BUDGETING FOR STATEHOOD IN THE NORTHERN TERRITORY

EDITED BY

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Budgeting for Statehood in the Northern Territory

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Preface

THE HON. STEVE HATTON MLA

The theme of this important collection of essays is Budgeting for Statehood in the Northern Territory. All of the contributors were asked to consider some of the unique aspects of the Northern Territory when studying the budgeting aspects associated with achieving Statehood. Constitutional development lies at the heart of this process.

The Draft Constitution

During the August 1996 sittings of Parliament in the Northern Territory, an historic occasion occurred with the tabling of the Territory's Draft Constitution. The document was the Final Draft Constitution as prepared by the Northern Territory Legislative Assembly Sessional Committee on Constitutional Development.

It was with a great deal of pride that I tabled that historic document. For me, together with a dedicated group of people, it represented a decade’s work. The constitutional process towards producing the draft document began in 1985 and drew support from a small group of Territory politicians from both sides of the Assembly, and their support staff. There was widespread community consultation and it was a slow, sometimes tedious, often frustrating process, involving much research, a lot of paper, many public hearings and submissions, and lengthy debate and deliberations within the Committee.

1 Minister for Correctional Services, Minister for Parks and Wildlife, Minister for Sport and Recreation, Minister for Ethnic Affairs.
In total, the Sessional Committee on Constitutional Development received 141 written submissions and numerous other verbal submissions. The Committee now has a regular mailing list of close to 4000 and produced a number of publications to its credit and has been involved in many related activities. Overall, the process of constitution-making has been an open, democratic process, with maximum opportunity for input by all the community. As Territorians, we are charged not only with writing our own constitution, but also ensuring that the homegrown constitution will also benefit future Territory societies. The Constitution will be required to operate in the interests of all sections of the Territory community and it is obviously important to produce a workable document. The views of all Territorians are important as we move towards Statehood in the year 2001.

**A Multicultural Society**

The people of the Northern Territory live in a unique multicultural, multi-racial society with people from almost every imaginable background. Overlaying this, of course, is the very significant position of the Aboriginal people in our society. Aboriginal people comprise 26 per cent of our population and have effective control of half the Northern Territory’s land mass. Seeking to develop an approach which recognises the diversity of backgrounds of Territorians, whilst constructing a framework for our common future, has been one of the greatest challenges for the Sessional Committee in the process of producing the *Draft Constitution*. Consistently, Aboriginal people have expressed strong common concerns, and even fears, in the process of moving to Statehood.

**Statehood**

The *Draft Constitution* was also prepared in association with plans for the future constitutional development of the Northern Territory within the Australian Federal System. The goal is full Statehood on equal constitutional terms with the existing states. We wish to be a full partner in the Australian Federation. The Government and others believe that statehood is our
constitutional right and this is reflected in the Committee's Terms of Reference.

When adopted, the Draft Constitution will be the Constitution of the Northern Territory as Australia's newest State although, possibly the Constitution could be brought into operation before any grant of Statehood.

The Draft Northern Territory Constitution defines how the new State will be shaped and governed. It does not, however, contain all of the provisions needed for a grant of Statehood – some terms and conditions would have to be fixed by Commonwealth legislation under Section 121 of the Australian Constitution.

It is a separate but related process to the conditions of Statehood and in our view is a matter for the Northern Territory people alone to decide.

The Draft Constitution provides a point of reference from which further debate can proceed and I will continue to keenly follow the course of the debate, as I am sure will the other members of the Sessional Committee on Constitutional Development.
The Fiscal Framework
Budgeting for Statehood in the Northern Territory

CHRISTINE FLETCHER

Since the Northern Territory achieved self-government in 1978, governments in the Territory have been attempting methodically to accumulate more and more of the trappings of statehood. How people measure the progress of the Territory’s achievements depends on different perceptions of what it means to be a state instead of a territory. Among some of the most significant questions that arise in debates over how to recognise the characteristics of statehood are territorial and population size (including demographics) and, most importantly, the level of democratisation, electoral systems, how equity is reflected in public policy and in the organisation of government institutions, the effectiveness of public administration, a respect for general rights and, the quality of the relationship between government and the Aboriginal and Torres Strait Islander population.

In a democratic system such as Australia, all of the issues mentioned above provide an indication of the level of maturity of governance in the Northern Territory and, given the regional economic disparities between the different state governments in the federation, the question of statehood rests largely on support from the other governments. Budgets are a particularly important part of the statehood argument, particularly as the Northern Territory has a comparatively small population – there are
approximately 180,000 individuals living in that part of Australia and over 26 per cent of those people are indigenous – and comparatively limited access to revenue.

Many of the indicators of potential or impending statehood are related directly to the existing financial relationships between the commonwealth and the other states. For example, and for historical reasons, there is a set of principles designed by both the states and the commonwealth and used by the latter to determine the level of expenditure that each state and territory will require for the purpose of budgeting. Under the existing practices, when those principles are applied to the pool of commonwealth general purpose revenue, it matters not whether the sub-national region is a state or a territory. In other words, for financial purposes, the commonwealth government makes no direct distinction between the territories and the states. From a practical perspective, the reasons for standardising general expenditure to all of the states and territories has a strong management appeal. It is also appealing in relation to the development of Australian federalism because it focuses on the nature of fairness, egalitarianism and equity between the peoples of the states and territories. In historical terms, there are important political reasons behind the commonwealth’s lack of general financial discrimination between the states and territories – these reasons hark back to the 1930s when Western Australia and Tasmania threatened to secede from the federation.

The question of how to recognise an equitable process for deciding the distribution of national expenditure is determined very much by competition between the ‘big’ states – New South Wales and Victoria – and the ‘smaller’ states – Queensland, Western Australia, South Australia, Tasmania, the Australian Capital Territory and the Northern Territory (see Fletcher 1992 & 1996). The ‘big’ states would benefit enormously if the commonwealth changed its position on standardising the needs of all of the states and adopted a straight-forward per capita distribution approach – the greater the population, the greater the share of the national ‘cake’. But, the outcome for the population in the ‘small’ states would be devastating – particularly in the Northern Territory. The Territory would not be able to sustain a viable governing position as an independent region within the
federation. Without overstating the implications of the system of transfers basically driven by the larger states – many communities would collapse; basic services would disappear; investment from all sources would be probably withdrawn because of lack of infrastructure and, finally, constituent dissatisfaction would lead to a situation where the current structure of government and administration might become unsustainable – certainly, the legislative position of the Northern Territory within the constitutional system of states and territories would be considerably weakened. Politically, so far as the Commonwealth is concerned, and in view of its demonstration of constitutional authority over the Territory’s voluntary euthanasia legalisation, the Territory would be relegated to a position of total mendicancy. Any attempts to exercise regional autonomy outside of the municipal process could be constitutionally scorned – needless to say, the Territory’s own draft constitution would not survive in any meaningful form.

There is, however, a very strong relationship between fiscal federalism, ‘good governance’ and statehood. If statehood is to be achieved then the Northern Territory will be obliged to convince not only its own constituents but also the other Australian governments of its virtues and maturity. For some, the belief that the Northern Territory is mature enough to govern without Commonwealth interference will require a relatively small step – for others, it requires a huge leap. Part of the problem lies with the fact that the Commonwealth Parliament has already demonstrated its constitutional prowess over the Territory plus, from the indigenous community, the view that their people have fared better (or less worse) under the Commonwealth than under the Northern Territory will inevitably shape the outcome. Financially, on the surface, the move to statehood looks less difficult – a perception shared by most of the contributors to this volume – than the political realities of constitutionalism and party politics. This forms part of the explanation developed by Cliff Walsh in his introduction to the historical evolution of fiscal federalism in Australia and, more specifically, the principles and practices that form the foundations for fiscal federalism to function in relation to the Northern Territory.
Walsh sets the framework for the theme of this book by reminding us of the global and regional context of government, particularly the multi-level nature of intergovernmental relations and federalism. The way in which fiscal relationships work should not be understated in the Territory’s bid for statehood. According to Walsh:

Complex inter-governmental relationships are inevitable in a well-working federal system, including the fiscal component of federalism. It is important to make sure that we have a system in which there is mutual respect between the various tiers of government and a professionalism in the dealings between these governments – one which parallels international affairs (p 16).

The sort of professionalism that Walsh refers to is a matter of priority within the public sector in Australia and all of the contributors leave no doubt of its importance in setting budgetary management trends throughout the states and territories. Both Alan Tregilgas from South Australia (chapter 3) and Mike Harris, Western Australia (chapter 4) address the significance of new management trends in their respective states, notably in the areas of accountability, input-output-outcomes and best practice. In the case of South Australia, Tregilgas argues that the principles set out under the purchaser/provider model are the most useful as a guide to ‘roles of government’ dilemma if a paradigm approach is adopted. In Western Australia, the key indicators to the reform of the public sector are adapted from the New Zealand model and Harris establishes a strong argument based on financial management to explain the process towards achieving more effective service delivery (see WA Treasury 1996).

Gary Henry shifts the focus onto the Northern Territory and argues for consideration to be given to the peculiarly unique position of the Territory in term of fiscal federalism. He points out that the economic and financial dimension of the Territory is already on a par with the other states, at least, so far as the question of budgetary management is concerned. Although, by the same token, he also points out that many of the issues leading to the future successful management of economic development are likely to be based on increasing the existing revenues available to the Northern Territory – for example, mining royalties. As we see by Norman Fry’s paper, the likelihood of
shifting royalties from one group of stakeholders to another group is not simply an accounting process – these are issues central to the debates over the possible transition to statehood. Norman Fry's paper is a strongly argued position on Aboriginal rights in relation to land. He uses his background in tertiary education as a platform from which to advocate more meaningful reform and consideration, and conciliation. Fry's argument is preceded by Catherine Hull from the Commonwealth Grants Commission and, as a regular contributor to fiscal federalism forums, the Commission establishes a useful framework for equity by explaining exactly how the system of commonwealth expenditure really works. Catherine Hull illustrates the significant issues of budgetary concern through a series of tables and, for students of the Commonwealth Grants Commission, Hull's chapter follows in the tradition of the Commission as an excellent guide to the institutional operations of fiscal federalism in Australia (Commonwealth Grants Commission 1997).

Finally, and with a view to expanding our perceptions of the Northern Territory, Geoff Forrester explains the importance of the Territory's role in the northern-most part of Australia's region. He draws attention to the commercial benefits of the Territory's union with Indonesia and other related countries in east Asia and, also, makes the point that there are benefits for the other Australian states in supporting the Northern Territory. Overall, Forrester's chapter adds a further international dimension to the issue of budgets, governance, regional development and statehood in what is an interesting and useful collection of perspectives on, what might be termed, a set of global principles for guiding the Northern Territory towards statehood in the future.

Ron Duncan caps off the debate over the ability of the Northern Territory to achieve statehood by providing a lively overviews of all the arguments.
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Federalism and the Fiscal System

CLIFF WALSH

The purpose of this chapter is to put paid to the overall context within which the discussion of more specific issues of budgets and particularly of budgeting for the Northern Territory is to be conducted. In any economic and political system the fiscal system is exemplified most clearly in the annual budgets. The fiscal system has a key role in staging economic and community development outcomes. In a technical sense, the fiscal system is a means of mobilising resources and revenues with which to provide the infrastructure – both physical and social – and to finance the services that underpin economic activities and social progress. How successfully that takes place depends not just on how well revenue is mobilised but, critically also, on how effectively service delivery is organised. At the peak of the fiscal system are the Premiers Conferences on state, territory and commonwealth budgets and the accompanying government deliberations. But, at the base of the pyramid are the people whose needs are more than the governments can actually supply. At the end of the day it matters not how well designed our fiscal system is but whether infrastructure is adequate and services reach the people.

In a political sense, the fiscal system is the principal means by which governments attempt to articulate and implement their
economic and social priorities and shape their nation's or their region's future development. Effectiveness depends on the capacity not just to articulate priorities, but to actually proceed and implement them through the budgetary process and through the service delivery mechanisms that have been established in government.

In a highly globalised world fiscal policies which are adopted by government, and the assessments that are made of the fiscal strength of the nation or a region, will have a significant impact on the capacity of government to attract increasingly skilled people, entrepreneurs and capital. The tensions, including the tensions created by globalisation, will affect economic development on the one hand and community and social development more generally.

These issues apply to all economic and political systems, but, in a federal political system, the fiscal system is exemplified in federal fiscal arrangements because it actually involves multiple levels of government bureaucracies and communities. Not only is the fiscal system of federal nations more complex, but from a national perspective but it is also potentially more fragile and more difficult to manage and coordinate. Also, it is more difficult for state and territory governments to control. But, in principle, it is more susceptible to local government and/or community associations and community organisations to influence.

The federal fiscal stocks are obviously primarily a reflection of the basic set of constitutional arrangements that define the roles and responsibilities in relation to its creed of different spheres of government. On the other hand fiscal institutions reflect the historical evolution of a particular set of constitutional structures which bond our particular politico-economy – times of war, economic depression and so on. However, the Australian constitution itself only tells us a part of the story of what the fiscal federal system structure actually is.

While the facts and the statistics paint a picture of a reasonably well ordered, if somewhat complex, fiscal structure, the practical reality is quite different. The federal fiscal system is intrinsically subject to the push and pull of politics, hard-bound politics, bureaucratic politics and community politics, all of which reshape the outcomes from those that are effected at higher levels.
Equally importantly and in context with the Northern Territory, when we talk about the federal fiscal system, there is a tendency to focus on questions of the division of responsibilities, of working for the Premiers Conferences, and the system of grants between tiers of government that flow from the commonwealth to the states, territories and local governments. We often overlook the fact that the commonwealth's own-purpose spending, whether on health, labour market programs, industry support or, especially in the Territory, on Aboriginal and Torres Strait Islander affairs, and also through the defence budget, has a significant impact on its own account. In fact, in the Northern Territory, as significant as commonwealth grants may be, the commonwealth's own-purpose spending is of a similar magnitude to those that the Australian Bureau of Statistics reveals.¹ The commonwealth's own role as a spending agency has potentially as large an impact as the grants system in terms of how resources actually get distributed across the states and territories in Australia as well as in terms of the economic consequences of that sort of spending.

**Three Spheres of Government**

The federal fiscal structure in Australia, more generally the public sector, is organised essentially into three spheres of government – the commonwealth, the six original sovereign states and the two mainland federal territories and the other sphere of government – comprised of local government, community associations, and a host of community-based government structures.² An important point about Australia's Constitution which defines the relationship between these governments, and one which is often overlooked or misunderstood, is that the commonwealth was given very few exclusive powers by the Australian Constitution. It has exclusive powers over Customs and Excise duties, over the coining of money, and over initiating referendums: there are three main functions other than those areas that are essentially

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1 According to figures compiled by Senator Grant Tambling's office and supplied to the author in 1996.

2 Both territories have self-governing status and in most fiscal and other inter-governmental aspects, now effectively receive the privileges of the states so far as the fiscal imputations are concerned.
about its own internal structure. What the commonwealth has is a very large number of powers connected concurrently with the states in which commonwealth laws prevail in event of a conflict. Over the whole set of issues, including taxation, defence, foreign affairs powers are essentially concurrent powers even though we would expect defence and foreign affairs, to be in large measure, exclusive to the commonwealth. However, the Territory’s Memorandum of Understanding with neighbouring countries reflects the fact that foreign affairs is of interest to the states as well. The commonwealth shares concurrent social welfare benefits, pensions, postal and communications services, banking and insurance, matrimonial causes, property rights, trade marks and so on. Even in those spheres where, in principle, the commonwealth could attempt to completely occupy the field and utilise legislation to effectively override the states, it relies on the states to see things through. The Constitution also lent to the states residual legislative responsibilities for those areas where the commonwealth was not given ministerial, exclusive or extensive powers – that includes most areas of law and order, health, hospitals, land, housing and urban development, regulation of interstate commerce and industry, agriculture, development of national resources, rail and road transport, provision of water, gas, electricity and control of local government. But we are also well aware that Section 96 of the Constitution gave the commonwealth power to make grants to the states on those terms and conditions as the Commonwealth Parliament sees fit. This has provided the commonwealth with the ability to influence significantly both policy making and administrative arrangements in those areas that are essentially exclusive of the role of the states and territories. Throughout the post-war period this has allowed the commonwealth to influence policy making and administration.

Local government received no formal recognition in the commonwealth’s system of functions. Local government is a relatively small part of service delivery in the Australian system compared to other countries where local government has had some sort of role typically in relation to police, in relation to health or hospitals and in relation to education, none of which it does here in Australia. Even in the development of social justice
values, governments have not really given a very extensive role to local government although the policies vary between the states and territories.

The respective roles of the commonwealth/state and local spheres in Australia indicate that the commonwealth is basically responsible for about 52 per cent of total public sector expenditures for its own purposes, the states are responsible for about 43 per cent, and local government for about 5 per cent. Other aggregate data reveal that the important issues include taxation, debt, capital and employment. The point to be strongly made is that the states are major players in ownership of public sector capital in Australia, relative to the commonwealth. The other side of the coin is the way that commonwealth, state and local authorities share expenditures compared to their share in the raising of revenues, particularly in taxation levies. The commonwealth's own-purpose outlays amount to a little over half of total public sector outlays and are concentrated primarily in the kind of things which include particularly, social security, welfare, health benefits and defence. But there are also some national infrastructure activities such as airports, roads, national security and so on. The states' public sectors own-purpose outlays representing about 43 per cent of the total and are predominantly used for the delivery of education services, health services, for transport, housing and community amenities, public order, safety and so on. The states deal with the delivery of social services within the development of their regional economies. The relatively small local government sector primarily deals with roads and structural maintenance, sewerage, drainage, some postal services to households and also some human services which relate to health utilities.

