Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates, 2 June – 4 June 2009

Question: bet 50

Topic: **Federal Financial Relations Framework**

Hansard Page: **Written**

Senator Kroger asked:

1. Please explain the new Federal Financial Relations Framework.
2. What was the reason for agreeing to a new framework?

Answer:

1. Federal Financial Relations Framework

On 29 November 2008, COAG agreed a new Intergovernmental Agreement on Federal Financial Relations that provides the overarching framework for the Commonwealth's financial relations with the States and Territories (the States).

The new framework is the culmination of extensive joint work by all levels of government. It commenced on 1 January 2009 and provides a solid foundation for COAG to pursue economic and social reforms to underpin growth, prosperity and social cohesion into the future. There are a number of elements to the framework that represent a fundamental shift in the way the Commonwealth provides financial assistance to the States. These include:

- the Intergovernmental Agreement on Federal Financial Relations;
- the Federal Financial Relations Act;
- rationalisation of payments;
- centralised payment arrangements;
- greater Budget flexibility for States and Territories;
- improved public accountability, including a new performance reporting framework, with a focus on the achievement of outcomes and performance benchmarks; and
- new opportunities to drive reform through National Partnerships.

The Intergovernmental Agreement on Federal Financial Relations

The Intergovernmental Agreement, which commenced on 1 January 2009, establishes a robust foundation for the Commonwealth and the States to:

- collaborate on policy development and service delivery; and
- facilitate the implementation of economic and social reforms in areas of national importance.

All policy and financial relations between the Commonwealth and the States are now governed under the provisions of the Intergovernmental Agreement. The main objective of the Intergovernmental Agreement is to improve the wellbeing of Australians through:

- collaborative working arrangements, including clearly defined roles and responsibilities and fair, sustainable financial arrangements, to facilitate a focus by the parties on long-term policy development and enhancing government service delivery;
- enhanced public accountability through simpler, standardised and more transparent performance reporting by all jurisdictions, and 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 GST payments to the States, equivalent to the revenue received from the GST; and
- the equalisation of fiscal capacities between the States.

Federal Financial Relations Act

The Commonwealth's financial relations with the States now come under the umbrella of one piece of legislation, the *Federal Financial Relations Act 2009*. This will improve public transparency of these payments and the ability of the Parliament to scrutinise the payment arrangements.

Rationalisation of payments

Under the new framework, payments for specific purposes made by the Commonwealth have been rationalised, without reducing the overall quantum of payments. Previously, each payment for a specific purpose had its own negotiating, administrative and monitoring processes. Under the new framework, the States continue to receive GST revenue, but the specific purpose payments have been rationalised into five new National SPPs:

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

The National SPPs are associated with six National Agreements, including the *National Indigenous Reform Agreement*, which contain the mutually-agreed objectives, outcomes, outputs and performance indicators, and clarify the roles and responsibilities, that guide the Commonwealth and the States in the delivery of services across the sectors of healthcare, education, skills and workforce development, disability services and affordable housing, and Indigenous reforms.

Some existing payments for specific purposes and election commitments have become National Partnership **project** payments, where they support national objectives and provide a financial contribution to the States to deliver specific projects.

Centralised payment arrangements

A key feature of the new framework is the centralised payment arrangements which will simplify payments to the States, aid transparency and improve the States' budget processes.

Previously, payments to the States were provided by Commonwealth portfolio departments to the relevant state agencies, and each payment has its own payment and administrative arrangements. Under the new arrangements all payments are centrally processed by the Commonwealth Treasury and paid direct to each state treasury. State treasuries will be responsible for distributing the funding within their jurisdiction.

Greater flexibility

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

Under the new framework, the States are required to spend each National SPP in the relevant sector — for example, the States are required to spend the National Healthcare SPP in the healthcare sector — but they have budget flexibility to allocate funds within that sector in a way that ensures they achieve the mutually-agreed objectives for that sector.

