Review of
Commonwealth – State Funding

# BACKGROUND PAPER

A review of the allocation of Commonwealth Grants to the States and Territories

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# MESSAGE FROM **THE COMMITTEE**

As we celebrate the centenary of Federation this year, and reflect on the Australia we want for the twenty-first century, it is timely to review a key aspect of federal arrangements: the system of allocation of Commonwealth grants to the States and Territories.

This system affects the well-being of all Australians. The Australian Constitution allocates to the States responsibility for provision of many of the services that are most important to Australians' daily lives. These include health, education, law and order, public transport and roads. But the Constitution, and federal fiscal arrangements under it as they have developed through the twentieth century, allocates the most important revenue raising powers to the Commonwealth.

The resulting imbalance between the States' large responsibilities and limited revenues makes Commonwealth grants to the States – both general purpose and specific purpose grants – centrally important to the delivery of health, education and other services.

The system of Commonwealth–State financial relations has grown organically over the past century. Some features make sense in terms of their historical origins, but are harder to understand in contemporary terms. When the GST was introduced by the Commonwealth in 2000, the Commonwealth and States agreed that the proceeds of this tax should become the base or pool for general purpose grants to the States, and be divided among the States through the same mechanisms that had long been used to allocate such grants.

Now, at the beginning of the second century of Federation, is a good time to stand back and to assess the merits of the arrangements that have evolved through the first century.

This Review of the system of allocation of Commonwealth grants has accordingly been commissioned by the Governments of New South Wales, Victoria and Western Australia.

We have been asked to undertake the Review independently of the Governments that have commissioned it. The views presented in our report will be our own independent conclusions.

The Review will measure the current system against the following criteria:

- efficiency – is there a way of allocating Commonwealth grants that would help generate more income, employment and economic growth?
- equity – is the current system equitable for all Australians, and is there a way that would be fairer?
- simplicity and transparency – is the system unduly complex or obscure?

We extend a warm invitation to all Australians to contribute to this important Review.

We intend to consult widely, to ensure that our analysis and recommendations are well-founded and in the best interests of Australia and all Australians.

The Review will provide an opportunity for all interested individuals and organisations to contribute to shaping a system of Commonwealth grant distribution which is fair, efficient and designed for a modern and growing Australian economy in an increasingly competitive world.

This Background Paper has been prepared to help you to make a contribution.

It provides practical information on how you can do so, and outlines the context for the Review – including historical background, a description of current arrangements and relevant fiscal information.

At the end of the consultation process, views and comments received will be considered and help to inform the Committee's reports, which will become public documents.

We encourage you to participate and look forward to receiving your submissions by 15 February 2002.

Ross Garnaut

Vince FitzGerald

# PART A: OVERVIEW

## 1. About the Review

### 1.1 Terms of Reference

1. To review and to report to the Governments of New South Wales, Victoria and Western Australia on the methods of allocating Commonwealth grants to the States, the Australian Capital Territory and the Northern Territory (the States).
2. In particular, the members of the Review Committee should report on whether the current system is effective in relation to:
   (i) efficient allocation of resources across Australia to enhance national employment and economic growth;
   (ii) achievement of equitable outcomes for all Australians; and
   (iii) simplicity and transparency.
3. The Review should examine and report on the appropriateness of the pattern of intergovernmental transfers. In assessing whether the system is effective in delivering efficient and equitable outcomes for all Australians, the Report should consider the respective budgetary circumstances of the various Governments, and the respective social and economic characteristics of their residents.
4. The Review Committee should assess whether alternative approaches to allocating Commonwealth grants to the States would achieve the objectives described in paragraph 2 above more effectively than the existing system, and if appropriate recommend options for reform. Any proposals for reform of the current system should address costs and processes of adjustment to change.
5. The Review should consult extensively with interested parties.
6. The Final Report should be provided to the Treasurers of New South Wales, Victoria and Western Australia no later than 31 May 2002.

## 1.2 Understanding the Terms of Reference

The terms of reference require the Committee to review the existing *methods* of allocating Commonwealth grants to the States and Territories (the States) and the appropriateness of the *outcomes* of the existing processes.

In examining the methods and outcomes of the existing processes, the Committee will consider both general purpose (untied) and specific purpose (tied) payments. The Committee will also examine, where appropriate, the interaction between these grants to the States and the Commonwealth's own outlays and revenues.

Specifically, the terms of reference require the Committee to review the current system against the broad principles of efficiency, equity and simplicity and transparency.

### Efficiency

The Review will examine the extent to which the existing processes promote or discourage the allocation of Australian resources to the uses in which they can add most to national output and employment.

Does the existing system of allocating Commonwealth funding to the States lead to labour and capital being used more or less productively?

Do the existing methodologies affect efficiency by influencing the policy decisions of States?

Does the existing system of allocating Commonwealth funding have transaction costs and would any alternative system have lower costs?

### Equity

The current system of transfers undoubtedly seeks to promote greater equity between Australians in different States. The Review will examine the extent to which this objective is actually achieved under the current system, as well as assessing whether any alternatives could produce better equity outcomes.

### Simplicity and transparency

Simplicity and transparency are important principles in the 'design' of any system of intergovernmental transfers. In addition to reducing the administrative burden, a simple and transparent system promotes openness and accountability.

A system which is simple and transparent is also likely to be more effective in achieving the desired outcomes (however defined) through promoting a better understanding of the links between decisions and by supporting fuller participation in, and a higher quality of debate on, policy questions.

## 1.3 Key features of the current system

A brief summary of the key features of the current system of Commonwealth–State funding is outlined below. Further detail on the current system and other relevant information is provided in Part B of this Background Paper.

### Significance of Commonwealth grants

- Commonwealth grants to the States total approximately $50 billion per year, including approximately $30 billion in the form of untied grants and $20 billion from Specific Purpose Payments (SPPs) or tied grants.
- States rely heavily on Commonwealth funding. About 50 per cent of State revenue is provided by various Commonwealth grants.
- The heavy reliance of the States on Commonwealth grants is driven by the Commonwealth's dominance in taxation collection and the States' responsibility for many of the major service delivery functions set down in the Constitution.

### Distribution between the States

- Table 1.1 shows the per capita distribution of the principal forms of grants to the States – (untied) allocations from Goods and Services Tax (GST) revenues and SPPs.

**TABLE 1.1:** Distribution of GST revenue and SPPs, 2001-02 ($ per capita)

| | NSW | VIC | QLD | WA | SA | TAS | ACT | NT | AUSTRALIA |
|---|---|---|---|---|---|---|---|---|---|
| **GST Revenue** | 1 267 | 1 198 | 1 422 | 1 373 | 1 688 | 2 316 | 1 737 | 6 666 | 1 410 |
| **SPPs** | 1 007 | 1 017 | 972 | 1 152 | 1 040 | 1 060 | 1 096 | 2 122 | 1 034 |

*Source: Commonwealth Budget Papers, 2001-02.*

- New South Wales, Victoria and Western Australia all receive less than the Australian average per capita share of GST revenues. Queensland, South Australia, Tasmania and the Territories receive more than the Australian average per capita share.
- New South Wales, Victoria, Queensland and the Australian Capital Territory receive a lower than average per capita share of SPPs.
- The Commonwealth is also required to provide Budget Balancing Assistance ($2.5 billion in 2001-02) for a number of years to ensure that no State is financially worse off under the GST-related changes.
- Another important aspect of the current arrangements is the distribution of the Commonwealth's own expenditures and the incidence of Commonwealth taxes and other revenues among the States (further discussion is provided in section 4.3).

PART A

# 2. How to Participate in the Review

## 2.1 Key dates

| | |
|---|---|
| **Launch of the Review** | 30 November 2001 |
| **Release of Background Paper** | 11 December 2001 |
| **Due date for submissions** | 15 February 2002 |
| **Interim Report** | March 2002 |
| **Seminars on equity and efficiency implications** | February–March 2002 |
| **Final Report** | 31 May 2002 |

## 2.2 Contacts

If you have any inquiries about the information provided or you would like more copies of this paper, please contact the Secretariat.

| | |
|---|---|
| **General enquiries** | (03) 9651 5145 |
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## 2.3 How to make submissions

Anyone can make a submission. It can be as short as a letter outlining views on one or a few matters related to the Review, or a more substantial document canvassing a range of issues. As far as possible submissions should contain or cite relevant data and documentation to support the views expressed.

Submissions will become publicly available documents once placed on the Review's website. This will normally occur shortly after receipt of the submission, unless it is marked confidential or accompanied by a request to delay release for a short period of time. Any sensitive information that is not to be made publicly available should be provided under a separate cover and clearly marked CONFIDENTIAL.

## 2.4 Participating in workshops

The Committee will be conducting technical seminars to examine in detail efficiency and equity issues that are central to this Review.

The seminars will focus on research and modelling work that is being undertaken as part of the Review.

They will provide an opportunity for interested individuals to discuss the ongoing research on the effects of current and alternative Commonwealth–State funding arrangements.

If you are interested in attending these seminars, please contact the Secretariat for further information.

# PART B: BACKGROUND

## 3. How the System Grew: A Brief History

- The Commonwealth's revenue raising powers far outweigh its expenditure responsibilities. Conversely, the States' own revenue raising powers are not sufficient to pay for the expenditures for which they are responsible. As a consequence, revenue sharing between the Commonwealth and the States has been required since Federation.

- The Commonwealth took unilateral control over income taxation during World War II – a tax base that the Constitution had left open to both levels of government, and which had been an important pre-war State tax. The Commonwealth has not made room for the States to re-enter this field after the war, generally increasing the States' reliance on the Commonwealth for funding.

- The Commonwealth Grants Commission (CGC) was originally formed to calculate special grants for particular States experiencing fiscal hardship. Its role has grown to making recommendations on the distribution of around $30 billion of GST revenue to all States on a regular basis.

- The introduction of the GST and the associated agreements on Commonwealth–State financial relations have given the States access to the proceeds of a broad-based revenue source, without changing the fundamental reality that the States rely on grants from the Commonwealth.

- In 2001-02, total grants from the Commonwealth to the States are estimated at $50 billion, of which about $20 billion are SPPs, i.e. tied to particular uses and in some cases on condition that the recipient States maintain or increase funding for these purposes.

# PART B

## 3.1 The Federation and revenue sharing between the States

A permanent revenue sharing arrangement between the Commonwealth and State Governments was an original feature of the Constitution of Australia, drafted in the 1890s and implemented from 1 January 1901. Section 92 of the Constitution established free trade between the States and forbade them from imposing customs and excise duties. In 1896-97, customs and excise duties represented 76 per cent of all colonies' taxation.

The Constitutional allocation of service responsibilities left much of the load to the States, as their responsibilities included important services such as health, education and law and order. The Constitution also provided the Commonwealth with greater access to broad-based taxes. This necessitated significant revenue sharing to enable the States to meet their expenditure responsibilities.

In October 1901, the Commonwealth introduced a uniform national tariff. Initially, the revenue from this tariff was returned to the States in which it was generated; however, over time this moved to a per capita redistribution. The return of this revenue was specifically provided for in the Braddon Clause of the Constitution, which specified that, for the first ten years of Federation, the Commonwealth would return at least three-quarters of customs and excise duties to the States.

In 1910, the *Surplus Revenue Act* replaced those provisions by granting the States $2.50 per capita, with an additional payment to Western Australia of $500 000. Half of the additional payment to Western Australia was financed by a reduction in the payment to all States and phased out over 25 years.

The introduction of, and subsequent increases to, an Australian tariff had a differential effect on the six States. Tariff protection benefited States with an industry structure that favoured import substitution, by allowing them a price buffer against competing foreign manufactures, and in a few cases against foreign agricultural products (notably Queensland sugar). Conversely, tariff protection was detrimental to States that were not heavily involved in manufacturing, as they were obliged to pay higher prices for goods that were inputs into their production processes, whether produced domestically or overseas. The States in the former category were New South Wales, Victoria and, to a lesser extent, Queensland. The States that suffered most from high tariffs were Western Australia and Tasmania.

## 3.2 Changes in horizontal equalisation arrangements

Tasmania (as well as Western Australia) was granted additional Commonwealth payments from 1912 onwards, in recognition of its difficult budgetary circumstances. In 1927, the States agreed to a new Commonwealth–State arrangement, under which the Commonwealth assumed responsibility for States' debts and the States agreed to a fixed annual grant, held at 1926-27 levels, to be used to fund interest repayments.

The onset of the Depression in 1929 exacerbated the financial difficulties experienced by Western Australia within the Federation. Western Australia then, as now, was strongly export oriented, selling primary products on the export market while buying manufactured goods and Queensland sugar on a protected market. The large increase in Australian protection during the Depression compounded unemployment and other economic problems of the export States. Popular support for secession rose in Western Australia.

