

PART 1: AUSTRALIA'S FEDERAL RELATIONS

The Commonwealth is working in partnership with the States in a number of key reform areas benefitting all Australians. Significant progress has been made in implementing the reform agenda through the federal financial relations framework. The framework has proven to be flexible and dynamic, facilitating reform activity, including health reform, and responding to the global recession and, more recently, natural disasters.

The States receive substantial financial support from the Commonwealth. In 2011-12, the Commonwealth will provide \$95.0 billion in total payments to the States.

OVERVIEW

The Commonwealth is leading an ambitious reform agenda that involves collaboration with the States. As part of the reform agenda, the Commonwealth is working with the States in areas such as health reform, skills and education, and infrastructure development. The Commonwealth is also supporting the rebuilding of communities affected by recent natural disasters.

In the short-term, Commonwealth and State budgets will be affected by recent natural disasters and the lingering effects of the global recession. However, Australia's economic fundamentals remain strong and the Commonwealth is committed to returning the Budget to surplus by 2012-13. Although the fiscal position of the States is expected to improve over the forward estimates, at an aggregate level, States will remain in fiscal deficit through to 2013-14.

This Budget continues to deliver on the Commonwealth's strict fiscal strategy by exercising fiscal discipline in the context of the economic recovery and the second phase of the mining boom. The 2011-12 Budget also takes important steps to expand the productive capacity of the economy, address capacity constraints and ensure the Australian economy is well positioned to convert the opportunities of the mining boom into greater prosperity for more Australians.

In this Budget, the Commonwealth is placing a high priority on building a bigger and better trained workforce and investing in critical infrastructure to expand the productive capacity of the economy. A number of new measures have been announced as part of this Budget that involve collaboration with the States, including reforms under the *Building Australia's Future Workforce* package and funding provided for infrastructure as part of the Regional Infrastructure Fund and the Regional Development Australia Fund.

Significant progress is being made through the Council of Australian Governments (COAG) in achieving reform and responding to the key challenges facing Australia. This includes undertaking National Health Reform to respond to Australia's ageing population, which will place increasing pressure on the country's health and aged care systems. The Commonwealth also recognises the seriousness of mental illness and is making mental health a national priority as part of this Budget, including through working with the States to provide support and services for people with mental illness.

The Commonwealth is also providing substantial funding to the States to assist with rebuilding communities and infrastructure following recent natural disasters.

A number of reviews are underway or being implemented to bolster the reform agenda and strengthen Commonwealth-State relations.

In 2011-12, the Commonwealth will provide the States with \$95.0 billion in payments for specific purposes and general revenue assistance. This represents a 1.2 per cent increase in total financial assistance from 2010-11.

MAJOR GOVERNMENT REFORMS AND NEW DEVELOPMENTS

National Health Reform

On 13 February 2011, COAG reached a *Heads of Agreement on National Health Reform* which will form the basis of negotiations for a new *National Health Reform Agreement* to be signed by July 2011.

The *Heads of Agreement on National Health Reform* combines reforms to the financing of the Australian health and hospital system with major changes to the governance arrangements between the Commonwealth and the States. The reforms will deliver better health and hospital services for all Australians and provide a secure funding base for health and hospitals in the future.

Under the *Heads of Agreement on National Health Reform*, the Commonwealth will increase its funding contribution to pay 50 per cent of the efficient growth in hospital costs. This will be done in two stages, increasing to 45 per cent in 2014-15 and 50 per cent in 2017-18. These arrangements address a fundamental structural problem in hospital funding where the costs of delivering services are rising faster than the States can raise money to pay for them.

The Commonwealth will also take on full policy and funding responsibility for aged care (other than in Victoria and Western Australia where negotiations are continuing).

In recognition that a strong primary health care system is the key to providing patients with the health care they need, and will relieve pressures faced by hospitals, the

Commonwealth and States have agreed to work together on system-wide policy and planning for GP and primary care services.

These reforms are outlined in greater detail in the Health Overview — *Delivering better hospitals, mental health and health services*.

