

10 The role of HFE in Indigenous service provision

The redistribution of GST revenue that occurs as a result of differences between the proportion of Indigenous people in States' populations is referred to (in CGC parlance) as the effect of *Indigeneity*.

The CGC currently captures *Indigeneity* in seven of the 14 expense assessment categories. These are predominantly social services assessments, that is, education, health, justice services, welfare and housing and services to communities.

During the course of this review the Panel has received submissions that advocate the removal of *Indigeneity* from HFE and submissions that seek its retention. A common theme amongst many submissions was that more needed to be done to address entrenched disadvantage, and that HFE did no more than give States the capacity to provide the average level of services. Although it is beyond the Panel's Terms of Reference, some submissions suggested additional Commonwealth funding is required.

Stakeholder interest in *Indigeneity* appears to be heightened because of the significant amount attributed to that disability in the CGC's tables showing the redistribution by disability (Table 7 in the 2012 Update report).

10.1 How much GST revenue does *Indigeneity* redistribute?

Indigeneity has historically been the biggest influence on the GST distribution on the expense side. Table 10.1 below shows the amounts of GST revenue redistributed due to *Indigeneity* in each of the past five years.

Table 10.1: Amount redistributed due to *Indigeneity*

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total	% of expense redist
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	
2008 Update	-372	-839	290	231	-125	8	-38	844	1,373	44
2009 Update	-376	-884	308	213	-124	15	-39	888	1,423	45
2010 Review	-466	-1,426	441	427	-184	18	-68	1,258	2,143	55
2011 Update	-551	-1,696	527	521	-231	16	-87	1,501	2,565	49
2012 Update	-434	-1,637	655	530	-215	40	-73	1,134	2,360	42

Source: CGC, various Updates and 2010 Review.

Until the 2012 Update, the redistribution attributed to *Indigeneity* had been increasing in line with the increase in the redistribution from all expenditure disabilities in recent years. The amount redistributed due to *Indigeneity* has generally increased over time, because State spending per Indigenous person is increasing faster than State spending per non-Indigenous person, as governments seek to address entrenched disadvantage.

Although increases in average spending and growth in the GST pool increase the size of the redistribution of GST due to *Indigeneity*, the main driver of the redistribution is the diverse distribution of Indigenous people across States. If each State had the same proportion of Indigenous people, an increase in spending on Indigenous people would have little or no effect on the GST redistribution.

As shown in Table 10.1, the Northern Territory can expect to receive around \$1.1 billion more GST revenue in 2012-13 than if it had the average proportion of Indigenous people in its population.

10.2 Drivers of GST redistribution due to *Indigeneity*

As noted earlier, two key factors drive the redistribution of GST due to *Indigeneity*:

- the States' proportion of Indigenous people
- the additional cost of providing services to Indigenous people.

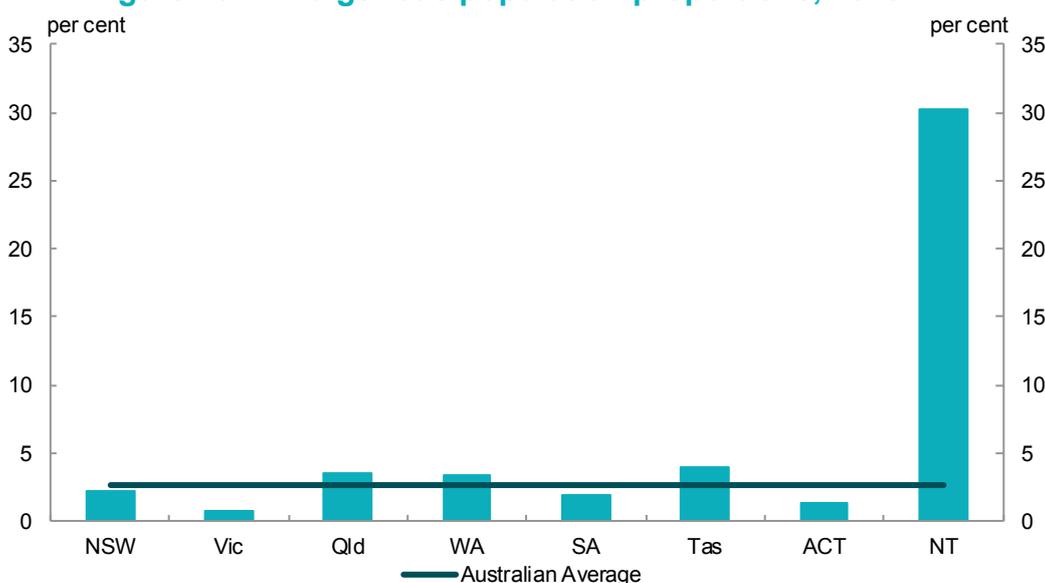
Details of these drivers are in the paragraphs below.

