

CHAPTER 3

ADDRESSING THE TERMS OF REFERENCE: LINKING NEEDS AND RESOURCE ALLOCATION

1. Chapter 2 examined issues associated with identifying and measuring needs, and constructing indexes of relative need on a regional basis. It concluded that data deficiencies, particularly at the regional level, often do not allow appropriate indicators to be constructed.

2. **Even if appropriate indexes of relative need could be constructed on the basis of adequate data, there are complex issues associated with linking them to resource allocation that would also have to be considered before they could be used to allocate resources.** Those issues, which are considered in this Chapter, are as follows.

- (i) Needs are met by mainstream and Indigenous-specific programs funded by the Commonwealth, the States, local governments and non-government organisations. Modelling allocations of Commonwealth funds, therefore, requires assumptions about the co-ordination, level and distribution of the funds from the other sources.
- (ii) Local cost, efficiency and effectiveness factors influence the types of services and the service delivery processes that best meet needs in each region.
- (iii) Needs in each function are affected by activities, or the lack of them, in other functions.
- (iv) The links between the funds made available to meet needs and the resulting changes in outcomes are not measurable.

SOURCES OF FUNDS AVAILABLE TO MEET NEEDS

3. The needs of Indigenous people are met by funds from a range of sources, which creates interactions that an allocation process must take into account. The sources of funds are:

- (i) Commonwealth mainstream programs — that operate directly through payments to individuals or non-government service providers, or through specific purpose payments (SPPs) to the States or local government;
- (ii) Commonwealth Indigenous-specific programs¹ — funded partly through Commonwealth own-purpose outlays and partly through SPPs;
- (iii) State and local government mainstream programs — funded from their own revenues and their general revenue assistance (untied funding) from the Commonwealth;
- (iv) State and local government Indigenous-specific programs — funded from their own revenues and their general revenue assistance (untied funding) from the Commonwealth;
- (v) private sector funds from charitable and other sources; and
- (vi) user charges.

Commonwealth and State Government Programs

4. Responsibility for the functions covered by this Inquiry is split between the Commonwealth, State and local governments². The split of responsibilities is supported by complex relationships between the three spheres of government which have implications for program design, funding and service delivery.

5. The Commonwealth has a major role in the formation of policies and practices for the provision of services. It also makes funds available to the States, local government and the non-government sector to provide services. The States have a role in policy development and program design. They are also the major service providers and the activities of local government affect some of the functions, especially infrastructure provision.

6. Table 3-1 shows expenditure during 1998-99 by the Commonwealth and State governments on the broad functional areas covered by this Inquiry. While the functional classifications used in preparing the data in the tables include expenditure that is not in the scope of this Inquiry³, the table shows that:

- (i) the importance of the funding roles of the Commonwealth and the States vary between functions; and

¹ Indigenous-specific programs include all ATSIC programs, direct funding of Aboriginal Community Controlled Health Services and the Indigenous Employment Program.

² The exception is the employment function which is the responsibility of the Commonwealth.

³ For example, the SPPs in the Housing and Community Amenities category include payments from the Natural Heritage Fund and the employment data include expenditure on apprenticeships. But this does not significantly affect the conclusions on the allocation of responsibilities among the three sources of funds.

- (ii) the Commonwealth plays a small direct role in service provision, except for employment and health.

Table 3-1 COMMONWEALTH AND STATE EXPENDITURES, 1998-99

		Commonwealth direct expenditure	Commonwealth SPPs to States	State expenditure	Total
Health Services					
Expenditure	\$m	16 510	7 265	12 099	35 303
	%	47.6	17.5	34.9	100.0
Housing and Community Amenities					
Expenditure	\$m	362	1 001	3 055	4 418
	%	8.2	22.7	69.1	100.0
Schools Education					
Expenditure	\$m	705	4 240	12 264	17 209
	%	4.1	24.6	71.3	100.0
Training					
Expenditure	\$m	357	866	1 898	3 121
	%	11.4	27.7	60.8	100.0
Employment					
Expenditure	\$m	2 035	4	691	2 730
	%	74.6	0.1	25.3	100.0

Source: ABS Government Finance Statistics, 1998-99, ABS Catalogue No. 5512.0, Canberra.