National Health Reform funding

The Commonwealth will provide National Health Reform funding from 1 July 2012 to fund its increased responsibilities. This funding will have two elements: base funding equivalent to the current National Healthcare Specific Purpose Payment (SPP); and efficient growth funding to be provided from 1 July 2014.

The national efficient price, which will be used in the calculation of efficient growth, will be determined annually by the Independent Hospital Pricing Authority. The introduction of an efficient price from 1 July 2012 introduces a solid market-based reform that will drive greater efficiency and innovation in the public hospital system.

The Commonwealth has guaranteed that its increased contribution for efficient growth will be at least \$16.4 billion greater than the States would have received from the National Healthcare SPP alone between 2014-15 and 2019-20. If the amount required to fund the Commonwealth's hospital growth commitments is less than \$16.4 billion, the residual amount will be paid to fund health services that will ameliorate the growth in demand for hospital services.

In addition, the Commonwealth is providing the States with funding of \$3.8 billion for a package of reforms and investments in health and hospitals.

Changes to the funding responsibilities of the Commonwealth and the States giving effect to the Commonwealth's commitment to take on full policy and funding responsibility for aged care will be budget neutral for the Commonwealth and the States. Discussions are continuing between the Commonwealth and the States on the mechanism to achieve this neutrality.

Victoria and Western Australia have agreed to further consider the Home and Community Care elements of the National Health Reforms, for resolution before the next COAG meeting.

Funding governance

A new national funding pool will be established into which both the Commonwealth's and States' contributions for public hospital services will be made. Funding within the national funding pool will be administered by an independent and jointly-governed national funding body distinct from Commonwealth and State departments.

The national funding pool will comprise an account for each jurisdiction which is quarantined from the contributions provided by other States. Contributions made into

the pool will be disbursed directly to local hospital networks in accordance with State instructions. States will fund the residual cost of hospital services, including any costs above the efficient price.

The establishment of a national pool and independent funding body to administer the pool will ensure that all hospitals are funded under the same transparent arrangements.

Continuing to invest in health

Mental illness affects nearly every Australian in some way. This Budget is investing \$1.5 billion to deliver additional services, a greater focus on prevention and early intervention, and a more targeted and better coordinated mental health care system.

The Commonwealth will provide \$200.0 million to the States over five years for a new National Partnership to help address major service gaps in their mental health systems. The National Partnership will focus on accommodation support for those at risk of homelessness, as well as presentation, admission and discharge planning in major hospitals to help improve system-wide access to, and coordination of, services for people with severe mental illness.

The Commonwealth will also invest in the prevention and early intervention of mental health services for children and young people. This includes \$219.8 million to the States over five years in a 50/50 partnership to establish up to 16 Early Psychosis Prevention and Intervention Centres to provide holistic support for young people with emerging psychotic disorders, and their families.

Complementing investments in health services, the Health and Hospitals Fund provides for investment in health infrastructure, to ensure that substantial funding is available for capital investment to underpin major improvements in efficiency, access and outcomes in health care and to support the Commonwealth's health reform agenda. The Commonwealth will provide total payments of \$1.8 billion over six years from the Health and Hospitals Fund in total payments, including payments to the States, to support the development of health infrastructure projects of national significance in regional areas including payments to the States. This regional package builds on the \$3.2 billion allocated in the 2009-10 Budget to upgrade hospital infrastructure and expand medical research and training infrastructure.

Skills and education

Education and skills training, and access to employment contribute to higher productivity growth and higher labour force participation. Investments in skills and education will assist in improving productivity and expanding the capacity of the economy.

A strong training system will be instrumental in meeting longer term labour needs and sustained economic growth. The Commonwealth has announced, under the *Building Australia's Future Workforce* package, that it will offer the States a new reform-focussed National Partnership agreement to deliver a higher quality and more productive vocational education and training sector. The new National Partnership agreement will provide up to \$1.75 billion over five years from 2012-13 (including \$715.1 million over the forward estimates) to those States willing to commit to ambitious reform.