State shares of Indigenous people are different

A key driver of the CGC's assessment of needs related to indigenous communities is the State's proportion of Indigenous people.

The largest numbers of Indigenous people live in New South Wales and Queensland, with around 170,000 and 165,000 respectively. Western Australia and the Northern Territory have similar Indigenous populations, around 78,000 and 70,000 respectively. However, the CGC's assessments are based around the proportion of Indigenous people in States rather than total Indigenous population. Figure 10.1 shows the proportion of each State's population represented by Indigenous people.

Figure 10.1: Indigenous population proportions, 2010-11



Source: Productivity Commission, 2012 *Indigenous Expenditure Report*.

The Northern Territory’s proportion of Indigenous population, at around 30 per cent, is substantially greater than the Australian average, at around 2.5 per cent. The proportion of Indigenous people in the Northern Territory is markedly different to any other State in Australia. Queensland and Western Australia have similar proportions of Indigenous population — about 3.5 per cent. Although more than double the number of Indigenous people live in Queensland compared with Western Australia, the total population in Queensland is about double that of Western Australia. Many more Indigenous people live in New South Wales, but because of New South Wales’ large population overall, it has a smaller proportion than the Australian average.

Those States with Indigenous population proportions above the Australian average (Figure 10.1) receive a greater share of GST (Table 10.1). Having different Indigenous population proportions alone does not cause a redistribution of GST. The redistribution arises because States spend more on services for Indigenous people.

States spend more on services for Indigenous people

The 2012 Indigenous Expenditure Report (IER) found that on average States’ spending per capita on Indigenous people was 2.9 times that spent per capita on non-Indigenous people in 2010-11. There was some variation with Western Australia having the highest spending ratio with spending per capita on Indigenous people 3.4 times that on non-Indigenous people. The Northern Territory spending ratio was about the average (2.9) and slightly above that in Queensland and New South Wales.

Although the Northern Territory ratio of Indigenous to non-Indigenous spending was about the same as the Australian average¹, its higher proportion of Indigenous people results in Indigenous spending accounting for more than half the Territory budget.

Table 10.2 below shows the spending per capita ratio on Indigenous to non-Indigenous people for each State.

Table 10.2: Indigenous to non-Indigenous expenditure per head of population ratio, 2010-11

NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
2.5	3.1	2.5	3.4	3.2	1.4	2.6	2.9	2.9

Source: Productivity Commission, 2012 Indigenous Expenditure Report.

On average, States spend more on providing services per Indigenous person than per non-Indigenous person, especially in areas such as health, justice, and welfare and housing, which are increasing as a proportion of State budgets. It follows that (all else being equal) States with a higher proportion of Indigenous people than average will be assessed as having higher service costs overall and will be given a higher than average proportion of GST revenue.

¹ The Northern Territory’s spending ratio was marginally above the Australian average.

10.3 What the Panel found

After examining concerns put to it about the operation of the HFE system in relation to Indigenous needs, the Panel has concluded that:

- the Northern Territory does not unduly influence its GST share
- there is no evidence the Northern Territory underspends on Indigenous services
- HFE is not the right vehicle to address entrenched disadvantage.

Details of how the Panel drew these conclusions are in the paragraphs below.