In April 1933, Western Australians voted for secession in a referendum by a majority of two votes to one. This led to Western Australia presenting a secession petition to Westminster in 1934, asking permission to withdraw from the Commonwealth. The secession push did not proceed any further, but those events were important in the Commonwealth's decision to form the CGC in 1933.

Tasmania presented the case for an independent body, whose role would be to assess the needs of States for special grants, at the Premiers' Conference in 1932. In May 1933, the Commonwealth introduced the *Commonwealth Grants Commission Bill*, which was gazetted in July 1933. The Act enabled the formation of a three-member independent commission, which commenced work in 1933. Its role (as specified in the Act) was to assess the States' applications for financial assistance under section 96 of the Constitution.

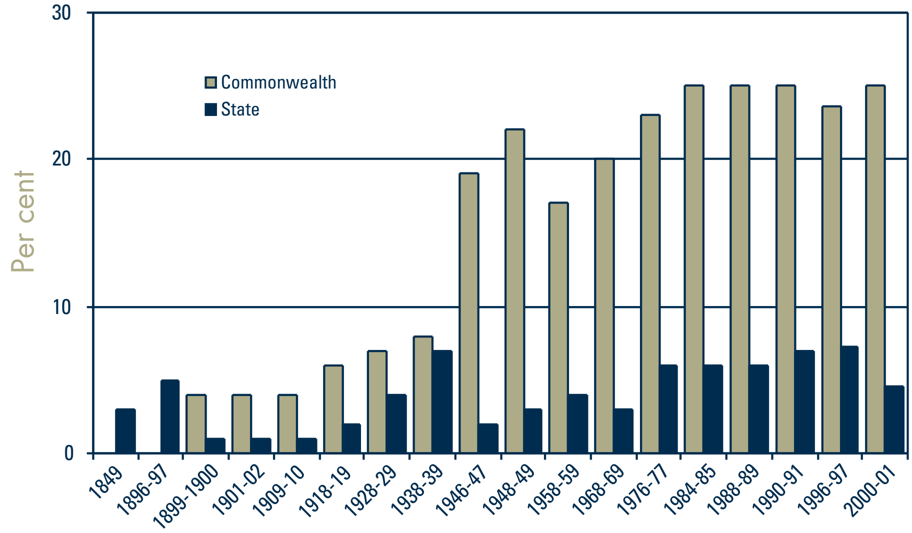
## 3.3 Increased Commonwealth taxing powers – the changing face of fiscal equalisation

### Uniform income tax and implications for Commonwealth–State financial relations

In 1942, the Commonwealth Government assumed total responsibility for taxation of income as a temporary measure to assist in financing World War II. However, the Commonwealth's unilateral jurisdiction over income taxation became permanent after the conclusion of the war.

The Commonwealth's assumption of control over income taxation greatly increased the degree of vertical fiscal imbalance between the two tiers of government, increasing the States' reliance on Commonwealth assistance to adequately fund their expenditure responsibilities. By 1938-39, States raised over 70 per cent of total income tax collected in Australia, and ceding access to this revenue to the Commonwealth left them with very little own-source revenue.

**CHART 3.1:** Taxation as a percentage of GDP




*Source: Smith,* Taxing Popularity; *Australian Bureau of Statistics.*

From 1946, the role of the CGC became one of recommending the distribution of tax reimbursement grants. The interstate distribution recommended by the CGC took account of the age structure and density of a States' population, and was phased in over ten years. Under this system, a State was still able to apply for special grants if it considered that its base grant was insufficient to allow it to carry out its expenditure responsibilities.

During the 1950s, Victoria unsuccessfully pursued two legal challenges to the Commonwealth's uniform tax legislation. The High Court allowed the Commonwealth to use its grants powers to oblige the States not to re-enter a field of taxation opened to them by the Constitution. The matter was the subject of a Special Premiers' Conference in March 1959. The conference failed to agree on the return of income tax power to the States, but at a subsequent Premiers' Conference in 1959, the Commonwealth submitted a proposal for a change in the system of intergovernmental grants to recognise that the grants were no longer specifically compensation for income tax revenue forgone.

The formula that distributed the pool was based on each State's population growth, the increase in the average earnings for Australia as a whole and a 'betterment factor' of 10 per cent which was applied to the percentage increase in average earnings. Western Australia and Tasmania were free to apply for special assistance on top of their base grants, and Queensland and South Australia were able to apply for special assistance in times of extreme hardship.

## Growth of tied grants from the Commonwealth to the States

Federal financial relations were again transformed during Gough Whitlam's term as Prime Minister from 1972 to 1975. There was a large rise in SPPs to the States (and through the States to local authorities). SPPs are tied grants from the Commonwealth in areas where the Commonwealth has limited or no Constitutional responsibility. SPPs were first paid to the States in 1923 for roads, and have grown in importance over time – particularly between 1972 and 1975.

The Fraser Government's stated policy was to reduce, phase out or abolish many SPPs – without compensatory increases in untied revenue grants. In practice there was only modest change. When the first SPPs were introduced in 1923, they represented less than 2 per cent of total grants to the States; in 2000-01, they represented nearly 41 per cent of total grants to the States.

## Fraser's 'New Federalism'

In 1976, as part of the Fraser Government's 'New Federalism' policy, the (untied) financial assistance grants – as general purpose grants were then called – were replaced by 'tax sharing entitlements', whereby the States received a fixed percentage of Commonwealth personal income tax receipts, distributed on the basis of existing per capita relativities. Access to personal income taxation was re-opened to the States. However, the States declined to impose personal income taxes of their own and the Commonwealth did not make room for them by reducing Commonwealth personal income tax. A State that took up the option would have had to impose an *additional* tax or surcharge.

When the Northern Territory was granted self-government on a State-like basis in 1978, the CGC treated it as a 'claimant' State, i.e. a recipient of special grants. In 1982, the arrangements for special grants for claimant States were discontinued and all States' (including the Northern Territory) general revenue assistance was determined by the relativities recommended by the CGC. From 1993-94, the Australian Capital Territory was included with the six States and the Northern Territory in the distribution of the pool of general revenue funds, its funding distribution having already been subject to CGC recommendations from 1978.

The extent of vertical fiscal imbalance between revenue powers and expenditure responsibilities in the Federation increased substantially in 1997, when the States lost the capacity to impose business franchise fees on liquor, tobacco and petroleum products. This resulted from the High Court decision that held such fees to be excises and reserved to the Commonwealth. The Commonwealth compensated the States for their lost revenue by increasing its own excise on those products and returning the revenue to the States in the form of a new component of untied grants.

Vertical fiscal imbalance increased again with the introduction of the GST by the Commonwealth, when the States agreed to cease to levy certain taxes (see section 3.5).

## 3.4 Changing role of the Commonwealth Grants Commission

The role of the CGC has grown substantially over the 68 years since its establishment in 1933. From making recommendations on applications for special assistance from States experiencing financial hardship in the 1930s, the role of the CGC has evolved to making recommendations on the distribution of around $30 billion of GST revenue to all States on a regular basis.

Accompanying the widening of the CGC's responsibilities, there has been a shift in the way the CGC goes about its task, from dealing with hardship to equalising among the States. In the CGC's Third Report in 1936, it expressed the rationale for special grants as follows:

> Special Grants are justified when a State through financial stress from any cause is unable efficiently to discharge its functions as a member of the federation and should be determined by the amount of help found necessary to make it possible for that State by reasonable effort to function at a standard not appreciably below that of other States.
>
> *Commonwealth Grants Commission, Report on the Applications made in 1936 by the States of South Australia, Western Australia and Tasmania for Financial Assistance from the Commonwealth under Section 96 of the Constitution, 1936.*

In the 1999 Review, the CGC defined its principle of fiscal equalisation as follows:

> State Governments should receive funding from the Commonwealth such that if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the capacity to provide services at the same standard.
>
> *Commonwealth Grants Commission, Report on General Revenue Grant Relativities, 1999 Review.*

The 1999 definition implies a much higher ambit of equalisation than the 1936 definition. The CGC was built around the concept of calculating grants required for compensation of States which were suffering financial difficulty, and has grown into a system under which the CGC sets out to equalise all States in fiscal terms. In the process it redistributes approximately $2 billion from three States to the other five. This comprehensive approach to equalisation is a relatively new phenomenon. In addition, the CGC's five-yearly review process often produces additions to the scope of the CGC's assessment.

Another interesting feature of the current definition is that it gives no consideration to the relative efficiency with which States operate. The scope of the CGC's assessments has also come to embrace an increasingly wider range of State budget functions.

## 3.5 Impact of the GST

The *Intergovernmental Agreement on the Reform of Commonwealth–State Financial Relations* (the Intergovernmental Agreement), which was signed by all jurisdictions in mid-1999, put in place a further substantial change in Commonwealth–State financial relations.

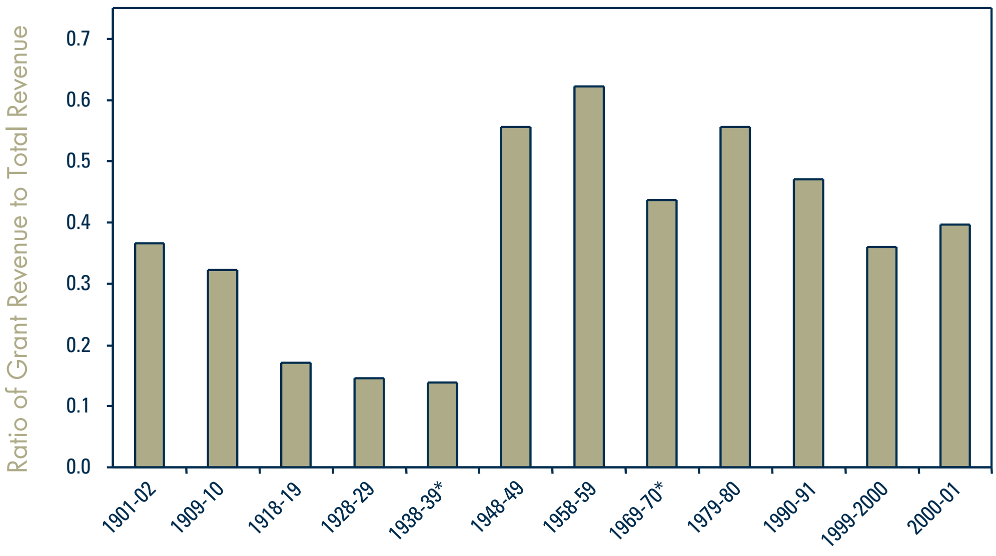
Under the Intergovernmental Agreement, the States receive all the proceeds of the Commonwealth's GST revenue. The payments of financial assistance grants and revenue replacement payments to the States ceased at the same time. In addition, the States agreed to give up a range of State taxes and to reduce their gambling taxation rates.

The Intergovernmental Agreement also obliged the States to bear the cost of the First Home Owners Scheme, and to pay for the costs associated with the administration of the GST by the Australian Taxation Office. The Intergovernmental Agreement provided that no State's budget would be worse off as a result of the introduction of the GST and related measures. Currently, total GST revenue received by the States is less than the sum of State revenue foregone and additional expenditure responsibilities. Consequently, the Commonwealth is, for the time being, funding the shortfall through Budget Balancing Assistance.

The introduction of the GST was arguably the largest change in Commonwealth–State financial relations since 1942. While the States now have access to the proceeds of a broad-based growth tax, albeit one that the Commonwealth controls, there has been no corresponding reform to either the extent and nature of SPPs or the arrangements for allocating general revenue assistance.

As a result of the Intergovernmental Agreement, the States' reliance on the Commonwealth for funding has actually increased again. While not in the magnitude of the changes of 1942, when the States temporarily vacated the income tax field in favour of the Commonwealth, these changes increase an already high dependence of the States on the Commonwealth. This dependence is likely to increase further as the GST is projected to grow faster than most State taxes.

**CHART 3.2:** Vertical fiscal imbalance over 100 years of Federation




*Source: Matthews and Jay,* Federal Finance; *Matthews and Grewal,* The Public Sector in Jeopardy; *Smith,* Taxing Popularity; *Australian Bureau of Statistics.*
*Note: Years marked * include local government.*

PART B

# 4. The Existing Approach

- Commonwealth grants to State Governments currently total around $50 billion per annum, or 27 per cent of total Commonwealth expenditures (see table 4.1).
- The majority of these grants (around $30 billion) are 'general purpose', i.e. they can be used by States for any purposes. The remainder ($20 billion) is earmarked for specific services such as health, education, roads and housing.
- This chapter reviews the system of Commonwealth grants to State Governments, with emphasis on the allocation of grants between States.
- The chapter also briefly reviews the interstate distribution of the Commonwealth's own expenditures (totalling $137 billion), as well as the interstate distribution of Commonwealth revenue sources (totalling $186 billion).