One of the most important points relates to revenue and expenditures and to the vertical fiscal imbalance. The commonwealth is responsible for 52 per cent of outlay and raises 74 per cent of taxation revenue. The states and territories with responsibility for 43 per cent of expenditures raise only 21 per cent of taxation revenue. For the states and territories sector as a whole, they rely on the commonwealth for 40 per cent of the revenues for their expenditures. For the Northern Territory it still relies on 73 per cent. South Australia, Western Australia and
Tasmania would be above that average of 40 per cent, close to 50 in the case of both Tasmania and South Australia. The Northern Territory has a particular endowment there which will be discussed later.

For Australia, the situation of vertical fiscal imbalance is much more extreme than in any other of the mature federations that we typically compare it with – the United States or Canada – it is a feature of the system that we have to live with.

The commonwealth is alone in raising income taxes and excise and sales taxes. The states raise their revenue through taxes that the commonwealth does not normally occupy: payroll tax, stamp duties, motor vehicle taxes and franchise fees. Local government relies on land taxes. It is an incredibly stratified system. In the end, all tax comes out of the pockets of the people. Tax is money that belongs to the people whether governments take it in the form of payroll tax, income tax or sales tax. At the end of the day, the entire system is much more intertwined than would first appear. The reasons are well known. During World War II, the commonwealth took control of income tax as an emergency measure and then decided it wanted to continue the monopoly over income tax in the post-war period. This is entirely unlike what happened in Canada, for example, where although the federal government asserted control over income tax during the wartime period, it was explicitly articulated as a rental arrangement, so when the provinces decided that they would like to get back into the area they could do so effectively. The other component that explains the Australian situation is the fact that the High Court has interpreted excises as the exclusive jurisdiction of the commonwealth. The states are therefore unable to introduce any broad-based sales tax, unlike the Canadians or the Americans. The question of how appropriate that particular interpretation is determined, is one that can continue to be debated. The states have managed to establish franchise taxes on alcohol, tobacco and petroleum products and the usual taxes. The High Court is perfectly aware of that. But it is also perfectly aware that the states have become so dependent on those revenue sources that any attempt to cease them would be a major problem.
Summary payroll tax is a most important source of tax for all states but not within the two territories. As far as the other taxes, the letter of the Constitution tends to vary even more depending on state and territory preferences. In the Northern Territory there is a relatively high share of franchise fees and a relatively high share of financial levies although, to some extent, those relatively high shares might evolve in effect from some other bases.

The picture of state and territory revenue shares obviously raises the question of tax reform. Should something be done about it? It is not intrinsic to the Northern Territory's entry into statehood that we first enter into a reform of the fiscal system. But governments who are bound to spend should be, to the greatest extent possible, responsible for raising the revenues to enable them to do so. This is a fundamental democratic principle and the lack of that association in Australia seems to be a little bit of a problem. In 1991 the Premiers and Chief Ministers proposed that there should be a shared national income tax devised for those purposes. That led, among other things, to the fall of Bob Hawke from the Prime Ministership, and with Paul Keating in power there was no chance of that happening. It was then that the states and territories became incredibly introverted with the issue and, although they are calling for tax reform, it is not necessarily fixed reform from the point of view of a democratic principle.

The flip side of this revenue dominance of the commonwealth is that we have a high dependence of the states and territories on grants. In recent years the commonwealth has been making grants to the states and territories of over $30 billion a year. The commonwealth financial system is something like over 40 per cent of state outlays while the states have less than 40 per cent of state outlays.

Grants

The other important trend that has occurred in recent years is the form in which those grants from the commonwealth is coming to the states has been increasing and moving in the direction of tied grants until recent years. Turning back to the early 1970s, general purpose payments were about three-quarters of the total. Since then the commonwealth has become more involved in education and health than previously was the case. A huge surge in tied
grants under the Whitlam government was somewhat reversed by Fraser and was reversed again under the later Labor administration. Sometimes there is a dimension which depends to a limited extend on other events, for example the Medicare arrangements, or on the relationship between revenue payments and specific purpose payments over that period. Of all tied grants, few have particularly onerous matching requirements, although they are associated with subsidies. But there is also a substantial amount of administrative and political interaction with these reforms. For example, there is a series of ministerial tangibles dealing with issues, from Premiers Conferences down through heads of government forums. Starting through 1990–91 at the Premiers Conferences and subsequently COAG, fiscal reform depended on attempts to make the system of intergovernmental relations work better, and to reduce the inference of tied grants. There has been success with reforms in relation to the business enterprise sector of the public sector as a whole, and also to the reform of regulatory functions, as a result of national competition policy on the one hand and mutual recognition of standards on the other. Complex inter-governmental relationships are inevitable in a well-working federal system, including the fiscal component of federalism. It is important to make sure that we have a system in which there is mutual respect between the various tiers of government and a professionalism in the dealings between these governments – one which parallels Australia’s approach in government to government relations in international affairs. Those are essential to making intergovernmental relations work well for the sake of people.

Finally, it seems that the complexities are part of the design of our federal system. Complexity is inevitable. The decision to build a federal union implies the creation of a national government in addition to regional governments which means that national majorities have also been created. National majorities compete with regional majorities, views and issues and influence economic and social development in the various regions of Australia. The commonwealth doesn’t operate in its own territory, it operates in the territory of the different states and territories. By putting the

3  Fletcher C & Walsh C 1995.
4  Walsh C 1996.
commonwealth into the system we create the capacity to overlap. In fact, the particular form of the Constitution that our founders adopted, with the commonwealth having concurrent jurisdiction over large monetary areas invites overlap. Sometimes reforms are slow, but on balance there are lots of arguments why federalism is better than any alternative.

Early in 1996 the National Commission of Audits recommended that the commonwealth should distinguish its role. That is a naive observation. Why would the commonwealth be able, or even want, to stay out of the policy area? The commonwealth and the states will continue to compete consistently for the delivery of policy ideas to their people. That is their job – they are required to do so – they are required to represent the interests of their constituents and so the system will inevitably overlap and be duplicated in some respects. The problem will be not to create an unnecessarily bureaucratic and duplicated system to make overlapping intolerable. We may be able to reform parts of the system in various ways but we will not repeat the complexities of the system and we ought not to. To be successful we need a good system for managing inter-governmental relations with the commonwealth and to make things work better.
References


Roles, Responsibilities and Comparative Public Sector Reform
Redefining the Roles and Responsibilities of Government

*Ends vs Means*

**Alan Tregilgas**

**Introduction**

This paper examines the *paradigm shifts* which have been occurring within public administration in many jurisdictions in Australia and internationally, focusing on their fiscal dimension. In particular, three major, and inter-related, new paradigms\(^1\) are described and their major policy implications identified. These paradigms are: the principal-agent metaphor; inputs-outputs-outcomes; and the purchaser-provider distinction.

To make the topic manageable and given the ground which some later speakers might cover, my focus is on:

- the 'budget sector', not on the public trading or commercial enterprise sector of government;
- the expenditure side of the ledger, leaving funding and tax issues aside;
- the service delivery activities of government, as opposed to its regulatory roles;

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\(^1\) A *paradigm* is a set of basic concepts which has the potential to provide important insights into activities or behaviour.
Budgeting for Statehood in the Northern Territory

- 'allocative' issues, not fiscal responsibility or macro issues; broad public management issues, leaving budgetary reform and financial management improvement to others;
- the management and governance processes of government, not the mix of policies or services per se; and
- the circumstances facing governments; generally, not the situation in particular here in the Northern Territory.

Hence, 'my' focus is mainly on 'public management': 'management' being concerned with the optimal utilisation of resources towards desired results; and 'public' as the activities concerned take place in a political context and within political constraints, such as parliamentary control over the use of taxpayers' funds.

The paradigms canvassed have implications for management both within individual public sector organisations and at the macro-level across the public sector as a whole. The latter involves machinery-of-government aspects of 'institutional design', i.e. the systems and structures of government and the allocation of government functions among departments and other agencies.

Traditional Approaches to the 'Roles' of Government

Traditionally, the exercise of a government's responsibilities in respect of service provision — in response to perceived 'market failure involving either 'public goods' or situations' where there is a community perception that government 'provision' is fundamental to meeting social objective — has been synonymous with the direct provision of goods and services by the government itself. This is typically organised through Westminster style government departments. At their best, these departments exhibit and foster the community service ethos implied by the term 'public service'.

The key organisational design features of the 'traditional' model are:
- maintenance of public sector practices sharply distinct from the private sector in terms of continuity, rewards, promotion, and the like; and
• restrictions on discretionary behaviour by politicians and senior officials by means of a complex system of centralised control, with detailed specification of delegations of authorities.

As such, the central focus is on how to limit political corruption and the waste and incompetence that is held to go with it. Put bluntly, the underlying assumptions are that politicians are inherently corrupt; that private business is monopolistic; and that public sector professionals are disposed to act as ‘trustees’ for the community.

As a consequence, the traditional system of financial management and control focuses on the cash cost of inputs, such as personnel, travel, capital expenditure and the like.

Problems Experienced under the Traditional Model

A wide range of concerns have emerged over the structure and operations of the public sector under this traditional model, namely:

• concerns over the accountability of officials to ministers;
• concerns over effectiveness: do government departments achieve the goals set for them?
• concerns over efficiency: even where they achieve their objectives, do government departments do it at anything like a satisfactory level of efficiency?
• concerns that the traditional personnel and IR arrangements and regulations are an impediment to the efficient and effective operations in the public sector;
• concerns that departmental structures have evolved in a more or less ad hoc fashion, with most machinery-of-government changes resulting from new initiatives or political manoeuvring;
• concerns about the heavy reliance on departments, and often a large number of departments at that, and so a relatively large ‘core’ of government;
• concerns that most departments undertake a range of advisory, delivery and regulatory functions, often combining commercial and non-commercial responsibilities, which
  – foster conglomerate organisations which are difficult to manage,
  – cloud the purpose and objectives of departments, with performance goals being hard to define and the process of performance appraisal complex,
  – gives rise to ‘information asymmetry’, where information that would form part of an explicit relationship if contracted between independent organisations often is buried in internal management decision-making and is poorly documented, and
  – see a tendency for policy and funding advice to be ‘captured’ by the provider interests, with the consequence that a government’s primary source of advice on policy and resources often comes from parties with a direct interest in service delivery;

• concerns that, not only does the traditional framework not engender strong pressure for efficient resource use, it can create strong incentives for departments to expand for the sake of expansion;
  – with deficiencies in outcomes produced by the market often sufficient to justify a significant expansion of government activity, with little general questioning of whether governments can in reality achieve more effective and efficient outcomes through direct provision;

• concerns that there are no genuinely objective rules to specify which services are more appropriately provided by the public or private sectors
  – while traditional economic principles limit the case for government provision of goods and services to ‘public goods’ or to those involving natural monopoly or to where there are issues impinging on fundamental community values, in practice the last category is so general as to leave governments with a wide range of apparent discretions;

• concerns that government spending on service provision has often run well ahead of the willingness of electorates to pay
the full cost out of current taxes and charges, giving rise to deficit financing of recurrent costs of government service provision; and

- concerns that ministers are provided with insufficient information about public sector performance and on which to make many of the necessary judgments, with only partial information available on inputs and resources consumed and little or no information available on the outputs provided and the impacts of those outputs.

In sum, with its concentration on preventing the misuse of public funds, the traditional approach to public management does little to ensure that taxpayer or capital funds are put to best use. Ultimately, any inefficiency must be funded by way of higher charges or taxes, or passed on to the community as costs arising from poor service or regulation.

The ‘New’ Public Administration

The ‘traditional’ view was pretty much conventional wisdom in all jurisdictions until 10–15 years ago. Over the last decade or so, a reform movement in public sector management has been growing worldwide, based on a reaction to the constraints on achieving efficiency and effectiveness inherent in traditional public sector service provision and plainly apparent in many jurisdictions by the 1980s. In the process, a series of public sector reform principles have been developed, adopted and refined in a number of jurisdictions around the world.

The Efficiency Unit set up by the United Kingdom Government in the mid-1980s was one of the most prominent early manifestations of the international reform movement, and the New Zealand experiment saw its own brand emerge in the second half of the 1980s (Boston et al 1996, see also Improving Management in Government 1988).

Here in Australia, the reform principles recommended by all seven Commissions of Audits have drawn on a framework of principles which have now been ‘field tested’ and refined in many jurisdictions around the world over the last decade (National Commission of Audit 1996, see also Report of the Queensland Commission of Audit 1996).
The reforms have not just changed the instruments or techniques of public management, they have also brought significant changes to the style and mode of governance and the culture of the public sector. This is reflected in, among other things, the adoption of a new language of discourse. Terms not used before the mid-1980s are now commonplace, such as contestability, contracting out, outputs, outcomes, ownership interest, purchase agreements, stakeholders, strategic planning, transparency and agent-principal relations (Osborne & Gaebler 1993).

The New Paradigms

Against this background, I now turn to describing in more detail the three new ‘paradigms’ evident within public administration today.

1 Principal-agent metaphor

The ‘principal and agent’ metaphor involves social and political life being understood as a series of contracts, with the agent seeking to perform various tasks on behalf of the principal and, in exchange, the principal agreeing to reward the agent in a mutually acceptable way. Given that individuals are prone to self-interest seeking, the interests of agents and principals are bound to conflict, so stressing the need to find ways of negotiating, writing and monitoring contracts to minimise such opportunities on the part of the agent.

Besides leaning heavily on ‘agency theory’, the ‘new’ public administration is also influenced by ‘public choice theory’ which suggests that public officials tend to behave in self-interested ways by maximising rewards, including by increasing the size and power of their organisations.

The essential policy prescription of agency theory is to ensure that agents serve principals in accordance with stated or implied contractual conditions. Important in this regard is clarifying and defining the relationships between ministers and top officials, and between departmental chief executives and their senior managers.

Likewise, this view of the world implies that departments should have clear cut managerial missions and systems of
accountability. Accountability requires a reporting basis that is consistent with objectives and responsibilities, and which comprehends all resources used when measuring the input costs and outputs involved.

The new model implies a lessening of differences between the public and private sectors, and a change away from procedural rules towards a stronger focus on results. It also involves a shift in patterns of trust; with more trust in short-term contracts, competition and market testing to hold opportunism, shirking and slack-seeking in check, and with less reliance on procedural checks.

The aim of reform is to shift public sector management:

- *away* from employing bureaucratic processes, which are based upon trustee notions and a view that private sector practices are inherently corrupt and inappropriate;

- *towards* strategies consistent with best practice in organisations world wide.

Both agency and public choice theories recognise that incentives are an important means of changing bureaucratic behaviour. Appropriate incentives may be personal, such as performance pay (positive) or termination for non-performance (negative); or organisational, such as financial measures designed to ensure sound financial management of assets. Such incentives help to ensure that contractual agreements are fulfilled and that self-interest is channelled productively.

Bringing the principles and practice of public management more into line with those of the private sector is not to deny that important differences will remain between the two sectors. Nor should it assume that private sector organisations are better managed than public sector ones. But it is equally wrong to assume that private sector practices have no relevance to public management.

2 Inputs – outputs – outcomes

This second paradigm is based upon the distinction between:

- *inputs*, which are the resources or components used to produce goods and services;

- *outputs*, which are the goods and services produced by government to meet its policy goals; and
• outcomes, which are defined as the results ultimately desired by government for their policy goals.

For example, particular health and hospital services are an output; the outcome is the overall health status of the population.

The concepts of inputs, outputs and outcomes provide a basis for the evaluation of programs and activities in terms of:
• economy: the degree to which the lowest price is being achieved for a given quality and quantity of inputs;
• efficiency: the degree to which the maximum output is being achieved for a given level of inputs;
• effectiveness: the degree to which a nominated outcome is being achieved by the selection of the mix of outputs; and
• appropriateness: the degree to which the objectives or outcomes of a program are in fact the priority of the government and address the real needs of the community.

The policy implications of the input-output-outcome paradigm are several.

As to the respective responsibilities of ministers and their departmental chief executives, the 'new' public administration argues that chief executives should not be held accountable for outcomes. Outcome measures are notoriously difficult, and causality between departmental activities and outcomes usually uncertain, both breaching conditions essential for effective accountability relationships. As a consequence, the growing preference is for departments and their chief executives to be responsible primarily for achieving the target level and quality of outputs, and the efficiency with which outputs are produced; and for ministers, as representatives of the community, to be concerned primarily with the achievement of outcomes, and selection of the mix and source of outputs to achieve given outcomes.

An outputs focus also promises a significant paradigm shift in management practice, with recognition that value creation occurs not by better management of poorly designed processes but through the design of waste free processes that meet customer needs. Likewise, management attention would increasingly be placed not on managing costs per se but rather on managing the activities which cause costs to be incurred.
Redefining the Roles and Responsibilities of Government: Ends and Means

Ultimately, if a government does not provide the outcomes that the community desires, it will pay the penalty at the polls. Shifting the focus from input to outputs opens the way for improved output and outcome oriented measures around which contracting or performance measurement can be based, and against which funding can be more meaningfully provided. Without a clear definition of outputs, and ultimately of outcomes, it is difficult to implement a results-based management structure and a contract-based resource allocation process.