The Northern Territory does not unduly influence its GST share

The substantial proportion of the Northern Territory budget devoted to services for Indigenous people can lead some to the conclusion that it drives the size of the Indigenous disability and ensures that the Northern Territory continues to receive a large GST distribution.

However, the CGC’s assessments are based on a calculation of average spending by States on Indigenous people and States contribute to the average level of spending in proportion to their share of total Indigenous residents. The States with the highest absolute number of Indigenous people, New South Wales and Queensland, have the greatest effect on the average. If these States changed their spending on Indigenous people, increasing or decreasing, this would have a much larger impact than any change the Northern Territory made in its spending on Indigenous people.

Should the gap between what States spend on average on Indigenous people compared to others decline, the GST distribution effect would also decline. Finally, in the unlikely event that spending per Indigenous person was to become less than for the population as a whole, the HFE system would redistribute GST revenue away from the Northern Territory.

There is no evidence the Northern Territory underspends on Indigenous services

The latest Indigenous Expenditure Reports (IER) data indicate that the Northern Territory’s relative spending on Indigenous people is comparable with other States. As shown earlier the Northern Territory’s per capita spending ratio of 2.9 is at the Australian average, and is meeting ‘average’ spending requirements.

Although the Northern Territory spends more than half its budget on service provision to Indigenous people, this appears to allow them to provide services at the Australian average standard of services to Indigenous people, but this may not necessarily be ‘enough’ to address Indigenous disadvantage.

HFE is not the right vehicle to address entrenched disadvantage

The current system of fiscal equalisation is based on average spending across all States, it is not the appropriate vehicle to promote above average spending in a particular State or States. While simply funding Indigenous spending outside the GST distribution could

enable above average spending in any particular year, the equalisation process will redistribute the funding over time. Removing that part of the GST redistribution relating to *Indigeneity*, or a subset of Indigenous people, from the equalisation process and funding it through other payments would change the mix of tied and untied funding, but not the total Commonwealth funds to each State. New *Indigeneity* SPP/NPP payments would not affect the relativities for GST redistribution purposes if excluded from the CGC's assessment.

Table 10.3 below shows the change in the mix of tied and untied funding for each State of this approach for 2012-13.

Table 10.3: Funding Indigeneity through PSPs, 2012-13

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Change in GST	434	1,637	-655	-530	215	-40	73	-1,134
Change in PSPs	-434	-1,637	655	530	-215	40	-73	1,134
Total Change	0	0	0	0	0	0	0	0

Source: CGC, various Updates and 2010 Review.

While this approach would not change the total funding of any State, it would ensure the funding allocated to services for Indigenous Australians is spent in that way, and increase the accountability for States with above average proportions of Indigenous people. This could imply those States are not spending enough now, but the Panel does not consider that to be the case.

Practical problems in adopting this approach would arise if other States' SPPs need to be reduced to fund *Indigeneity* due to the amounts involved being large in relation to some States' SPP funding. For example, the reduction in Victoria's SPP funding required by this approach of around \$1.7 billion represents around half its national payment for schools. As the current system of fiscal equalisation is based on average spending across all States, the CGC will give each State the average capacity to address disadvantages and make no assessment of what needs to be spent to tackle any particular disadvantage. Where States increase spending to overcome disadvantage, be it from a realignment of priorities or from additional taxes, the spending becomes part of the average against which all States are assessed. Changing the source of funding from the GST pool to a National Partnership (NP) will only allow States to provide the average level of service, not overcome any disadvantage.

To overcome Indigenous disadvantage above average spending is required, and any additional funding must be external to the equalisation process. This has occurred in recent years, with the Northern Territory Emergency Response (NTER) and subsequent (Northern Territory) Closing the Gap programs that address Indigenous disadvantage in the Northern Territory.

Commonwealth funding for State government service provision for indigenous people is generally included in the current system, and equalised over time. However, where the intention is for the funding to overcome a disadvantage these may be quarantined, or kept out of the CGC's assessments. This currently occurs for the National Partnership on Closing the Gap in the Northern Territory payments.