The Commonwealth will also provide \$80.0 million under a new National Partnership to fund training places for single and teen parents affected by changes to workforce participation requirements.

The forthcoming review of the *National Agreement on Skills and Workforce Development* will allow the Commonwealth and the States to strengthen their joint commitment to training.

In addition to improving the skills of the workforce, education is critical to building human capital and driving a high-skill, high-wage economy.

The Commonwealth remains committed to transforming the quality of the Australian education system and making every school a great school. A key component of this measure involves recognising and rewarding great teachers through the *National Rewards for Great Teachers* Program which will establish a nationally consistent performance management system for teachers and a scheme which recognises the best-performing teachers with reward payments. As part of this initiative, from the start of 2014, the Commonwealth will provide \$125 million each semester in reward payments for the best teachers based on their performance in the previous year.

A focus on students with a disability is also an important part of this Budget through the *Schools – Support for improving learning experiences and educational outcomes for school students with disability* initiative. This measure will provide assistance to teachers and schools to support students with a disability, and provide an opportunity to identify the additional support strategies which make a positive difference for students with a disability. The Commonwealth will provide \$153.2 million over the two and a half years to December 2013 through a National Partnership with the States, and \$42.4 million through funding agreements with non-government schools.

Infrastructure development, including regional Australia

The Commonwealth has an important role in facilitating productivity growth through investment in infrastructure, promoting macroeconomic stability, and appropriate microeconomic reform. The Commonwealth is investing in key infrastructure projects, in partnership with the States, to ensure enhanced productive capacity in the economy. The investment in infrastructure is expected to leverage private sector investment.

The Commonwealth has committed \$6.0 billion to the Regional Infrastructure Fund (RIF) over the 11 years to 2020-21 to reinvest proceeds of the mining boom in regional Australia. The Commonwealth has committed at least \$2.0 billion from the RIF to Queensland and Western Australia.

The RIF will be funded predominantly through the Minerals Resource Rent Tax, to be introduced on 1 July 2012. As part of the agreement with the Independents, the Commonwealth has also established a Regional Development Australia Fund (RDAF). The fund consists of \$573 million from the RIF and funds from the former Priority Regional Infrastructure Program, to a total of \$1.0 billion over five years. The fund is to be used for local projects identified by Regional Development Australia committees.

These funds have been established to invest in capacity building projects, with investment in rail, roads, ports and other critical infrastructure supporting jobs in regional and mining communities and the broader Australian workforce.

The RIF and the RDAF complement three other key funds established by the Commonwealth to support long-term investment in Australia's future: the Health and Hospitals Fund; the Education Investment Fund; and the Building Australia Fund.

A significant number of infrastructure projects are delivered through these funds in partnership with the States. In addition, the flagship Nation Building program is investing \$3.8 billion in state and local government infrastructure in 2011-12.

Regional Australia is an important focus of infrastructure investment to ensure that all Australians benefit from economic growth and improved wellbeing. In addition to important road and rail infrastructure being funded in regional areas under the Nation Building program, the Health and Hospitals Fund and the Education Investment Fund have dedicated funding rounds that give priority to projects in regional areas.

To realise the full benefits of infrastructure investment and reduce regulatory inefficiencies, COAG has agreed to establish national transport regulatory frameworks and three national regulators for heavy vehicles, rail and maritime safety. This Budget provides additional funding for the completion of the COAG National Transport Reforms, which will establish national approaches to heavy vehicle, rail and maritime safety regulation.

The Commonwealth also recognises the importance of local government in delivering and maintaining key local infrastructure. The Commonwealth provides significant funding through Financial Assistance Grants to local government that can be used to improve local government infrastructure. The Commonwealth has decided to bring forward payments for local government services from 2011-12 to be paid in 2010-11.

Rebuilding communities affected by natural disasters

Recent natural disasters have had a profound affect on the Australian community. This Budget reflects the substantial commitment the Commonwealth has made to support affected communities to deal with the tremendous impact of these disasters.