3 Purchaser - provider roles of government
The final new paradigm recognises that the government and its departments combine two key roles:

- as a purchaser of outputs (i.e. goods and services) on behalf of the community, where the key requirement is the achievement of the highest quality outputs at lowest possible prices, and the attainment of a desired outcome over time; and

- as owner of agencies and enterprises which are providers of a wide range of goods and services, where the principal interest should be on the best possible return on the resources allocated to these agencies and enterprises at the same time as ensuring that those resources are effectively safeguarded and enhanced.

In this way, a government’s responsibility for ensuring that high quality services are provided to the community can be regarded as an entirely separate issue to how best to manage the provision of such services.

As to the policy implications of this paradigm, it is suggested that the community’s interest will be maximised by a government giving highest priority to its role as a purchaser of services on behalf of the community. Governments are considered most likely to produce the best results when they operate like referees and supervisors, specifying the results required and giving the highest weight to the interest of citizens in ensuring that they obtain highest quality services.

As a corollary, a commitment by government to ensure that certain services are provided to the community need not necessarily equate to a commitment to provide the services directly. In situations where the private market fails to secure the
desired service levels required by government, there are alternatives to the traditional model of full government provision. In particular, there are many situations where the government may be able to ensure delivery by playing a facilitating role, either through regulation or subsidy, or by purchasing the services on behalf of the community without the need to own the infrastructure and production processes required to provide the service.

Whether or not acting as a service provider itself through its own agencies, another important implication is that government should clearly separate and distinguish its role as purchaser from its role as provider, thereby avoiding competing or conflicting roles (as referees shouldn't be players as well). Even where they are government owned, service providers should be managed at arms' length from the purchasing decision to avoid the conflict of interest implicit in the traditional model.

Also implied is that the management of a government-owned service delivery function should act commercially and that market-based processes should play an important role in stimulating quality performance.

Likewise, to make the achievement of efficiencies an ongoing process, purchases of services should be as competitive as possible, so that service providers within and outside the public sector can tend for the right to provide government services. Contestability has two dimensions: an ability to compare outputs among departments, and an awareness of cost comparisons with similar outputs in the private sector.

These considerations also underpin the idea of contracting out, where the government pays a private provider for services to either government or the community, something which has gained increasing currency since the start of the 1990s among Australian governments. While there is little dispute that public ownership of infrastructure and direct delivery of services is appropriate in the case of pure public goods, a much less compelling case for direct provision can be made where there is a community perception that government provision of a particular goods or service is fundamental to meeting social goals.

A predisposition to allow the private sector to compete to provide services should not be interpreted as devaluing the
worth to the community of the services themselves. Rather, it focuses government’s role clearly on the interests of the citizens in ensuring that they can obtain high quality services, not whether they are provided in-house. It puts the onus on government to demonstrate that in-house provision best serves that community interest.

Potential ‘Ends’ or Benefits

To summarise, the objectives underlying development of the new model of public administration are:

- to improve allocative and productive efficiency;
- to enhance the effectiveness of government programs;
- to provide better value for money in public service provision in a fiscally sustainable fashion;
- to improve the accountability of public sector institutions;
- to reduce the size of the core public sector;
- to minimise the opportunities for the non-transparent use of public power;
- to improve the quality of the goods and services produced by government agencies;
- to make public services more accessible and responsive to customers; and
- to better link planning, budgeting and monitoring processes within government.

Principal ‘Means’ or Tools

The main policy tools or instruments of the application of these new paradigms are as follows:

- integration to the maximum extent possible of planning, budgeting, reporting and performance evaluation processes within government;
- the outcomes (or end-results) desired by the government being the main drivers of planning, budgeting and management in the public sector, allowing ministers to focus
on the most cost effective method of achieving given outcomes;

- information on the outputs purchased or provided by each government department being readily available, to enable ministers to question which of the government's outcomes are being promoted, whether alternative outputs or alternative providers might better support those outcomes, and what are the true costs of producing and supplying outputs among alternative providers;

- whether purchasing services directly for the community or services for itself, providing funding against outputs, not inputs;

- devolving responsibility for input and resourcing decisions to departments and their chief executives sufficient to remove restrictions on their ability to manage in order to become more efficient and effective, with any increased devolution being matched by the strongest feasible framework of accountability not only for the use of resources but also for performance and results;

- the management process at every level accounting for all resources used in producing each service output, with planning budgeting, resource management and reporting all on a fully transparent, comprehensive accrual accounting basis;

- the use of clear contractual arrangements to align the interests of agents and providers with those of the government;

- purchases of services on behalf of the community being as competitive as possible, with service providers within and outside the public sector tendering for the right to provide government services; and

- where public provision is retained, the management of service delivery functions acting commercially and the government's primary focus as an owner being on maximising investment value/returns and on minimising risk, with policy objectives being handled through the separate funding of community service obligations.
These paradigms also encourage the use of the following business analogy concerning governance issues within government.

- The Cabinet may be seen as a board of directors, with the Premier or Chief Minister as the chairman of the board of the government, and the Treasurer as the Director of Finance of the Board.

- Parliament may be seen as representing the shareholders of the business, holding in trust the votes of the public.

- Central agencies correspond to the head office or corporate headquarters, and assist the Cabinet in setting strategic objectives and policies, in planning and overall resource allocation, in promoting the use of best practice and in performance assessment. The key clients of central agencies are the Premier, the Treasurer and Cabinet.

- Line agencies correspond to the production units of the business (or the subsidiaries of a holding company). The key clients of line agencies are the customers to whom they sell products - in many cases ministers who purchase services for and on behalf of the public and, in others, the public itself which purchases the services of departments directly through user charges.

**What Relevance to Smaller Jurisdictions?**

Smaller jurisdictions like South Australia and the Northern Territory should find the benefits offered by the new public administration as attractive as do larger jurisdictions. In fact, they may be more valuable given clouds which hang over commonwealth funding and, for the Territory, the pressures on the infrastructure and services fronts experienced on account of faster growth.

The only area of particular concern might be the costs involved in redesigning systems and processes to meet the requirements of the new approach. Given the importance of people and leadership skills, much depends on the quality of the people at the top. This is always a greater challenge for smaller jurisdictions. Also, some of the structural solutions (eg
organisational separation of purchaser and provider) may be too expensive because of the tyranny of diseconomies of scale.

All this implies that smaller jurisdictions must give careful consideration to how to achieve the benefits but in more cost-effective ways. In particular, smaller jurisdictions would be wise to seek a 'free ride' wherever possible from implementation experience in larger jurisdictions. Likewise, many principles will need to be applied flexibly, and in a more evolutionary fashion than possible in larger jurisdictions.

All up, were smaller jurisdictions to cling to the traditional model for longer than necessary to minimise the costs of transition to the new system, they are only likely to be disadvantaged as their public sectors became less competitive compared with their larger peers, with adverse effects on their relative taxation levels and/or standards of services. Even in smaller jurisdictions, the new public administration offers the best hope for ensuring that:

- their governments possess a framework to demonstrate commitment to achieving outcomes for the community;
- government-determined outcomes clearly drive planning, budgeting and management in government departments and agencies, and so greater departmental responsiveness to the priorities of government;
- ministers are better able to identify low value activities in the public sector; and
- ministers possess better information on departmental performance, including benchmark comparisons with similar providers, both inside and outside the public sector.

**Conclusion**

The paradigm shifts evident within public administration open the way to harnessing the whole field of efficient and effective modern management practices, from both the public and private sectors. They offer greater prospects for achieving the best service delivery in government from the resources available than have been possible under earlier approaches to public administration.
References


Financial Management Reform
Towards Best Practice

Mike Harris

There are five broad areas covered in this presentation.

1 Background to Financial Management Reform – referring to the rationale and underlying pressures for financial management reform confronting governments in Australia and overseas.

2 Key Financial Management Reforms – the reforms are wide-ranging and a number of key areas are addressed.

3 Stocktake of Reforms by Jurisdiction – based on an earlier survey conducted by Western Australian Treasury, supplemented by the results of a more recent survey by the Commonwealth Department of Finance. The list of financial management reforms is not exhaustive, but rather a focus on key areas.

4 Elements of Best Practice – the identification of elements of best practice associated with each of the key financial management reforms.

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1 The views expressed in this paper are my own, and they do not necessarily reflect the views of either the Government of Western Australia or the Treasury Department.
5 Implementing Change for Statehood – the intention is to briefly cover key aspects of ‘best practice’ together with some of the lessons learned by those involved in the financial management reform process.

**Background to Financial Management Reform**

Throughout the world, there is commonality in what governments are attempting to achieve in public sector reform, namely, increasing the efficiency and effectiveness of public services and the delivery of high quality services to the community at low cost. This has led to a convergence of ideas and directions in public sector reform, as the trend has been to pursue best practice in public sector financial management and to improve the quality of public sector decision making and resource allocation processes.

Key public sector ‘needs’ including containment of public sector outlays and reduction in public sector debt; together with ‘demands’ on the public sector for better value for money and greater accountability.

Overall, there has been a shift in focus of public sector financial management from inputs and process controls to performance results. While the financial management reform initiative is evident across all public sector agencies, including commercialised trading enterprises, the focus of this paper is on budget funded agencies.

**Principles Underlying Financial Management Reform in the Public Sector**

Some of the principles underlying financial management reform in the public sector are:

- **Parliamentary Scrutiny** – this is necessary to ensure that government’s demand for funds is sufficient, not excessive; and that resources are used efficiently and effectively.

- **Accountability** – there must be a requirement for Chief Executive Officers to report performance to Ministers, who in turn report agency performance to Parliament.
• Improved Managerial Performance – agencies require the encouragement, incentive, flexibility, initiative and responsibility to improve management practices, as well as the efficient and effective use of available resources.

• Financial Management Reform must be consistent with the principles of financial integrity, responsibility, equity and devolution.

Benefits from Financial Management Reform

The benefits flowing from public sector Financial Management Reforms are heavily biased towards improving the availability of information to assist decision making by interested parties, eg the community (taxpayers), Parliament, Ministers, and agencies.

• Community
  – better information and value for money.

• Parliament
  – performance information on agencies and government as a whole.

• Ministers
  – better information on agency performance; focus on producing required outputs.

• Agencies
  – awareness of role, responsibilities, available resources and performance.

The converse of course, is that there is more information available publicly with which to measure the performance of all decision makers, including government and agencies. It also needs to be recognised that the budget sector is far more complex than other sectors due to a range of factors including:

• diversity of roles carried out by agencies;

• funding from the public purse;

• absence of a market mechanise; and

• the overlap of social imperatives.
Keys to Successful Financial Management Reform

- **Budget Process: Meaningful and Efficient** – this can be achieved through a range of financial management reforms including specification of government's strategic objectives and desired outcomes; the adoption of early budgets; the publishing of forward estimates of expenditure and revenue; and allowing agencies the flexibility of inter year funding transfers.

- **Good Business Practices** – the drive for financial management improvement demands that managers adopt good business practices which include full (accrual based) cost attribution to goods and services; access to competitive tendering and contracting (outsourcing); benchmarking; revenue retention arrangements; a strategic approach to asset management; and initiatives to minimise costly information reporting requirements of managers.

- **Empower Managers and Employees to Achieve Results** – successful financial management reform and agency performance in general is heavily dependent on the extent to which managers and employees are empowered to achieve results. Relevant reforms to achieve this effect include the introduction of global budget allocations; the shift in focus from FTE/staff ceilings to managing on the basis of operating costs; the publication of forward estimates of expenditure and revenue; and access to revenue retention/agency bank account arrangements.

Having recognised the necessity of financial management reform and identified both the underlying principles and a number of keys to success, the observed trend of governments across jurisdictions is to pursue best practice in public sector financial management for the purpose of improving the quality of public sector decision making and the resource allocation processes.

In government, best financial management practice involves setting goals and working to achieve these via an appropriate financial management framework.
Financial Management Framework

The ‘appropriate’ financial management framework should reflect the principles of:

• devolution of authority/autonomy for managers;
• accountability;
• fiscal discipline;
• clarity of objectives;
• performance measurement and evaluation;
• client focus;
• ‘gain sharing’ for agencies;
• high standards of staff expertise.

A public sector Financial Management Framework should also link policy, planning, resource management, reporting and review in a comprehensive and integrated manner that enhances effective and efficient agency management, whilst enabling a central agency such as Treasury to satisfy its macro level responsibilities.

Having established the Financial Management Framework, the next step is to address a range of key financial management reforms.

Key Financial Management Reforms

There are eleven key financial management reforms, embraced by governments, that are currently at different stages of implementation across jurisdictions.

1. Financial management legislation
2. Budgeting and appropriation processes
3. Output based management
4. Forward estimates system
5. Accrual Reporting/accounting
6. Full cost user charging
7. Net appropriations/revenue retention
8. Strategic asset management
9. Competitive tendering and contracting
10 Cash management and banking
11 Performance evaluation.

While a decision needs to be made by each jurisdiction regarding the priority and speed with which each financial management reform is progressed, all the identified reforms are regarded as essential to any jurisdiction serious about pursuing 'best practice' to enhance the efficiency and effectiveness of service delivery by public sector agencies, consistent with the outcomes identified by government for the community.

The list of reforms is not meant to be exhaustive. At the same time, reforms and developments in other jurisdictions are continually changing, and hence I would advocate frequent and ongoing dialogue between jurisdictions as an effective aid to the financial management reform process.

*Stocktake of reforms by jurisdiction*

Before addressing specific financial management reforms let us consider what can be termed a 'Stocktake of Reforms by Jurisdiction'.

The results of the 'Stocktake' summarised below are based on information gathered from a number of sources by the Treasury Department of Western Australia.

Given that the financial reform process is dynamic, the stage of progression with the initiatives may vary across jurisdictions and the most recent stage of development may not necessarily be reflected in the following summary.
## Figure 1 Stocktake

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<td>Accrual Reporting/Accounting</td>
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Source: Treasury Department of WA
Elements of ‘Best Practice’
The list of financial management reforms and the associated discussion relating to elements of ‘best practice’ is not meant to be exhaustive. Rather, the intention is to provide a broad outline of what best practices should contain in relation to each of the identified reforms.

Hopefully, the information gleaned from this exercise will form a sound basis on which financial management reforms can be pursued, after taking into account the unique circumstances of a particular jurisdiction.

Financial Management Legislation
The key attributes of legislation for financial management are:

- specification of standards for the financial management of public sector operations and the annual reporting of performance to parliament;
- accounting for public monies and property by agency-accountable officers.

Financial Management Legislation is absolutely essential as it is the fundamental element for any progress with public sector financial management reform.

In the past, financial legislation has been couched in prescriptive terms with a focus on inputs, as well as a heavy compliance role in terms of micro level reporting and accountability for public sector managers.

In contrast, current financial management legislation is intended to empower managers to be innovative and to adopt ‘best practice’ in their task of managing the performance of their agency in the most efficient and effective manner. At the same time the legislation specifies standards for the management of public sector operations, including the performance reporting criteria. The emphasis is now on outputs and outcomes, rather than solely on inputs.

Once the required financial management legislation is in place, the next step is to address the budgeting and appropriation processes.
Budgeting and Appropriation Processes

- **Global Budgeting/One Line Appropriations** – removes inflexible item level controls and allows agencies maximum incentive and flexibility to internally reallocate resources to meet operational demands.

- **Consolidated Fund Budget** – combines recurrent and capital sources of funds to show total resources available to budget sector managers.

- **Accrual Budget Presentation** – identifies the full accrual cost of services; followed by deduction of any associated revenues to give the ‘net cost of services’. A further adjustment for non cash items is then required to identify the annual cash appropriation figure. In the longer term, the logical extension may be to move to some form of accrual budget appropriations.

- **Pre 1 July Budget** – this initiative enhances the policy statement and financial planning aspects of the budget for the benefit of agencies, the community, government and Parliament. Apart from helping to make the budget process more meaningful, a pre 1 July Budget timetable is also consistent with the reforms intended to introduce a more commercial and business like approach to financial management in the public sector including Output Based Management. This initiative is addressed in more detail in the following figure.
**Output Based Management**

Briefly, Output Based Management (OBM) enables government:

- to determine policy objectives and the outcomes desired for the community; and
- to resource (purchase) the outputs required to achieve those outcomes from public and or private sector agencies in a contestable (competitive) environment.

Under the Output Based Management concept, which may also be referred to as Output Based Budgeting or Contractual Budgeting, governments are held responsible for specifying outcomes, and agencies are responsible and accountable for delivering outputs.

Output Based Management requires agencies to focus on becoming product/service oriented with management operations conducted more along business lines. Therefore other financial management reforms such as published forward estimates of expenditures and revenues, accrual reporting/accounting, full cost user charging, and strategic asset management are viewed as
integral components to the realisation of the full benefits from Output Based Management.
Each of these related financial management reforms is addressed below.

**Forward Estimates System**

- Provides future resourcing parameter within which Ministers and CEOs have flexibility to reallocate resources.
- Integrates with the annual budget.
- Replaces onerous requirements for agencies to prepare micro-level incremental budget submissions each year.

Published forward estimates of expenditure and revenue provide indicative estimates of resource requirements for the continuation of existing policies.

The forward estimates assist medium term strategic decision making by government, as well as a base for agencies to conduct forward planning.

The forward estimates system is usually integrated with the annual budget process, thereby replacing the previously onerous requirement on agencies to prepare micro level incremental budget submissions each year.

**Accrual Reporting/Accounting**

A further key financial management reform, is the introduction of accrual reporting/accounting. Accrual reporting requires departmental financial statements to be prepared on an accrual (full cost) rather than cash basis and is an intermediate step in the phased implementation of full accrual accounting by agencies and accrual based presentation in budget documents.

The benefits of accrual reporting/accounting can be identified at four levels.

