

7 Intergovernmental financial relations

Features

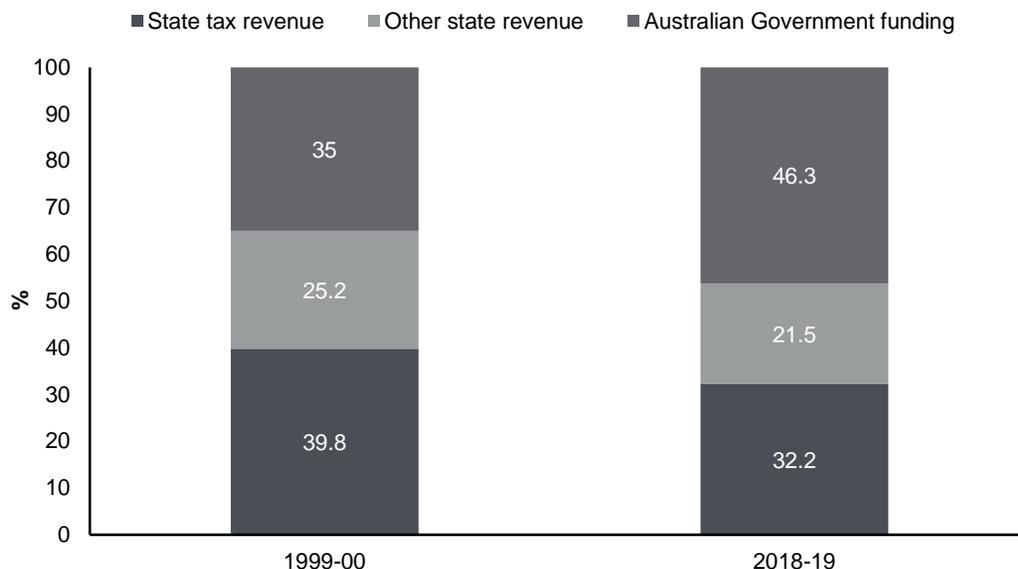
- Queensland's ability to meet its service delivery and infrastructure responsibilities is dependent on payments from the Australian Government with over 45% of Queensland General Government revenue coming from the Australian Government.
- Estimated Australian Government funding in 2018-19 for Queensland is \$26.776 billion; \$14.794 billion in GST revenue and \$11.982 billion in payments for specific purposes (National Specific Purpose Payments and National Partnership payments).
- Queensland's GST revenue in 2018-19 is \$415.2 million lower than that received in 2017-18. Queensland has a reduced GST share because of factors such as strong mining royalties and population growth below the national average in the three years to 2016-17. The Australian Government's direction to the Commonwealth Grants Commission to exclude selected payments from GST distribution calculations has also negatively impacted Queensland's share of GST.
- In 2018-19, \$11.982 billion is provided for payments for specific purposes comprising:
 - \$4.557 billion for National Health Reform
 - \$4.408 billion for Quality Schools
 - \$2.034 billion for National Partnership payments, including \$1.487 billion for the Infrastructure Investment Program, \$158 million for Natural Disaster Relief and Recovery Arrangements (NDRRA) and \$88 million for Universal Access to Early Childhood Education
 - \$669.5 million for National Specific Purpose Payments, including \$366 million for disability services, and \$303.5 million for skills and workforce development
 - \$313.6 million for National Housing and Homelessness.
- Queensland is currently negotiating a number of agreements with the Australian Government. Three key agreements are the National Health Reform Agreement, Quality Schools Agreement and the National Housing and Homelessness Agreement.
- Despite repeated requests from states and territories, the Australian Government has not provided greater certainty on the longevity of some funding, preferring instead to provide short-term extensions, or none at all in the case of remote housing, rather than make long-term commitments. The Australian Government also continues to impose stringent conditions in new agreements. This is inconsistent with the principles of the Intergovernmental Agreement on Federal Financial Relations.
- Similarly, Queensland is particularly challenged by a lack of sufficient funding from the Australian Government towards nationally significant infrastructure projects in Queensland, most notably Cross River Rail.