7. **Mainstream and Indigenous-specific services.** Most of the expenditures by the Commonwealth and State governments on the provision of services are made through mainstream services⁴. They include Medicare, public hospitals, schools education, public housing and Job Network. **Since mainstream programs are intended to meet the needs of all Australians and were included in our terms of reference, we considered it essential to establish whether Indigenous Australians access these services on an equitable basis.**

8. **It is clear from all available evidence that mainstream services do not meet the needs of Indigenous people to the same extent as they meet the needs of non-Indigenous people.** In general, Indigenous people experience greater disadvantage and have greater needs than non-Indigenous people and, for geographic, economic and cultural reasons, mainstream services are less accessible to them. We consider the reasons for this, and their implications, in Chapter 4.

⁴ They are commonly called 'citizenship' services. That is, they are intended to meet the needs of all Australians who require the service and meet eligibility requirements where these apply.

9. Governments have taken actions to improve Indigenous access to some mainstream programs. They have also developed supplementary Indigenous-specific programs to address the greater and more complex needs of Indigenous people.

10. As a result, a mix of Commonwealth and State mainstream and Indigenous-specific programs is used to meet the needs of Indigenous people. This mix is not always well co-ordinated, occurs in each function and gives rise to many interactions.

- (i) Economic, demographic and geographic differences between regions mean that the extent to which mainstream programs meet the needs of Indigenous people vary from region to region. The regional distribution of Commonwealth and State Indigenous-specific funds depends, in part, on how accessible mainstream programs are for Indigenous people and how well they meet their needs.
- (ii) Because the Commonwealth and the States are involved in providing services in each of the functions (with the exception of employment services), the extent and type of service each government provides depends partly on what the other does.

11. The Inquiry relates primarily to Commonwealth mainstream and Indigenous-specific programs and services, including those that operate through SPPs. These are only a part of the total resources spent on each function. However, allocating those funds on the basis of needs should take account of the contributions the other sources of funds (especially those from the States) make to meeting needs.

12. Allowing for the different contributions of each sphere of government and the changing nature and size of those contributions in a statistically based allocation model is very difficult. A previous attempt by ATSIC to apply a formula based approach to the allocation of its funds was unsuccessful, partly because it could not take account of the expenditures of other Commonwealth agencies and the States.

Other Sources of Funds to Address Indigenous Needs

13. There is a broad community expectation that all Australians make some contribution through taxes and charges towards the costs of government services they receive. The expectation is that this contribution is linked in some way to income or capacity to pay.

14. Some Indigenous people receive income from land and other community business enterprises, mining royalties distributed through Land Councils and compensation payments of various kinds.

15. Consideration of whether these funds should have any impact on the distribution of Commonwealth funds available to meet needs was not a simple issue. For example, it was necessary to examine the legal nature of the funds, to whom they are paid, and why. Members of the wider community contribute to government services only

through taxes and charges. However, to the extent that they choose to use private income to purchase private assets, such as a house, their actions meet some of their needs.

16. We concluded that funds Indigenous people receive from land and business enterprises that are similar to income received from investments or leases of assets by non-Indigenous people, should be treated as personal income. As such, they should be taken into account in assessing the capacity of the recipients to pay fees and charges for government services (such as housing rent) and in deciding eligibility for government benefits. But this private income should not be seen as a source of funding for the direct provision of services or the development of community infrastructure.

17. Funds from other private sector sources, such as benevolent trusts and charities, may have different effects across regions. We excluded them from our considerations because we considered they play a minor role and data were not available.

PROGRAMS AND SERVICES

18. Meeting needs requires funds to be used to provide programs and services so that outcomes are improved. How well the services meet needs depends on many factors, including:

- (i) how well the programs are designed;
- (ii) how well the services are operated;
- (iii) whether people believe the service is relevant to their needs; and
- (iv) the social and economic environment in which they are delivered.

19. If these factors, which affect the cost and efficiency of services, were the same in all regions, they would have no effect on resource allocation and could be ignored in an allocation model. However, they can and do vary between regions. A needs based allocation process should therefore be sensitive to them. In practice, where allowances are made, it is usually through consultative and collaborative processes because they cannot be easily reflected in statistical collections.

20. Recognising that the cost of delivering services and the efficiency of service providers varies between regions indicates that getting service delivery processes right is an important element of effectively targeting resources to meet need. It also raises the question of whether the allocation of resources should compensate for the differences in cost and efficiency.