1. In conjunction with accrual budgeting it provides a financial framework for managing resources more economically and efficiently within agencies, primarily through recognition of the full cost of services or goods.

2. Accrual accounting improves agencies' internal monitoring procedures.
3 Overall Budget Sector financial management and reporting is improved.

4 Accrual accounting is a precondition for a more competitive and open approach to the Budget Sector.

A further advantage of the accrual accounting/reporting initiative is that it should lead to a streamlining of the processes and information requirements for reporting and management, removing the duplication associated with the preparation of both cash and accrual based reports.

The progression of accrual reporting/accounting also facilitates the preparation of consolidated financial statements at the whole of government level, thereby providing a major enhancement to public sector accountability.

Closely aligned with accrual reporting/accounting, is the move to full cost user charging.

**Full Cost User Charging**

- Identification of full cost of providing goods and services.
- Application of full cost based charge or fee to recoup cost of providing goods/service, consistent with the ‘user pays’ principle.
- Complements net appropriation/revenue retention initiative, encourages cost-effective charging.

The identification of full costs and application of corresponding user charges seeks to regulate the supply of and demand for goods and services. Further benefits for agencies include:

- fully costing activities provides an accurate basis for comparison with alternative providers of goods and services, in both the public and private sectors; and
- having identified the full cost of goods and services, a decision can then be made regarding the appropriate price to be charged for the good or service.

**Net Appropriations/Revenue Retention**

Incentive and flexibility for agencies to:

- maximise revenue generating opportunities;
**Financial Management Reform**

**Towards Best Practice**

- recover full costs;
- rationalise existing ‘free’ or cost inefficient services; and
- initiate new activities.

The introduction of net appropriations/revenue retention arrangements is considered to provide a number of benefits for budget sector agencies including:

- rationalising demand for and usage of services by the levying of full cost based charges;
- agencies have an incentive to
  - identify revenue raising opportunities,
  - fund new services or expand existing services by revenues raised,
  - gain a share in any net financial benefits or excess revenues arising from improved efficiency in or demand for services,
  - raise revenue by disposal of surplus or under-performing assets;
- both agencies and the overall Budget benefit from increased revenue opportunities; and
- enabling the Budget to distinguish between funds derived from taxation and agency own source revenues.

**Strategic Asset Management**

- Emphasis on optimal use and management of all existing and new public sector assets.
- More rigorous and systematic approach to capital investment decision making.
- Agencies encouraged to look at non-asset solutions such as contracting out and subsidising community service groups.

This initiative aims to achieve better value for money from the service delivery and financial performance of all existing and new public sector assets. The initiative can also benefit agencies through ‘gain sharing’ asset realisation arrangements.

Agencies are usually required to be involved in all aspects of asset management, from the planning to the delivery stage, with a strong emphasis on up front planning.
Agencies may also be encouraged to look at non asset solutions such as contracting out and subsidising community service groups.

A related aspect is encouragement of the private sector to provide infrastructure on a basis in which there is a sharing of both the benefits and risks.

A further key financial management reform is Competitive Tendering and Contracting (CTC), commonly referred to as Outsourcing.

**Competitive Tendering and Contracting**

Benefits of Competitive Tendering and Contracting can be generated on three fronts.

1. Cost savings for government (and taxpayer).
2. Stimulation of private sector industry.
3. Receipt of best value for money services by the public.

Competitive Tendering and Contracting (Outsourcing) may be defined as the process in which a government agency establishes standards for the delivery of specified goods or services, and then invites bids for a contract to deliver the goods or services.

This initiative is one element of a range of activities whereby governments can use the discipline of open competition to lift the quality of public sector services, and which reflect an international trend to return to core business.

In undertaking this reform, it is important for agencies to firstly ensure that service delivery requirements are specified correctly in the contracts with service providers and secondly, that the required contract management expertise exists within agencies to ensure contracts are properly managed.

**Cash Management and Banking**

Although there are a whole range of issues that could be addressed under this topic, the comments here are confined to three broad areas.

2. Electronic Funds Transfer.
Cash Management Policies/Practices
The management of cash is best addressed at the whole of government level where economies of scale work to obtain the best outcome for government.

This approach may be seen by some as impacting on the perceived solvency or financial viability of budget dependent agencies if viewed in a purely commercial sense and the financial structures of agencies may not look the best when compared to entities operating in the private sector. However, it should be recognised that this only reflects the government’s internal funding arrangements and not the financial position of the government. The latter is revealed in the financial statements prepared on a whole of government basis.

Electronic Funds Transfer
The increased emphasis on the use of Electronic Funds Transfer for both the payment of accounts and the receipt of revenues provides opportunities for considerable savings to government because it replaces manual and paper based activities with electronic alternatives.

Public Bank Account Investment Policy
For the Western Australian Budget sector, the current policy is for surplus funds in the Public Bank Account to be separated into short and long term components, with the short term funds invested in authorised investments for terms not greater than 365 days. Long term funds may be invested in authorised investments with a term to maturity not exceeding five years.

Performance Evaluation
Performance Evaluation may be defined as the periodic review and assessment to assist managers and other interested parties to make informed decisions about issues of:
• relevance/appropriateness;
• effectiveness; and
• efficiency.

Evaluation is an essential link between assessing the effectiveness and efficiency of agency functions/activities, and accountability. It is a major tool for continually improving the quality of decision
making, gaining better value for money, and reporting management successes in these endeavours.

A very important and relevant point to remember here is the expression: "if its measured it gets done".

Eleven key areas of financial management reform have been addressed. In the following section some of the issues relating to 'best practice' in the context of 'Implementing Change for Statehood' will be discussed.

Implementing Change for Statehood

At the outset, financial management best practice requires government to specify its strategic objectives or goals and the desired outcomes for the community. An appropriate Financial Management Framework should then be developed to facilitate the required Financial Management Reform (FMR) process, involving:

- specification of government's strategic objectives and desired outcomes;
- framework to facilitate FMR;
- benchmark annual FMR effort against identified 'best practice';
- strategy to move to 'best practice'; and
- cultural change.

There is a need for ongoing review and evaluation, including Benchmarking, as financial management reforms are not ends in themselves, but rather part of a continuous process of improvement.

Successful financial management reforms are also about cultural change, and hence their success relies on the personal commitment of public sector managers and their ability to ensure that all employees constantly search for better ways of doing things.

The 'outcomes' by which the success of the financial management reform process can be measured are identified in the following summary.

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Summary

Financial Management Reform is not an end in itself and can only be measured in terms of ‘outcomes’:

- better allocation of resources;
- more economic and efficient use of resources;
- service more responsive to customer demands; and
- improved accountability for performance.

Given the existence of a constantly changing work environment, financial management reform is not an end in itself, and best practice requires ongoing assessment of emerging opportunities for improvement in both the range and mode of service delivery.

Progress in this pursuit of financial management best practice can only be measured in terms of ‘outcomes’ such as the more economic and efficient use of resources; services more responsive to customer demands; and improved accountability for performance.

An alternative way of summarising the keys to successful financial management reform is as follows:

- existence of a meaningful budget process;
- adoption of good business practices; and
- managers and employees empowered to achieve results.

Lessons Learned

These lessons have been learned from the involvement of others in the FMR process.

Cultural Change

The success of financial management reform relies on commitment by all staff to continuous improvement.

Results Orientated Managers

It is important for managers to recognise the key role of evaluation. This commitment to evaluation requires the availability of relevant performance information and the constant search for options to improve performance.

Risk Management

Prudent risk management can significantly improve performance.
Empowering Employees
Attention to the development of employees' skills will result in them contributing their best towards meeting desired objectives or outcomes.

Outcomes Focus
The benefits of financial management reform are best achieved by encouraging Parliament to focus on the outcomes produced, rather than the micro detail of departmental spending.

As a further comment on empowering employees, it is worth noting the following extract from a speech delivered by US Vice President Al Gore:

A government that puts its people first puts its employees first too. It empowers its employees and frees them from mind numbing rules and regulations, delegates authority and responsibility, and provides them with a clear sense of mission ... We have to empower them not only with authority, but also with flexibility ... with the information upon which to base good decisions and with the confidence to move forward in serving the customers well (National Performance Review Orientation, April 15, 1993).
References


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Budgeting for the Impact of the Commonwealth Budget in the Northern Territory

Gary Henry

There seems to be a common view that the granting of statehood to the Northern Territory will have some form of economic or financial impact on the Territory. In 1995 a working group of commonwealth and Territory officials was established to report on issues related to the possible grant of statehood to the Territory. One of the issues addressed was financial and economic implications.

The conclusions of that report stated clearly that, with a few exceptions, there was unlikely to be any significant economic or financial implications for the Territory as a result of granting statehood. Why is that? The simple answer is that as far as its economic development or financial relations with the commonwealth are concerned, the Territory is already treated as a state in nearly all respects. The working group report noted that the powers and obligations of the Territory in fiscal affairs are equivalent to those of the states.

The Territory is responsible for the management of its own budget, for the provision and management of the same types of public services that are provided in the states, has almost identical revenue raising responsibilities and powers, and is treated the
same as the other states in terms of its financial relations with the commonwealth.

That the Territory has responsibility for the management of its budget and for the provision of similar services is fairly obvious, as is the Territory's capacity to impose taxes and charges.

Our financial relationship with the commonwealth is less obvious as it is somewhat shrouded in the mystique of the Premiers Conference and the machinery of the Commonwealth Grants Commission.

The Commonwealth Grants Commission is responsible for recommending the per capita relativities to be applied in distributing the pool of available commonwealth funds in order to achieve a measure of horizontal fiscal equalisation between the various jurisdictions. Well, so much for the simple explanation!

In effect this means that the Commission provides recommendations on the per capita distribution of funds necessary to provide each jurisdiction with roughly similar capacity to provide services to their residents, while imposing similar taxes and charges on residents. This is horizontal fiscal equalisation, and in financial terms at least, it is the glue that holds our federation together.

Without fiscal equalisation between states and territories there would be different classes of Australian citizens depending on which jurisdiction they lived in. Without fiscal equalisation each jurisdiction would either have to levy higher taxes and charges or provide lower standards of services.

Within this process the Commission assess the various disabilities each jurisdiction faces in the provision of services. For example, in the Territory our small dispersed population and the consequent lack of economies of scale impact significantly on the cost of providing services relative to the cost of providing the same standard of service in the more populous states. The Commission also considers the apparent capacity of each jurisdiction to raise its own revenue to meet the cost of services. Weighing up these two factors it then determines what relative weighting should be given to the financial assistance provided to each jurisdiction to enable each to provide similar standards of services.
In arriving at its recommendations the Commission treats each state and territory in a similar manner. This treatment would be unchanged by the granting of statehood to the Northern Territory. The second step in determining the level of financial assistance from the commonwealth occurs at the Premiers Conference. It is at this stage that the commonwealth and states and territories agree on the size of the pool of commonwealth funds to be distributed between the states and territories. In recent years this has been based on a formula approach whereby the amount of available funds is increased from year to year based on population growth and inflation. This approach was commenced by the previous commonwealth government and has been maintained by the present government (ignoring the short term contributions each state and territory has been required to make towards the commonwealth's deficit reduction target).

The important point here though is that this process, like the Grants Commission's process, is entirely independent of the constitutional status of the various jurisdictions. Thus, while ever the commitment to horizontal fiscal equalisation remains, and as I said this is a key feature of our federation, the Territory's financial relations with the commonwealth will be unaffected whether or not statehood is granted to the Territory.

To return briefly to the working group report. I mentioned earlier that there were a few exceptions to the conclusion that granting statehood would have no effect on the fiscal status of the Territory. It is probably worth picking up on those few aspects which were noted in the report.

Firstly, there is the issue of uranium mining. At present, the commonwealth retains ownership and control of uranium resources in the Territory. This is not the case in other jurisdictions and would clearly be one issue to be resolved in any decision to grant statehood to the Territory. Under the present arrangements, the commonwealth collects royalties on uranium mining in the Territory. While the Territory receives a grant in lieu of uranium royalties, this is less than the amount raised by the commonwealth and less than the Territory would potentially raise if it were able to levy royalties itself.

However, if control of uranium were to pass to the Territory with the granting of statehood, the Grants Commission process
would recognise any increased revenue capacity that this provided to the Territory and hence the Territory's perceived disadvantage would be reduced. In other words, while the Territory might gain access to greater revenues through control of uranium, its financial assistance from the commonwealth would be reduced by an equivalent amount.

The Territory might gain access to greater revenues because past experience has shown that in other similar cases, the Territory's ability to levy royalties has been fettered by the pre-existing commonwealth negotiated contracts. None of this provides an argument against transferring control of uranium resources to the Territory, but is rather a simple statement of fact. Even with the offsetting reduction to financial assistance grants, the Territory would still gain a greater degree of self reliance from such a change.

Secondly, the working group recognised that the present control of national parks in the Territory was also an anomaly in terms of how other states are treated. If control of commonwealth national parks in the Territory were to pass to Territory control with the granting of statehood, there would be some minor financial implications. On the one hand the Territory would be required to take over the upkeep of the parks, while on the other it would be able to gain access to current revenues generated through the parks. In net terms, based on current practices this would represent a cost to the Territory, however, again the recurrent costs of operating the parks would be picked up through the grants commission process.

Thirdly, the working group referred to the Aboriginal Land Rights Act. While there are many views which would be relevant to any decision here, the working group recognised that the Territory was heavily reliant on its mining and agriculture industries and that the operation of the Land Rights Act may influence the capacity of the Territory government to obtain revenues through economic development in these areas.

Finally, the working group considered the potential effect on the Island Territories of Ashmore and Cartier. Prior to self government in 1978 these territories were deemed to be part of the Northern Territory. It could be argued that with the granting of statehood they should be returned to the control of the
 Territory. The likely financial impact of such a move would probably be fairly insignificant. The Territory would incur the costs of administering the area but may gain access to any revenues flowing from the development of mineral or energy resources in the area. However, as with other issues mentioned above, the increased costs or revenues would also be captured in the grants commission process leaving the Territory theoretically no worse or better off in a purely financial sense.

In considering these aspects, the working group concluded that:

there are a number of areas in which the current arrangements between the commonwealth and the Northern Territory differ from those between the commonwealth and the states. While elements of these may affect the rate of economic development it is apparent that the operation of the horizontal fiscal equalisation processes result in their having little impact on the financial position of the Territory. Given the continuation of the current HFE [Horizontal Fiscal Equalisation] processes, the current financial arrangements in relation to uranium mining, national parks, the operation of the Aboriginal Land Rights Act, and the status of Ashmore and Cartier Islands do not carry any significant (financial or economic) implications for the question of statehood. Unless there were to be a fundamental change to the HFE processes, any change to these arrangements would appear to depend on factors other than economic and financial considerations.

The following section touches lightly on some of issues which are worth noting in terms of the Territory’s relationship with the commonwealth. As most of us would be aware the Territory is more reliant on commonwealth revenues than are the states. For the Territory the commonwealth provides 73 per cent of its revenues while the average for the states is 42 per cent.

Thus fiscal and budgetary policy decisions by the commonwealth can have a much larger impact on the Territory budget than is the case for the states. To put that another way, if the commonwealth sneezes we may well catch a cold.

However, this reliance on commonwealth funding does not mean that the Territory is under raising in terms of its own revenue raising efforts. On the contrary, the Territory raises around the state average in terms of its own-source revenue.
Grants Commission data for 1994–95 shows that the Territory raised just under $1700 per capita, compared to an all state average of $1660 per capita. This has not always been the case. As can be seen from Figure 1, the Territory has increased its own source revenue raising effort significantly over recent years. However, it is clear that the states have also been increasing their revenue raising effort.

Why this has occurred is evident from Figure 2. Commonwealth grants to the states and territories have been fairly flat throughout the 80s and 90s, forcing the states and territories to increasingly look to their own resources to fund their expenditure.

Now this might not be too bad if the restraint imposed by the commonwealth on the states was mirrored in its own fiscal stance. However, as Figure 3 shows, while the states have been required to get by with a reduced share of the nations resources, and have kept their expenditure in check, the commonwealth has been rapidly increasing its own purpose expenditure.

Another aspect of this is that the make up of the grants to the states and territories has also changed during this period. Figure 4 shows that the reduction in grants to the states and territories has largely been in the area of untied funds. This means that the states and territories have had a declining level of discretion over the use of total grants provided by the commonwealth. Figure 5 illustrates this point in a slightly different format.

The Northern Territory has felt this effect somewhat more than the states, as commonwealth grants to the Territory have declined more rapidly than they have for the states (Figure 6). There are a number of reasons why this has occurred. Following self government the Territory was required to invest heavily in new and replacement infrastructure. As that backlog of capital works was overcome the commonwealth withdrew some elements of assistance to the Territory. Nevertheless, the reductions in funding to the Territory have been severe.

Not only has the Territory had to increase its revenue raising effort, but we have also had to constrain expenditure. Figure 7 shows that current expenditure in the Territory has been held fairly constant over the last decade.
Figure 8 shows that the majority of budgetary pressure has been taken up in capital expenditure. While all states and territories have reduced capital expenditure over recent years the decline in the Territory has been greater.

In aggregate then, the Territory has been required to contain its expenditure more than the states (Figure 9). To complete the circle this reflects the fact that the Territory has a small population and economic base to raise revenue from, and is hence more reliant on commonwealth funding. With the commonwealth directing more of the nation's resources to its own expenditure and less to the states and territories the Territory has felt the impact more severely than the states.

This is quite independent of any issue concerned with the granting of statehood to the Territory. The impacts of commonwealth policy decisions illustrated here would not be any different if the Territory was a state. As far as these issues are concerned we are already party to the same processes that apply to the states.