7.1 Federal financial arrangements

Federal financial relations in Australia are characterised by different levels of government sharing responsibility for raising revenue and delivering services to communities. State and territory governments' ability to raise revenue is less than required to meet their service delivery responsibilities. Alongside this, the Australian Government raises more revenue than is required to meet its service delivery responsibilities. This is called vertical fiscal imbalance (VFI), and requires the sharing of revenue between the Commonwealth and states and territories.

In 2016-17, the Australian Government collected the majority of taxation revenues (79.6%), while states and territories (states)¹ collected 16.8% and local governments the remaining 3.6%². National tax reform and other changes since 2000 have led to the Commonwealth having greater capacity to raise revenue compared to states and therefore an increase in VFI. Chart 7.1 shows that states received 35% of their revenue from the Australian Government in 1999-2000, with this forecast to significantly increase to 46.3% in 2018-19³.

Chart 7.1 General Government revenue sources, all states, 1999-2000 and 2018-19¹



Note:

1. 2018-19 are estimates.

Sources: ABS Government Finance Statistics Cat No. 5512.0 and state and Australian Government Budget Papers.

¹ States refer to states and territories unless otherwise specified.

² ABS Government Finance Statistics Cat No. 5506.0

³ National aggregates and interstate comparisons in this chapter will use Australian Government estimates for consistency. Queensland specific figures are consistent with Queensland Budget estimates.

In Australia, VFI is addressed through a system of intergovernmental payments from the Australian Government to the states which allows the states to meet their service delivery and infrastructure responsibilities. The Australian Government provides two types of payments:

- general revenue assistance payments such as the GST which are able to be used by states for any purpose (untied funding)
- payments for specific purposes (tied funding) such as National Specific Purpose Payments (SPPs) and National Partnership payments (NPs) which support specific projects or service areas.

Without a contribution by the Australian Government, states would not be able to provide essential services and infrastructure.

Another feature of Australian federalism is horizontal fiscal imbalance (HFI). HFI arises from disparities between the states' capacity to raise revenue and deliver services. Some states can raise higher revenue or deliver services at a lower cost compared to other states. Over time, this can distort capital and labour mobility towards states providing higher level of services.

To address this, GST revenue collected by the Australian Government is distributed to states in a way that ensures each is provided with the fiscal capacity to deliver the same standard of services and infrastructure to their population no matter where they live. This is known as horizontal fiscal equalisation (HFE).

The Commonwealth Grants Commission (CGC) uses the principle of HFE in recommending to the Australian Government how GST revenue should be distributed. The amount each state receives is a function of the amount of GST revenue collected (the GST pool) and the share of revenue recommended by the CGC.

In April 2017, the Australian Government directed the Productivity Commission to review the current HFE system to determine its impact and whether preferable alternatives exist. Further details are provided in Box 7.1.

Box 7.1 Productivity Commission Inquiry into HFE

The Productivity Commission's (PC) inquiry into Australia's system of HFE commenced on 30 April 2017. This inquiry examines the current system of distributing GST revenue to the states and its impact on productivity, efficiency, economic growth and the incentives for states to undertake fiscal reforms.

The PC released a draft report on 9 October 2017. It found that the current system achieves a high degree of equalisation but has the potential to discourage states from pursuing efficiency-enhancing reform. In response, the PC canvassed several alternative systems for distributing GST revenue. A key element of these alternative systems is that states are not equalised to deliver the same standard of services and infrastructure to their population. In each alternative system, Queensland would receive significantly less GST revenue. Under one system, the PC estimates that Queensland would have received \$1.588 billion less GST in 2017-18 compared to the current system. This is equivalent to losing 5,000 teachers, 5,000 nurses, 3,000 police officers and 1,135 firefighters.

In its submission to the PC in December 2017, and at the public inquiry in Brisbane on 5 February 2018, the Queensland Government strongly advocated for the principle of HFE. It also stressed the importance of a system that recognises the different circumstances of each state so that additional funding can be directed to states with unavoidably higher service delivery costs.