The Northern Territory should not be removed from equalisation

During the course of the Review the Panel was urged to recommend removing the Northern Territory from the equalisation process, usually with the suggestion that the Commonwealth fund the Territory directly.

The Panel does not consider removing the Northern Territory from equalisation to be an appropriate path to take as it is a sovereign entity within the Federation and it should not be treated differently to other States. The Panel considers that all States, and Territories, should be able to tailor the delivery of services to meet the needs and desires of their citizens, and removing any State or Territory from the equalisation process would prevent this.

10.4 Other *Indigeneity* related issues

Measuring Indigenous expenses directly

The CGC does not currently assess *Indigeneity* at an aggregate level but captures the costs faced by States within relevant expense assessment categories. These are predominantly social services assessments, such as, education, health, justice services, welfare and housing, and services to communities.

In reporting on the impact of *Indigeneity* on the redistribution (Table 7 of the 2012 Update report), the CGC does not directly estimate the redistribution due to *Indigeneity*. Instead, the estimate is derived by assigning to Indigenous people the cost weights and / or spending levels relating to non-Indigenous people in each expenditure category, with all else unchanged, then comparing the resulting GST redistribution with the GST redistribution from the actual assessments. Estimates for other disability factors are obtained in a similar fashion, by applying average spending for (or removing) that disability, holding everything else constant, and comparing the resultant redistributions with the actual assessment redistributions.

In its first interim report, the Panel saw merit in exploring whether assessments could be developed to more directly measure needs due to disabilities than the category of spending approach currently adopted.² The Panel has been advised the data required for assessments to be made on this basis are not available.

Recognition of above average costs

In its submission, Western Australia says that its *Indigeneity* costs are not fully recognised due to population undercounts and insufficient recognition of higher costs.

Western Australia considers that Australian Bureau of Statistics population estimates undercount its Indigenous population and also argues that the CGC wrongly assumes that Indigenous persons are equally disadvantaged across the nation in comparable areas, whereas Western Australian Indigenous people in fact suffer higher disadvantage. Western Australia estimates the adverse annual impact on its GST share of a range of issues it has with current CGC methods. Western Australia estimates that the

² GST Distribution Review, *Interim Report*, March 2012, Chapter 7.

Indigenous population undercount costs it \$50 million per annum and that differences in Indigenous disadvantage cost it \$300 million per annum.³

The use of averages in the HFE system will equalise all States to the average, but cannot recognise all of their higher costs. Any State concerned about undercount and incomplete recognition of costs should take its claims to the CGC in the next review.

Reporting on Indigenous expenses

Reports such as the Indigenous Expenditure Reports, National Indigenous Reform Agreement reporting, and Overcoming Indigenous Disadvantage reports provide an evidence base upon which to design policies and programs to improve outcomes for Indigenous Australians. The Panel found the information in these reports helpful in developing its understanding of the issues Commonwealth and State governments face in providing services to Indigenous Australians.

The Indigenous Expenditure Reports contain estimates of expenditure on Indigenous specific services and services provided to Indigenous people through mainstream services, by the Commonwealth and States. Much of the Commonwealth's indirect spending is in the form of payments for specific purposes and general revenue assistance (including GST payments). Information on State based revenues does not appear in the Indigenous Expenditure Reports, and including it in future reports would widen the evidence base.

Finding 10.1

The current HFE system seeks to address only the costs to States that are the average policy, including those associated with service provision to Indigenous communities. On that basis there is no rationale for removing Indigeneity from the HFE system.

However, precisely because the current system equalises to the average, it cannot overcome the disadvantage experienced by some Indigenous communities. Improving outcomes for these communities will require a concerted effort by Commonwealth and State governments. Where additional measures are required, they would best be undertaken outside the HFE system and excluded from it, so that the HFE system does not frustrate the desired change.

The Indigenous Expenditure Reports (IER) are important as a means to understanding differences in service provision costs between Indigenous and non-Indigenous people. It would assist the long term assessment of Indigeneity if stakeholders could expand the IER reporting process to include measures of revenue as well as expenditure.

3 Western Australian Government submission to the GST Distribution Review, October 2011, pages 65-66.