Figure 1 Own-Source Revenue

1980-81 = 100

Figure 2  State and Territory Revenue

Figure 3  Adjusted Own-Purpose Expenditure
Figure 4 Commonwealth Grants to States and Territories – as a Proportion of State Expenditure

Figure 5 Commonwealth Grants to States and Territories
Figure 6  Commonwealth Grants Per Capita in Real Terms

Figure 7  Current Expenditure

1980-81 = 100
Figure 8  Capital Expenditure

1980-81 = 100

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Six States
Northern Territory

Figure 9  Total Expenditure

1980-81 = 100

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Six States
Northern Territory
Public Sector Budgets and the Role of the Commonwealth Grants Commission

Catherine Hull

The most important interaction between the Commonwealth Grants Commission and state and territory budgets is through the per capita relativity factors (the relativities) used at the annual Premiers Conferences to share general revenue funds between the states and territories. The commonwealth uses the factors to distribute available funds, but the Commission recommends the factors to apply.

Premiers Conferences always appear to bring out strong passions and political posturing among state and territory leaders. This often involves comment on the relativities, but we assume this is aimed at achieving the best deal for those they represent. The size of the relativity factor calculated by the Commonwealth Grants Commission is of some importance for state and territory budgets – particularly the Northern Territory’s budget. The states and territories together receive almost 36 per cent of their recurrent revenues from the commonwealth as general revenue assistance. The Northern Territory receives nearly 70 per cent.
The main issues to be discussed are:

- the calculation of the relativities and the principle behind them;
- why the relativities change each year and the impact of those changes on state and territory budgets; and
- what changes could be made to the system to ‘improve things’ for the states and territories.

In addition, I would like to discuss a number of less obvious interactions between the work of the Commission and budgets of the commonwealth, the states and the territories, including:

i. how the Commission uses the outcomes of state and territory budgets in calculating relativities;

ii. how I understand some states and territories use by-product information in Commission reports to assist in framing their budgets;

iii. how the commonwealth budget has an impact on the work of the Commission;

iv. how the work of the Commission has had an effect on methods used to distribute Specific Purpose Payments (SPPs) from the commonwealth; and

v. how the work of the Commission, including its data requirements, has resulted in better understanding of the service needs of particular groups in society, such as Aboriginals and people from non-English speaking backgrounds.

Figure 1 provides a summary of these interactions.
Background

The main task of the Commonwealth Grants Commission is to advise the Government on how it should distribute the pool of general revenue grants (financial assistance grants and most hospital funding grants) between the states. It does this in response to terms of reference issued by the Minister for Administrative Services. It calculates a set of per capita relativity factors to be applied as weights to state populations. Shares of total weighted population are then calculated and applied to a pool of general revenue funds (decided by the commonwealth in its budget deliberations) to calculate grants for each state and territory.

The Commission was first given the task of reporting on whether any change in the existing factors was desirable in 1978. However, it was not until 1988–89, following the fourth review of per capita relativities completed by the Commission in 1988, that the Northern Territory’s general revenue grants were calculated using relativity factors.
In the 1985 Review, the Commission concluded that, ‘in principle it would be entirely appropriate for the Territory to be treated comparably with the six states’ but that more time was needed to bring the financial arrangements between the Northern Territory and the commonwealth into line with those applying between the states and the commonwealth, and for the Commission to establish a satisfactory basis for the assessment of disability factors. It was decided at the May 1988 Premiers Conference that the Northern Territory would become part of the commonwealth-state arrangements, although special revenue assistance has been paid in each subsequent year. According to the commonwealth, this has been to ease the Northern Territory’s transition to the distribution assessed by the Commission. According to the Northern Territory Treasury and recognised in a Working Party report by commonwealth and territory officers, the special revenue assistance was to allow for needs of the Territory outside the standard budget. This assistance has reduced from $59 million in 1988–89 to $10 million in 1996–97.

However, in Commission processes, the Northern Territory is treated as if it is a state and no special allowances are made. Nonetheless, in 1995–96, the pool of funds to be distributed was $18 744.5 million and the Northern Territory received 4.9 per cent of this, although its population share was only 0.97 per cent. Its relativity factor of 5.0332 accounted for the difference. Table 1 shows the relativity factors used at the 1995 Premiers Conference for each of the states and territories\(^1\) and how these were used to derive grants.

\(^1\) From this point in the paper, the term States is used to include the Australian Capital Territory and the Northern Territory, unless the context indicates otherwise.
### Table 1 Calculation of State General Revenue Grants\(^{(a)}\), 1995–96

<table>
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<tr>
<th></th>
<th>NSW</th>
<th>Victoria</th>
<th>Qld</th>
<th>WA</th>
<th>SA</th>
<th>Tas</th>
<th>ACT</th>
<th>NT</th>
<th>Total</th>
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<td>(1) Per capita relativities</td>
<td>0.8743</td>
<td>0.8506</td>
<td>1.0435</td>
<td>1.0521</td>
<td>1.2047</td>
<td>1.5437</td>
<td>0.8916</td>
<td>5.0332</td>
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<td>(2) December 1995 populations (000s)</td>
<td>6155.0</td>
<td>4521.8</td>
<td>3316.5</td>
<td>1747.0</td>
<td>1475.9</td>
<td>473.2</td>
<td>304.9</td>
<td>176.7</td>
<td>18170.8</td>
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<tr>
<td>(3) Weighted populations (1) times (2)</td>
<td>5381.3</td>
<td>3846.2</td>
<td>3460.7</td>
<td>1838.0</td>
<td>1778.0</td>
<td>730.5</td>
<td>271.9</td>
<td>889.3</td>
<td>18195.8</td>
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<tr>
<td>(4) Share of total weighted population (per cent)</td>
<td>29.6</td>
<td>21.1</td>
<td>19.0</td>
<td>10.1</td>
<td>9.8</td>
<td>4.0</td>
<td>1.5</td>
<td>4.9</td>
<td>100.0</td>
</tr>
<tr>
<td>(5) Grants distributed according to (4) ($m)</td>
<td>5543.6</td>
<td>3962.2</td>
<td>3565.1</td>
<td>1893.4</td>
<td>1831.6</td>
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(a) Pool of Financial Assistance Grants and Hospital Funding Grants.

### The Principle of Fiscal Equalisation

The relativity factors are based very largely on the principle of fiscal equalisation, which is that:

> each State should be given the capacity to provide the average standard of State-type public services, assuming it does so at an average level of operational efficiency and makes an average effort to raise revenue from its own sources.

The aim of this principle is to ensure that all state Governments are funded so that all Australians can be provided with the same access to appropriate state government services. Whether such services are provided is a matter for the people, through their state Government and the democratic processes, but it can be argued that all Australians are being treated equally by the commonwealth.

It is important to emphasise that equalisation is designed to achieve equal capacity, not equal results. This is because the
Commission's recommendations are to do with untied general revenue grants and each state is free to decide its own priorities. In principle, the policies followed by a state government do not make any difference to the grant it receives. For example, the payment to a state which chooses to pursue low tax policies is based on the assumption that it is making the Australian average effort to raise revenue. Any revenue shortfall it suffers because of its policies must be accommodated by providing below average services, by operating with greater than average efficiency, or by borrowing. Over time, however, the low revenue raising efforts or changed expenditure levels would have indirect effects on the assessments for all states because those assessments are based on an average of what all states do.

It is sometimes argued that equalisation should apply to performance rather than capacity. This would require that general revenue assistance be made conditional on the states following prescribed policies. But the essence of the Australian federation is that the states have specific spheres of responsibilities for providing services and raising revenues; and it would not be consistent to bind them to follow identical policies across the board.

Indeed, one of the advantages of a federal system is generally thought to be the possibility of different policies being followed in different states, according to the varying priorities of state residents (or voters). Of course, where the Commonwealth Government sees a national interest in the common pursuit of a particular policy, it may provide grants to states conditional on those policies being pursued (SPPs).

**The Calculation of Per Capita Relativities**

The relativity factors reflect the Commission's assessment of states' relative capacities to raise their own revenues and their relative costs of providing services. Such assessments are made in some 20 areas of state revenues, such as pay-roll tax and mining revenues, and 40 areas of service provision, such as schools education and hospital services. I will ignore the mechanics of making such assessments, but it is important that they recognise policy neutral revenue-raising or cost advantages or disadvantages (termed disabilities by the Commission).
A disability is an influence beyond a government's control that:

- requires it to spend more (or less) per capita than other governments on average to achieve the same objective; or
- results in it raising more (or less) revenue per capita if it applies the average tax policies.

The important elements of this concept are that a disability must be beyond the control of the government being assessed or represent some average policy of the states. Revenue disabilities taken into account include the relative size of the turnover being taxed, the size of the private sector pay-rolls, or the ability of an industry to generate value added. Expenditure disabilities taken into account include the relative size of the relevant population to which a service must be provided, the geographic spread of the population to which it must be provided and the socio-demographic characteristics of service users and their relative need for the service.

The mechanics of combining all these different assessments into a set of relativity factors are set out in detail in Commission Reports. Briefly the steps involved are:

- Construct the standard budget by defining the recurrent functions (both revenue and expenditure) in which the Commission wishes to make comparisons.
- Calculate the financial per capita standard for each category.
- Identify and estimate disability factors or comparable revenue bases.
- Apply disability factors or revenue base factors for each state for each category for each year of review to the standard, to give standardised per capita figures.
- Calculate the total per capita financial assistance required for each state as:
  
  standardised per capita expenditure
  minus standardised per capita revenue
  plus standard per capita budget result.

---

• Take account of SPPs where we believe they meet part of the state's requirement for financial assistance from the commonwealth, by deducting the state's actual receipts from its financial assistance requirement.
• Calculate the relativity for each state by dividing the total per capita financial assistance requirement of each state, adjusted for SPPs, by the standard or average per capita adjusted financial assistance requirement. This is done for each of five years and the results averaged.

Impact of Annual Changes in Relativities on State and Territory Budgets.

Since the 1988 Review, the Commission has not only included the Northern Territory in its assessments, but it has also been asked by governments to update the relativities annually, using the latest available figures but retaining the methods established in the latest review. Thus, updated relativities have been calculated in 1989, 1990, 1991 and 1992. A full review was undertaken in 1993 and the methods developed in that review have been applied in updates in 1994, 1995 and 1996. The Commission is presently working on a 1997 Update and a further review for 1999.

Annual updates were expected to reduce the problem of allowing for trends, transient factors and temporal changes and to smooth the transition for state budgets to new relativities previously calculated in three yearly reviews in which both methods and data changed. Reviews are intended to take place every five years, although the 1999 Review will take place six years after the 1993 Review, to allow the Commission to incorporate all the data from the 1996 Census.

To a large extent updates have been successful. Table 2 shows the impact of annual changes in relativities, with other influences such as the size of the pool and the state populations held constant. Changes in state economic conditions have been reflected in the changes to state grant shares, even if they are lagged somewhat because of the five year historical average the Commission is required by the terms of reference to use. Victoria's grant shares have increased because of the relative slump in Victoria's economy in the late 80s and early 90s. Queensland and Western Australia, on the other hand, have
experienced falls in their grants because of their exceptional economic growth. In all but two years the Commission has recommended relative increases in the Northern Territory's factor and therefore to its grants.

Changes in relativities have been relatively small for most states most of the time. Even the very large increases for New South Wales (in 1993–94) and Victoria (in 1996–97) represented only about a three per cent change. However, on some occasions, the change represented almost five per cent of a state's grant. Increases of almost five per cent occurred for the Northern Territory in 1991–92 and 1994–95 and Tasmania in 1991–92. A decrease of almost five per cent occurred for Queensland in 1994–95 and South Australia in 1993–94. The decrease of $28 million in the Northern Territory's grant that will occur in 1996–97 represents a three per cent reduction because of changes in the relativities alone.

Other changes influence what a state actually receives. Increases in the size of the pool have tended to dampen reductions in grant shares and there have been very few instances where states have actually received less than they received in the previous year. Population changes also influence what states receive, with increases resulting in higher total grants. Changes in the amount of SPPs received by state also change the general revenue grants it receives. An increase in SPPs, without any other changes, will reduce a state's general revenue grants; a reduction will increase its grants.
Table 2 Grants Implied by Commonwealth Grants Commission Relativities\(^{(a)}\)

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Percentage difference from grants in previous year

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Public Sector Budgets and the Commonwealth Grants Commission

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(a) Applied to the 1995–96 pool, excluding the ACT, and using constant populations as at December 1995
This is not to say that the actual annual changes in grants have not caused problems for state budgets. Table 3 demonstrates that, while most states have received at least small increases in most years, on at least nine occasions a state received less in general revenue assistance than it received in the previous year. The decreases were relatively small, with all being about or less than two per cent of their grants in the previous year, except for decreases in 1993–94, when the pool itself reduced. Western Australia lost 5.38 per cent and Queensland, 4.00 per cent. However, this does not necessarily mean that states received less in total commonwealth assistance. They may have received additional funds in special revenue assistance or SPPs.

Nonetheless, a $100 per capita reduction in a state’s grant in 1995–96 would be of some importance to its budget decisions. For the Northern Territory, this would be equivalent to a two per cent change in its grant, but would be equal to a quarter of its expenditure on Secondary Government Education.
<table>
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Percentage differences from grant in previous year

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(a) Excluding general revenue assistance.
Why do these Changes Come About?

The changes in relativities come about because of the changing circumstances of the states over time. These include changes in:

- state capacities to raise revenues and costs of providing services;
- state policies, particularly those of the more populous states, on the priorities accorded to particular functions;
- the amount of SPPs and general revenue assistance made available by the commonwealth; and
- broader commonwealth-state financial arrangements.

These changes are reflected in the data the Commission uses in its assessments. They interact with methods the Commission uses to calculate the relativities and produce differential changes for particular states.

For example, the major cause of the increase in Victoria’s grant in the 1996 Update was the large fall in its revenue raising capacity. The major cause of the fall in Western Australia’s grant was the large increase in its revenue raising capacity.

Queensland’s grant changed little because of compensating changes arising from the positive effect of compositional changes in the standard budget and reductions in its disabilities. The compositional effects (changes in the importance of categories in the standard budget) arose because of changes in state revenue and expenditure patterns. When a category increases its importance in the standard budget, there is an increase in grants for states with low revenue raising capacities or high costs of service provision and a decline for states with high revenue raising capacities or low costs of service provision. Queensland has relatively low revenue raising capacities in a number of categories (such as pay-roll taxation, gambling taxation and contributions from electricity and gas trading enterprises), the importance of which increased in the standard budget. The importance of stamp duty on conveyances has decreased because of the collapse in commercial property values, mainly in New South Wales and Victoria. Because Queensland is assessed as having a high revenue raising capacity in this category, the
reduced weight of this category meant that Queensland’s grant increased.

Similarly, commonwealth decisions on the amount of general revenue assistance to be made available to the states can influence the size of annual changes. Table 4 shows that over the period 1989–90 to 1994–95 standard expenditure rose by 17.7 per cent, mostly financed by own-source revenues which rose by 31.7 per cent while general revenue increased by 8.1 per cent. The greater reliance of the states on own-source revenues has increased the importance of the revenue side of the equalisation process. Because of the greater volatility of revenue assessments, annual redistributions between states are larger than they might have been.

Table 4 Movements in General Revenue Assistance, Specific Purpose Payments-Source Revenues and Expenditure, 1989–90 and 1994–95

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Note: Because the standard budget result is not shown, the proportions for general revenue assistance, specific purpose assistance and own-source revenue do not sum to 100.

Commission standard budget definitions have been used to obtain the data in this table so that, for example, general revenue assistance includes Financial Assistance Grants, Special Revenue Assistance and Commonwealth payments treated by absorption.

Changes in the amount of general revenue assistance also affect the relativities. Other things being equal, increases in this amount move the relativities closer to one, while reductions move relativities further from one. This happens when a change in general revenue assistance changes the denominator in the
calculation of a state’s relativity factor but the assessed adjusted total financial assistance requirements of a state do not change. In the 1996 Update, because of changes in the treatment of some SPPs, the level of general revenue assistance was revised upward by $326 million (1.9 per cent of total general revenue assistance). States such as New South Wales and Victoria with relativities well below one benefited, while states with relativities above one, particularly the Northern Territory, lost.

Changes in SPPs can also alter the relativities. If a state receives an increased share of an SPP and its disabilities are not adjusted to recognise an additional need for the funding, then its general revenue grant will fall. Conversely, if a state’s share of an SPP decreases, and disabilities are not reduced, then its general revenue grant will increase. The former happened in the 1996 Update to the Northern Territory. The increase between 1989–90 and 1994–95 in the Territory’s share of Grants for Aboriginal Purposes resulted in a reduction in its general revenue grant. No adjustment was made to the Northern Territory’s disabilities as no evidence was presented that the increased share of the SPP was due to an increase in needs. Whether the terms of reference would allow such a change in method in an update is open to debate. However, a similar increase in Aboriginal and Torres Strait Islander Commission (ATSIC) grants and state expenditures in Western Australia in an earlier update was taken into account, following the change in commonwealth policy.

Major changes in commonwealth-state financial arrangements also have an impact on relativities because the Commission’s terms of reference require them to be reflected retrospectively in the calculations. Because Identified Road Grants are being absorbed into the pool of general revenue grants, the relativities for 1994–95 and 1995–96 were calculated to reflect the situation that would exist in the year in which they would be applied. This change in the treatment of these payments had an impact on the grants of a number of states, including New South Wales, Victoria and Western Australia.