21. If costs differ between regions for reasons that are outside the control of the provider or any of the funding agencies (for example because transport costs are high or staff must be provided with incentives to work in certain areas) a clear case exists for compensating for the higher costs. Providing the data are available to measure the effects of location on costs, adjustments can be included in an allocation model. We have done some

work on estimating the effects of location on costs, especially in providing schools education. The report from our health consultant also contains some information on costs in the health area.

22. However, the treatment of efficiency differences is more complex. The following questions illustrate the issues.

- (i) If the measured housing needs of a region were reduced by its greater maintenance effort or by more efficient service delivery, would it be fair that its share of resources be reduced?
- (ii) Conversely, would it be fair to provide a community with extra resources if aspects of service delivery that it could control were below the average level of efficiency?
- (iii) What if the lack of co-ordination between an agency responsible for infrastructure and other service providers increased the costs of providing services to the community?

23. We think that the answer to the first two questions is no. This means that funding allocations should reflect the needs for services that would exist if the community's levels of effort, and effectiveness and efficiency in service delivery, were comparable with some benchmark, such as the national average.

24. The answer to question (iii) is much more debateable. Inefficiency in co-ordination should probably not be compensated for. However, not doing so could result in the needs of the community being inadequately met. Such situations may suggest a separate requirement for resources to build the capacity of the community to plan and manage services.

25. It is important that there are no disincentives to a community becoming more efficient or more involved in service provision. At present, however, data to indicate when adjustments for relative efficiency or community effort might be required, and the size of any such adjustments, are not available.

INTERACTIONS BETWEEN FUNCTIONS

26. **The extent to which needs are met, or outcomes achieved, depends on the outputs of several programs and the social and economic circumstances in which the services are provided. Cross-functional interactions are relevant to all the functions we have examined.**

- (i) Education outcomes depend not only on teaching inputs provided, but also on the health status of students, housing arrangements, perspectives of students on future employment opportunities, family socio-economic status, and attitude towards education.

- (ii) Over half the changes in the health status of Indigenous people can be attributed to actions outside the health function, such as housing, infrastructure and education.
- (iii) Employment outcomes are affected by initiatives aimed at improving education outcomes and community development.

27. The fact that outcomes in one function rely partly on those in another poses problems for effective service delivery. Rational decisions by an agency about its own responsibilities may restrict or enhance the extent to which other agencies can meet their objectives. For example, it might be sensible for an agency responsible for roads to defer maintenance on a road to a small community, but this may reduce access to the community and increase the costs of all other service providers.

28. Environmental health initiatives are another example of services that have widespread effects. Inspection services, drains, dust control and repairs to essential infrastructure may, by themselves, not be seen as warranting a high priority; they may not even be the explicit responsibility of any one agency. However, in the broader picture, they do warrant a high priority because they are essential inputs to improving housing, health and education outcomes.

29. Another example could be the resource management tasks that arise in all organisations. Some funding agencies attempt to maximise outputs from their limited resources by only providing communities or organisations with funds to deliver services. That is, the funding agencies expect that the additional administration costs arising from the project, including the reporting requirements it creates, will be met from existing sources.

30. **If indexes of relative need are to be used to allocate resources, these links must be understood and taken into account. In practice, this is increasingly being done by establishing joint planning or co-ordinating mechanisms involving service and funding agencies and Indigenous people.** Details of some of those mechanisms are discussed in Chapter 4. The critical role and importance of joint planning arrangements cannot be incorporated in a quantified index based approach to allocation.

LINKING RESOURCES AND NEEDS

31. Developing an index based method of allocating funds to regions on the basis of relative needs rests on the assumption that the greater the statistical measure of need, the greater the requirement for funds. **In most cases, it is assumed that there is a proportional relationship between changes in needs and the requirement for funds.**

32. **This assumption is flawed. Simply put, if measured needs in one region are twice those of another, it does not follow that closing the gap would require the more disadvantaged area to receive twice the funds of the less disadvantaged area. It may need less than twice the funds, or it may need more.**

33. At the functional level, the relationships between differences in indicators of relative need and the requirements for funds to achieve better outcomes are far from simple. As one submission noted, 'it is often thought that relating expenditure to need is a simple exercise. It is not'.⁵ Our experience confirms this view.

