

Health reform and Commonwealth-State financial relations

Economic Research paper

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- Health care reforms agreed to by the Commonwealth and State government's this week (except WA) include a major change in Commonwealth-State financial relations.
- From 1 July 2011 the States will only receive 70% of all GST revenue raised, rather than the current 100%.
- This revenue will be form part of the Commonwealth's commitment to fund 60% of the new National Health and Hospitals Network.
- While losing 30% of GST revenue could be seen as a negative for the States, they will also see a reduction in their health expenditures.
- In addition, the Commonwealth has guaranteed that no State will be made worse off by the new financial arrangements, with the upside risk to health spending in the out-years to fall on the Commonwealth.
- Over the medium-term, therefore, the financial reforms to the health system are likely to be a positive for the States and could act to support State-govt/CGS bond spreads.

Introduction and implications:

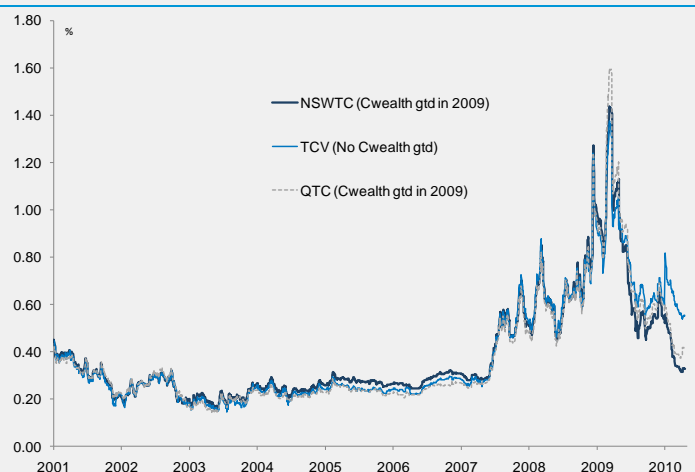
Ahead of the introduction of the 10% goods and services tax (GST) on 1 July 2000 the Commonwealth and state & territory governments signed the inter-governmental agreement (IGA) that established a new era in Commonwealth-State financial arrangements. The IGA stipulated that in return for abolishing a number of taxes, the states & territories would receive 100% of the money raised by the GST – with the revenue flow distributed via (a complicated) formula to ensure horizontal fiscal equalisation.

On the back of the health funding agreement between the Commonwealth and state & territory governments agreed to earlier this week (except by WA) this IGA will now be altered.

From 1 July 2011, around 70% of all money raised by the GST will be returned to the states, with the remaining flowing into a pool that will be used to fund the national health system.

While the removal of around 30% of all GST revenue from the states & territories could be viewed as a negative for the financial position of the states, over the medium-term this is unlikely to be the case. Indeed, the package of health and financial reforms announced this week could be seen as a medium-term positive for the states & territories (see below for details) and could, over time, act to put further downward pressure on State-government bond spreads to Commonwealth bonds.

NSWTC, TCV and QTC 10 year spreads to CGS



Source: Citi



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The positive implications for the states & territories could include:

- The Commonwealth has agreed that under any reforms to Commonwealth-state financial relations that “no State would be worse off financially as a result of the Commonwealth’s implementation of reforms.”
- The centralisation of funding for the health system, while reducing state revenue, will also reduce the proportion of state expenditure (currently estimated at around 25% of total spending) that is applied to health, and
- Any upside risk to the cost of health funding over the medium-term, ie. associated with the ageing population, will likely be borne by the Commonwealth and not the states.

Some details:

The Commonwealth and state & territory governments (except WA) agreed this week to the establishment of the National Health and Hospitals Network. The key details of this agreement include:

- The Commonwealth will become the major funder of Australian public hospitals, by funding 60% of the efficient price of all public hospital services delivered to public patients;
- The Commonwealth will have funding and policy responsibility for GP and primary health care services, and aged care.
- Responsibility for hospital management will be devolved to new Local Hospital Networks;
- New higher national standards and transparent reporting will be provided on the performance of the health system;
- In addition to funding 60% of public hospital services, the Commonwealth will also fund 60% of capital, research and training in public hospitals and, over time, move to fund 100% of the national efficient price of primary care equivalent outpatient services;

- The health agreement notes that “this commitment means that the Commonwealth will be responsible for absorbing the majority of cost growth in the health and hospital system. It represents a substantial increase that will permanently reverse the decline in the Commonwealth funding contribution for public hospital services over the past decade.”
- The Commonwealth will also move to have full funding responsibilities for health care such as community health centres, primary mental health care, immunisation, cancer screen centres and aged care.
- In terms of funding this reform to the health system, the Commonwealth and states (except WA) have agreed that funding will come from a combination of:
 - Funding sources from the already existing national health care specific purpose payment;
 - An agreed amount of state GST revenue (with this amount currently set at around 30% of all GST revenue); and
 - Additional top-up funding to be paid by the Commonwealth, reflecting the Commonwealth’s greater responsibility for financing growth in hospital costs.

In terms of the funding arrangements, the following is also relevant:

- Each state’s retained GST will be allocated to health and hospital services in that state. This will be revenue-neutral for states.
- The amount of GST to be retained and allocated to health and hospitals will then be fixed from 2014/15, based on 2013/14 costs.
- The agreement also notes that “the Commonwealth will absorb an estimated \$A15.6bn in additional growth costs from 2014/15 to 2019/20 by ‘topping up’ payments to the states. The benefit to states will grow significantly beyond this period. All states will be no worse off in the short-term, and better off over the longer term.

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