The PC final report was provided to the Australian Government on 15 May 2018. At the time of finalising the 2018-19 Budget papers, states have not been provided with the report or the PC final recommendations.

7.2 Australian Government funding to the states

As discussed in section 7.1, total Australian Government payments to the states are made up of general revenue assistance payments and payments for specific purposes.

Total Australian Government payments for the states in 2018-19 are expected to be \$126.751 billion, an increase of \$4.312 billion, or 3.5%, from 2017-18.

Within this total, payments to states for specific purposes in 2018-19 are expected to be \$58.554 billion, a 1.0% increase from 2017-18. These consist of:

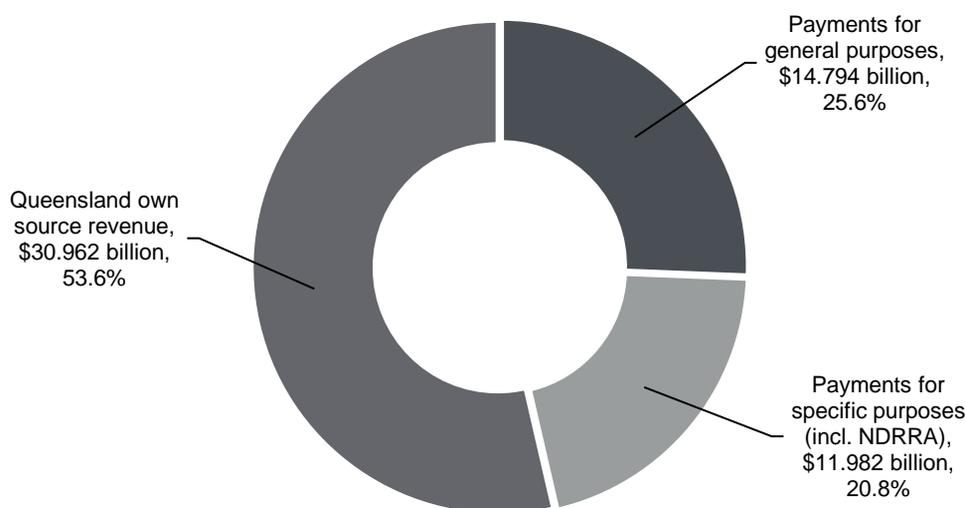
- \$21.189 billion in National Health Reform funding
- \$19.518 billion in Quality Schools funding
- \$13.840 billion in National Partnership payments
- \$2.471 billion in National Specific Purpose Payments
- \$1.536 billion in National Housing and Homelessness funding.

7.3 Australian Government funding to Queensland

Estimated Australian Government funding in 2018-19 for Queensland, included in the 2018-19 Queensland Budget, is \$26.776 billion⁴, a decrease of \$523.2 million, or 1.9%, compared with 2017-18.

Australian Government funding is estimated to account for 46.4% of Queensland's total General Government Sector revenue sources in 2018-19 (shown in Chart 7.2). Australian Government funding has grown significantly as a proportion of Queensland's total revenue since the introduction of the GST in 2000, consistent with the broader national trend.

Chart 7.2 General Government Sector revenue sources, Queensland, 2018-19¹



Note:

