

4.2 DEVELOPMENTS IN COMMONWEALTH-STATE FINANCIAL RELATIONS

Introduction

This chapter outlines developments in the ACT's financial relations with the Commonwealth and States' that occurred in 2003-04 and highlights possible developments in the forward years.

The implementation of A New Tax System (ANTS), with a Goods and Services Tax (GST) as its cornerstone, is now well entrenched. The GST has proven to be a strong growth tax, and while presenting States with new opportunities, also presents a number of potential risks.

The Commonwealth has complied with the guarantee that no State will be financially worse off from the new funding arrangements. In 2003-04, for the first time the ACT, in company with all jurisdictions except New South Wales and Victoria, will receive GST revenue higher than its Guaranteed Minimum Amount (GMA). This trend is expected to gain momentum in the forward years with Victoria joining the other jurisdictions in 2004-05, thereby allowing States to review the need to retain a range of business stamp duties, following closely on the existing decision to abolish Bank Account Debits Tax by 1 July 2005.

A hallmark of ANTS, underpinned by the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations (IGA), is that the distribution of GST revenues between jurisdictions is based on the application of the Horizontal Fiscal Equalisation (HFE) principle in accordance with the findings of the Commonwealth Grants Commission (the Commission). The estimates for 2004-05 and forward years in the chapter are based on the Commission's recommendations outlined in the Report on State Revenue Sharing Relativities 2004 Review (2004 Review Report) and agreed at the 2004 Treasurers' Conference.

The Commission's methodology review, conducted over the past five years, culminated in a number of far reaching revisions to the way GST funding will be distributed to the States for the years commencing 2004-05.

Following intense lobbying at the 2004 Treasurers' Conference by the larger States, jurisdictions agreed to conduct a work program commencing in 2004-05 to simplify the Commission's methods. Importantly, however, the call for a complete review of the principle of HFE was not accepted.

Finally, 2003-04 saw the completion of negotiations of a number of important Commonwealth Specific Purpose Payment (SPP) programs. Negotiations in respect of a number of other SPPs are on the horizon, with some potential risks attached for the Territory's share of future grant funding from the Commonwealth.

General Revenue Assistance to the ACT

Commonwealth funding accounts for approximately 42%, on average, of the Territory's General Government Sector revenues.

Table 4.2.1 below, summarises the expected level of Commonwealth funding for the ACT. These estimates are based on the Commonwealth Treasurer's 26 March 2004 *Statement of Estimated Payments*.

**Table 4.2.1
Commonwealth Funding to the ACT**

Payment	2003-04	2004-05	Var	Var	2005-06	2006-07	2007-08
	Est. Out. \$m	Budget \$m	\$m	%	Estimate \$m	Estimate \$m	Estimate \$m
GST Revenue Grants	645.1	657.6	12.5	1.9	689.6	724.3	760.3
National Competition Payments	11.0	12.4	1.4	12.7	12.8	13.0	13.4
Total General Revenue Assistance	656.1	670.0	13.9	2.1	702.4	737.3	773.7
Specific Purpose Payments:							
Health (inc Health Care Grants)	109.7	114.4	4.7	4.3	118.9	124.8	130.9
Social Security and Welfare	22.9	23.6	0.7	3.1	24.9	26.1	27.1
Education	117.7	124.4	6.7	5.7	132.0	140.1	148.8
Public Order and Safety	4.6	3.2	-1.4	-30.4	3.2	3.2	3.2
Housing	18.7	18.7	0.0	-	18.7	18.7	18.7
Local Government	54.0	55.1	1.1	2.0	56.2	57.6	59.1
Other	15.3	14.6	-0.7	-4.6	12.7	10.8	11.0
<i>Special Revenue Assistance to the ACT^(a)</i>							
Police	10.9	7.4	-3.5	-32.1	7.6	7.8	8.0
Corporate Affairs Compensation	4.1	4.2	0.1	2.4	4.3	4.4	4.5
Roads	0.0	2.6	2.6	#	2.7	2.7	2.8
Net Special Revenue Assistance	15.0	14.2	-0.8	-5.3	14.5	14.9	15.3
Total Specific Purpose Payments	357.9	368.2	10.3	2.9	381.2	396.2	414.1
Other Commonwealth Payments							
Vocational Education and Training (inc ANTA)	20.6	21.0	0.4	1.9	21.5	22.0	22.4
Other	12.3	5.1	-7.2	-58.5	5.2	5.2	5.2
Total Other Commonwealth Payments	32.9	26.1	-6.8	-20.7	26.7	27.2	27.6
Total Commonwealth Funding	1 046.9	1 064.4	17.4	1.7	1 110.2	1 160.5	1 215.4

Note: Totals may not add due to rounding.

(a) Previously included under General Revenue Assistance as Special Fiscal Needs.