THE EXISTING APPROACH

**TABLE 4.1:** Commonwealth expenditures, 2001-02

| | $m |
|---|---|
| **Grants provided to States for general purposes** | **30 654** |
| GST payments | 27 480 |
| Budget Balancing Assistance | 2 444 |
| National Competition Policy payments | 716 |
| Special Revenue Assistance (to the ACT) | 14 |
| **Grants provided to States for specific purposes** | **20 652** |
| Specific Purpose Payments 'to' | 15 155 |
| Specific Purpose Payments 'through' | 5 067 |
| Specific Purpose Payments direct to local government | 430 |
| **Other expenditures** | **137 049** |
| **Total** | **188 355** |

*Source: Commonwealth Budget Papers, 2001-02.*

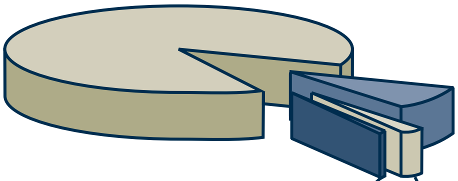
# PART B

## 4.1 General purpose grants

### Overview

The composition of general purpose grants for 2001-02 are summarised in table 4.1 (above). Around $27 billion, or 90 per cent, of these grants are now GST revenues passed to the States by the Commonwealth.

**CHART 4.1:** General Purpose Grants to the States, 2001-02

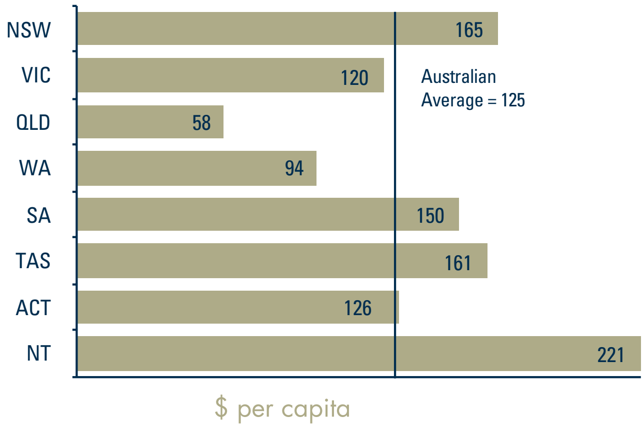



*Source: Commonwealth Budget Papers, 2001-02.*

The GST proceeds are allocated by the CGC to the States using the principle of horizontal fiscal equalisation. The CGC's interpretation and application of that principle is discussed in detail later in this section. As discussed previously in section 3.5, the GST is not a revenue windfall for the States. In fact it is currently insufficient to cover the revenues given up by the States and additional expenditure responsibilities. The Commonwealth will pay around $2.5 billion in Budget Balancing Assistance in 2001-02 to meet its commitment under the Intergovernmental Agreement that no State will be financially worse off under the GST related changes. In the longer run, however, growth in GST revenue is expected to obviate the need for ongoing balancing assistance to be paid to the States.

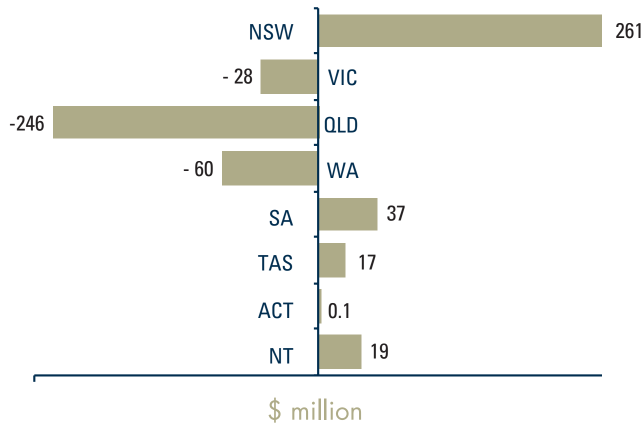
The importance of the Budget Balancing Assistance as a revenue source varies widely among the States (see charts 4.2 and 4.3), as some States have lost less revenue than others through the national tax changes and need less compensation. For example, Queensland did not impose a Financial Institutions Duty and therefore lost less revenue through the tax changes (which abolished Financial Institutions Duty).

**CHART 4.2:** Distribution of Budget Balancing Assistance, 2001-02




*Source: Commonwealth Budget Papers, 2001-02.*

**CHART 4.3:** Variation from equal per capita distribution, 2001-02




*Source: Commonwealth Budget Papers, 2001-02.*

The other significant component of general purpose grants comprises National Competition Policy payments, which now total around $700 million per annum. These payments are provided to the States in return for implementation of competition reforms, and are allocated on an equal per capita basis among the States.

As shown in table 4.1, the Australian Capital Territory receives $14 million in special assistance, which is provided to compensate the Territory for circumstances in its relationship with the Commonwealth that do not apply in other States. In the past, other jurisdictions (principally the Northern Territory) have also received special assistance for budget difficulties.

## Distribution of the GST by the Commonwealth Grants Commission

The CGC determines the allocation of GST revenues (and previously the distribution of financial assistance grants) among the States, according to its interpretation of the principle of horizontal fiscal equalisation. This principle, as articulated by the CGC, aims to give each State the same capacity to provide services.

As discussed in section 3.4, the CGC and its application of the principle of horizontal fiscal equalisation have played a role in providing grants to the States since the 1930s, but there have been significant changes over time. In addition to the increased role of the CGC in determining the distribution of general purpose grants, its interpretation of the principle of horizontal fiscal equalisation has shifted from a principle of *rough parity* (i.e. enabling States to function at a standard not appreciably below that of other States, if they make reasonable effort) to a formal requirement of achieving absolute *equality* of capacity, as follows:

> State Governments should receive funding from the Commonwealth such that, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the capacity to provide services at the same standards.
>
> *Commonwealth Grants Commission, Report on General Revenue Grant Relativities, 1999.*

To implement this principle, the CGC aims to give a higher share of grants to States which have a below average capacity to raise their own revenues and/or have to spend more to provide the same standard of services as other States.

The CGC also provides a higher share of grants to States that receive lower levels of SPPs. In this way, the reach of fiscal equalisation is effectively extended to encompass these specific purpose grants.

A major aim of the CGC is to be policy neutral. States receive extra money if it can be demonstrated that they face higher costs in providing services (or have a lower capacity to raise their own revenues) *for reasons outside their control*. For example, States with a higher proportion of their populations in remote and/or high cost areas, or with a higher proportion of their populations requiring higher service levels (e.g. indigenous persons, aged persons, school students), receive a higher share of grants. Similarly, States with a smaller mining industry receive a higher share of grants in recognition of their lower capacity to raise revenue from royalties.

As a result, the process has two main aims. First, it aims to identify the factors outside the States' control which affect their expenditure requirements (or their ability to raise revenues). Second, it aims to quantify the impact of these factors. The CGC undertakes this analysis for each area of State expenditure (e.g. hospitals, schools, police) and revenue (e.g. payroll tax, land tax, royalties).

Relative expenditure requirements of States are based on many indicators of demand and cost of services, including: population size and age structure; income; indigenous population; degree of low English fluency; number of welfare recipients; community size and remoteness; isolation from other States; use of public versus private services; wage, rental and electricity costs; industry size; and road length.

Relative revenue capacities of States are based on the size of their revenue bases, such as wages and salaries (payroll tax), land values (land tax) and mining industry profits (royalties).

In providing allowances for differences in State spending requirements, the CGC also takes into account the type and standard of services provided on average by States to different population groups, or in different types of locations. For example, the CGC takes into account that services are provided to a different standard in remote areas compared with metropolitan areas, and that outcomes for indigenous persons are generally not to the level achieved for non-indigenous persons (despite the greater resources provided for the needs of indigenous persons). *Accordingly, the CGC does not give the States the capacity to provide the same outcomes for persons in all locations, or to all types of persons.*

After determining States' different expenditure requirements (and different capacities to raise revenues), States' grant entitlements are calculated using the following formula:

- a per capita share of the total pool of funds;
- plus 'expenditure needs' to reflect differences in the demand for, or cost of, services between States (e.g. due to socio-demographic and location characteristics);
- plus 'revenue needs' to offset differences in revenue raising capacity between States (e.g. differences in capacity to collect mining royalties);
- plus 'needs for Specific Purpose Payments' to offset differences in levels of Commonwealth Specific Purpose Payments received by States.

As data to implement this formula will not yet be available for the grant allocation year, the actual calculations are based on a rolling five-year average of States' relative circumstances prior to the grant allocation year. Notional equalisation grants are assessed for each of the five years. These grants are then converted into relativities, which express the per capita equalisation grant for each State as a ratio of the national average per capita equalisation grant. These relativities are then averaged over five years and used to distribute the combined pool of GST revenues and hospital funding grants in the grant allocation year.

The CGC calculates a second set of relativities for distributing the financial assistance grants which would have resulted from a continuation of the Commonwealth–State financial arrangements that applied in 1999-2000 (i.e. pre-GST). This is an important determinant of each State's Budget Balancing Assistance entitlement.

The CGC undertakes comprehensive reviews of its methods every five years (the next review is due to be reported in 2004), as well as annual updates of its findings to roll forward the five-year data period.

Table 4.2 illustrates the impact of needs on the 2001-02 allocation of GST revenues and hospital funding grants (the relevance of hospital funding grants is explained later in this section).

**TABLE 4.2:** Contribution of Needs to Grant Shares 2001-02 ($ per capita)

| | | NSW | VIC | QLD | WA | SA | TAS | ACT | NT |
|---|---|---|---|---|---|---|---|---|---|
| Per capita share of GST revenues and hospital funding grants ***a*** | | 1 747 | 1 747 | 1 747 | 1 747 | 1 747 | 1 747 | 1 747 | 1 747 |
| Needs | | | | | | | | | |
| *Expenditure* | ***b*** | *-39* | *-305* | *-67* | *313* | *34* | *411* | *6* | *5,640* |
| *Revenue* | ***c*** | *-127* | *66* | *46* | *-222* | *287* | *495* | *267* | *118* |
| *SPPs* | ***d*** | *27* | *22* | *26* | *-134* | *-6* | *-29* | *-17* | *-476* |
| *Total* | ***e = b+c+d*** | *-138* | *-217* | *6* | *-43* | *314* | *876* | *257* | *5 281* |
| Grant entitlement | ***f = a+e*** | 1 608 | 1 530 | 1 752 | 1 704 | 2 061 | 2 623 | 2 003 | 7 028 |
| Relativity | ***g = f / a*** | 0.920 | 0.875 | 1.003 | 0.976 | 1.179 | 1.501 | 1.146 | 4.022 |

*Source: Commonwealth Budget Papers, 2001-02; Commonwealth Grants Commission Report on General Revenue Sharing Relativities, 2001 Update.*

This brief description of the CGC's existing methodology framework obscures the fact that the actual methodology applied is complex, giving attention to fine detail.

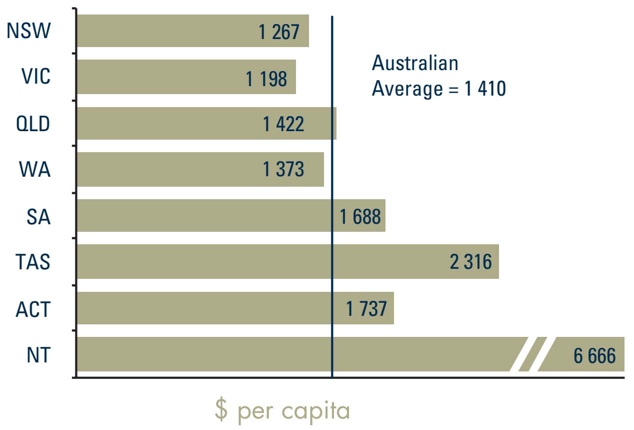
The CGC organisation costs around $5 million per annum to run.  A similar level of resources is probably put in by the States in aggregate, mainly to present arguments and evidence to the CGC about factors that affect States' spending and revenue raising needs.

## Allocation of GST revenues

A State's GST revenue entitlement is based on the application of the CGC's per capita relativities to a combined pool of GST revenue and hospital funding grants.  The GST revenue entitlement for each State is its share of the combined pool less its hospital funding grant entitlement determined under the Australian Health Care Agreements.  The practical effect of this is that the Australian Health Care Agreements are overridden by the distribution determined by the CGC.