- (i) With the exception of housing, clear relationships between inputs and measures of needs, or outcomes, are not established and are unlikely to be simple, uniform or consistent in all circumstances. For example, it is possible that in some cases (say where there are high needs arising from environmental health problems) relatively low levels of funds may produce large gains in health outcomes. In others (say where social problems predominate), large expenditures might be required to achieve small gains.
- (ii) Relationships may not exist (outcomes may not improve at all with increased funding) if the people do not support some or all aspects of the services provided.
- (iii) The best ways of achieving particular outcomes generally differ with location, as would the efficiency and effectiveness of the service⁶.
- (iv) Geographic location affects costs of providing services — employing a person, travel and freight generally costs more in remote areas. Differences between regions in the extent to which cultural practices and beliefs affect the way services are provided also influences costs⁷.

34. These factors are linked and their impacts on each other and changes in outcomes are complex. At present, there is little understanding of those links and impacts, making judgement an essential element of resource allocation processes.

35. Building an understanding of the links and impacts would require complex analysis. Undertaking such analysis would require a detailed survey of service providers and Indigenous communities and time series data that measure inputs and changes in outcomes. That information is not available. While the analysis would inform future decision making processes, it would not avoid the need for judgement.

ALLOCATION PRINCIPLES

36. In addition to the technical relationships between needs indicators, services and resources, principles for allocating funds are also required. There are different concepts

⁵ Dr W Sanders, Submission to Indigenous Funding Inquiry, May 2000.

⁶ For example, differences in community capacity affect the extent to which programs can be provided and managed locally, as well as the costs of doing so.

⁷ For example, in its consultancy report, the Office of Aboriginal Health in Western Australia assumed that providing culturally appropriate health services could increase costs by 10 per cent.

of equity and how it can be achieved. Decisions on the allocation of funds must be based on a clear understanding of the concept and approach to equity that is being applied.

37. Some possible approaches to equity are that funds should be allocated so that:

- (i) equal outcomes are achieved — those who are in greater need would get extra resources until their position was the same as that of others: but social and economic circumstances in particular locations could make this unachievable in the short term;
- (ii) resources are shared equally among all locations — which probably would not reduce the differences between locations in relative needs;
- (iii) resources go to the areas where they can produce the greatest good, such as where the improvement in outcomes would be the most rapid — a capacity to benefit approach which introduces an element of efficiency into the allocation; and
- (iv) resources go to where the people have the greatest capacity to use them effectively — another perspective of capacity to benefit, which could be perceived as rewarding the efficient or the more advanced groups rather than those in most need, and it may increase differences between groups as the funds may go to the better off communities.

38. The choice between these and other possible approaches to equity is a matter of judgement rather than technical analysis and rests on the concept of equity that is held. It is an issue on which urban and remote Indigenous people have different views, and on which Indigenous and non-Indigenous perspectives could also differ. Indigenous people should be involved in making decisions about the appropriate concept and approach.

Capital and Recurring Needs

39. Another dimension that is relevant to a consideration of possible allocation principles and equity objectives is whether needs are recurring or of a capital nature. At its simplest, a recurring need exists if services need to be continually provided — educating one child in a family does not reduce the educational need of the children that follow. A capital need, on the other hand, implies that once a service or facility is provided, needs would be met for a longer period of time.

40. Health, education, training and employment are generally viewed as recurring services; and infrastructure and housing as capital. However, capital needs are not restricted to physical capital and facilities. Community capacity building (social development) could also be treated as a capital expense as it has long lasting impacts on communities.

41. These descriptions are broadly consistent with what happens in practice. Health, education and employment services are delivered on a recurring basis while there is a demand. That is, the focus of individual service providers is on dealing with the

immediate task arising from the flow of people they must treat, teach or help to find employment.

42. Consideration of the allocation processes adopted by ATSIC for the National Aboriginal Health Strategy (NAHS), the largest single Indigenous-specific infrastructure and housing program, is useful. NAHS is a holistic approach to meeting housing, environmental health and infrastructure needs. It is a national program with resources allocated in a two stage process.

- (i) Funds are allocated among the States on the basis of broad indicators of the need for housing and infrastructure and the cost of providing the facilities.
- (ii) The intrastate allocation is based on detailed assessments of the health impact of each potential project. Projects are ranked from the most needed (the location that has the most 'capacity to benefit' and thus the highest priority) to the least needed. Funds are allocated by starting with the highest priority and working down the list until the available budget is spent.

43. The NAHS allocation process is a highly targeted approach that has successfully directed resources to the regions of greatest need.

