governments do not incorporate their insurance premiums for natural disasters into the data they provide to the CGC. In an answer provided to the committee in response to a CGC questionnaire in April this year, the South Australian Government noted that these were not included in the CGC's data request for the 2011 Update. Further, the SAFA's payments to state government entities for insurable losses are not recorded in the data provided to the CGC.[14]

3.19 The South Australian Government has also indicated that its NDRRA data:

> ...will be significantly amended for the 2012 Update as we have recently completed a whole-of-government collation of NDRRA eligible expenditure (for lodgement with the Commonwealth) for the 2006–07, 2007–08, 2008–09 and 2009–10 financial years. The process for collating our NDRRA data has been prolonged due to the need to obtain supporting source documents (eg invoices) and the requirement to have the data audited.[15]

The Commonwealth Grants Commission's data request

3.20 The Secretary of the CGC told the committee that in the past, the Commission relied on gross state expenses data being reported on a consistent basis. It is now 'discovering' that some states do and do not have insurance, 'which is leading us to work again with the states to ensure that data comes to us is done on a comparable basis'.[16] As he told the committee:

> ...doubts have been raised by people making claims that they are insured or not insured, so we are now sitting down and saying, 'Can we just get a clear picture of whether you are insured or not and whether you have included in the past receipts from insurance or not in the data that you have provided to us.'[17]

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13 Mr John Spasojevic, *Proof Committee Hansard*, 13 May 2011, p. 12.

14 South Australian Government, *Response to CGC questionnaire* of 7 April 2011. Information provided to the committee by the Commonwealth Grants Commission on 27 May 2011 in response to a Question on Notice.

15 South Australian Government, *Response to CGC questionnaire* of 7 April 2011. Information provided to the committee by the Commonwealth Grants Commission on 27 May 2011 in response to a Question on Notice.

16 Mr John Spasojevic, *Proof Committee Hansard*, 13 May 2011, p. 15.

17 Mr John Spasojevic, *Proof Committee Hansard*, 13 May 2011, p. 14.

3.21 The committee has been provided a copy of the CGC's data request for the 2011 Update. The document is a request for information from the states and territories regarding their net expenses on natural disaster relief. The document states: 'it is essential that you provide both revenue and expenses accurately since the Commission needs to determine net expenses for its (GST) assessments'.[18] However, the committee is concerned that the CGC's data request does not specifically include reinsurance premiums as an itemised expense. In the committee's view, the states and territories should include their past insurance recepts in the data that they provide to the CGC (see chapter 5).

Amending the NDRRA

3.22 On 3 March 2011, the same day the Senate referred this inquiry, the Federal Government announced that it will amend the NDRRA with the effect that the amount of funding states and territories will be entitled to following a natural disaster will be contingent on their own insurance arrangements. Under the new arrangements:

- states and territories will not be eligible to receive the maximum level of Commonwealth support unless they undergo regular assessments of their insurance arrangements by an independent specialist, such as the state Auditor-General;
- the first independent assessment must be published by 30 September 2011 with further independent assessments at intervals no greater than three years apart and following any significant change in the state's insurance arrangements. The state is required to publish the outcome of the independent assessment;
- these reports will be assessed by the Department of Finance;
- they will then be considered by the Attorney-General, who may make recommendations to the states or territories in regards to their insurance or mitigation strategies; and
- if a state or territory has failed to take appropriate action within a reasonable time, then the amount that state or territory would be reimbursed under the NDRRA may be reduced.[19]

3.23 The Government believes that the proposed changes will help ensure all state and territory governments have adequate capital or insurance to fund the replacement and restoration of infrastructure following a catastrophe.[20]

18 Commonwealth Grants Commission, *Data request for 2011 Update*, p. 1.

19 The Hon. Julia Gillard MP, 'Flood levy to pass, natural disaster relief and recovery arrangements strengthened', 3 March 2011, http://parlinfo/parlInfo/download/media/pressrel/614623/upload_binary/614623.pdf;fileType=application/pdf#search=%22'natural%20disaster%20relief%20and%20recovery%20arrangements'%22 (accessed 9 May 2011).

3.24 Part 4 of the 2011 NDRRA Determination sets out the general conditions for Commonwealth assistance. These conditions include that the state must have reasonably adequate capital or access to capital to fund liabilities or infrastructure losses, including through, but not limited to:

- commercial insurance/reinsurance;
- any state COAG reinsurance fund or pool; and
- state department premium contributions (i.e. internal state funds).[21]

3.25 In terms of the Commonwealth's review of the state's independent assessment, the 2011 NDRRA Determination lists the following imperatives:

- that a state has a responsibility to put in place insurance arrangements which are cost effective for both the state and the Commonwealth;
- that the financial exposure borne by taxpayers (at both levels of government) under this Determination should be minimised; and
- that the onus is on a state to explore a range of insurance options in the market place and assess available options on a cost benefit basis.[22]

3.26 In terms of the first of these principles, the Queensland Government told the committee:

> With respect to the current process, we have commenced discussions through heads of Treasury in terms of the arrangements going forward post the Attorney-General announcing those changes. I believe that this is all part of understanding how we determine what are cost-effective arrangements. I am not aware that in the past there has been any requirement on the Queensland government to address its insurance arrangements with this sort of consideration in mind.[23]

3.27 In terms of the third principle (above), chapter 2 noted that the Queensland Government is currently actively seeking a 'cost-effective' reinsurance policy from the international market.[24]

3.28 Each of the Commonwealth's reviews of the states' insurance arrangements will include an examination of matters such as:

- the nature of any insurance / reinsurance sought and offered;
- the amounts of any premiums and excesses;

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20 The Hon. Julia Gillard, 'Flood levy to pass, natural disaster relief and recovery arrangements strengthened', 3 March 2011.