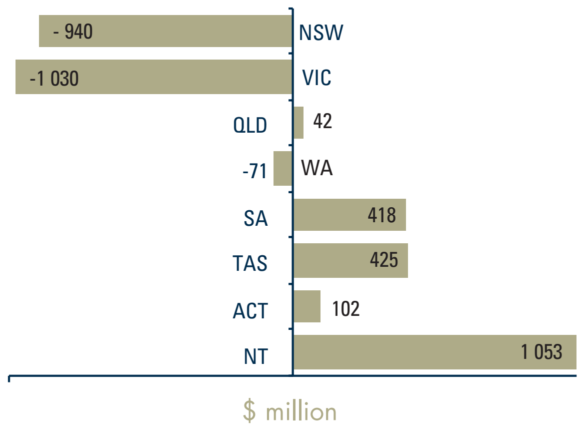
As shown in charts 4.4 and 4.5, New South Wales, Victoria and Western Australia have a share of GST revenues that is less than their share of the national population, while all other jurisdictions have a share of GST revenues that is greater than their population share.

**CHART 4.4:** Distribution of GST revenue, 2001-02




*Source: Commonwealth Budget Papers, 2001-02.*

**CHART 4.5:** Variation from equal per capita distribution, 2001-02




*Source: Commonwealth Budget Papers, 2001-02.*

# PART B

## Issues around the Commonwealth Grants Commission fiscal equalisation process

On a practical level the CGC process is complex, with documentation running to nearly two thousand pages of annual reports and working papers. The complexity reflects the CGC's attempts to take account of, in fine detail, the myriad of factors affecting States' expenditures and revenues.

Many elements of the calculations reflect judgements by the CGC about the way to quantify factors, or the extent to which factors are important in affecting State expenditures and revenues. The basis for judgements is not always clearly documented, and judgements can change significantly over time. Despite many years of close examination by the CGC and the States, there continues to be intense debate and analysis about the quantification of expenditure and revenue needs.

The appropriateness of the principle of fiscal equalisation for distributing grants has often come under scrutiny, having regard to both equity issues and possible effects on the efficiency of States' delivery of services, and the efficient allocation of resources generally across the nation.

It has sometimes been suggested that grants should be allocated to promote equitable outcomes for Australians across the Federation, rather than to equalise the capacity of States. It has also been suggested that allocation of grants should provide incentives to improve the performance of State Governments. However, there has been no general agreement on what such objectives should mean in practice.

The 'policy neutrality' objective of fiscal equalisation highlights some of these issues.

Policy neutrality aims to avoid the situation where States can influence their grants through their policies. For example, if grants were based on States' actual expenditures or revenues, there might be incentives for States to spend more or tax less in order to receive a higher share of grants.

There are different views on how policy neutral CGC methodology really is. For example, it has been suggested that States can, in the long term, influence their population's need for services (and the need to spend money on services), or the health of their economy (and the capacity to raise taxes and royalties).

Policy neutrality means that States are given the capacity to provide an average standard of services (at an average level of efficiency) *regardless of whether those services are in fact provided below or above that standard.* In general, States provide much of the same range of services, but at different levels or standards and with differing efficiency. Opinions are divided about the merits of this approach.

- Some believe that the States' grant entitlements should not be independent of the standard and efficiency of services they provide (e.g. States should not receive extra money for services if they do not spend it on those services, or do not spend it efficiently).
- Others argue that policy neutrality is necessary to prevent distortionary grant seeking behaviour by States, that the measurement of service standards and efficiency is extremely difficult, and that it is appropriate for a federal system to give each State the freedom to choose service outcomes within an overall framework of equal capacity to provide services.

Similar issues arise for States' revenue raising efforts – should State grant entitlements be independent of the effort they make to raise their own revenue?

The CGC's treatment of SPPs also generates controversy. Some argue that, as the CGC's process effectively redistributes specific purpose funding, this overrides the Commonwealth–State agreements on funding allocations, *undermining achievement of the objectives of the SPPs.* Others argue that this is not the case, since the Commonwealth is required to endorse the CGC's recommendations before they take effect, that the Commonwealth can (if it wishes) 'quarantine' SPPs from the CGC processes, and that the objectives of SPPs are achieved, since States must spend the agreed monies on the agreed objectives (even if this comes at a cost to their general purpose grants).

The impact of fiscal equalisation on national resource allocation cannot be examined in isolation from other Commonwealth fiscal and regulatory measures that impact on national resource allocation and, as a result, efficiency and equity.

## Trends in general purpose grants

There have been significant changes in States' shares of general purpose grants over the last 20 years, as shown in table 4.3. For the last two years, the figures are calculated on a pre-GST basis for comparability with earlier years. Grant shares before the mid-1980s depart significantly from current fiscal equalisation arrangements.

**TABLE 4.3:** Relative per capita general purpose grants, Australia = 100

| | NSW | VIC | QLD | WA | SA | TAS | ACT | NT |
|---|---|---|---|---|---|---|---|---|
| 1982-83 to 1986-87 | 80.2 | 80.0 | 113.2 | 118.7 | 116.0 | 146.5 | 201.8 | 529.5 |
| 1987-88 to 1991-92 | 80.1 | 78.7 | 109.3 | 119.5 | 122.5 | 140.2 | 189.0 | 560.4 |
| 1992-93 to 1996-97 | 81.8 | 82.7 | 106.2 | 109.0 | 122.3 | 158.2 | 125.8 | 590.3 |
| 1997-98 to 2001-02 | 84.6 | 82.9 | 102.3 | 94.2 | 125.9 | 181.6 | 121.0 | 613.2 |

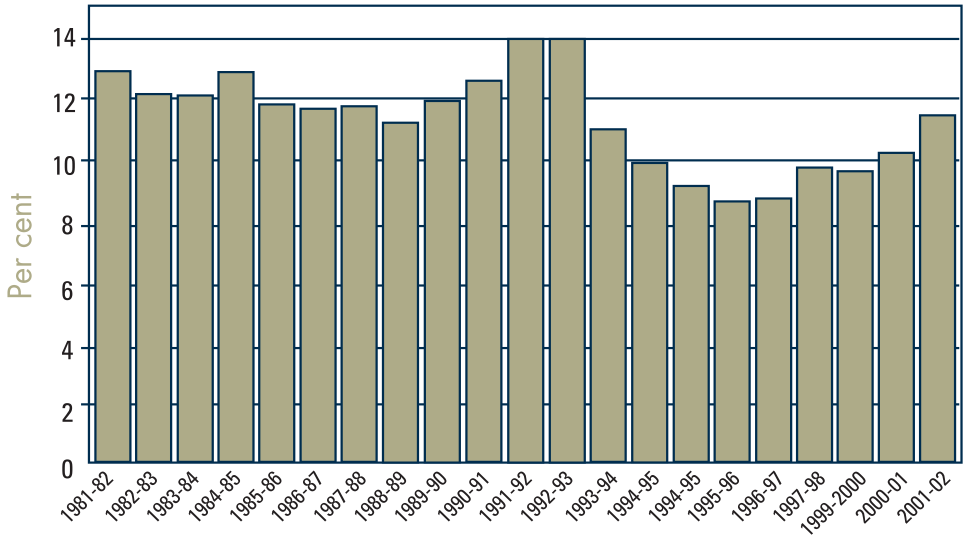
*Source: Commonwealth Budget Papers, various years.*

*Note: The ACT relativity prior to 1988-89 has been notionally set at the 1988-89 level.*

The relative funding shares of Western Australia, Queensland and the Australian Capital Territory have fallen significantly, while shares for other jurisdictions have increased to varying extents, with the increase being most rapid in Tasmania. In per capita relativity terms, Western Australia's share of general purpose grants has decreased by about 21 per cent, Queensland's share has fallen by 10 per cent and the Australian Capital Territory's share has fallen by 40 per cent. The Tasmanian and Northern Territory shares have increased markedly.

Chart 4.6 shows how the aggregate redistribution of general purpose grants has changed over time, as measured by the total level of above-equal per capita funding received by jurisdictions as a proportion of the grant pool.

**CHART 4.6:** Percentage of grant pool redistributed among States




*Source: Commonwealth Budget Papers, various years.*

The 1992-93 peak in redistribution shown in chart 4.6 reflects a high point in the Queensland and South Australian relativities. Large falls in Western Australia's relative funding led to the low point in 1996-97. Since then, the redistribution has grown again and is projected to grow considerably over the next few years (according to South Australian Department of Treasury and Finance estimates).

## 4.2 Specific Purpose Payments

### Role of Specific Purpose Payments

Specific Purpose Payments (SPPs) are grants from the Commonwealth to the States for specified services, such as health, education, roads and the environment. The Commonwealth will provide $20 billion in SPPs in 2001-02, comprising 40 per cent of total grants to State Governments.

SPPs are subject to individual agreements which attach a variety of terms and conditions to the grants. They are also usually classified as either:

- Payments 'to' the States, which are for programs administered by the States ($15 billion in 2001-02); or
- Payments 'through' the States, which are payments on-passed to other bodies, principally non-government schools and local governments ($5 billion in 2001-02).

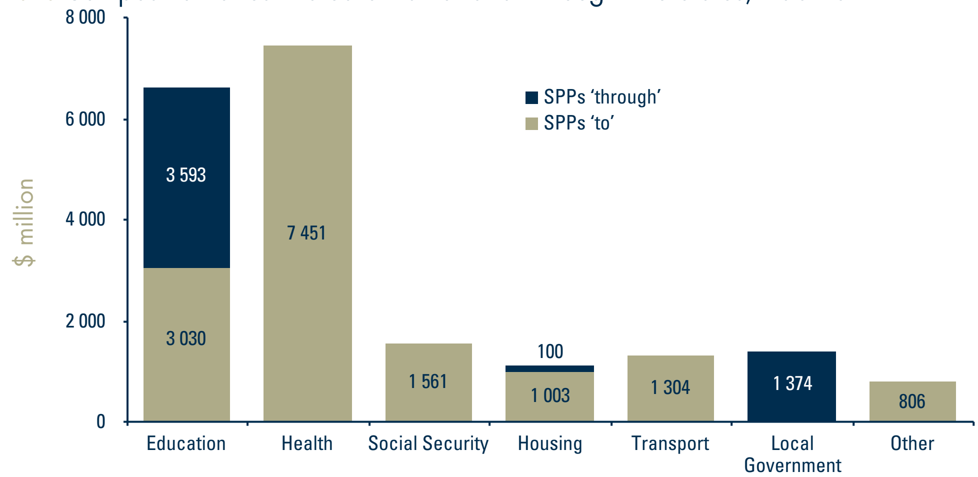
The legal basis for SPPs and other Commonwealth grants is in section 96 of the Constitution, which provides that "the [Commonwealth] Parliament may grant financial assistance to any State on such terms and conditions as the Parliament thinks fit".

The Commonwealth uses SPPs for a number of reasons, including:

- to introduce programs reflecting Commonwealth wishes in areas of State Constitutional responsibility (the majority of SPPs);
- to impose or encourage national standards (e.g. free public health and vocational training standards);
- to pay States for the delivery of Commonwealth programs (there are only a few examples of this sort, e.g. funding legal aid for federal law cases);
- to compensate States for the cost of Commonwealth initiatives (such as the cost to the States of increased access to pensioner concessions); and
- to comply with international obligations (e.g. payments to help manage World Heritage areas).

Chart 4.7 below illustrates the concentration of SPPs in the areas of health and education.