44. The approach illustrates that, for capital needs, the equity objective could be interpreted as being that funds should be allocated to close (or reduce) the gaps in relative needs between communities as quickly as possible within existing resources, by starting from the communities most in need and moving up. If this objective is accepted, principles for allocating resources could be:

- (i) equal (real) resources should be devoted to addressing equal need; and
- (ii) more (real) resources should be devoted to a group with greater need, such that it has the greatest possible opportunity to close the gap between it and the next group.

45. These principles reflect concepts of fairness and equity and the focus on relative needs in the terms of reference. They imply that locations should be ranked according to priority based on depth of need, with funds allocated on the basis of the order of priority.

46. An allocation process based on these principles requires needs to be assessed and ranked for small areas or communities on a regular basis. Funds to be allocated to regions or States would be determined in a bottom up fashion by summing the amounts attributed to the communities within them. This is possible for housing and infrastructure projects but may be more difficult in functions where data for small areas may not be available and analysis of data on a State or region basis could mask some of the variations between small areas. More importantly, it is questionable whether such a bottom up process is the most appropriate in cases of recurring needs.

47. Notwithstanding the benefits we see in its procedures, the equity objective of NAHS is not accepted by all. Some people think the allocations are 'unfair' because some communities have had more than one project funded while others have not had any. These views suggest a belief that equity is achieved by a more equal sharing of currently available funds, rather than allocation on the basis of relative need of people or groups of people.

48. If such a view of equity were to be accepted, allocations of resources might be based on population shares. We do not think this is the concept of equity which underpins our terms of reference.

49. At the functional level, the ongoing nature of recurring needs, (for example, where each patient or each year of schooling represents a new task) creates a continuing requirement for funds to provide services. In these circumstances, funds might best be allocated so that all regions have the financial capacity to provide a similar level of outcomes. This may mean that, while all regions receive funding, those with the greatest needs receive some additional funds to help close the gaps between them and the regions with higher levels of outcome. Funds for the function might be best allocated among States and regions using shares of potential demand; allowances for cost differences; allowances for differences in efficiency beyond the control of service providers; and an allowance for differences in the needs of the people or groups of people being served.

50. Potential rather than actual demand is suggested because actual demand would not reflect the effects of barriers that reduce access. The allowances for needs could take the form of particular programs within the function being allocated on a highly targeted basis to localities with the greatest average needs.

Introducing a Different Method of Distribution

51. **Any change in methods of distributing existing resources has an inescapable implication that some regions would lose funding and others would gain. Our investigations indicate that while there are regional differences, Indigenous people in all regions have high needs relative to the non-Indigenous population. This raises the question about the extent to which redistribution is beneficial.**

52. **Large redistributions risk losing the benefits of investments made over a number of years, including those in developing organisational capacity and people. That is, real costs of such redistribution may be high.** In these cases, it might be more appropriate to maintain the existing distribution of current resources and apply new distribution approaches to new and expanded funds if and when they are made available.

CONCLUSIONS

53. This Chapter looks at issues that must be addressed in linking needs and resource allocation. Even if adequate data were available to prepare suitable indexes of relative need, there would be both conceptual and practical difficulties in applying a formula based approach to allocation. Our conclusions are as follows.

- (i) Mainstream and Indigenous-specific programs are complementary and are both essential to meeting the needs of Indigenous people.
- (ii) Since mainstream programs are intended to meet the needs of all Australians, and were included in our terms of reference, we considered it essential to establish whether Indigenous Australians access these services on an equitable basis. It is clear from all available evidence that mainstream services do not meet the needs of Indigenous people to the same extent as they meet the needs of non-Indigenous people.
- (iii) There are many sources of funds available to meet the needs of Indigenous people and allocation methods used for any one program should take account of what is happening in other programs. Similarly, the allocation of funds for Indigenous-specific programs must take account of mainstream programs.
- (iv) There is no obvious and simple proportional relationship between measures of needs and the funds required to achieve outcomes.
- (v) The extent to which needs are met, or outcomes achieved, depends on the outputs of several programs and the social and economic circumstances in which the services are provided. Allocation processes must take account of these interactions.
- (vi) While measures of relative need can be useful as a guide to assisting judgements on how resources might be better distributed, a formula based approach cannot be used without judgement, which is an essential feature of allocation.
- (vii) Indigenous people in all regions have high needs relative to the non-Indigenous population. An important question is the extent to which redistribution is beneficial. Any change in methods of distributing existing resources means that some regions would lose funding and others would gain. Large redistributions risk losing the benefits of investments made over long periods of time, including those in developing organisational capacity and people. The real costs of redistribution may be high.