Some changes in state relativities also occur because of revisions to earlier years’ data.
Is this Equity?

It can be argued that changes in relativities largely reflect the changes in states’ fiscal positions brought about by their changing economic and demographic circumstances. The increasing grants for Victoria and the reducing grants for Queensland and Western Australia are proof of this. These changes are, however, lagged because relativities are based on five years of data up to seven years prior to the year in which they will be applied. Over time, equalisation will be achieved.

However, is it fair that the budgetary decisions, particularly of the larger states, have such a large influence on the relativities because the Commission uses a weighted average? Is it fair that a state’s grant can change without a change in the disabilities it experiences? Is it fair that changes in commonwealth policy in another area can change the amount of general revenue a state receives? In an exercise, where comparisons are made in terms of an internal standard based on what all states and the commonwealth do, then I guess the answer is yes – it is fair, assuming the comparisons are correctly made.

How can we Improve Things?

I do not think the Commission would claim that all comparisons and judgements it makes are totally correct or the only ones possible. I think we would say we do the best we can, based on imperfect information and the requirements of terms of reference. In every review, and for new items relating to an update, the Commission hears arguments from the states on how its assessments can be improved. Some general questions of process that readily spring to mind and that warrant re-consideration in the 1999 Review are:

• Is the population weighted internal standard used by the Commission the best choice, or does it have unintended consequences? I will explore this further below when I examine other ways in which the Commission’s work interacts with state budgets.
• Does the present system of annual updates and five yearly reviews strike the best balance between equity and pain to states? Do annual updates result in sufficiently smooth
adjustments to state grants? Or are the changes destabilising? Do circumstances change in the states so quickly as to make five yearly reviews of methods inadequate? Were three yearly reviews better?

• Should changes in commonwealth-state relations be reflected retrospectively in the relativities or should these be ignored?
• Are relativities sufficiently up-to-date to provide assistance to states when they need it? Did Victoria's increase in grants come too late? Should relativities be based on a shorter review period or should more be done to make sure they reflect conditions that will be applicable in the year in which they are used?
• Is greater annual stability in grants required? Should the updating of the relativities mean that the only changes that are introduced are through the substitution of the latest year's relativity for the earliest year's relativity? No other changes would be made to earlier years.
• What can be done to reduce the volatility of the relativities caused by changes in general revenue funds?

Other Interactions

Commission Standards

Financial standards
As noted above, the starting point of the Commission's work is the development of standards against which the revenue raisings (from own sources) and expenditures of each state can be compared. These financial standards are derived from state accounting records.

To enable expenditure and revenue standards to be calculated, the states' financial transactions, and the operating surpluses or deficits of selected state business enterprises, are put into a common framework or standard budget. All capital transactions are excluded. The standard for each expenditure function is the average per capita spending by all states and the standard in each revenue category is the average per capita revenue raised by all states. That is, the standards are Australia-wide averages.
The standards are based on what states actually do, on average, and are thus internal. They may be contrasted with external standards derived from views about what states should be spending (or raising). The use of internal standards has the advantage of obviating any need for the Commission to make value judgements on what standard is appropriate – and it avoids any implication that the actual level of a state's spending (or revenue raising) is somehow inappropriate.

Table 5 illustrates for a number of categories the differences between the actual revenue and expenditure of the Northern Territory, the standard the Commission presently uses and the standard that could be used if equal weight were to be given to the experiences of each of the states (the unweighted standard). This shows that giving equal weight to the experiences of each state tends to reduce the revenue standards and increase the expenditure standards. This is because the less populous states have a lesser influence on the population weighted standard than do the more populous states. There are arguments for and against each approach.
<table>
<thead>
<tr>
<th>Category</th>
<th>NT Actual</th>
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<th>Unweighted Standard</th>
<th>Diff. between weighted &amp; unweighted</th>
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<tr>
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<td>189.13</td>
<td>155.09</td>
<td>34.05</td>
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<tr>
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<td>147.58</td>
<td>79.54</td>
<td>92.15</td>
<td>-12.61</td>
</tr>
<tr>
<td>Business franchise fees - tobacco</td>
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<td>115.09</td>
<td>134.86</td>
<td>-19.77</td>
</tr>
<tr>
<td>Business franchise fees - liquor</td>
<td>96.70</td>
<td>38.65</td>
<td>44.74</td>
<td>-6.09</td>
</tr>
<tr>
<td>Mining</td>
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<td>51.90</td>
<td>68.69</td>
<td>-16.78</td>
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<tr>
<td>All other revenues</td>
<td>610.33</td>
<td>734.57</td>
<td>665.74</td>
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**EXPENDITURE**

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<td>-44.70</td>
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<td>2684.36</td>
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Policy standards

Similarly, in the calculation of disability factors, the Commission derives the use and cost weights to be applied to particular groups of users from what states actually do. Average policy standards are derived from the outcomes of state budgets and other data showing differential patterns of actual use of particular services by the different groups. States provide evidence of the different costs they experience in providing services and the Commission averages the weights for particular states to derive a policy neutral measure. Again, different methods of calculating the policy neutral weights give different answers.

Table 6 provides three examples – one where a simple average is used, one where total population of each state is used to derive the average and the third where the total number of Aboriginals in each state is used. The implications for the Northern Territory of the different approaches are quite important. Weights of between 3.5 and 4.7 are possible and the effect on the disability factors quite large. For the Northern Territory, its disability factor could vary between 1.58 and 1.86. In terms of dollars, this would be very important. For a standard of $100, these disability factors would result in standardised expenditures of $158 or $186.

In reality, the Commission rarely has information from all states on cost differential for all groups using the range of services. Where it does, total population weighting is the normal approach. Where less information is available, judgement is often used to derive a policy neutral weight.
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Hypothetical Cost data – ratio of costs of servicing an Aboriginal to a non-Aboriginal

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<th>Aboriginals</th>
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Australian average cost weighting

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<tr>
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<tr>
<td></td>
<td>Population weighted</td>
<td>3.47</td>
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<td>Aboriginal weighted</td>
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<td>Effect on disability</td>
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<td>Population weighting</td>
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<tr>
<td></td>
<td>Disability factor</td>
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</tr>
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<td>Service base weighting</td>
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<tr>
<td></td>
<td>Disability factor</td>
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</tr>
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</table>

Table 6: Commission Standards and Disability Factors
Standardised Revenues and Expenditures

Combining the financial and policy standards results in standardised revenues and expenditures. These represent what the Commission thinks each state can raise or needs to spend, if it applies standard or average policies. Table 7 provides a comparison of Northern Territory actual, standard and standardised revenues and expenditures for a number of categories. The difference between the standard and the actual levels is a measure of the disabilities the Northern Territory faces in raising revenues and providing services.

Benchmarking

For many years, the databases and findings of the Commission have been used informally by State Treasuries and others to assist states in framing their budgets. States compare their expenditures and revenues with those of other states, consider why there is a difference and decide whether they wish to continue the policy causing the difference. States consider whether they are prepared to pay for a policy or whether they want to change it. New South Wales has established a permanent body, the Council on the Cost of Government, to consider these matters in a formal on-going manner.

Other formal inquiries established by states to examine their economic management and efficiency have used Commission data. Since the early 1990s, major inquiries by independently appointed bodies have reported on the public finances of New South Wales, Victoria, Tasmania, Western Australia, South Australia and the ACT. All used Commonwealth Grants Commission data to support their findings.

Table 7  Actual, Standard and Standardised Revenues and Expenditures, Northern Territory, 1994–95

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>REVENUE</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pay-roll taxation</td>
<td>347.54</td>
<td>372.02</td>
<td>301.67</td>
<td>70.35</td>
</tr>
<tr>
<td>Land revenue</td>
<td>0.00</td>
<td>78.18</td>
<td>33.51</td>
<td>44.67</td>
</tr>
<tr>
<td>Gambling taxation</td>
<td>113.06</td>
<td>189.14</td>
<td>167.22</td>
<td>21.92</td>
</tr>
<tr>
<td>Business franchise fees</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>– petroleum products</td>
<td>147.58</td>
<td>79.54</td>
<td>120.76</td>
<td>-41.22</td>
</tr>
<tr>
<td>– tobacco</td>
<td>210.92</td>
<td>115.09</td>
<td>201.12</td>
<td>-86.03</td>
</tr>
<tr>
<td>– liquor</td>
<td>96.70</td>
<td>38.65</td>
<td>60.20</td>
<td>-21.55</td>
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<tr>
<td>Mining</td>
<td>169.31</td>
<td>51.90</td>
<td>187.86</td>
<td>-135.96</td>
</tr>
<tr>
<td>All other revenues</td>
<td>610.32</td>
<td>734.58</td>
<td>651.46</td>
<td>83.12</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>1695.43</td>
<td>1659.10</td>
<td>1723.80</td>
<td>-64.70</td>
</tr>
</tbody>
</table>

| **EXPENDITURE**       |                |               |                       |                             |
| Government primary education | 744.59        | 295.52        | 641.30                | 345.78                      |
| Government secondary education | 394.08        | 252.20        | 413.96                | 161.76                      |
| TAFE                  | 449.21         | 143.26        | 214.87                | 71.61                       |
| Hospital services     | 641.12         | 510.84        | 662.06                | 151.22                      |
| Community health services | 544.51        | 81.72         | 264.22                | 182.50                      |
| Police                | 372.55         | 147.78        | 724.20                | 576.42                      |
| Aboriginal community services | 323.89        | 8.21          | 433.40                | 425.19                      |
| Services to industry  | 586.07         | 109.76        | 232.18                | 122.42                      |
| Debt charges nec      | 1254.12        | 171.33        | 598.06                | 426.73                      |
| Other expenditure     | 2657.57        | 963.74        | 2975.16               | 2011.42                     |
| **TOTAL**             | 7967.71        | 2684.36       | 7159.41               | 4475.05                     |

(a) Revenue needs are calculated as standard less standardised. Expenditure needs are calculated as standardised less standard.
(b) Influences on State Revenue and Expenditure Patterns.
The Commission's reports and working papers have also been the primary data source in other studies of the state public sector, including an analysis of the effects of immigration on state budgets, a study on the efficiency of state spending which the Institute of Public Affairs carried out for the Economic Planning Advisory Council, and the annual evaluation by the Evatt Foundation of the fiscal, economic, social, environmental and administration performance of state governments.

Table 8 illustrates some changes made by states to their revenue collection and expenditure patterns over time. It shows that once the ACT was included in the general revenue sharing arrangements, it moved its land revenue effort from well below standard to above standard. The Northern Territory still chooses not to apply a land tax. Queensland's effort in Business Franchise Fees - tobacco has moved from well below standard to almost equal to standard. The total taxation data shows the increase in effort by Victoria as it increased its tax rates in a range of taxes as it struggled to balance its budget.

In Government Secondary Education, the ratios show that Queensland and the Northern Territory have increased their levels of service provision. Queensland has also increased its level of service provision in Hospital Services. Victoria has reduced its levels of service provision in both Government Secondary Education and Hospital Services from above standard to below standard. The Northern Territory appears to have a very low level of service provision in Police.

More recent benchmarking studies by the Industry Commission, discussed in an earlier session of this workshop, are providing additional information on state performance.

<table>
<thead>
<tr>
<th></th>
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<th>Vic</th>
<th>Qld</th>
<th>WA</th>
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<th>Tas</th>
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<td>Land revenue</td>
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<tr>
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(a) Ratio of actual revenue to standardised revenue. Australia = 100%.

(b) Ratio of actual gross expenditure to standardised gross expenditure. Australia = 100%.
Grant design effects
Some academics have claimed that the equalisation processes used by the Commission have caused states to alter their revenue and expenditure policies to maximise their grant shares. In December 1995, Swan and Garvey\textsuperscript{7} argued that the equalisation system encouraged states to seek to increase their grant shares by overspending on services in which they had cost disadvantages, and by raising taxes in areas in which they had comparative revenue disadvantages. Similarly, Williams\textsuperscript{8} claimed, that there was some evidence that ‘... governments provide relatively more of those services which the Grants Commission deems to be relatively costly in the state and therefore attract relatively more funds under the cost equalisation formula’\textsuperscript{9}.

While such behaviour is theoretically possible, budgetary pressures and political imperatives suggest that a more realistic strategy would be to seek to reduce costs in high cost services, and to raise taxes in areas where the most revenue could be raised for a small increase in tax. Otherwise, states would be gambling that any future increases in revenue grants would outweigh the immediate and on-going budgetary benefits of cutting costs and levying efficient taxes.

This would be a big gamble because of the uncertainty about the size of the future pool and the budget strategies of other states, and also because of the possibility that the Commission would change its assessment methods to minimise obvious grant manipulation. That is not to say that states do not consider the grant implications of policy choices, only that grant implications are only one aspect.

For example, in 1993-94, the Victorian government decided to change its funding of superannuation from an emerging to a fully funded basis as a result of recommendations made by its

\textsuperscript{7} PL Swan and GT Garvey, The Equity and Efficiency Implications of Fiscal Equalisation, 1995.


\textsuperscript{9} As Williams’ analysis was based on actual expenditures of States which included cost disabilities, this finding is somewhat unremarkable.
Commission of Audit. In addition, it made a one-off contribution of $1400 million from the Consolidated Fund to various superannuation schemes to meet the Government's liability for previously deferred employer contributions.

Before deciding to make these changes to its funding of superannuation, Victoria sought advice from the Commission on how it would treat these payments and of the consequences for Victoria's grant share. Victoria was advised that, under 1993 Review methods, the superannuation payments made on an emerging basis and the one-off contribution would be classified as recurrent superannuation expenditure. This was because the Commission makes no distinction between payments made under emerging or fully funded schemes and because the standard budget is prepared on a cash basis.

Victoria was also advised that the inclusion of $1400 million in superannuation expenditure in 1993-94 would cause a sizeable increase in the standard. Because Victoria's cost of service provision ratio in the Superannuation category was below the Australian standard, this would cause a decline in its relativity and grant share. The Commission estimated it would cost Victoria some $25 million in general revenue grants over a five year period of reviews and updates. Nonetheless, Victoria proceeded with those changes to its method of funding superannuation and also made the repayment.

The Commonwealth Budget

The commonwealth budget provides important information for the Commission because our terms of reference ask us to base our assessments on:

the presumption that those expenditure and revenue functions which have been, or which are to be, transferred from the commonwealth to the states and the territories, or vice-versa, with effect from any time between the beginning of the review period and 30 June 1997, had been transferred prior to 1 July 1991.10

Thus, we 'backcast' the arrangements that will exist in the year in which the per capita relativities will be applied into the years of

10 Draft terms of reference for the 1997 Update.
the review period by altering the data for that period to reflect the new arrangements. Details of changes in commonwealth-state financial arrangements are usually provided in commonwealth budget documents.

In the past, commonwealth budget documents have also provided information on SPPs provided to the states and on any major changes to these. As noted above, because we regard most of these as being available to meet state fiscal requirements, they are deducted from a state's total financial assistance requirements before relativity factors are calculated.

**Distribution of Special Purpose Payments**

Over time, the work of the Commission has caused many commonwealth departments to reconsider the methods they use for distributing SPPs to the states. There have been a number of different outcomes:

Some departments have changed the methods they used to distribute their SPPs so that the distributions are more in line with Commission assessments. This happened with the Medicare grants when the Department of Health decided to use age-sex weights to distribute the funds to the states. Table 9 illustrates the change in the distribution that resulted and the distribution that would have occurred if the Commission General Medical Services assessment relativities had been adopted. The change made by the Department of Health brought our distributions much closer together.

Some departments have expressed concerns that the work of the Commission overrides their distributions. While it is true that an SPPs distribution may be overridden in a financial sense, it is not true that the policy objectives of the SPP are overridden. States must continue to spend the funds in the way agreed when accepting the SPP. In addition, when the commonwealth considers it necessary, the Commission has been instructed in terms of reference to certain SPPs in ways that the Commission would not have chosen, if left to its own devices.

For example, the Commission is required to leave out of its calculations some of the Hospital Funding Grants and has been told not to assess certain disabilities in its Hospital Services assessment. Also, the financial assistance provided under the
South Australian Assistance Package has been excluded from the assessments by the terms of reference to ensure that the benefit of the assistance is not redistributed to the other states by a change in the distribution of general revenue funds.

Some SPPs, such as the Identified Roads Grants are being absorbed into general revenue funds and will be distributed according to Commission relativities. I hope this is because of the belief that the CGC distribution is better, rather than because it is easier to do it that way.

Table 9 Hospital Funding Grants

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Recognition of Needs of Special Groups

An important outcome of the work of the Commission has been the development of data collections which recognise the special needs of particular population groups in the provision of services. At the beginning of the review process (that is in 1981 and 1982), few data were available on the use of services by Aboriginals, people from non-English speaking backgrounds or people of low socio-economic status. Information on relative costs of providing services to particular groups or in particular locations was almost non-existent.

The Commission initiated a number of delivery unit surveys on the provision of schools education, hospital and police services and had continuing discussions with bodies such as the Australian Institute of Health and Welfare and the Institute of Criminology to attempt to improve the available data. For the 1999 Review, good data will be available on service provision for schools education, hospitals (from the Hospital Cost and Utilisation Studies), corrective services (from ABS). Reasonable data, which are rapidly improving, will be available for TAFE,
police, and court services. Some data will be available for community and mental health services and nursing homes. Data on the provision of welfare services continues to be elusive.

These data not only make the Commission’s task easier and the results more equitable, but also must make service delivery outcomes better. If providers know about the needs of target groups, then services can be better focused and more effective, even if for some groups, there is still a way to go to achieve equitable outcomes.