**CHART 4.7:** Composition of estimated SPPs 'to' and 'through' the States, 2001-02

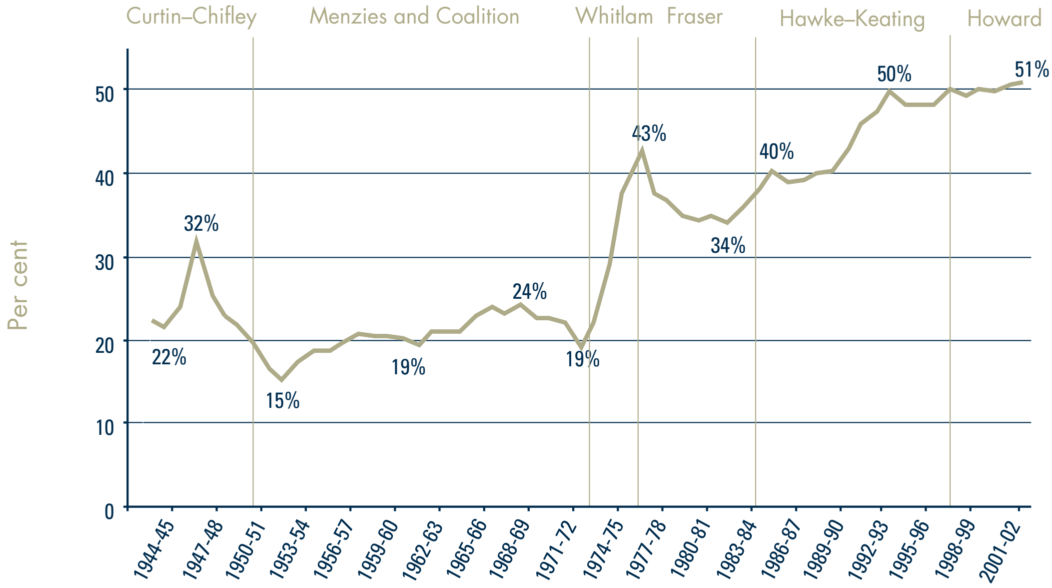



*Source: Commonwealth Budget Papers, 2001-02.*

## History of Specific Purpose Payments

SPPs have grown substantially in importance over time. As shown in chart 4.8 below, SPPs have increased from 22 per cent of total Commonwealth payments in 1942-43 to 51 per cent of total Commonwealth payments in 2001-02. (Note: data for 2000-01 and 2001-02 is adjusted to enable comparison on a consistent basis between pre and post-GST years.)

**CHART 4.8:** SPPs as a percentage of total payments to the States




*Source: Commonwealth Budget Papers, various years.*

*Note: Data for 2000-01 and 2001-02 is adjusted to enable comparison on a consistent basis between pre and post-GST years.*

SPPs were introduced in the 1920s to provide assistance for road construction and debt costs. Otherwise, SPPs remained limited in scope until after World War II. Following World War II there was a gradual increase in the number of tied grant programs, including for housing, education, agriculture, some health programs and infrastructure developments. As noted earlier, SPPs escalated markedly in the mid-1970s under the Whitlam Government, with comprehensive funding for education and public hospitals and the provision of general purpose grants for local government. Since then, SPPs have continued to increase slowly as a proportion of total Commonwealth funding to the States.

# PART B

## Issues around Specific Purpose Payments

One of the most striking features of the system of SPPs as it now stands is the extremely large number of separate SPP programs. The Commonwealth identifies over 120 separate SPPs, many of which consist of a number of sub-programs. Funding provided through SPPs varies enormously, from less than $200 000 per annum nationally (e.g. Unattached Humanitarian Minors Program) to over $6 billion per annum nationally (Health Care Grants).

Questions have often been raised about the efficiency – at both ends – of maintaining a large number of small SPP arrangements. More fundamentally, as many of the SPPs are in areas in which the States have sole responsibility under the Constitution, questions are asked about whether it is efficient and appropriate for the Commonwealth to be determining priorities in such areas – especially since, in practice, it is the States which deliver and manage the services on the ground.

Commonwealth conditions on SPPs show substantial variation. Some of the largest SPP programs (e.g. funding for government schools and hospitals) have a limited set of conditions and provide States with a relatively high degree of flexibility to provide services (consistent with the general objectives of these SPPs), whereas small SPP programs can involve substantial Commonwealth oversight and micro management. Conditions can include requirements for:

- Commonwealth approval of specific detailed programs;
- States to provide matching funding and/or maintain existing expenditure effort;
- States to meet targets for specified services;
- States to provide performance reports; and
- States to provide access to services on a basis agreed with the Commonwealth.

As a general rule, the Commonwealth has been concerned to ensure that its funding does not result in a diminution of State effort and that the States contribute to new or increased Commonwealth SPP programs.

The focus of States' accountability to the Commonwealth has usually been on *expenditures* (and more recently *outputs*) for particular programs, rather than *outcomes* achieved (which often depend on a broad range of government programs, among other factors). Similarly, effectiveness and efficiency measures often focus on particular programs rather than outcomes.

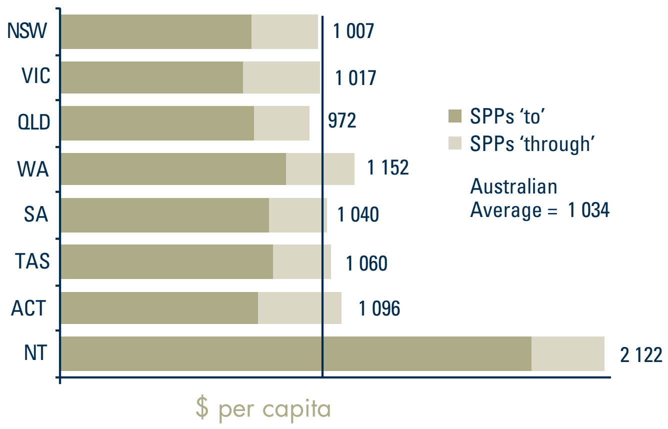
In the last decade, many commentators (including the Commonwealth's Joint Public Accounts Committee) have suggested that SPP agreements should give greater emphasis to the achievement of agreed outcomes, although it is recognised that suitable outcome measures are often not yet available and will require significant development.

## Current distribution and transfers between States

The distribution of SPPs between the States is based on a variety of mechanisms including population shares, Commonwealth discretionary allocations and formulae that attempt to capture the cost of, and/or demand for, services funded by the SPP.

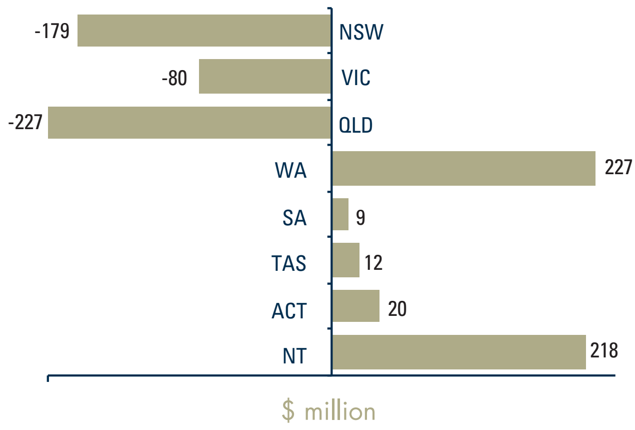
As shown in chart 4.9, New South Wales, Victoria and Queensland have a share of SPPs that is less than their share of the national population. All other jurisdictions have a share of SPPs that is greater than their population share. The large excess in funding for Western Australia is due to the payment of its share of petroleum royalties from the North West Shelf project as an SPP.

**CHART 4.9:** Distribution of SPPs, 2001-02




*Source: Commonwealth Budget Papers, 2001-02.*

**CHART 4.10:** Variation from equal per capita distribution, 2001-02




*Source: Commonwealth Budget Papers, 2001-02.*

## Trends

Table 4.4 below shows significant variability over time in the shares of SPP funding received by each State, with the most pronounced net movements in the five States with smaller population.

**TABLE 4.4:** Relative per capita Specific Purpose Payments, Australia = 100

| | NSW | VIC | QLD | WA | SA | TAS | ACT | NT |
|---|---|---|---|---|---|---|---|---|
| 1982-83 to 1986-87 | 95.3 | 90.5 | 89.5 | 112.2 | 112.6 | 141.3 | 103.0 | 366.0 |
| 1987-88 to 1991-92 | 95.3 | 100.6 | 93.2 | 103.2 | 102.3 | 129.8 | 104.5 | 228.5 |
| 1992-93 to 1996-97 | 95.6 | 92.9 | 98.2 | 109.4 | 117.1 | 116.7 | 103.7 | 181.6 |
| 1997-98 to 2001-02 | 96.1 | 92.6 | 97.6 | 117.0 | 106.5 | 116.0 | 107.5 | 186.3 |

*Source: Commonwealth Budget Papers, various years.*

*Note: The ACT relativity prior to 1988-89 has been notionally set at the 1988-89 level.*

Table 4.5 shows State shares of total grants, i.e. the shares of general purpose grants and SPPs combined.

**TABLE 4.5:** Relative per capita total grants, Australia = 100

| | NSW | VIC | QLD | WA | SA | TAS | ACT | NT |
|---|---|---|---|---|---|---|---|---|
| 1982-83 to 1986-87 | 86.4 | 84.2 | 103.5 | 116.1 | 114.6 | 144.4 | 161.6 | 462.9 |
| 1987-88 to 1991-92 | 86.7 | 88.2 | 102.4 | 112.4 | 113.5 | 135.4 | 152.8 | 416.3 |
| 1992-93 to 1996-97 | 88.3 | 87.6 | 102.4 | 109.2 | 119.8 | 138.4 | 115.2 | 395.6 |
| 1997-98 to 2001-02 | 90.3 | 87.7 | 100.0 | 105.5 | 116.3 | 149.1 | 114.2 | 402.1 |

*Source: Commonwealth Budget Papers, various years.*

*Note: The ACT relativity prior to 1988-89 has been notionally set at the 1988-89 level.*

## 4.3 Commonwealth revenues and expenditures other than grants

### Commonwealth expenditure patterns

The Commonwealth affects the distribution of economic activity across States through its own expenditures and revenue raising activities, in addition to the effects of the distribution of its grants to the States. Is this relevant to assessment of the effects on efficiency and equity of the allocation of Commonwealth grants? To assist discussion of this matter, some data are presented here on the distribution of Commonwealth expenditure and revenue raising across States.

The incidence of the Commonwealth's own expenditures (apart from grants to State Governments, which have been examined) shows significant divergence from what would result from shares being proportional to population. For example, welfare payments reflect the number of eligible recipients in each State, which varies with such factors as the demographic profiles and unemployment rates of the States.

The Australian Bureau of Statistics estimates the incidence of Commonwealth expenditures as part of its State Accounts. Table 4.6 shows the latest estimates for some major components of Commonwealth expenditures.

**TABLE 4.6:** Commonwealth expenditures – estimated distribution among States, 1999-2000 ($ per capita)

| | NSW | VIC | QLD | WA | SA | TAS | ACT | NT | AUST |
|---|---|---|---|---|---|---|---|---|---|
| Final Consumption Expenditure [a] | 2 033 | 1 963 | 1 904 | 1 677 | 1 827 | 1 799 | 26 998 | 5 946 | 2 381 |
| Gross Fixed Capital Expenditure [b] | 155 | 107 | 47 | 74 | 82 | 79 | 1 909 | 247 | 137 |
| Personal Benefit Payments | 2 776 | 2 720 | 2 681 | 2 534 | 3 022 | 3 238 | 2 289 | 1 845 | 2 734 |
| Subsidies [c] | 57 | 78 | 116 | 250 | 51 | 64 | 10 | 247 | 93 |

*Source: Australian Bureau of Statistics.*
*Notes: (a) Recurrent departmental costs (e.g. salaries, rent) and defence expenditures.*
*(b) Capital departmental costs.*
*(c) Excludes diesel rebates.*

The high level of final consumption and capital expenditures in the Australian Capital Territory reflects its location as the national capital. These expenditures fund services which benefit the nation as a whole. They are also the original rationale for and the major driver of the Australian Capital Territory economy.

Table 4.7 shows the extent to which Commonwealth expenditures shares set out in table 4.6 vary from population shares. (Positive figures indicate that the Commonwealth spends more in that State than its population share.)

**TABLE 4.7:** Commonwealth expenditures – variation from population shares, 1999-2000 ($ million)

| | NSW | VIC | QLD | WA | SA | TAS | ACT | NT |
|---|---|---|---|---|---|---|---|---|
| Final Consumption Expenditure [a] | -2 237 | -1 980 | -1 688 | -1 318 | -830 | -274 | +7 635 | +692 |
| Gross Fixed Capital Expenditure [b] | +118 | -140 | -320 | -119 | -82 | -28 | +549 | +21 |
| Personal Benefit Payments | +268 | -64 | -187 | -374 | +431 | +237 | -138 | -173 |
| Subsidies [c] | -230 | -73 | +82 | +294 | -62 | -14 | -26 | +30 |

*Source: Australian Bureau of Statistics.*
*Notes: (a) Recurrent departmental costs (e.g. salaries, rent) and defence expenditures.*
*(b) Capital departmental costs.*
*(c) Excludes diesel rebates.*

## Incidence of Commonwealth revenue raising

The incidence of Commonwealth revenue raising also varies across States, due to the varying characteristics of individuals and economic activities in each State.

Table 4.8 shows estimates of the distribution of some major Commonwealth revenue raising among States. The distributions have been calculated to reflect the location of activities from which the revenues are derived (place of residence for personal income tax, location of gross operating surplus for company tax, location of production and sale respectively for petroleum production revenues and excise, and location of consumption of goods and services for GST). This is not the same as the final incidence of Commonwealth taxes on individuals, which may differ significantly from the distributions presented in table 4.8. For example, while company income tax is levied on company profits, the final incidence may be borne by employees (through lower wages), consumers (through higher prices) or by shareholders (through lower dividends or share prices).

