



Australian Government
Commonwealth Grants Commission

File ref:

The Secretary
Senate Community Affairs Committee
PO Box 6100
Parliament House
Canberra ACT 2600



Dear Mr Humphery,

Thank you for the invitation to provide a submission for the inquiry into Government Expenditure on Indigenous Affairs and Social Services in the Northern Territory.

I am responding to your request as a Staff Submission rather than as a formal response from the Commission.

In response to part (a) of your Terms of Reference, I note that the Commonwealth Grants Commission (the Commission) does not have data which would allow it to identify the actual expenditure on service delivery or the outcomes achieved in Indigenous communities in the Northern Territory. COAG has initiated a process to collect compatible data on expenditure on services to Indigenous Australians and the outcome of those services, with the first report available in 2009.

In response to part (b) of your terms of reference I would like to supply the following information.

The current system of Commonwealth transfers to the States reflects the terms of the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations signed by the Commonwealth and the States in June 1999. Among other things, it:

- provides that all revenue from the GST (and health care grants), after deducting costs of collection, will be paid to the States to be spent according to their budget priorities; and
- specifies that the distribution of the GST revenue among the States will be based on horizontal equalisation principles and distributed using per capita relativities based on the recommendations of the Commission.

Accordingly, the Commission is asked each year to recommend a distribution of the receipts from the GST and Health Care Grants (the pool) to achieve Horizontal Fiscal equalisation. Horizontal Fiscal equalisation aims to give each State the same fiscal capacity; meaning that

- If States levied comparable taxes, then, with their GST revenue, they would have the same capacity to provide comparable services.

The Commission makes this recommendation in February each year for the coming financial year based on data for the five preceding financial years (reference years). It analyses the data for each historical year to determine what post hoc distribution of the pool would have equalised State fiscal capacities in each year and averages these results to form its recommendation for the year ahead.

Importantly the Commission does not attempt to forecast what States might spend or how much revenue they might raise in the coming year nor does it base its recommended distribution of the pool on such forecasts. The Commission does not form a view of what average State spending might be in different areas, eg on education, nor on different sets of residents, in the year for which it is making its recommendations. Similarly it does not form a view of what any one State would need to spend in that year to deliver a service comparable to the average of all the States.

The Commission's "funding formula" does not contain any expected, or target, or ideal level of expenditure by State, program, location or intended service recipient consistent with the recommended distribution of the pool. This is consistent with the general purpose nature of this transfer. The States have discretion as to how they use their share of the pool.

For the purposes of its historical analysis, the Commission estimates what States would have needed to spend to provide the average level of service in each of its reference years. The difference between that estimate and what States actually spent in those years has been used by some commentators as a guide to the appropriateness of State policy. Reaching such conclusions appears to be based on the premise that States should deliver a comparable level of service. This runs counter to the principle underlying the distribution of GST revenues which guarantees States autonomy to respond to the views of individual electorates in deciding how these funds are to be used.

Caution needs to be exercised in comparing actual expenditure data and the Commission's assessments for some technical reasons. The Commission's assessments are based on the average efficiency of service delivery, while actual expenditure data reflects actual efficiency. Consequently the gap between actual and assessed expenditure might not reflect the gap in the quantum of service delivery. Also there may be inherent differences between the States not fully captured in the Commission's assessments because reliable data is not available to measure those effects. In this case the gap between actual and assessed can not automatically be fully ascribed to the policy choices of individual State Governments.

Further, such comparisons need to recognise that decisions leading to actual expenditures and the Commission's assessments are made at very different points of time, with different information and for very different purposes. The core of the Commission's approach is to say that to deliver a comparable service a State should spend the observed average State spending. It would deviate from that average if it faced inherent State circumstances which would lower or increase its expenditure. For example, with a younger population it could be expected to spend more per capita on primary education.

However, when States frame their budgets they have no knowledge of what the average expenditure of all States will be in the budget year. They have to frame their expenditure plans around their circumstances as they see them at the time. After the event all States will deviate from the observed average expenditure. That difference cannot be a criticism of State policy because it is a mechanical outcome of the independent State budgetary processes. Unless the States co-operate in framing their budgets and set joint policies State budget outcomes will diverge from the average.

The Commission undertakes its historical analysis to determine what States should have received from the pool in the past as a guide to their receipts in the future. When it calculates what a State would have needed to spend to provide the average level of service, and the revenue it would have raised with average taxation policies it also re-calculates the distribution of the pool for that year. That distribution can differ significantly from the distribution which actually occurred in the year and on which State Budgets were prepared. For example, in 2006-07 the Northern Territory received \$1.985B in GST revenue. When the Commission first examined 2006-07 as a historical reference year, it would have allocated it some \$2.173B an increase of \$188M. Had the Northern Territory actually received this additional revenue it is likely that its actual expenditure profile would be different and it is moot to ponder if it would have been closer to what the Commission assessed or further away. The important point is that the Commission's assessed figures and the State actuals are not strictly comparable for some policy analysis purposes. They are derived to suit the Commission's terms of reference.

The Commission's recommendations are often interpreted as providing States with the capacity to deal with disadvantage. If the average policy of the States is to expend resources to tackle a particular disadvantage then the Commission's approach will give each State the capacity to tackle this disadvantage in a comparable way. Importantly the Commission makes no independent assessment of what would need to be spent to address that disadvantage. At an extreme, if the average policy of the States was to cease assisting a particular disadvantaged group then the problems of that group would have no impact on the distribution of the pool. So it only makes sense to say the Commission's recommendations deal with disadvantage, by recognising that the Commission reflects the average policy of the States in dealing with that disadvantage in its work.

I seek the Committee's agreement to provide a copy of this Submission to the Northern Territory Treasury.

Yours sincerely



John Spasojevic
Secretary
13 October 2008