1. Percentage may not add to 100% due to rounding.

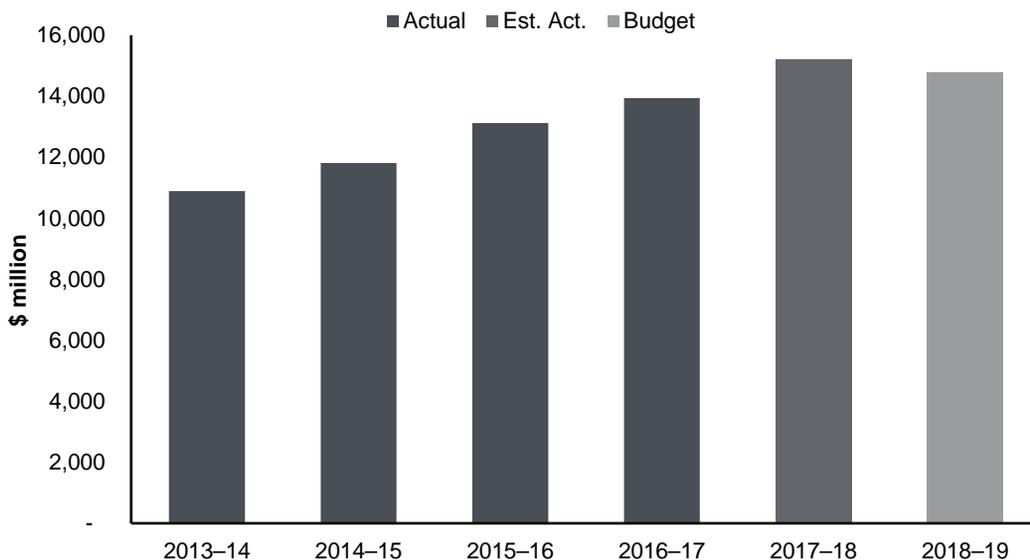
Source: 2018-19 Commonwealth Budget Paper No. 3 and Queensland Treasury estimates.

⁴ This figure differs to Chapter 4 Australian Government payments estimates, owing to the exclusion of direct Australian Government payments to Queensland departments for Commonwealth own purpose expenditure.

7.4 GST revenue payment

GST revenue accounts for all general revenue assistance payments Queensland receives. In 2018-19, Queensland expects to receive \$14.794 billion of GST revenue, \$415.2 million or 2.7% less than the amount received in 2017-18 (see Chart 7.3).

Chart 7.3 Estimated GST payments to Queensland, 2013-14 to 2018-19¹



Note

- Figures include the balancing adjustments which account for differences between the GST paid to states and the final GST pool size and population outcomes in the prior year.

Sources: 2018-19 Commonwealth Budget Paper No. 3 and Queensland Treasury estimates.

The decrease in GST revenue in 2018-19 reflects the CGC's recommendation that Queensland receive a lesser share of GST compared to 2017-18. This is expressed as a relativity; the measure of a state's fiscal capacity compared to other states, after considerations are made for its ability to raise revenue and provide services. A state with a lower relativity is considered to have a higher fiscal capacity and requires a lower share of the GST. In 2018-19, the Australian Government accepted the CGC's recommended relativity for Queensland of 1.09584, down from 1.18769 in 2017-18.

The CGC has recommended a decrease to Queensland's share of GST for 2018-19 due to the following:

- Queensland's population growth over the assessment years from 2014-15 to 2016-17 was lower than the national average, leading to a reduction in Queensland's assessed need for infrastructure investment relative to the rest of Australia
- Queensland required less GST funding to cover natural disaster expenses compared to years following the major flood and cyclone events between 2011 and 2014
- strong commodity prices increased Queensland's mining revenue which in turn improved the state's ability to meet its own expenditures
- Queensland received more than its population share of Commonwealth payments which increased its capacity to provide services.

Queensland's GST revenue is also adversely affected by the Australian Government excluding some payments from the GST distribution calculations. These have favoured other states in recent years, for example, funding for the Perth Freight Link paid to Western Australia and payments made to states under the Asset Recycling Initiative. The adverse effect of such payments on Queensland's GST share last several years before they are no longer relevant to the calculation of the State's GST share.

The CGC Report on GST Revenue Sharing Relativities (2018 Update) provides detail on the factors that determine Queensland's GST share. It also provides information on Queensland's share of GST compared to other states and the reasons underpinning these differences. Table 7.1 shows the relativities and resulting GST distributions for each state and territory for 2018-19.