**TABLE 4.8:** Commonwealth revenues – estimated distribution between States, 1999-2000[(a)] ($ per capita)

| | NSW | VIC | QLD | WA | SA | TAS | ACT | NT | TOTAL |
|---|---|---|---|---|---|---|---|---|---|
| Personal income tax | 3 936 | 3 574 | 3 129 | 3 649 | 3 073 | 2 744 | 5 210 | 3 364 | 3 586 |
| Company income tax[(b)] | 1 282 | 1 296 | 1 026 | 1 840 | 964 | 779 | 1 138 | 1 885 | 1 259 |
| Petroleum production revenues[(c)] | 0 | 232 | 0 | 473 | 0 | 0 | 0 | 33 | 105 |
| Petroleum excise[(d)] | 473 | 450 | 542 | 653 | 472 | 492 | 572 | 1 015 | 505 |
| GST | 1 326 | 1 271 | 1 153 | 1 150 | 1 095 | 1 061 | 1 420 | 1 104 | 1 238 |

*Source: Commonwealth Budget Papers, 2001-02.*
*Notes: (a) Except personal income tax (1998-99 data) and GST (2000-01 data).*
*(b) The estimates here are based on the distribution of gross operating surplus across States. They are therefore not necessarily a close estimate of final incidence of company tax.*
*(c) Petroleum Resource Rent Tax, crude oil and LPG excise, and petroleum royalties. Includes gross collections from the North West Shelf project, part of which are returned to Western Australia as grants to the State.*
*(d) Excises on the sale of petroleum products, net of diesel rebates.*

Table 4.9 shows the extent to which Commonwealth revenue raising set out in table 4.8 varies from population shares. (Positive figures indicate that the Commonwealth collects more from that State than its population share.)

**TABLE 4.9:** Commonwealth revenues – variation from population shares, 1999-2000[(a)] ($ million)

| | NSW | VIC | QLD | WA | SA | TAS | ACT | NT |
|---|---|---|---|---|---|---|---|---|
| Personal income tax | +2 231 | -54 | -1 591 | +116 | -763 | -397 | +501 | -42 |
| Company income tax[(b)] | +147 | +174 | -825 | +1 088 | -442 | -226 | -38 | +121 |
| Petroleum production revenues[(c)] | -673 | +604 | -370 | +690 | -156 | -49 | -32 | -14 |
| Petroleum excise[(d)] | -209 | -262 | +131 | +276 | -49 | -6 | +21 | +99 |
| GST | +578 | +160 | -304 | -167 | -215 | -83 | +57 | -26 |

*Source: Commonwealth Budget Papers, 2001-02.*
*Notes: (a) Except personal income tax (1998-99 data) and GST (2000-01 data).*
*(b) The estimates here are based on the distribution of gross operating surplus across States. They are therefore not necessarily a close estimate of final incidence of company tax.*
*(c) Petroleum Resource Rent Tax, crude oil and LPG excise, and petroleum royalties. Includes gross collections from the North West Shelf project, part of which are returned to Western Australia as grants to the State.*
*(d) Excises on the sale of petroleum products, net of diesel rebates.*

PART B

# 5. Other Federations

- Australia exhibits significantly greater vertical fiscal imbalance than the federations of Germany, the United States and Canada.
- The United States is, fiscally, the least centralised of the four federations. This means that revenue is returned to the States in which it is generated. Strong constitutional provisions deliver a high degree of taxation autonomy to state-level governments in both Germany and Canada as well.
- In the United States there is no system in place to equalise fiscal capacity across the States. Horizontal fiscal equalisation in the United States occurs only indirectly (and partially) via grant-in-aid programs.
- Like Australia, both Germany and Canada attempt horizontal fiscal equalisation using general purpose grants. However, unlike Australia they employ processes taking account only of revenue considerations, choosing not to focus on matters of expenditure.
- Canada's system of (partial) horizontal fiscal equalisation is designed only to aid poorer Provinces, not to achieve full equalisation. The German and Australian systems are the only ones which attempt to 'equalise down' States with greater financial capacity, but Germany does not seek to do this to the same extent as Australia.

**TABLE 5.1:** Australia compared with other federations in advanced economies

| COUNTRY | VERTICAL FISCAL IMBALANCE | HORIZONTAL FISCAL EQUALISATION |
|---|---|---|
| **Australia** | HIGH<br>• Federal Government controls major tax bases | COMPREHENSIVE<br>• Responsibility of Federal Government<br>• Full equalisation based on State revenue and expenditure |
| **Canada** | MEDIUM<br>• State income taxes 'piggy-backed' on to federal taxes<br>• Sales tax applied by both levels of government | PARTIAL<br>• Responsibility of Federal Government<br>• Partial equalisation based on State revenue |
| **Germany** | MEDIUM<br>• System of revenue sharing between tiers of government | PARTIAL<br>• Responsibility of Federal Government and richer States<br>• Partial equalisation based on State revenue |
| **United States** | LOW<br>• Income taxes applied by both levels of government, States typically 'piggy-backing' to an extent<br>• Sales tax at State-level only | MINIMAL<br>• Indirect equalisation via grant-in-aid programs |

PART B

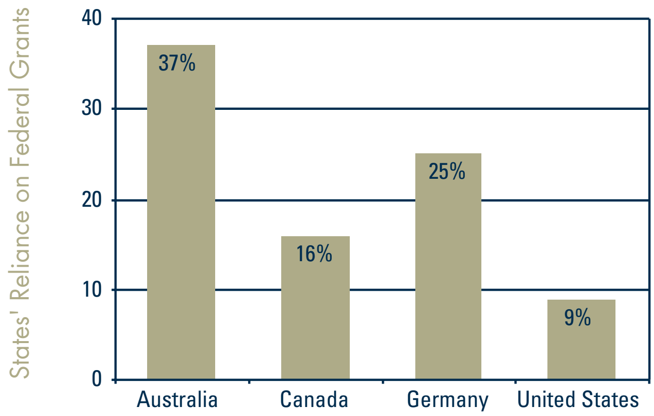
## 5.1 Background

By international standards, Australia has a high degree of vertical fiscal imbalance. Table 5.1 demonstrates this by comparing Australia with other federations in advanced economies – Canada, Germany and the United States.

The relative size of equalisation transfers from federal to state-level government is greater in Australia. The system currently in place in Australia is more complex and detailed than any other.

This chapter examines the issue of vertical fiscal balance and looks at the HFE systems in use in the federations of Germany, Canada and the United States. It attempts to draw comparisons with the situation as it currently stands in Australia.

**CHART 5.1:** Vertical fiscal imbalance in different federations, 1997-98




*Source: International Monetary Fund, Government Financial Statistics 2000.*

## 5.2 Germany

### Vertical fiscal balance

Germany has based its federal financial arrangements on a system of revenue sharing. This results in the major tax bases of income and expenditure, most notably the Value Added Tax (VAT) being shared between the tiers of government (table 5.2).

**TABLE 5.2:** Distribution of public incomes across government levels

| | WAGES AND INCOME TAX | CORPORATION TAX | VAT |
|---|---|---|---|
| **Federation** | 42.5% | 50% | 52.2% |
| **Länder** | 42.5% | 50% | 45.7% |
| **Communes** | 15% | 0% | 2.1% |

*Source: Andreas Kienemund, The Distribution of Public Incomes at the Diverse Government Levels in the Federal Republic of Germany.*

# PART B

While the Basic Law is specific about the allocation of income tax and corporation tax, it is less prescriptive about VAT. The distribution of VAT revenue is therefore the moveable component in the process of fiscal arrangements between the Federation and the Länder (state-level government in Germany).

Consequently, the distribution of VAT shares is one of the most difficult problems in financial relations between the two tiers of government. Since 1986, the shares have been 65 per cent for the Federation and 35 per cent for the Länder.

The Bundesrat, an upper house in the Federal Parliament that represents the Länder, has a key role in maintaining vertical fiscal balance. Federal legislation on taxes requires the consent of the Bundesrat.

## Horizontal fiscal equalisation – general purpose grants

The system of fiscal equalisation in Germany is a result of efforts to meet the constitutional requirement of 'equivalent (not equal) living conditions' in the Länder.

Income and corporate tax revenue adheres to the principle that it will be available to individual Länder in the same proportion as that in which taxes are raised in those Länder. On top of this, 75 per cent of the Länders' VAT revenue is distributed on a per capita basis.

Following this distribution of taxes, the relative fiscal strength of the individual Länder – assessed only by available revenues – determines the starting point for horizontal fiscal equalisation. This takes place in three stages:

- Firstly, the remainder of the Länder's VAT component (25 per cent) is used for the purpose of providing additional allocations to the fiscally weak Länder. This enables them to attain up to 92 per cent of the average per capita revenues of all Länder.
- The second stage is the use of payments made by the wealthier Länder to the poorer Länder. This brings the weaker Länder up to a minimum 95 per cent of the average per capita revenue of all Länder (the Basic Law only requires that Länder are reasonably equalised).
- Finally, Federal Supplemental Grants are made to financially weak Länder in order to complement the coverage of their general financial requirements. Unlike the horizontal equalisation payments, Federal Supplemental Grants may take special expenditure necessities of individual Länder into account.

## Horizontal fiscal equalisation – specific purpose grants

None of the payments or grants that constitute Germany's horizontal fiscal equalisation process have conditions attached to their expenditure.

## Comparison with Australia

The German Basic Law not only specifies the basis upon which the financial relations between the Federation and the Länder are to be organised, but it also prescribes the assignment of powers to make tax legislation and, in the case of income and corporate profits tax, how much tax revenue shall be distributed between the tiers of government. This contrasts with the Australian Constitution, which does not offer any guidelines on the allocation of access to certain shared tax bases, and does not require fiscal equalisation.

The Basic Law gives constitutional recognition to municipalities, or groups of municipalities, and specifies how this level of government shares the proceeds of certain taxes. Germany is unlike Australia in this approach.

The high degree of vertical fiscal imbalance that is evident in Australia can be attributed to the fact that the Commonwealth Government has captured ownership of the major tax bases. In Germany, vertical fiscal imbalance is much less significant as these main taxes are shared with the Länder.

The horizontal equalisation system in Germany differs from Australia in two important ways.

1. The locus of responsibility for equalisation: in Australia, this lies with the Commonwealth Government, whereas in Germany the function is undertaken by both the Federation and the richer Länder.
2. Germany's system is much less comprehensive: it only takes account of revenue raising capacities across the Länder, excluding expenditure considerations; and it only attempts to reasonably equalise Länder, as opposed to the Australian model of seeking to achieve full equalisation.

# 5.3 United States

## Vertical fiscal balance

The United States federal system is highly decentralised, with revenue being allocated back to where it was raised. This is a legacy of the financial independence of Federal and State Governments throughout the nineteenth century.

The Federal and State Governments can each employ any tax not prohibited by the Constitution, or in the case of States by (valid) federal law. The only explicit limitations contained in the Constitution prohibit State use of import and export duties and duties on tonnage. (The Australian High Court has taken the concept of 'excise' a long way from the latter.)

Both the federal and state tiers of government levy a tax on personal income, although the federal income tax leaves only limited room for the States. Each level of government is largely responsible for collecting its own taxes, but the States can minimise administrative effort to an extent by 'piggy-backing' on the federal income tax structure and returns. (This would also be possible in Australia if the income tax base was shared.)

The United States is one of the few developed countries without a broad-based national sales tax. However, many States levy their own expenditure taxes. One of the reasons that the Federal Government has not introduced a national sales tax is the objection of State and local authorities to federal encroachment in an area that has traditionally been theirs alone.

As a result, with the ability of States to choose from a wide variety of tax bases and rates (but with most States clustering around similar models), the United States enjoys a low degree of vertical fiscal imbalance.

# PART B

## Horizontal fiscal equalisation – general purpose grants

There is no systematic method in place for equalising State fiscal capacity. Some equalisation occurs indirectly through a variety of grant-in-aid programs (e.g. funding directed towards Alaskan native villages and the Mexican border).

Tax competition, rather than harmonisation, is thought to generate a number of perceived benefits: it is perceived to act as a check on government power, increases responsiveness to citizens, improves resource allocation, results in greater efficiency in government operations, and produces higher quality public services.

## Horizontal fiscal equalisation – specific purpose grants

There are no specific purpose grants directly aimed at horizontal equalisation. However, some of the grant-in-aid programs identified do require States to apply them to particular areas of expenditure (e.g. highway construction).