21 Attorney-General's Department, *2011 NDRRA Determination*, p. 8.

22 Attorney-General's Department, *2011 NDRRA Determination*, p. 9.

23 Mr Neil Singleton, *Proof Committee Hansard*, 13 May 2011, p. 41.

24 Mr Neil Singleton, *Proof Committee Hansard*, 13 May 2011, p. 31.

- the events and extent of assets covered;
- the amount covered per event;
- maximum possible loss;
- reinstatement terms;
- claims experience; and
- any related matters.

3.29 NDRRA Guideline No. 5 notes that the Commonwealth Attorney-General will request that the Department of Finance and Deregulation review the independent assessments submitted by the states to:

- establish benchmarks for the appropriateness of each States' insurance arrangements;
- assess the appropriateness of states' insurance arrangements; and
- make recommendations as to differential thresholds or differential rates of assistance that should apply under the Determination depending on the appropriateness of individual state's insurance arrangements.

3.30 The Determination adds that if a state fails to take appropriate action within a reasonable timeframe in response to a review's recommendations on the state's insurance, the amount of Commonwealth assistance will be reduced in accordance with the three principles above.[25]

3.31 In terms of the requirement that the first independent assessment of the states' insurance arrangements must be published by 30 September 2011, Treasury made the following comment:

> The Treasury, the Department of Finance and Deregulation and the Attorney-General's Department have had initial discussions with the states around these arrangements and how they are going. I guess it is probably fair to characterise that they think the 30 September time frame is a challenging one, but we are working with the states to see what can be done by that time frame. And we are looking at the information that people at the department of finance who will be making an assessment would need to be able to make their assessment of the states' reports, and basically working out all of the practical arrangements that need to be done to meet that time frame.[26]

25 Natural Disaster Relief and Recovery Arrangements, *Attorney-General's Department*, p. 9.

26 Mr Damien White, *Proof Committee Hansard*, 13 May 2011, p. 3.

Broader review of disaster insurance arrangements

3.32 On 4 March 2011, Assistant Treasurer the Hon. Bill Shorten MP announced an independent review into disaster insurance in Australia—the Natural Disasters Insurance Review. The Minister's media release emphasised that:

> [T]he Australian Government is concerned that appropriate national measures are in place to foster more complete sharing of risk and equitable sharing of the cost of damage and loss resulting from floods and other natural disasters.[27]

3.33 The review will consider insurance arrangements for individuals and businesses for damage and loss associated with flood and other natural disasters. It will be chaired by Mr John Trowbridge, with Mr John Berrill and Mr Jim Minto as members and will report to the Commonwealth by the end of 2011. Treasury told the committee that the review panel is being assisted by the Australian Government Actuary, Mr Peter Martin, and is supported by a secretariat within Treasury. The review is undertaking wide-ranging consultations and intends to publicly release an issues paper in late May. The final report will be provided to the Assistant Treasurer by 30 September 2011.

3.34 The review will consider a number of specific issues, including:

- the extent of, and reasons for, non-insurance and underinsurance for flood and other natural disasters in Australia;
- the ability of private insurance markets to offer adequate and affordable insurance cover for individuals, small businesses and governments for flood and other natural disasters;
- factors that may impede the private insurance market in offering such cover;
- measures that could improve the ability of the private insurance market to offer such cover and the take-up of such cover by individuals, small businesses and governments;
- whether there is a case for subsidising insurance premiums for individuals and small businesses in the areas of highest risk facing the highest premiums;
- whether there is a role for the Commonwealth Government in providing disaster insurance or reinsurance to the private sector, through mechanisms such as a national disaster insurance program, and, if so, what are the best options;
- the impact or likely impact of any Commonwealth Government intervention in disaster insurance on the private insurance market; and
- the relationship between disaster mitigation measures taken by State and local governments against flood risks, and the impact of such measures, or the lack

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27 The Hon. Bill Shorten MP, 'National Disasters Insurance Review', *Media release no. 39*, 3 March 2011.

of them, on the availability and affordability of flood and other disaster insurance.[28]

3.35 The panel has also been asked to examine the likely impacts of intervention on the private insurance market and whether a relationship exists between disaster mitigation measures and the availability and affordability of insurance. Specifically, the terms of reference ask the panel to consider whether the existing Commonwealth and state arrangements for dealing with natural disaster recovery and resilience should be supplemented by the establishment of a natural disaster fund to support the rebuilding of public infrastructure in the aftermath of events such as the recent floods.[29]

Concluding comment

3.36 The committee welcomes the government's announcement that the current NDRRA will be reviewed with a view to tightening eligibility for Commonwealth payments. The committee notes that the financial incentives in these arrangements will now be tied more closely to compliance of each State and Territory with adequate insurance provisions.

3.37 The committee also believes the Natural Disasters Insurance Review is timely. It is particularly interested in the capacity of the private insurance market to offer a cost-effective and comprehensive reinsurance program for the states' and territories' assets.

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28 The Hon. Bill Shorten, 'National Disasters Insurance Review', *Media release no. 39*, 3 March 2011, http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/039.htm&pageID=003&min=brs&Year=&DocType= (accessed 10 May 2011).

29 Natural Disasters Insurance Review, *Terms of Reference*, http://www.treasurer.gov.au/Ministers/brs/Content/pressreleases/2011/attachments/039/039.pdf (accessed 23 June 2011).