Table 7.1 Recommended relativities and estimated GST shares, 2018-19

	NSW	Vic.	Qld	WA	SA	Tas.	ACT	NT
CGC recommended relativity	0.85517	0.98670	1.09584	0.47287	1.47727	1.76706	1.18070	4.25816
GST Share (\$ million)	18,442	17,261	14,794	3,315	6,887	2,488	1,328	2,805
GST per capita (\$)	2,290	2,642	2,934	1,266	3,956	4,733	3,161	11,405
<i>Sources: 2018-19 Commonwealth Budget Paper No. 3, Commonwealth Grants Commission Report on GST Revenue Sharing Relativities - 2018 Update.</i>								

Currently the CGC is reviewing its method for determining the distribution of GST among the states. Through the 2020 Methodology Review, Queensland aims to ensure the assessment accurately reflects the challenges of delivering services to a large and decentralised state and that the State receives its fair share of GST revenue

The final report for the 2020 Methodology Review will be provided to the Commonwealth and states by 28 February 2020.

7.5 Payments to Queensland for specific purposes

Payments for specific purposes comprise funding for:

- National Health Reform
- Quality Schools
- National Housing and Homelessness
- National Specific Purpose Payments (SPPs)
- National Partnership (NP) payments.

Queensland is expected to receive \$11.982 billion in payments for specific purposes in 2018-19. This is \$107.2 million lower than 2017-18 and is mainly due to the cessation of the National Partnership on Remote Housing in 2017-18.

Table 7.2 Estimated Payments to Queensland for Specific Purposes¹

	2016-17 Actual \$ million	2017-18 Est. Act. \$ million	2018-19 Budget \$ million
National Specific Purpose Payments	907	925	670
Skills and workforce development	296	299	304
Disability services	341	353	366
Affordable housing ²	269	273	..
National Health Reform funding	3,851	4,595	4,557
Quality Schools funding	3,874	4,157	4,408
National Housing and Homelessness funding²	314
National Partnership Payments (incl. NDRRA)	3,228	2,412	2,034
Total payments for specific purposes	11,860	12,089	11,982
Notes:			
1. Numbers may not add due to rounding.			
2. From 2018-19, funding under the National Affordable Housing SPP and the National Partnership Agreement on Homelessness is combined under the National Housing and Homelessness Agreement.			
<i>Sources: 2018-19 Commonwealth Budget Paper No. 3 and Queensland Treasury estimates.</i>			

In 2018-19, National Health Reform funding accounts for 38% and Quality Schools funding accounts for 36.8% of the total payments for specific purposes respectively. The estimated decrease in National Health Reform funding from 2017-18 to 2018-19 is due to funding for services provided in previous years being recognised in 2017-18. Queensland projections of National Health Reform Funding differ from the projections contained in the 2018-19 Commonwealth Budget. For 2018-19, Commonwealth projections assume higher activity growth than is projected in service agreements between the Queensland Department of Health and

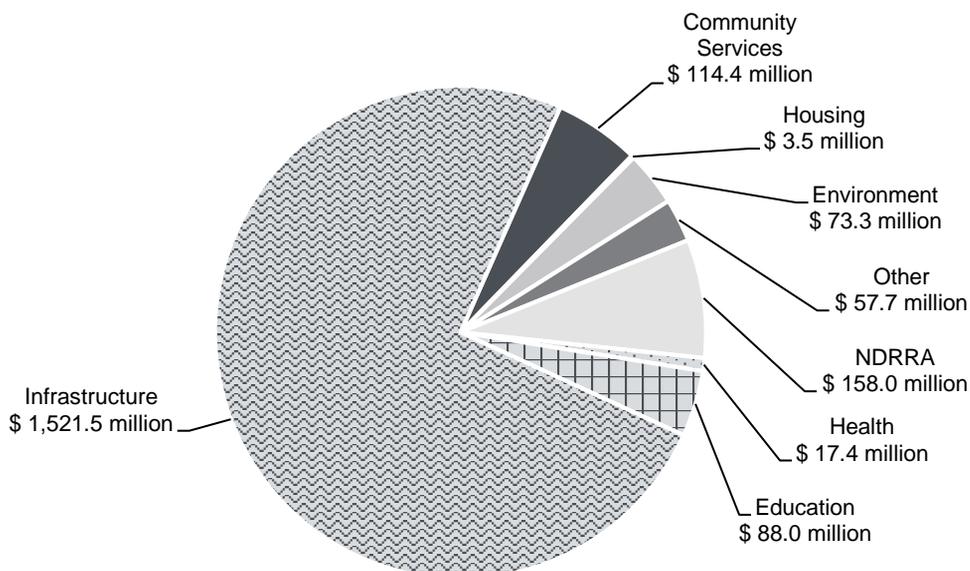
Hospital and Health Services. Actual National Health Reform payments may vary from estimates based on actual public hospital activity delivered each year.