## Comparison with Australia

The United States' approach to vertical and horizontal balance is very different to Australia's. History has played a large part in the development of a system that encourages the independence of Federal and State Governments in the field of taxation. In addition, unlike Australia, the United States has no recent history of a completely centralised income tax.

Allied to this, an environment of tax competition rather than tax harmonisation exists among the States.

The United States seems to place less value on equity or equalisation and greater emphasis on diversity and decentralised ways of doing things. Consequently, the United States is the least harmonised of the federal countries included in this comparison.

## 5.4 Canada

### Vertical fiscal balance

Canada operates a system based on autonomous State (or Provincial) taxation. The Federal Government has accepted that the Provinces need 'tax room' in order to raise revenue to meet their expenditure requirements. As a result, the Provinces are able to levy a varied range of taxes.

Tax Collection Agreements between the Federal Government and the Provinces provide for joint Federal–Provincial use of the same income tax base. The Provinces, with the exception of Québec and Ontario, set their own personal and corporate income tax rates as a proportion of that charged by the Federal Government. The taxes are collected by the Federal Government and then remitted directly to the Provinces in a 'piggy-back' approach to taxation administration. (In the United States, 'piggy-backing' does not extend to central collection – only to reliance by States, if they wish, on federal tax definitions, structures and reported amounts.)

In addition, three different forms of sales tax – organised differently – are applied by the Canadian Provinces. The Federal Government also administers a separate goods and services tax, the revenue from which is used for federal expenditure. The provincial retail sales taxes are also collected by the Federal Government and their proceeds remitted to the Provinces.

Canada has a decentralised fiscal position with low vertical imbalance.

### Horizontal fiscal equalisation – general purpose grants

The high degree of taxation autonomy available to the Provinces means that revenue per capita can vary greatly between them. The Federal Government employs three main mechanisms aimed at horizontal equalisation across the Provinces. Revenue and not expenditure differences between the Provinces are considered for the purpose of equalisation.

The Canada Health and Social Transfer, representing approximately two-thirds of all federal transfers to the Provinces, supports provincial health care, post-secondary education, social assistance and social services. It takes the form of a cash payment and a tax transfer. Uneven per capita allocations, a legacy of the old Canada Assistance Plan and the Established Programs Financing programs, have affected the equity of the Health and Social Transfer in its early years. However, the 1999 Budget announced that these disparities in funding would be eliminated by 2001-02 when all Provinces will receive identical per capita Health and Social Transfer entitlements.

A system of equalisation payments makes up the bulk of the remaining transfers. The system involves a comparison of 33 different revenue sources, virtually the entire range of revenue instruments used by Provincial and Municipal Governments. The amount of money transferred is according to a 'Five Province Standard' which is a population-weighted average of British Columbia, Manitoba, Ontario, Québec and Saskatchewan. This is seen to reflect the normal capacity to raise revenues.

The remaining equalisation transfer is Territorial Formula Financing. This is a payment to the Territorial Governments which recognises the higher costs of providing public services in the north of Canada.

While the equalisation payments are unconditional, the Health and Social Transfer and Territorial Formula Financing are seemingly conditional. However, they are in fact paid into general Provincial revenues and can be used for any purpose.

## Horizontal fiscal equalisation – specific purpose grants

All federal transfers to the Provinces are paid into consolidated revenue funds, and in this way are different from specific purpose grants.

## Comparison with Australia

Canadian fiscal federalism had a remarkably similar history to that of Australia until World War II. From that time the two took different paths – Canada gradually became fiscally more decentralised, while Australia became more centralised.

The Canadian system, like Germany's, is closer to vertical fiscal balance than Australia. The Provinces have a much greater degree of tax autonomy than Australian States and do not rely so heavily on federal transfer payments.

Horizontal equalisation calculations in Canada – like Germany but unlike Australia – do not take into account the expenditure requirements or difficulties of the individual Provinces. Rather it is only dissimilarities in revenue that are taken into account.

Finally, in Canada – unlike Australia – the system is designed only to aid the poorer Provinces. There is no attempt to 'equalise down' the Provinces which have the greatest capacity to attract revenue by their own efforts.

PART B

# 6. State Characteristics

STATE CHARACTERISTICS

This chapter provides basic factual information about the financial positions of each State, such as budget balances, debt, revenues and expenditures.

Table 6.1 compares key characteristics of each State.

**TABLE 6.1:** Key indicators for Australian States

| | | UNIT | NSW | VIC | QLD | WA | SA | TAS | ACT | NT |
|---|---|---|---|---|---|---|---|---|---|---|
| **GSP** | (a) | $ million | 231 327 | 164 365 | 103 814 | 68 089 | 41 617 | 11 269 | 13 087 | 7 784 |
| **GSP per capita** | (b) | $ | 35 591 | 34 256 | 28 860 | 35 878 | 27 743 | 23 972 | 41 904 | 39 642 |
| **GSP growth (10 year average)** | (c) | per cent | 3.6% | 3.6% | 5.2% | 4.7% | 2.5% | 1.7% | 3.4% | 2.9% |
| **Household per capita disposable income** | (d) | $ | 25 147 | 24 520 | 21 186 | 23 205 | 20 879 | 18 947 | 31 405 | 24 642 |
| **State budget balance/GSP** | (e) | per cent | 0.4% | 0.6% | -0.7% | 0.3% | -0.5% | 0.9% | 0.2% | -1.5% |
| **State net debt/GSP** | (f) | per cent | 3.2% | 1.0% | -9.5% | 0.6% | 2.8% | 6.7% | -4.1% | 16.2% |
| **State net assets** | (g) | $ million | 84 631 | 37 856 | 57 710 | 32 257 | 11 924 | 5 651 | 6 818 | 3 449 |
| **State net assets per capita** | (g) | $ | 13.09 | 7.94 | 16.18 | 17.13 | 7.96 | 12.01 | 21.94 | 17.64 |
| **Population** | | million | 6 463 | 4 765 | 3 566 | 1 883 | 1 497.6 | 470.4 | 310.8 | 195.5 |
| **Population growth (10 year average)** | (h) | per cent | 1.0% | 1.0% | 2.1% | 1.6% | 0.4% | 0.1% | 0.9% | 1.8% |
| **Land Area** | | $km^2$ | 800 642 | 227 416 | 1 730 648 | 2 529 875 | 983 482 | 68 401 | 2 358 | 1 349 129 |

*Sources: Australian Bureau of Statistics; Australia's National Mapping Agency; State Budget Papers 2001-02.*

*Notes:*

*(a) Chain volume measures, 2001.*

*(b) Chain volume measures, 2001.*

*(c) Average annual compound growth rate of GSP chain volume measures, 1990-91 to 1999-2000.*

*(d) Gross household disposable income per head of mean population, 2000-01.*

*(e) General government sector net operating balance, 2000-01 (est).*

*(f) As at 30 June 2001 (est).*

*(g) General government sector net assets as at 30 June 2000. Net worth is an economic measure of 'wealth' calculated as the difference between reported assets and liabilities. It should be noted that the values of some assets, such as historical buildings, are difficult to measure accurately.*

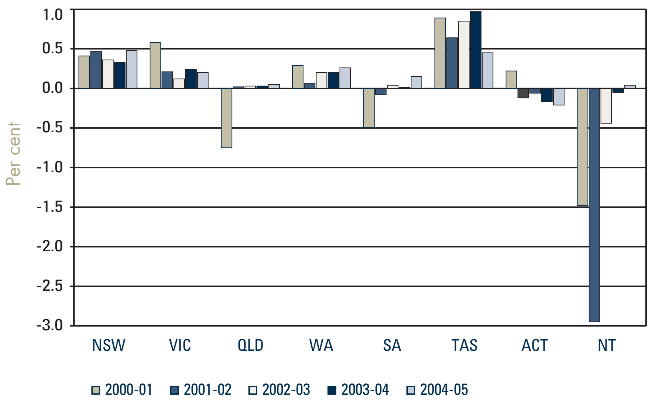
*(h) Average annual population growth from 1990-91 to 1999-2000.*

PART B

## 6.1 Budget position and outlook

Charts 6.1 and 6.2 below show, respectively, estimates of the general government sector operating balance and net debt as a percentage of Gross State Product (GSP) for all States from 2000-01 to 2004-05.

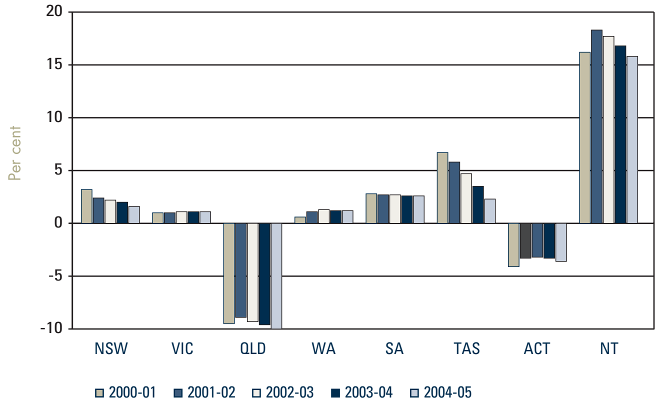
**CHART 6.1:** Operating Balance as a percentage of GSP




*Sources: Australian Bureau of Statistics; State Budget Papers, 2001-02.*

*Note: Accrual basis for all States except Tasmania and the Northern Territory which are shown in cash terms.*

**CHART 6.2:** Net Debt as a percentage of GSP




*Sources: Australian Bureau of Statistics; State Budget Papers, 2001-02.*

*Note: Accrual basis for all States except Tasmania and the Northern Territory which are shown in cash terms.*

### New South Wales

An operating surplus of 0.4 per cent of GSP is estimated for New South Wales in 2000-01. New South Wales has forecast operating surpluses of a similar magnitude over the forward estimates period to 2004-05.

New South Wales' net debt is estimated at 3.2 per cent of GSP as at June 2001. A steady improvement is projected over the forward estimates period, reaching 1.6 per cent of GSP by 2004-05.

### Victoria

Victoria recorded an estimated operating surplus of 0.6 per cent of GSP in 2000-01. Victoria is expected to record smaller surpluses over the forward estimates period of between 0.1 and 0.2 per cent of GSP.

Victoria's net debt is estimated at 1.0 per cent of GSP at June 2001. Net debt is expected to remain at this level over the forward estimates period.

### Queensland

Unusually, Queensland is expected to record an operating deficit of 0.7 per cent of GSP for 2000-01. A return to modest surplus (less than 0.1 per cent) is expected in 2001-02 and throughout the forward estimate period.

Queensland and the ACT are the only States with a negative net debt position. Queensland's net debt is estimated at -9.5 per cent of GSP at June 2001. Queensland's net debt position is expected to deteriorate marginally to -8.9 per cent of GSP in 2001-02, followed by a steady improvement. Net debt is forecast to reach -10 per cent by 2004-05.

## Western Australia

Western Australia recorded an operating surplus of 0.3 per cent of GSP in 2000-01, which is expected to fall to 0.1 per cent in 2001-02. Over the following years the surplus is expected to grow steadily, reaching 0.3 per cent of GSP by 2004-05.

Western Australia's net debt is forecast to increase from 0.6 per cent of GSP at June 2001 to 1.1 per cent of GSP in 2001-02. A further marginal increase to 1.3 per cent in 2002-03 is forecast, with a slight improvement over the following two years.

## South Australia

In 2000-01 South Australia will record an operating deficit estimated at 0.5 per cent of GSP. South Australia has projected a significant improvement in 2001-02, with the deficit forecast to shrink to 0.2 per cent of GSP. Further steady improvement is forecast over the following three years, with a surplus of 0.1 per cent of GSP forecast for 2004-05.

South Australia's net debt position is expected to improve marginally over the forward estimates period, from 2.8 per cent of GSP in 2000-01 to 2.6 per cent in 2004-05.

## Tasmania

Despite budgetary pressures stemming from low economic growth and a declining population, Tasmania has maintained surpluses in recent years. A surplus of 0.9 per cent of GSP is estimated for 2000-01 (in cash terms). Tasmania is forecast to remain in surplus throughout the forward estimates period, with the level of surplus fluctuating between 1.0 and 0.4 per cent of GSP.

Tasmania's net debt position is forecast to improve steadily from 6.7 per cent of GSP at June 2001 to 2.3 per cent in 2004-05.

## Australian Capital Territory

The Australian Capital Territory recorded an estimated operating surplus of 0.2 per cent of GSP in 2000-01, but is expected to decline into deficit in 2001-02 (0.1 per cent of GSP). The deficit is expected to increase to 0.2 per cent of GSP by 2004-05.