The Commonwealth expects to contribute \$4.64 billion to the States under the Natural Disaster Relief and Recovery Arrangements (NDRRA) towards relief and assistance, and rebuilding communities affected by recent natural disasters. This includes \$3.77 billion in financial assistance to Queensland to support recovery and reconstruction efforts associated with the Queensland floods and Tropical Cyclone Yasi.

In February 2011, the Commonwealth and Queensland Governments agreed the *National Partnership Agreement for Natural Disaster Reconstruction and Recovery*. The National Partnership complements the governance and accountability provisions established under the long-standing NDRRA. The Commonwealth has already provided \$1.0 billion to Queensland as an advance NDRRA payment under the National Partnership, and a further \$1.05 billion will be provided in 2010-11. An advance payment of \$500.0 million is also expected to be paid in 2011-12.

The Commonwealth has also announced its intention to provide an advance payment of \$500.0 million to Victoria for flood reconstruction and recovery in that State.

The Commonwealth will also provide a further \$3.84 billion under the NDRRA for past natural disasters. Overall, the Commonwealth will be providing \$8.48 billion in NDRRA payments.

Given the increasing regularity and severity of natural disasters, all governments have recognised that a national, coordinated and cooperative effort is required to enhance Australia's capacity to withstand and recover from emergencies and disasters. COAG adopted the *National Strategy for Disaster Resilience* at its meeting on 13 February 2011 and agreed to take immediate steps to implement it.

The *National Strategy for Disaster Resilience* focuses on the shared responsibilities of governments, business and communities in preparing for, and responding to, disasters. It sets out the concrete steps that governments at all levels can take to reduce risks posed by natural disasters and better support communities to recover from disasters. Other actions will include steps to support improved risk-based planning decisions, the take-up of insurance and the provision and construction of resilient infrastructure.

COAG AGENDA

Through COAG, the Commonwealth and the States are working together on major reforms that have contributed to economic prosperity and improved the lives of all Australians.

COAG has made significant progress in responding to the key challenges facing Australia of raising productivity, improving workforce participation to lift Australia's long-term economic potential, and dealing with significant demographic change. The health, skills and infrastructure reforms currently underway are key to this agenda.

At its February 2011 meeting, the Prime Minister put to COAG a streamlined agenda built around five themes of strategic importance that lie at the intersection of jurisdictional responsibilities:

- a long-term strategy for economic and social participation;
- a national economy driven by our competitive advantages;
- a more sustainable and liveable Australia;
- better health services and a more sustainable health system for all Australians; and
- Closing the Gap on Indigenous disadvantage.

The federal financial relations framework, introduced on 1 January 2009, provides a strong foundation for COAG to pursue economic and social reforms to underpin growth, prosperity and wellbeing into the future. National Partnerships which support these reforms are detailed in Part 2 of this Budget Paper.

Further details on the federal financial relations framework are at Appendix A of this Budget Paper.

REVIEWS RELATING TO COMMONWEALTH-STATE RELATIONS

A number of reviews have been completed or are being implemented to bolster the reform agenda and strengthen federal financial relations.

Review of the distribution of the GST

On 30 March 2011, the Commonwealth announced a review of the distribution of the Goods and Services Tax (GST) to the States (the Review) to ensure that Australia is best placed to deal with the long-term economic, environmental, demographic and social challenges which are transforming our economy.

The Review will examine whether improvements to the current form of horizontal fiscal equalisation, which determines the distribution of GST revenue to the States, can be identified to improve the efficiency, equity, simplicity and predictability of the current arrangements in light of these challenges.

The Review will not affect the distribution of the GST in 2011-12 and 2012-13. The Commonwealth Grants Commission will continue to make recommendations on the distribution of the GST and will be requested to update its methodology to reflect any agreed recommendations of the Review.

The Review will be conducted by the Hon Nick Greiner AC, the Hon John Brumby and Mr Bruce Carter.

The Review will be advised by a Heads of Treasuries Advisory Committee comprising representatives of all States and the Commonwealth and will seek public submissions. The Review will be supported by a secretariat within the Commonwealth Treasury, with representation from the States and other agencies as appropriate.