From 1 July 2018, the new National Housing and Homelessness Agreement (NHHA) will commence. The NHHA combines funding under the National Affordable Housing SPP and continues the homelessness funding under the National Partnership Agreement on Homelessness, which expires on 30 June 2018.

National SPPs, which encompass 5.6% of the total payments for specific purposes, are expected to decrease by 27.6% to \$669.5 million in 2018-19 (as shown in Table 7.2). The reduction is due to funding for the National Affordable Housing SPP being merged with homelessness funding, and reported as part of the new NHHA from 2018-19.

NP payments (including NDRRA), which account for 17% of the total payments for specific purposes, are expected to decrease by 15.7% to \$2.034 billion in 2018-19 compared to the previous year. This is mainly due to the cessation of the National Partnership on Remote Housing. A significant proportion of these payments is allocated for infrastructure, community services, NDRRA and education (refer to Chart 7.4).

Chart 7.4 National Partnership Payments by sector, 2018-19¹



Note:

1. Excludes Australian Government direct funding to local government.

Sources: 2018-19 Commonwealth Budget Paper No. 3 and Queensland Treasury estimates.

In the 2018-19 Commonwealth Budget, the Australian Government announced funding of \$5.2 billion for major infrastructure projects in Queensland, with most of the funding allocated outside the forward estimates. This includes:

- a further \$3.3 billion for priority upgrades along the Bruce Highway, including Pine Rivers to Caloundra (\$880 million) and Cooroy to Curra Section D (\$800 million)
- a contribution of \$1 billion to M1 Pacific Motorway projects (Eight Mile Plains to Daisy Hill and Varsity Lakes to Tugun)
- \$390 million for the Beerburrum to Nambour rail upgrade.

The Commonwealth Budget also provides funding for a number of national infrastructure initiatives that have implications for Queensland. This includes:

- \$15 million allocation for the Toowoomba to Brisbane Passenger Rail Business Case under the \$250 million Major Projects Business Case Fund
- \$1.5 billion Northern Australia strategic roads package to be shared across Queensland, the Northern Territory and Western Australia
- \$160 million to upgrade sections of the Outback Way, which links Laverton in Western Australia to Winton in Queensland. Funding will be shared across Queensland, the Northern Territory and Western Australia.

The Australian Government has failed to fund critical infrastructure such as Cross River Rail. Furthermore, it has applied inconsistent funding splits between the Commonwealth contribution compared to Queensland's contribution (e.g. 80:20 or 50:50) for similar projects, and regularly budgets its contribution well after projects commence and beyond the forward estimates. For example, for the two M1 Pacific Motorway projects, the Australian Government has only committed to 15.5% of its project contribution within the forward estimates.

Box 7.2 Projections of specific purpose funding to Queensland

Across the forward estimates, total payments for specific purposes are expected to steadily increase, with average growth of around 4% between 2019-20 and 2021-22.

National Health Reform funding for Queensland is expected to increase by an average of 5.5% per annum from 2019-20. Under the Addendum to the National Health Reform Agreement, the Australian Government will fund 45% of efficient growth in hospital activity subject to a national growth cap of 6.5% per annum. Current estimates are based on this methodology however, funding is subject to Queensland agreeing to the Addendum to the National Health Reform Agreement, including an agreed mechanism for finalising future National Health Reform funding determinations in a timely manner.