The Australian Capital Territory is the only State other than Queensland in a negative net debt position. The Territory's net debt position is expected to deteriorate from an estimated -4.1 per cent of GSP at June 2001 to -3.3 per cent of GSP in 2002-03, before improving to -3.6 per cent of GSP in 2004-05.

## Northern Territory

The Northern Territory recorded an estimated deficit of 1.5 per cent of GSP in 2000-01 (in cash terms), which is easily the highest of any State. In 2001-02 the deficit is expected to double to 3.0 per cent of GSP, before declining rapidly to achieve a projected balanced budget in 2003-04 and 2004-05. The spike in the Territory's deficit reflects the construction of the Darwin to Alice Springs railway.

The Northern Territory continues to have the highest level of net debt, at more than 16 per cent of GSP at June 2001. The Territory's net debt is expected to increase above 18 per cent of GSP in 2001-02, before declining steadily to about 16 per cent of GSP in 2004-05.

## 6.2 Revenue

### Revenue sources

State revenue sources can be divided into three broad categories – own-source tax revenue, Commonwealth grants and other revenue. Other revenue includes interest income and dividends from public trading enterprises. Chart 6.3 shows the percentage contribution of each of these categories of revenue to each States' total revenue.

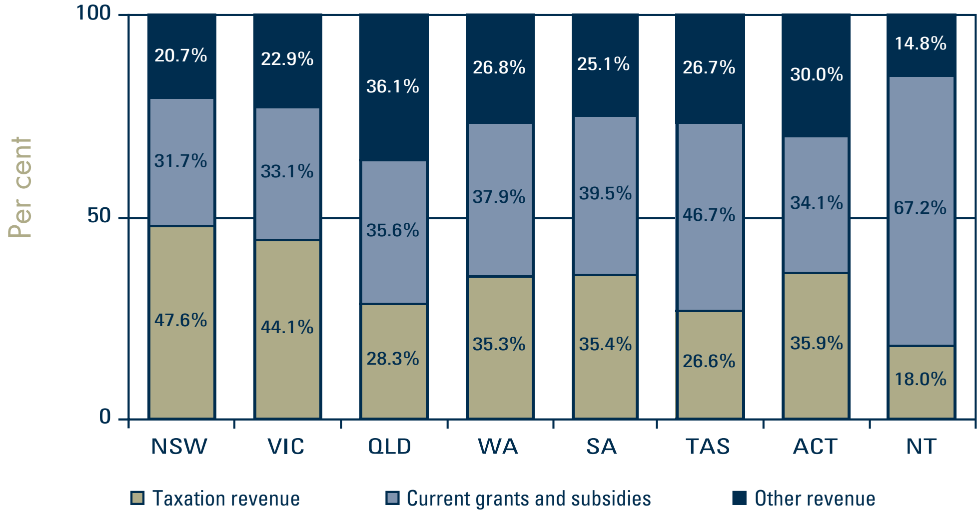
There is significant variation in the composition of revenue sources among the States.

Own-source tax revenue accounts for 48 per cent of total revenue in New South Wales, the highest of all States. Victoria is the next highest, with own-source tax accounting for 44 per cent of total revenues. South Australia, Western Australia and the Australian Capital Territory are mid-range, with own-source tax at around 35 per cent of total revenue. Queensland, Tasmania and the Northern Territory all have less than 30 per cent of their total revenue coming from own-source taxation, with the Northern Territory being the lowest at just 18 per cent.

A high proportion of own-source tax revenue corresponds with a relatively low proportion of Commonwealth grant revenue. New South Wales is the least 'reliant' on Commonwealth grants, with 32 per cent of their total revenue coming from Commonwealth grants. At the other end of the scale, Commonwealth grants account for 67 per cent of the Northern Territory's total revenue.

Chart 6.3 also highlights the unusually high percentage of 'other' revenue in Queensland (36 per cent). All of the other States are significantly below that mark, at between 20 per cent and 30 per cent, with the exception of the Northern Territory which receives only 15 per cent of its revenue from other sources. The relatively high level of 'other' revenue in Queensland is due to a high level of interest income and public trading enterprise dividends.

**CHART 6.3:** Composition of State revenue, 1999-2000



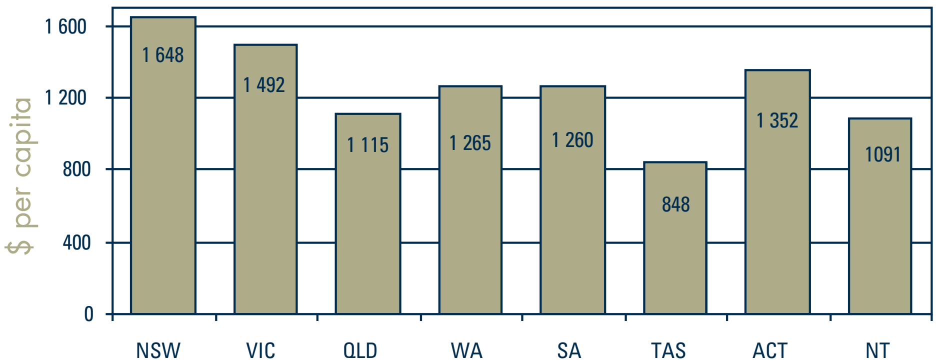

*Source: Australian Bureau of Statistics.*

## Tax revenue

The CGC collects annual information on tax revenue from each State and presents these figures on a comparable and consistent basis.

Chart 6.4 presents the CGC's most recent figures on per capita tax collections of all States. The results in the chart reflect differences in both capacity and effort. In 1999-2000, New South Wales residents paid the highest average level of taxes at $1 648 per capita, while Tasmanians paid little more than half of that price at an average of $848 per capita.

**CHART 6.4:** State Tax Revenue, 1999-2000




*Source: Commonwealth Grants Commission Report on State Revenue Sharing Relativities, 2001 Update.*

## Other revenue

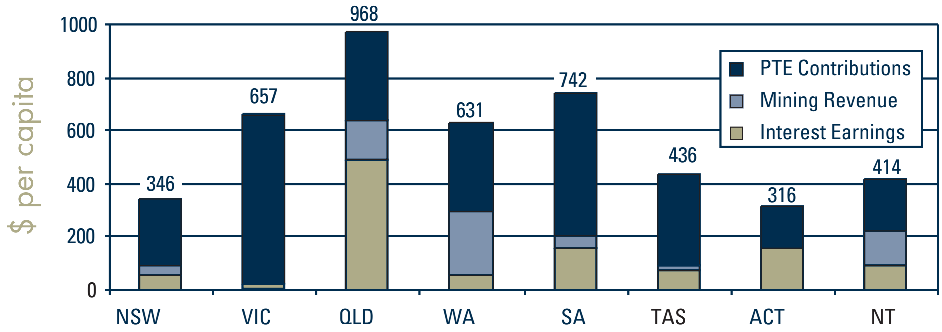
State Governments also raise money from sources other than taxes, including:

- interest earnings;
- mining revenue; and
- dividends from their public trading enterprises.

The amount of revenue raised from these sources varies significantly among the States as it depends fundamentally on the particular jurisdiction's characteristics. For example, significant fiscal reserves enable Queensland to raise around three times the Australian average in interest earnings, at $487 per capita compared with a national average of only $136 per capita. A large mining industry results in above average mining revenue for Western Australia. Victoria and South Australia collect comparably large contributions from their public trading enterprises.

Chart 6.5 shows States' total other revenue and the relative contribution of public trading enterprises, mining revenue and interest earnings.

**CHART 6.5:** Other revenue, 1999-2000




*Source: Commonwealth Grants Commission Report on State Revenue Sharing Relativities, 2001 Update.*

## Revenue raising effort

The ability of each State to raise taxation and other revenues varies.

The CGC produces an index that compares each jurisdiction's actual revenue with its assessed capacity, as shown in table 6.2. An index level above 100 indicates that a State is making an above average revenue effort. Conversely, an index level below 100 indicates that a State is making a below average revenue effort.

**TABLE 6.2:** Revenue raising effort index, 1999-2000, Australia = 100

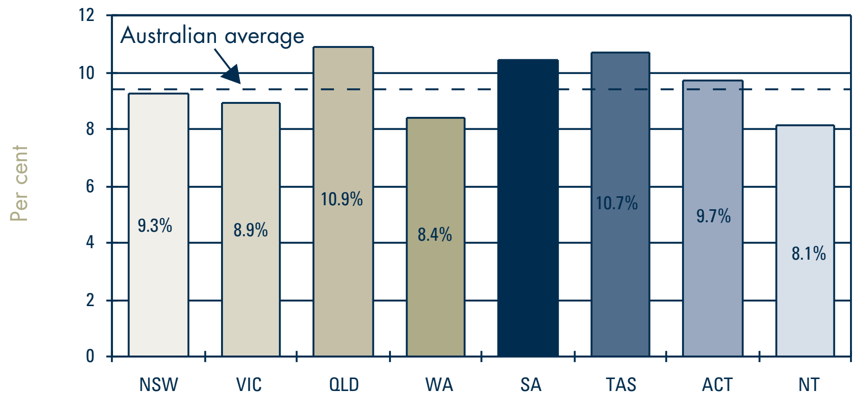
| | NSW | VIC | QLD | WA | SA | TAS` | ACT | NT |
|---|---|---|---|---|---|---|---|---|
| Taxation | 104.09 | 103.94 | 88.51 | 85.53 | 115.51 | 92.51 | 109.04 | 100.91 |
| Other | 61.09 | 122.51 | 147.81 | 78.93 | 126.92 | 78.95 | 59.41 | 56.96 |
| Total Own Source Revenue | 92.77 | 108.65 | 108.80 | 83.21 | 119.49 | 87.41 | 94.15 | 83.24 |

*Source: Commonwealth Grants Commission Report on State Revenue Sharing Relativities, 2001 Update.*

South Australia, Queensland and Victoria have the highest and above average revenue raising effort, with the other States exhibit below average effort. For many States there is a significant difference between the revenue raising effort for taxation and other own-source revenue – Queensland has the greatest contrast, with the second to lowest tax effort (89 per cent) and the highest effort for other revenue (148 per cent).

As an alternative measure, chart 6.6 below shows own-source revenue raised by each State as a portion of GSP. The pattern is similar to the revenue raising effort index measure in table 6.2 above.

**CHART 6.6:** Own-source revenue as a portion of Gross State Product, 1999-2000




*Source: Australian Bureau of Statistics.*

## 6.3 Expenditure

Table 6.3 shows the per capita expenditure of each State for 1999-2000.

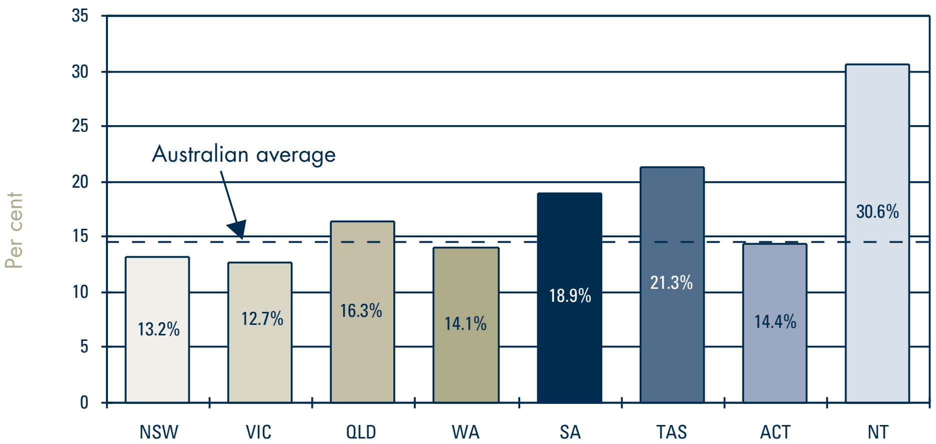
**TABLE 6.3:** Total expenditure per capita, 1999-2000

| NSW | VIC | QLD | WA | SA | TAS | ACT | NT | AUST |
|---|---|---|---|---|---|---|---|---|
| 4 639 | 4 290 | 4 754 | 5 198 | 5 333 | 5 236 | 5 923 | 11 066 | 4 784 |

*Source: Australian Bureau of Statistics.*

Chart 6.7 shows a comparison of State expenditure as a proportion of GSP.

**CHART 6.7:** State expenditure as a portion of Gross State Product, 1999-2000




*Source: Australian Bureau of Statistics.*

The most striking feature of table 6.3 and chart 6.7 is that the Northern Territory's expenditure is well above that of any other jurisdiction, both in per capita terms and as a percentage of GSP. Victoria, on the other hand, has the lowest level of expenditure on both measures.

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