The Review will provide an interim report to the Treasurer by February 2012 with a final report to be provided in August/September 2012. The report will be considered by COAG, with a final decision to be made on the new arrangements before the end of 2013.

Australia's Future Tax System Review and the Tax Forum

In October 2011, the Commonwealth will host a tax forum to continue the debate started by the release of the Australia's Future Tax System Review. It will focus on the broad sweep of topics in the review, with sessions to discuss personal tax, transfer payments, business tax, state taxes, environmental and social taxes, and system governance.

While this forum will canvass a broad range of issues associated with Australia's taxation system, the States will play an important role in discussions on specific elements.

Heads of Treasuries Review of National Agreements, National Partnerships and Implementation Plans under the Intergovernmental Agreement

The *Intergovernmental Agreement on Federal Financial Relations* (Intergovernmental Agreement) commenced on 1 January 2009. In its first report on implementation of the Intergovernmental Agreement, the Ministerial Council for Federal Financial Relations reported to COAG in December 2009 that while considerable progress had been made in implementing the framework, there was scope to improve the consistency of agreements with the principles of the Intergovernmental Agreement. COAG agreed that it was timely to take stock of how implementation was progressing and to address

implementation issues that had emerged in the Intergovernmental Agreement's first year of operation.

Heads of Treasuries, in consultation with Senior Officials, were tasked with undertaking a review of agreements under the framework by December 2010. The review focussed on the consistency of agreements with the Intergovernmental Agreement, and their effectiveness in enabling the achievement of the policy objectives agreed by COAG. The review was considered by COAG at its February 2011 meeting.

A key finding of the review is that the underlying principles of the Intergovernmental Agreement provide a strong foundation for pursuing the COAG reform agenda. However, while significant work has been undertaken by all levels of government to implement the Intergovernmental Agreement in a manner consistent with its original intentions, some challenges remain.

The review found that the Intergovernmental Agreement's underlying principles should be strengthened where necessary to sharpen the focus on outcomes, improve responsiveness and enhance public accountability. The outcomes of the review provide a basis for addressing the challenges that remain, to ensure that the federal financial relations framework remains sustainable and mutually beneficial. Implementation of the review commenced in 2011.

Further information on the review and on performance reporting under the framework is provided at Appendix A of this Budget Paper.

TOTAL PAYMENTS TO THE STATES

The Commonwealth is committed to the provision of ongoing financial support to the States' service delivery efforts, through two broad categories of payments: payments for specific purposes; and general revenue assistance.

The States receive significant financial support from the Commonwealth. In 2011-12, the Commonwealth will provide the States with payments totalling \$95.0 billion, comprising payments for specific purposes of \$45.5 billion, and general revenue assistance of \$49.5 billion, including GST revenue, as shown in Table 1.1. This represents a 1.2 per cent increase in total financial assistance compared to 2010-11.

As part of this Budget, the Commonwealth will provide substantial support to the States to implement major reforms, including:

- \$16.4 billion in efficient growth funding for public hospitals over the period 2014-15 to 2019-20 as part of the *National Health Reform* arrangements;

- \$1.8 billion over six years from the Health and Hospitals Fund in total payments, including payments to the States, to support the development of health infrastructure projects of national significance in regional areas;
- \$200.0 million to the States over five years for a new National Partnership to help address major service gaps in state mental health systems, and \$219.8 million over five years to the States in a 50/50 partnership for Early Psychosis Prevention and Intervention Centres;
- \$1.75 billion over five years from 2012-13 (including \$715.1 million over the forward estimates) to support reforms in the Vocational Education and Training sector, by utilising funding arrangements under a new National Partnership Agreement to drive higher quality and responsiveness in the sector;
- \$80.0 million to the States under a new National Partnership to fund training places for single and teen parents affected by changes to workforce participation requirements; and
- \$153.2 million over the two and a half years to December 2013 for a new *National Partnership Agreement on Schools – Support for improving learning experiences and educational outcomes for school students with disability*, and \$42.4 million through funding agreements with non-government schools.