While the States now have increased budget flexibility, they are also subject to greater accountability to the public through new reporting arrangements. In addition, roles and responsibilities have been clarified, and the performance of each jurisdiction will be independently assessed by the COAG Reform Council, reporting to the Prime Minister as Chair of COAG.

Improved public accountability

Improved accountability is a key objective of the new framework for federal financial relations. Commonwealth and State governments have committed to improving service delivery, by ensuring that the appropriate government is accountable to the community — not just for its expenditure in delivering services, but more importantly, for the quality and efficiency of the services it delivers and the outcomes it achieves.

While the States now have greatly improved budget flexibility in respect of the National SPPs, they are also subject to improved public performance reporting against clearly specified performance indicators and benchmarks.

Each of the six National Agreements establishes what the Commonwealth and States expect to achieve from their joint involvement, the role of each jurisdiction and the responsibilities for which they undertake to be accountable, and performance indicators and benchmarks which will inform the Australian public on progress towards achieving the outputs, outcomes and objectives.

The performance of the Commonwealth and the States in achieving mutually-agreed outcomes and performance benchmarks specified in National Agreements will be monitored and assessed by the COAG Reform Council, which will report publicly on an annual basis.

In addition, to assist the COAG Reform Council in its role, the Productivity Commission has been tasked by COAG to report every two to three years on the economic impacts and benefits of COAG's agreed reform agenda.

The new performance reporting framework reinforces the accountability of state governments to their own communities for their service delivery.

Opportunities to drive reforms – National Partnerships

National Partnership payments are a central element of the new framework, and are a mechanism to drive reforms or improve service delivery standards through incentive payments. National Partnership payments are provided to the States to:

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

Each National Partnership payment is supported by a National Partnership agreement which defines the mutually-agreed objectives, outputs and performance benchmarks.

Some existing payments for specific purposes and election commitments have become National Partnership **project** payments, where they support national objectives and provide a financial contribution to the States to deliver specific projects.

In areas that are a national priority — for example, implementing the seamless national economy — National Partnership **facilitation** payments are being used to assist States to lift standards of service delivery or acknowledge their commitment to implement reforms.

National Partnership **reward** payments are provided to those States which deliver reform progress. The reward payments are structured in a way that encourages achievement of ambitious performance benchmarks detailed in a National Partnership agreement. To provide transparency and enhance accountability in the performance assessment process the achievement of these benchmarks will be assessed by the independent COAG Reform Council.

2. What was the reason for agreeing to the new framework?

Australia’s federal relations are characterised by three broad features:

- the financial arrangements are influenced by the large expenditure responsibilities of the States relative to their revenue capacities, so that they rely on transfers from the Commonwealth to finance their activities — referred to as vertical fiscal imbalance;
- the States have different capacities to raise revenue and deliver services — referred to as horizontal fiscal imbalance; and
- overlapping roles and responsibilities in areas of government activity which can lead to sectors where regulation or services remain fragmented, with duplication of activities, lack of coordination and blurred accountabilities.

The new framework addresses issues which are largely associated with the third feature, by streamlining and clarifying financial assistance paid to the States. In the past, blurred roles and responsibilities between all levels of government have been an impediment to progressing national reforms that are necessary to build the productive capacity of the economy. Many of the short-term and longer term challenges facing the economy are issues that can only be addressed through effective cooperation between both levels of government. The new framework for federal financial relations is enhancing public accountability for service delivery by clarifying roles and responsibilities between levels of government, improving reporting on performance and instilling more collaborative working arrangements.

The centralisation of payment arrangements and greater flexibility around the use of funding assist in clarifying roles and responsibilities. These measures give States greater control over their Budgets, while increasing the expectations of service delivery and improving transparency through independent and public assessments conducted by the COAG Reform Council.

The new framework makes it easier for the community to understand which level of government is responsible for services, provides more flexibility for States to deliver services effectively, and gives the community more information to enable it to hold governments to account for their performance.