**Conclusion**

This overview of the interactions between the work of the Commission and public sector budgets illustrate that the fiscal equalisation system is soundly based on what states do and seems to achieve outcomes, in terms of general revenue grant allocations, that satisfy rational expectations. The information produced as a by-product of the Commission’s work has contributed to improving the performance of the state public sector in Australia by providing annual bench-marks against which states can monitor their performance and by providing data which service providers can use to better target their services. It has also lead to some changes in commonwealth-state financial arrangements.

It does not conclude that the system is perfect and should not be changed. It highlights a number of areas that could be considered by states and the commonwealth in terms of tailoring the system to better meet their needs.
References


The Bottom Line

NORMAN FRY

Introduction
At the workshop on Federalism in the Northern Territory in May 1996, an officer from the Chief Minister's department waxed lyrical about the ideal scenario for Northern Territory self-government.¹
Two of the key points raised at that conference were:
• control over the national parks; and
• unfettered access for mining and exploration all over the Northern Territory.
This is somewhat at odds with the softer rhetoric of the Northern Territory Government and the language of the final draft constitution prepared by the Constitutional Sessional Committee. It cannot help but make Aboriginal people wonder whether the softer approach is superficial and that those core attitudes prevail. The challenge for the Northern Territory Government is to convince us of their good faith on Aboriginal issues.

¹ Organised by the North Australia Research Unit, Darwin in May 1996. The proceedings are published as Fletcher C (ed), 1997, Federalism in the Northern Territory: Options for Fiscal Maturity, North Australia Research Unit, The Australian National University, Darwin.
This paper is about the bottom line for statehood in two senses: first, the fiscal bottom line; and second the political bottom line. The bottom line is this: unless the Aboriginal people of the Northern Territory support statehood, it must not go ahead and the Aboriginal people of the Northern Territory will not support statehood unless they are convinced that the government will not seek to unravel any of the rights we currently hold.

We have every reason to be cautious. We get very disheartened when we see or hear evidence that, deep down, the Northern Territory Government opposes the concept and the practice of Aboriginal land rights. Aboriginal people must be convinced that this is not the case, and the government has a lot of work to do to convince us of that.

The bottom line on the protection of our rights and the fiscal bottom line in relation to Aboriginal people’s economic stake in the Northern Territory are outlined below. Aboriginal people are a major economic power in the Northern Territory and for that reason alone the government must listen to our wishes in relation to a new constitution and, possibly, a new state. We are major stakeholders in this land.

**Aboriginal Interests in the Draft Constitution**

The Sessional Committee’s *Draft Constitution* has made some commendable attempts to deal with what they consider to be the interests of Aboriginal people. These measures include:

- recognition in the preamble of Aboriginal prior occupation;
- the proposal to entrench the *Aboriginal Land Rights (Northern Territory) Act 1976* as an Organic Law of the Northern Territory Parliament;
- the proposal to entrench sacred sites protection as an Organic Law;
- a form of recognition of Aboriginal customary law;
- a provision for an Act to ‘grant’ Aboriginal self-determination; and
- constitutional protection of language, social, cultural and religious rights and freedoms.
The Northern Land Council is pleased to see that the Committee is concerned to address Aboriginal interests. We suggest, however, that a far better way to do this is to carry out comprehensive consultations with Aboriginal people themselves.

If the Sessional Committee on Constitutional Development want to properly address the rights and needs of Aboriginal people in moving towards statehood, then it must look much further than what rights and entitlements are to be explicitly contained within the constitution. The entrenchment of those rights is important, but it must be accompanied by a genuine desire to listen to what Aboriginal people want, and a flexible and creative approach to meeting those needs and rights.

Some of the interests and issues which have not been dealt with in the final draft of the constitution include:

- recognition and entrenchment of forms of Aboriginal self-government – as opposed to self-determination;
- protection of the veto power under the Land Rights Act and rights to self-management of national parks;
- real recognition of Aboriginal customary law, and the Aboriginal justice system - instead of the weak support it has in the current draft;
- a Bill of Rights which protects not only universal human rights, but special indigenous rights, both collective and individual;
- financial arrangements for Aboriginal communities to provide real autonomy in decision-making;
- the need for any Northern Territory constitution to be adopted by a double majority: a majority of Aboriginal people and a majority of all Territorians.

We make these claims on the basis of the right of the original owners of the Northern Territory to exercise self-determination. Currently, Aboriginal people constitute 26 per cent of the Northern Territory population, however, they comprise more than 30 per cent of the permanent population. Aboriginal people are also the owners of 50 per cent of the land base, and a powerful economic force.
The Mabo decision of 1992 has recognised our prior ownership of Australia and our continuing native title rights; the Northern Territory constitution should explicitly recognise this as well, and the process of adoption of the constitution must reflect our special status.

The Bottom Line on Land Rights

This year Aboriginal people are celebrating the twentieth anniversary of the *Aboriginal Land Rights (Northern Territory) Act 1976*. There is much to celebrate. Nearly 50 per cent of the Northern Territory has been returned to its traditional owners and this has been the cause of much joy.

However, in the process of claiming back traditional land we have been constantly at loggerheads with the Northern Territory Government. Until very recently, they opposed every single land claim that was put before a Land Commissioner. The land claim process was envisaged in the Land Rights Royal Commission as an information-seeking and verifying process. The opposition of the Northern Territory Government has turned it into an adversarial process.

It has also been turned into a very expensive process. Estimates of the amount of money spent by the Northern Territory Government in opposing land claims range from $10 million upwards. This in turn has increased the costs to the land councils, as we have had to employ QCs and other specialist staff to defend our clients in appeals against the Land Commissioners’ findings.

Not one of the Northern Territory Government’s appeals has been successful.

This opposition to land rights has abated somewhat in recent times, however, comments like those made at the conference in May indicate that land rights is still a vexed issue for the Northern Territory Government.

The proposal to entrench the *Aboriginal Land Rights (Northern Territory) Act 1976* as an Organic Law in the new Northern Territory constitution has an attractive ring to it. We like the idea of protecting the *Land Rights Act* from amendment without proper processes, and giving it a special status.
The major stumbling block is whether the Northern Territory Government is ready to maturely and ethically protect Aboriginal land rights, after spending much of the last twenty years vehemently opposing them. The onus is on the government to demonstrate to Aboriginal people that it has the maturity to protect land rights. They must show us that they have changed, that they can deal fairly and appropriately with us. Until they do so there is little or no evidence that Aboriginal people will support any move to transfer powers from the Commonwealth Government to the Northern Territory.

That is the bottom line on land rights. It is not a threat or a standover tactic but, perhaps, a cautionary signal to the government not to run too far ahead with big plans without ensuring that they have the trust and confidence of the people whom they are meant to represent.

Room to Improve

If I were compiling an end of year school report on the Northern Territory Government I would be compelled to write one of those reports which parents dread receiving. It would report on inconsistencies - some flashes of brilliance, soured by major muddles. It would frequently use the words: ‘must try harder’.

In terms of the Northern Territory Government’s record in addressing the fundamental needs of its Aboriginal constituents, I would like to comment on two areas which are outstanding failures. The first is an area in which I have much personal experience.

It is in the area of education that some of the big problems occur. It is an abrogation of responsibility of the highest order that there is no secondary school for Aboriginal students outside the major population centres of Darwin, Katherine, Tennant Creek, Nhulunbuy and Alice Springs.

If students want to attend a secondary school, they must leave their home and family and travel to one of these centres. The alternative on their community is a form of second-rate education which barely brings them up to Year 8 standard.

It is also a great concern that Aboriginal studies is still not a compulsory subject in the Northern Territory curriculum. Some good work has been done by Aboriginal and non-Aboriginal
teachers in developing a curriculum but it has not been given a time allocation by the Education Department. Even in Darwin, 30 per cent of the children in primary schools are Aboriginal yet it is not seen as a priority to teach these children and their non-Aboriginal peers about Aboriginal culture.

The treatment of Aboriginal teachers by the Education Department is another problem area. It cannot be justified that non-Aboriginal teachers on communities receive housing, subsidised power, and subsidised food costs, while Aboriginal teachers do not.

Another area where much improvement is needed is community living areas. Community living areas are meant to provide secure title for Aboriginal people who have been dispossessed by the pastoral industry. Northern Territory legislation was intended to provide small excisions from pastoral land on which Aboriginal people had a right to live.

The Northern Territory's Pastoral Land Act does not, however, make this process simple or fair. The Act gives the Minister for Lands vast discretionary powers and builds in enormous statutory delays to the process. The latest chapter in the community living areas saga happened in September 1996.

The Minister for Lands, Mike Reed, rejected the approval for a community living area which had previously been given by his predecessor, Steve Hatton. Interestingly, this particular community living area was the only one in the Northern Land Council area which had ever been approved by a Minister without the consent of the pastoralists. Mr Reed rejected approval on the basis of undisclosed 'legal' advice, with the intention of denying these claimants a secure place to call their own, and thereby also denying them housing and basic services.

There are some positive signs, however. The Northern Land Council's Caring for Country program has been successful in working with a range of Northern Territory government agencies in environmental projects on Aboriginal land. We have also had some success in developing positive working relationships with the Department of Primary Industries and Fisheries in relation to fisheries management.

More frequently, Aboriginal land councils are invited to the table to discuss issues, rather than simply being marginalised in
the policy process. This is the kind of maturity which is needed to
bring the Northern Territory to statehood. I believe that we can
work together and when that happens the transition to statehood
will be much simpler.

The Economic Bottom Line

Other speakers have already mentioned the importance of
Commonwealth grants to the Northern Territory economy, and
the importance of the Aboriginal population’s needs in the
calculation of the size of Commonwealth grants to the Northern
Territory.

Attention is now drawn to another aspect of the important
economic role that Aboriginal people play in the Northern
Territory.

Recent research commissioned by the Northern Land Council
had the following findings:

- the Aboriginal economy of the Top End is a legitimate,
  substantial, stable and growing component of commercial life
  in Australia’s north. In 1994/95, the Aboriginal economy
  contributed almost $500 million to the local economy through
  the public and private sectors;

- the expenditures of Aboriginal people and organisations are
  intimately connected to the livelihoods of many non-
  Aboriginal businesses.²

Using Katherine as a case study, research found that Aboriginal
spending patterns are crucial to the stability and continued
growth of both the wholesaling and retail trade in the region. The
clear message from this research is that although Aboriginal
people are frequently portrayed as being dependent on
government funding or ‘taxpayers’ dollars’, this is a simplistic
reading for two reasons.
1. It ignores the substantial and growing size of privately-owned
   Aboriginal companies.

2 Pritchard B and C Gibson 1996. The BLACK Economy: Regional Development
strategies in the Northern Territory, NARU Report Series No 1, North Australia
Research Unit, The Australian National University.
2. It neglects a second level of dependency where regional economies and non-Aboriginal businesses within them are dependent on flows from the Aboriginal economy.

Perhaps the Commonwealth Minister for Aboriginal Affairs, John Herron, was more correct than he realised when he referred to Aboriginal affairs as the 'Aboriginal industry', however, this industry is not a parasite, as he implied, but a vital and substantial part of the Northern Territory economy.

This point is made to illustrate that Aboriginal people are important and active players in the contemporary Northern Territory. We are not a vestige of the past, a drain on the public purse, or a moral albatross around the neck of government.

In budgeting for statehood, the Northern Territory government must take into account our special rights as indigenous people and land owners, but also our role as major stakeholders and players in the economic development of the Territory. We deserve a place at the negotiating table on this basis.

**Balancing the Bottom Line**

I have spoken about our inherent rights as Aboriginal people that must be protected, and the need for the government to show maturity and good faith before we can trust them with land rights. I have also spoken of the additional measures which the Sessional Committee could consider if it wants to more adequately address Aboriginal interests.

Mention has been made of some instances where the Northern Territory Government needs to lift its game in service provision, protection of rights, and objective approaches to Aboriginal issues, and where some positive signs are emerging.

Lastly, it has been argued that apart from all our other special claims as indigenous people, we are a powerful economic player in the Northern Territory, and for that reason also we must be more closely connected to the development towards statehood.

But how can these things happen?

It is not enough to listen to the land council spokespeople, and it is not enough to read our reports and submissions.
Aboriginal people themselves must be involved in the process in comprehensive community consultations, and then allowed a special vote on the issue.

The Rights of the Terminally Ill Act 1995 is being taken to Aboriginal communities in a comprehensive education and information process. Though we might well argue it would have been better to do this before the Act was passed, it is still heartening to see the government prepared to invest so much in providing information to Aboriginal people. The new firearms legislation will undergo the same community education process.

Using these models, the government must institute a round of community meetings and education sessions based on the proposed constitution, prior to any formal decision-making.

At the same time, the government should be showing good faith in its dealings with Aboriginal people on issues relating to land rights, provision of services, funding and self-determination.

The bottom line must be balanced, and that means a balance of our rights and interests being protected in the constitution, and a balanced approach from the Northern Territory Government in dealing with us on all levels.

As a result of the government's adversarial approach to us in the past, Aboriginal people have developed strong and skilful organisations to represent our interests. We have the people and the skills to develop an excellent consultation strategy on the issue of statehood once we are convinced that the government is acting in good faith with us.

I invite the government to work with us on this one, rather than against us.
The Global Dimension of Statehood
8

The Northern Territory and its Role in the Region

Geoff Forrester

The focus of this paper is the South East Asia region and within this region the Northern Territory's closest neighbour, Indonesia. The views expressed in it mainly reflect my experience of the Northern Territory's role in South East Asia as observed from the Department of Foreign Affairs and Trade, where I worked for twenty-six years until June 1996.

For some time the Northern Territory has been pursuing a high profile for itself in Asia, a role it has been undertaking independently of, but in cooperation with, the Federal Government. The objective of the Northern Territory Government has been commercial benefit for the Northern Territory. The Northern Territory Government has pursued a strategy of building strong relationships across the region as the foundation for strong commercial relationships. Indeed, the Northern Territory has done more than any other of the states and territories of Australia to develop relationships in Asia. The positive image of the Northern Territory in the region is a positive influence for the whole of Australia in the region. The Northern Territory's efforts in Indonesia in particular have been acknowledged both widely and at the highest levels inside Indonesia and have contributed significantly to the Federal Government's own efforts to build relations with Indonesia.
China, Taiwan, Macau and Hong Kong are important elements in the Northern Territory's regional networks. The main focus, however, are the ASEAN countries generally and Indonesia, Malaysia, Brunei and the Philippines in particular. Within Indonesia itself, the Northern Territory has developed special links with the provinces of Eastern Indonesia and in 1992 signed a Memorandum of Understanding with the Government of Indonesia on economic cooperation with Eastern Indonesia.

The Northern Territory has also actively engaged in the development of the new sub-regional ASEAN grouping BIMP-EAGA. The initials stand for Brunei/Indonesia/Malaysia/Philippines – East ASEAN Growth Area. The BIMP-EAGA sub-region includes the East Malaysian states and Labuan; Brunei; the Southern Philippines; and the Indonesian provinces of North Sulawesi and West, East and Central Kalimantan.

ASEAN has established several such growth areas where intra-ASEAN international boundaries converge. The objective is to accelerate growth in areas which have tended to lag behind the growth centres of ASEAN members, promote cross-border investment and encourage the establishment (or re-establishment in many cases) of cross-border commercial linkages. The most successful example so far is the Singapore/Johore/Riau (SIJORI) Growth Area. Its success largely reflects the vibrancy of the Batam Development Authority and the efforts of Indonesia, in collaboration with Singapore, to exploit Batam's proximity to Singapore.

The Northern Territory Role in Historical Perspective
The Northern Territory experience in developing relationships with Indonesia parallels that of the Federal Government in the last 40 to 50 years.

In the late 1940s, at the end of the Second World War, the then Labor Government knew, in a halting way, that Australia needed a positive relationship with the post-colonial world then emerging around Australia. The principal motivations were strategic. Although new states like Indonesia and their leaders were entirely unknown quantities, they were now Australia's neighbours and the development of friendly relations
was the only logical choice. The then Minister for External Affairs, Mr Evatt, guided Australia through difficult choices in these early years and Australia made correct decisions in the United Nations Security Council in support of Indonesia's struggle for independence.

In the 1950s, a Liberal Minister for External Affairs, Mr Casey, and a young Department of Foreign Affairs had strong strategic reasons soundly based in geography to expand rapidly Australia's diplomatic presence in our newly independent neighbours and to develop an aid program for them. The Colombo Plan stands as a remarkable testimony to the vision of those who managed foreign policy in the 1950s and focussed on building relationships. The Colombo Plan educated many of those currently in senior positions in Government and business in the region and they now send their children to university in Australia.

The development of relationships was not matched, however, by the development of commercial links. The economies of the region, and Indonesia's in particular, were underdeveloped and there were no complementarities with Australia which would generate trade.

In the 1970s, the then Prime Minister, Mr Whitlam, gave further strong impetus to the bilateral relationship with Indonesia. He believed that Australia had to have strong, good relations with the region and with Indonesia in particular appropriate to the era of detente in Asia which was beginning with the opening of relations with the People's Republic of China and the end of the Vietnam War.

President Suharto warmly reciprocated Mr Whitlam's enthusiasm. They met four times and President Suharto visited Australia twice in the 1970s. The relationship reached a clear peak in this period. There was still, however, one thing missing. There was no economic or commercial relationship to speak of with Indonesia. Therefore the relationship was highly subject to political vicissitudes, for example on the issues of PKI (Indonesian Communist Party) detainees, human rights and the integration of East Timor.