Growth in Quality Schools funding for Queensland is expecting to average 6.7% per annum between 2018-19 and 2021-22 as a result of enrolment growth and increased per student funding. In June 2017, legislation was passed by the Australian Government to introduce a new needs-based funding model for schools. Under the new funding model, Queensland is expecting to receive \$7.856 billion for state schools and \$11.687 billion (including GST) for non-government schools over the forward estimates. Funding for the 2019 to 2023 calendar years is contingent on states agreeing to national and bilateral agreements with the Australian Government by the end of 2018.

Queensland is currently negotiating the bilateral agreement for the new National Housing and Homelessness Agreement (NHHA). Funding is due to commence in 2018-19, and combines funding for the National Affordable Housing SPP with homelessness funding. NHHA funding is expected to be relatively stable across the forward estimates.

Funding for National SPPs is expected to decrease from 2019-20 as the NDIS is fully implemented from the same year, which will redirect the National Disability SPP funding to the NDIS. Funding for the National Skills and Workforce Development SPP is expected to be relatively stable across the forward estimates.

7.5.1 Expiring agreements

The original intent of the Intergovernmental Agreement on Federal Financial Relations was to limit the number of NPs, allowing for funding to flow to states for efficient service delivery and reduce the reporting burden. Over time, the number of time-limited and low-value NPs has increased, reducing budget certainty and raising community expectations for ongoing services.

When agreements expire, states are left with limited opportunities to deal with the expiring NP as the final decision on continued funding is made through the Australian Government's budget process. The expiry of a number of large NPs over the last few years has brought the risks posed by fixed-term funding arrangements into sharp focus. States have had limited capacity to influence the continuation of expiring agreements and often there is little warning on whether funding will be continued. An early indication as to the continuation, lapse or other treatment of funding under expiring agreements is necessary to enable states to undertake effective service delivery and budgetary planning.

There are 14 agreements due to expire in 2017-18 or 2018-19. Funding will expire in 2017-18 for eight agreements, worth approximately \$212 million in 2017-18. There are six agreements where funding expires in 2018-19, worth approximately \$126 million in 2017-18.

The 2018-19 Commonwealth Budget provided no advice on renewal and/or funding for the National Partnership on Remote Housing following its expiry in 2017-18. Funding under this agreement improves housing outcomes by providing for new housing, housing refurbishments and housing-related infrastructure in Indigenous communities.

Further, short-term funding was announced for the National Partnership on Universal Access to Early Childhood Education until December 2019. This will be the sixth short-term extension for this agreement. Alongside this, no further funding to states was announced for the National Partnership on the National Quality Agenda for Early Childhood Education and Care following its expiry on 31 December 2018. The Commonwealth has committed to fund the Australian Children's Education and Care Quality Authority (ACECQA) until 30 June 2020 to administer the National Quality Framework for Early Childhood Education and Care.

When the Australian Government decides to cease funding for expiring agreements, this presents a significant ongoing fiscal risk for states, with impacts on the quality and continuity of much needed services delivered to some of the most vulnerable members of the community.

7.6 State-local government financial relations

In 2018-19, the Queensland Government will provide a total of \$1.667 billion in grants to local governments. This includes financial assistance grants paid by the Australian Government through the State to local governments.

The Government is providing funding of \$3.2 million over four years to undertake implementation planning to improve and simplify the administration of grants to local government.

The Government is providing funding of \$1.3 million in 2018-19 to develop a new grants management system. This is to progress recommendations from the *Review of Grants to Local Government: Current and Future State Assessments* and is an important initiative to make the interaction of Queensland Government and local governments more efficient and more effective in serving the people of Queensland.