In addition, the Commonwealth will contribute around \$4.64 billion under the NDRRA to the States to provide immediate relief and assistance to rebuild communities affected by recent natural disasters.

Payments for specific purposes

In 2011-12, the States will receive \$45.5 billion in payments for specific purposes, a decrease of 3.9 per cent compared with the \$47.4 billion the States will receive in 2010-11. In 2011-12, \$28.0 billion or 61.5 per cent will be provided as National SPPs, while \$17.5 billion or 38.5 per cent will be provided as National Partnership payments.

Part 2 of this Budget Paper provides further information on payments for specific purposes to the States.

General revenue assistance

In 2011-12, the States will receive \$49.5 billion in general revenue assistance, including GST payments of \$48.4 billion. This is an increase of 6.3 per cent compared with the \$46.5 billion the States will receive in general revenue assistance in 2010-11.

Part 3 of this Budget Paper provides further information on GST and other general revenue assistance to the States.

Table 1.1: Commonwealth payments to the States

\$million	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total(a)
2010-11									
Payments for specific purposes	14,753	10,708	9,821	4,984	3,759	1,317	710	1,304	47,356
General revenue assistance	14,042	10,639	8,414	3,263	4,296	1,672	877	2,372	46,524
Total payments to the States	28,796	21,347	18,235	8,247	8,055	2,989	1,587	3,676	93,880
2011-12									
Payments for specific purposes	14,292	10,256	9,510	4,700	3,883	1,084	659	1,103	45,515
General revenue assistance	14,988	10,908	9,139	3,677	4,493	1,743	903	2,672	49,459
Total payments to the States	29,279	21,163	18,649	8,377	8,375	2,827	1,562	3,775	94,974
2012-13									
Payments for specific purposes	13,725	11,120	10,259	4,860	3,364	1,013	633	780	46,611
General revenue assistance	16,216	11,690	9,883	3,723	4,719	1,845	958	2,883	52,853
Total payments to the States	29,941	22,810	20,142	8,583	8,083	2,858	1,591	3,663	99,464
2013-14									
Payments for specific purposes	13,636	11,831	12,461	5,230	3,031	1,003	647	730	49,499
General revenue assistance	17,270	12,202	10,993	3,705	4,907	1,865	960	2,963	55,812
Total payments to the States	30,906	24,034	23,453	8,935	7,938	2,868	1,608	3,693	105,311
2014-15									
Payments for specific purposes	12,859	10,850	9,901	4,642	2,937	962	669	633	44,357
General revenue assistance	18,090	12,845	11,578	3,983	5,097	1,928	1,005	3,040	58,498
Total payments to the States	30,949	23,696	21,478	8,625	8,035	2,890	1,674	3,673	102,855

(a) Total column may not equal sum of State totals. There is no basis on which to estimate State allocations for a number of payments, which are not reflected in State totals.

Total payments to the States as a proportion of government expenditure are estimated to be 26.0 per cent in 2011-12.

For 2011-12, total payments to the States as a proportion of gross domestic product (GDP) are estimated to be 6.4 per cent. Total payments to the States as a proportion of GDP are estimated to average 6.4 per cent over the 2010-11 to 2014-15 period, as shown in Table 1.2. Payments for specific purposes are estimated to average 3.0 per cent and general revenue assistance is estimated to average 3.4 per cent as a proportion of GDP over this period.

Table 1.2: Total Commonwealth payments to the States as a proportion of GDP

	National SPPs	National Health Reform funding	National Partnership payments (a)	GST entitlement	Other general revenue assistance	Total	Change from previous year	Per cent of GDP
\$million								
2010-11	26,264	-	21,092	45,450	1,074	93,880	-	6.8
2011-12	28,010	-	17,505	48,350	1,109	94,974	1.2	6.4
2012-13	16,152	13,676	16,782	51,750	1,103	99,464	4.7	6.4
2013-14	17,199	14,598	17,702	54,700	1,112	105,311	5.9	6.4
2014-15	18,360	16,154	9,843	57,400	1,098	102,855	-2.3	5.9

(a) Includes financial assistance grants for local government and payments direct to local government.