From the mid 1980s the Indonesian economy began to grow rapidly and to diversify into manufactures for export. The
Indonesian Government later opened up the mining industry. Opportunities opened for the first time for expanded trade in both directions and expanded Australian investment in Indonesia. The results are there in the statistics – a growing and increasingly strong economic relationship. Indonesia has become a major market for Australian exports of goods and services and a major destination for investment.

Indonesia’s growth has so far largely focussed on Java and Sumatra. The provinces of Eastern Indonesia, those closest to the Northern Territory, have lagged behind Java and Sumatra. While the Northern Territory has certainly benefited from accelerated growth in Indonesia over the past ten years, inevitably South Eastern and Western Australia have been the principal beneficiaries because shipping and air services are most intensive between these parts of Australia and Asia.

Proximity should be a key competitive advantage of the Northern Territory and that advantage is strongest in relation to the provinces of Eastern Indonesia. While they lagged behind Java and Sumatra, the Northern Territory was unable to capitalise fully on its geography.

**New Opportunities in Eastern Indonesia: Benefiting from Proximity**

The outlook for the Northern Territory has been changing for some time. A new situation and a consequent competitive advantage for the Northern Territory have begun to emerge as Jakarta has become serious about promoting growth in the Eastern provinces, as international investment begins to exploit the natural wealth of these provinces and as incomes in the area grow.

The official definition of Eastern Indonesia (Kawasan Timor Indonesia – KTI) includes the provinces of Irian Jaya; Maluku; East Timor; East and West Nusatenggara; South, South East, Central Sulawesi; and East, Central, South and West Kalimantan. The population is approximately 35 million. The region is rich in mineral resources, oil and gas and timber and has enormous agricultural potential. In many ways, it is Indonesia’s new
development frontier. And yet it has lagged seriously behind the growth centres of Java and Sumatra.

Darwin lies in the heart of Eastern Indonesia and within easy reach of its current and potential growth centres. It is 830 kilometres from Kupang in West Timor, which may emerge as one site for joint exploitation with Australia and Darwin of the oil and gas resources of the Timor Gap; 975 kilometres from Ujung Pandang, the manufacturing centre of Eastern Indonesia; 1055 kilometres from Timika in Irian Jaya, the centre of the Freeport mine; 1640 kilometres from Mataram in Lombok, a developing tourist centre; and 1935 kilometres from Balikpapan in East Kalimantan, a major mining and oil and gas centre.

The Northern Territory has several key political assets already in place which can help it exploit this emerging competitive advantage. It is fortunate to have solidly in place strong relationships with Jakarta and with the Eastern provinces well beyond what would normally be expected of a state of 180 000 people. The Chief Minister, Mr Shane Stone, is very well known at the highest levels in Jakarta. Of particular significance is the fact that he represented the Prime Minister at the funeral of the wife of President Suharto in May 1996 – a show of understanding and respect which will have an enduring impact in Jakarta. The Minister for Asian Relations, Trade and Industry, Mr Eric Poole, is also well known in Jakarta and in October 1996 was the first representative of a State or Territory to participate in the biannual Australia-Indonesia Ministerial Forum, during which Australia and Indonesia endorsed the Australia-Indonesia Development Area (AIDA) initiative under which both undertook to cooperate in accelerating the growth of Eastern Indonesia. The Northern Territory will play a major role in developing the initiative.

Parallel relationships exist with Kuala Lumpur, Kuching, Kota Kinabalu, Bandar Sri Begawan, Manila, Davao and General Santos City. The Northern Territory is a member of the BIMP-EAGA Business Council and an observer in BIMP-EAGA meetings of ministers and officials. The Northern Territory is being brought into Indonesian government planning and project implementation for its KTI strategy of accelerating growth in Eastern Indonesia.
Two examples demonstrate the commercial potential of this emerging competitive advantage.

**Live cattle**
The trade in live cattle between Northern Australia and South East Asia is already substantial and the prospects are that the trade will continue to grow rapidly. The success of the trade depends first on the accelerating growth of incomes in the region and, second, on the proximity of Darwin to these increasingly wealthy markets.

Turning to Indonesia\(^1\), the following table demonstrates the rapid increase in the live cattle trade with Indonesia in the past five years and predicts a substantial growth in the export of live cattle into Indonesia over the next fifteen years:

<table>
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<th>Year</th>
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<tr>
<td>1990</td>
<td>92 140</td>
</tr>
<tr>
<td>1995</td>
<td>304 646</td>
</tr>
<tr>
<td>2010</td>
<td>403 769 (estimate)</td>
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</table>

Northern Australia is overwhelmingly the major supplier of cattle for this trade. At present, 99.4\% of the cattle come from Northern Australia and of these 51.1\% are from the Northern Territory. The estimate for 2010 is based on a conservative assumption of GDP growth in Indonesia of 6.5\% per annum to 2010 and a .65\% per annum decline in the relative price of chicken in the same period. The trade may grow faster if growth rates are higher. There is also the scope for the Northern Territory to supply services and technology as Indonesian buyers establish modern facilities for fattening and slaughter.

The Northern Territory already has established markets in Brunei, Malaysia, Java and Sumatra. Demand from these

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\(^1\) The information on prospects for the live cattle trade with Indonesia comes from Shiji Zhao and Catharina Williams, "Forecast of Demand for Beef in Indonesia", Bureau of Transport and Communications Economics, Canberra, 1996.
traditional markets will continue to grow. Another source of increasing demand will be mining and other growth centres in Eastern Indonesia as mines open up, investment increases and the area’s growth generally accelerates. The Southern Philippines will grow as a market for the same reasons.

Direct smaller scale shipping is already being developed to service the smaller centres of Eastern Indonesia and the wider BIMP-EAGA sub-region. Darwin will increasingly benefit from its capacity to offer quick delivery of smaller, high value loads direct into remote and diverse ports across the area without the need for transhipment in Surabaya, Jakarta or Singapore.

**Mining**
The encouragement by the Indonesian and Philippines Governments of foreign investment in the mining and oil and gas sectors has led to an explosion of exploration at new sites in Eastern Indonesia and in the Southern Philippines. Many of the current and prospective mine sites in Eastern Indonesia are closer to Darwin than to Singapore, which has traditionally be the major supplier for the mining industry.

Darwin’s capacity to serve the broad needs of the mining and oil and gas sectors will be enhanced by three factors. The extent to which Darwin builds a strong support and supply capacity to service the Timor Gap development will equip it better to compete with Singapore in support of mining exploration and oil and gas developments in Eastern Indonesia. The development of regular sub-regional direct air services from Darwin will make the Northern Territory significantly more competitive in supplying goods and services to growth centres such as Balikpapan (coal, gas, copper, gold, diamonds), the Freeport mine in Irian Jaya and to Lombok (for supply to the Batu Hijau copper/gold mining project in Sumbawa). The continuing development of smaller-scale shipping of the kind servicing the live cattle trade will strengthen the Northern Territory’s competitiveness in supplying the mining industry in Eastern Indonesia and the Southern Philippines.

The Northern Territory will not seize all the mining business in Indonesia and the Southern Philippines but it has a chance to
do a lot of the new mining business to emerge in Eastern Indonesia and the wider BIMP-EAGA area.

The capacity of the Northern Territory to capitalise on the competitive advantage of proximity rests on a good reputation in the region and a high profile actively built and nurtured now for almost ten years. But there is no room for complacency. There is a need for constant dialogue with the Indonesian and other regional governments to ensure that a lucrative trade like that in live cattle continues to meet the interests of both sides. The Northern Territory must also be alert to challenges to its geographic advantage, for example from other Australian states, Singapore or Guam in the area of mine supply or from other Australian states in the live cattle trade.

The Northern Territory cannot underestimate the need to be vigilant and constantly active in promoting its capacities – even its existence. Recently in Jakarta a senior representative of a company crucial to realising Northern Territory’s ambitions in relation to a new mining site in Eastern Indonesia confessed to not having known where Darwin was, how close it was to the site and how developed its infrastructure was. The Northern Territory Government’s role is not relationship building for its own sake. Through the relationships which it has built across the region over ten years and which will have to be continually nurtured in the future to remain useful, the Northern Territory is well positioned to expand its exports and take advantage of the growth – at last – of Eastern Indonesia and the wider BIMP-EAGA region.
Conclusion

RON DUNCAN

The chapters in this volume cover two main areas: first, how the Northern Territory presently fits into the Australian federal fiscal system and how it might be catered for as a state rather than as a territory; and second, how the financial affairs of the Northern Territory are presently managed and might be developed in the future. The status of fiscal management in the Northern Territory, with its broad objectives of efficiency and equity, is taken as a measure of the maturity of the system and therefore of the entity’s capacity to be a state within the commonwealth. The chapters essentially fall into three groups – commonwealth/state relations, financial management reform, and equity. The purpose of this chapter is to explain how these three groups contributed to debate on the two main issues covered by the central focus of this volume.

In chapter 2 Cliff Walsh presents an overview of fiscal federalism as it has been defined in legislation and law and how it is implemented in practice. He evaluates the system in terms of how well revenues are mobilised on the one hand and how well services are delivered on the other. Walsh points to how the commonwealth and the states and territories are active on both sides of the ledger but in a rather unbalanced and overlapping manner and he emphasises how complex, fragile and difficult to operate the federal system is and how, inevitably, it must be that way – in particular, given that people can make representation at
all levels of government while, for their part, politicians representing people at different levels of governments compete over delivery of policies to the same electorates. Walsh does not hold out much hope for reform of the high level of vertical fiscal imbalance in the federal system and substantial intervention by the commonwealth government in how the states and territories deliver public services. He does make a strong case for reform of the revenue-raising process, arguing for 'no representation without taxation'. Without some change in the High Court's views on excises or changes in views at the federal level on broad-based consumption or expenditure taxes, the Northern Territory as a state will have to manage within the present highly unbalanced system. Some may argue that at least for purposes of equity – particularly in relation to Aboriginal communities – there should remain a strong federal control over the delivery of public services.

Alan Tregilas (chapter 3) and Mike Harris (chapter 4) focus on developments in public administration in South Australia and Western Australia. The paradigm shifts in thinking about how public administration should be performed which they discuss are of relevance to the topic of budgeting for statehood in the Northern Territory in as much as it should be seeking to be as effective as possible in the delivery of public services – again, as a way of demonstrating its capacity to be an equal partner with the states. Tregilgas discusses very comprehensively the shifts in the philosophy and practice of public administration, both internationally and in Australia. New directions in thinking in this area stem basically from a general disillusion with central government performance in the provision of public services. Tregilgas contrasts the traditional system in which the government makes decisions about which services to provide, provides them and allocates them – with resulting inefficiencies in terms of costs and ineffectiveness in terms of the service provision – with the new model of public administration. The new paradigm, which it is hoped will bring about a significant improvement in governance (ie, improved efficiency, accountability and quality in service provision, as well as less abuse of public powers) draws on strands of what is known in economics and political science as public choice theory. Principal-
agent theory recognises the problems that may arise in any contract where agents (who may be government officials, or people working for commercial firms or not-for-profit institutions) are acting in the interests of principals – who may be governments which are trying to achieve policy outcomes, or the public which is the consumer of services. Given that people seek to maximise their own self-interest, there are bound to be conflicts of interest between principals and agents. Public choice theory more generally begins from the basis that government is not made up of a benign group of politicians or officials acting in the interests of the public. Rather, a politician’s main objective is to be re-elected while a bureaucrat’s main objective is to maximise the budget which he/she controls. Therefore, the new model of public administration is to develop contracts between ministers and top officials, and in turn between top officials and departmental managers, which establish a set of incentives to ensure efficiency, transparency, and accountability in the delivery of specified outcomes. It is also hoped that incentives can be designed to encourage officials to be more entrepreneurial and risk-taking.

There is some debate on the question of whether the new concept of public administration down-plays the role of public mindedness by public officials. Also, questions have been raised about how to cater for requiring officials to assume more risks and be more entrepreneurial. While satisfying the public interest may be uppermost in the minds of some public officials, it has not proven to be a mechanism that generally achieves the kinds of performance that the public expects. It would be better, therefore, to rely on a mechanism that provides greater certainty of good performance. Contracts can do this by providing the appropriate sets of rewards and penalties or sanctions. But there is also a need for education of the public about the changed responsibilities of public officials, especially to combat the tendency within the political process to try to make political points when things go wrong. Mike Harris, for example, discusses the actions that the Western Australian government is taking to deal with the risks that arise in the context of these public contracts and thereby encouraging officials to be more entrepreneurial. The widespread development of financial risk management instruments, such as futures, options and swaps on commodity prices and interest
rates, provides means for hedging various kinds of risks arising in the management of public enterprises. And Tregilgas discussed how the new concept of public administration might operate in small states such as the Northern Territory would be. He was not able to provide any hard and fast answers but made some points of interest: first, the fixed costs of delivering services may be relatively large and therefore it is important for small states to find the most efficient ways of supplying services; second, as in the case of the Northern Territory, it will be able to ‘free ride’ on the experiences of those states which have gone down this path earlier; third, there will be pressure to be competitive with other states in the provision of services in order to attract businesses, while not offering the market size of the larger states.

Gary Henry (chapter 5), from the Northern Territory Treasury, addresses the question of whether the granting of statehood to the Northern Territory would have any financial or economic impact on the Territory. His position is that while the commitment to horizontal fiscal equalisation remains, and given that the Northern Territory is treated like the states in terms of its financial relations with the commonwealth, the granting of statehood would have no economic or financial impact. Any increased revenues such as from increased royalties if control over uranium mining were given to the new state or increased costs and revenues from gaining control of national parks would be offset through the Commonwealth Grants Commission process. But this argument does not recognise that in having control over these resources the new state would be in a position to increase its own taxation base and have more control over its expenditures. These changes should also enhance the status of the new state in the eyes of the other states.

Chapter 6, by Catherine Hull, shows the high level of dependence (nearly 70 per cent) of the Northern Territory’s recurrent budget on commonwealth general revenue distributions (double that of the states). This differential reflects the impact of the relatively high proportion of Aborigines in the Northern Territory’s population, which affects both the revenue raising ability of the Territory on the one hand and the extent of per capita public expenditure needed by the Northern Territory to try to achieve horizontal fiscal equalisation. The differential
also points to the challenge that the Northern Territory faces in convincing the states that it should be an equal partner in the federal fiscal relationship. A means of meeting this challenge is for the Northern Territory to enhance its revenue raising capacity. One way to do this, with much wider implications, is to promote the development of economic activity within the Aboriginal communities.

In chapter 7 Norman Fry, from the Northern Land Council, argues the case that in budgeting for statehood the Northern Territory has to take into account the special circumstances of Aborigines as major owners of land with strong interests in the development of self-government processes and the recognition of Aboriginal customary law. As he says, there are substantial and growing commercial activities based in Aboriginal communities. However, there is potential for greatly increased private economic activity in their communities, especially with the improvements in the availability of educational facilities that Fry is keen to see. One of the main areas for immediate exploitation is to maximise the earnings from land-based activity such as mining. Obviously, care has to be taken to see that such resource dependency does not dampen incentives and enthusiasm for other economic activities.

Finally, Geoff Forrester explores the relationships between the Northern Territory and the East Asian countries to the north, particularly Indonesia and the Philippines. The extent of the contacts between the Northern Territory and these countries is surprising to someone not familiar with developments in this area. Close political links have been established. The key question is to what extent these political links will translate into commercial links? The development of the live cattle trade is to be expected, given the rapid income growth of East Asian countries and the consequent improvement in their diets. Consumption of beef, pork and poultry has been increasing at a very fast rate throughout East and North Asia in recent years.

One of the important parameters in international trade is geographical proximity, which is why the Northern Territory is benefiting from the East Asian growth in demand for meat products. As Forrester points out, the Northern Territory is most proximate to the provinces of Eastern Indonesia. However,
income growth is also important in trade growth and the fact that Eastern Indonesia has lagged behind Java and Sumatra means that its trade, whether in the form of capital equipment, raw materials or consumption goods, has not flourished as yet. Forrester claims that this will change as the Indonesian government intends to promote development in Eastern Indonesia. An area of development said to hold promise for development of commercial links between the Northern Territory and Eastern Indonesia (and Southern Philippines) is mining. An important determinant of investment in this activity is security of tenure. Uncertainty created by landowner disputes over mining contracts or by changes in foreign investment regulations adversely affects mining investment. In this regard, some of the recent disputes over mining contracts in Indonesia are a concern. However, when mining investment is highly uncertain, one of the ways in which investors cope is by running the mine on a fly-in/fly-out basis and building as little long-term physical infrastructure on the site as possible (as well as high-grading and other forms of short-term exploitation). Therefore, the heightened uncertainty of mining in Indonesia might work to the advantage of Darwin, catering to fly-in/fly-out services – as is the case with Cairns in relation to mining in Papua New Guinea where the environment for mining investment is relatively uncertain.
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The theme for Statehood in the Northern Territory is the question of whether the Territory is financially equipped for statehood. In the volume, the contributors explore aspects of management and budgeting in the Territory’s desire to increase its status within the federation. The contributing essays cover national revenue and expenditure, the challenge of national expenditure and the potential impact for the Territory of competition between the 'big' states – New South Wales and Victoria – and the 'smaller' states – Queensland, Western Australia, South Australia, Tasmania and the Australian Capital Territory. A recurring theme throughout the volume is the strong relationship between fiscal federalism, service provision and statehood. If statehood is to be achieved, then the Northern Territory will need to convince not only its own constituents but also current Australian governments that it has reached a degree of fiscal and democratic maturity.

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