Table 7.3 Grants to local governments in Queensland^{1,2}

	2017-18 Est. Act. \$ million	2018-19 Budget \$ million
Aboriginal and Torres Strait Islander Partnerships	3	7
Environment and Science	38	61
Child Safety, Youth and Women	1	2
Communities, Disability Services and Seniors	63	60
Education	2	2
Natural Resources, Mines and Energy	33	..
Housing and Public Works	56	81
Innovation, Tourism Industry Development and the Commonwealth Games	31	2
Local Government, Racing and Multicultural Affairs ³	865	559
Premier and Cabinet	13	1
Queensland Ambulance Service	1	..
Queensland Fire and Emergency Services	2	2
State Development, Manufacturing, Infrastructure and Planning	382	544
Queensland Treasury	1	2
Transport and Main Roads	204	213
Other ⁴	26	132
Total Queensland Government grants	1,721	1,667
Notes:		
1. Includes current, capital and asset grants to local government authorities and Aboriginal and Torres Strait Islander councils. Includes Australian Government grants paid through the state to local governments.		
2. Numbers may not add due to rounding.		
3. Decline in 2018-19 reflects prepayment of Financial Assistance Grants by the Australian Government in 2017-18.		
4. Includes grants yet unallocated to government agencies and ceased entities following Machinery of Government changes.		

Box 7.3 Grants to local governments

The Queensland Government allocates considerable funding in the State Budget to support local governments across the State. The Queensland Government acknowledges the shared responsibilities in serving the people of Queensland and the important role local governments play. A summary of grant programs available to local governments are listed below.

Grant programs exclusively available to local government

Program Name	Description	Total Funding (2015-16 onwards)	Funding Allocated	Funding Not Yet Allocated
Works for Queensland	Support local governments in regional areas to undertake job-creating maintenance and minor infrastructure works.	\$600 million	\$400 million	\$200 million
Transport Infrastructure Development Scheme	Provide targeted investment in regional local government transport infrastructure.	\$460 million	Committed through the <i>Roads and Transport Alliance</i> as annual allocations to 17 formalised groups of councils (Regional Roads and Transport Groups) to prioritise as rolling four-year programs of work.	
Building our Regions	Provide funding for critical infrastructure in regional areas to support economic development, including generating jobs.	\$295 million	\$225 million	\$70 million
Local Government Grants and Subsidies Program	Provide funding for priority infrastructure projects that will enhance sustainable and liveable communities.	\$29 million per annum	Ongoing funding	
Coastal Hazard Adaptation Program - QCoast ₂₁₀₀	Assist coastal local governments to prepare plans and strategies for addressing climate change.	\$12 million	\$4.3 million	\$7.8 million
Queensland Water Regional Alliances Program	Assist regional councils to collaborate and improve efficiencies and administration around water infrastructure.	\$6 million	\$1.8 million	\$4.2 million

In addition to the above grant programs, the Government will be providing additional funding of \$38 million over four years from 2018-19 to establish the Disaster Resilience Fund. This fund will be administered by the Queensland Reconstruction Authority (QRA) and will be available to a range of organisations including local governments, to deliver mitigation and resilience projects. The QRA intends to seek matched funding from the Australian Government.

Funding is also made available to local governments under the Natural Disaster Relief and Recovery Arrangements which are a joint funding initiative of the State and Australian Governments to provide disaster relief and recovery payments to help communities recover following the effects of natural disasters.

The Government also understands there are added challenges faced by Indigenous local governments, which are often located in very remote areas of the State, to ensure their communities have access to essential services and critical infrastructure. In response, the Government has allocated substantial additional funding to specifically support Indigenous councils and their communities. A summary of grant programs available to Indigenous councils and their communities are listed below.

Grant programs to support Indigenous councils and their communities

Program Name	Description	Total Funding (2015-16 onwards)	Funding Allocated	Funding Not Yet Allocated
Indigenous Councils Critical Infrastructure Program	Contribute water, wastewater and solid waste infrastructure in Indigenous communities.	\$120 million	\$33.2 million	\$86.8 million
Major Infrastructure Program	Deliver environmental health and other infrastructure upgrades within the Torres Strait Island Regional Council, Torres Shire Council and Northern Peninsula Area Regional Council areas.	\$15 million	\$7.5 million	\$7.5 million
State Government Financial Aid	A financial contribution (in lieu of rates) to meet the costs incurred by Indigenous councils in the provision of local government services.	\$33.7 million per annum	Ongoing funding indexed by CPI	
Indigenous Local Government Sustainability Program (2016-18)	Assist Indigenous councils to increase their capacity, capability and sustainability.	\$8.2 million	\$7.6 million	\$550,000