2003-04 Estimated Outcome

The Territory will receive \$2.3m more (\$656.1m) General Revenue Assistance (GRA) from the Commonwealth in 2003-04 compared to the original budget estimate (\$653.8m). This minor increase in funding arises from the ACT's relative share (approximately \$27m) of \$1.4b growth in the 2003-04 GST revenue pool. This increase has been significantly offset by:

- the reallocation of Special Fiscal Needs (SFN) from GRA funding to SPP funding following the Commonwealth's decision to pay SFN as the SPP Special Revenue Assistance to the ACT (-\$15m);
- lower ACT population estimates, as advised by the ABS (-\$8.2m); and

- decreased National Competition Policy (NCP) Payments, following the National Competition Council's recommendation that 10% of the Territory's 2003-04 pool be suspended due to legislation review items assessed by the Council as incomplete, and the lower population effects mentioned above (-\$1.4m).

2004-05 Budget Year

The 2004-05 GRA (\$670m) is estimated to increase by \$13.9m or 2.1% over the 2003-04 estimated outcome (\$656.1m). The increase reflects an improvement in the size of the total GST revenue grant pool, which in 2004-05 is estimated at \$34.1b, or \$1.7b more than the 2003-04 pool (\$32.5b) and higher NCP payments. The increase has been partially offset by a decrease in the Territory's GST relativity.

The Commission's 2004 Review Report recommended a decrease in ACT's GST relativity from 1.14979 in 2003-04 to 1.12930 in 2004-05. This has the direct effect of reducing the ACT's relative share of the 2004-05 GST revenue pool by \$13.7m.

Based on the recommended 2004-05 GST relativity, the ACT expects to receive GST revenue totalling \$657.6m in 2004-05, an increase of \$12.5m or 1.9% when compared to 2003-04 (\$645.1m).

Forward Estimates for Commonwealth Funding

A degree of uncertainty exists in regards to GST forward year estimates, as the Commission recalculates States' GST relativities each year based on the latest available data. To illustrate the variability, the ACT's GST relativity grew by +4.5% between the 1999 Review and the 2002 Update before successive declines in 2003 and 2004. Despite these recent declines, the 2004 Review relativity is +2.4% above the 1999 Review relativity, which is equivalent to an additional +\$17.7m when applied to the 2004-05 pool.

Table 4.2.2 illustrates the change in the ACT's relativity between the 1999 and 2004 Review. Notwithstanding the recent downward trend, the ACT expects to continue to receive an above equal per capita share (relativity above 1) of the GST revenue pool in the forward years.

**Table 4.2.2
ACT Per Capita GST Relativities: 1999 Review to 2004 Review**

	1999 Review	2000 Update	2001 Update	2002 Update	2003 Update	2004 Review
ACT	1.10270	1.11289	1.14633	1.15216	1.14979	1.12930

The forward year GST revenue estimates contained in Table 4.2.2 are based on the trends inherent in the Commission's 2004 Review relativities.

The forward years' growth in total Commonwealth payments is predicated on:

- estimated growth in the GST revenue pool; and
- small increases in SPPs.

Estimated Impact of ANTS Tax Reforms on the ACT

The ACT expects to receive continued positive financial gains from the tax reforms in the future. That is, the Territory's relative share of GST grant funding exceeds its GMA (equivalent pre-tax reform level of funding).

The Commonwealth will in effect 'compensate' the States for the abolition of Debits Tax through increased GMA, however, this will not impact on the ACT (nor any other State, with the exception of NSW) as its GST exceeds its GMA by an amount greater than the Debits Tax revenue forgone.

National Competition Policy (NCP) Payments

As specified in the *Agreement to Implement the National Competition Policy and Related Reforms*, the States are expected to receive NCP Payments in three tranches. The first (\$200m per annum) and second tranche (\$400m per annum) payments were completed in 2001-02. The ongoing aggregate third tranche payment for all States of \$600m per annum commenced in 2001-02 and is indexed annually by inflation, and distributed on the basis of a State's population share. On this basis, the *maximum* 2003-04 third tranche NCP pool size available for all States is now expected to be \$764.8m.

In 2003-04, the ACT expected to receive \$12.2m. This has since been revised down to \$11m following the acceptance by the Commonwealth Treasurer of a recommendation by the National Competition Council, as detailed in its report *2003 Assessment of Governments' Progress in Implementing National Competition Policy and Related Reforms*. The Council recommended to the Australian Government that a 10% pool suspension to the ACT's 2003-04 competition payment be applied for legislation review items assessed by the Council as incomplete. The reinstatement or conversion of the suspended payment to a permanent deduction will not be known until details of the Council's next assessment report are made available in late 2003-04.

The future of NCP payments following the expiration of the third tranche payments on 30 June 2006 is discussed later in the Chapter.

Specific Purpose Payments (SPPs)

During the past year, the ACT has continued its involvement with the Commonwealth and State SPPs Heads of Treasuries Working Group. This group is predominantly involved in monitoring and reporting on SPP negotiations and pursuing reform in the development and administration of SPPs.

The following summarises the major issues progressed:

SPP Guarantee by the Commonwealth

Clause 5(v) of the IGA states that the Commonwealth:

- will continue to provide SPPs to the States; and
- has no intention of cutting aggregate SPPs as part of the ongoing process of tax reform.

To ensure the Commonwealth complies with these commitments, clause 42(vi) of the IGA directs the Ministerial Council for Commonwealth-State Financial Relations (commonly referred to as the Treasurers' Conference) to monitor future Commonwealth SPP policy.

To assist the Ministerial Council in performing its SPP monitoring function, the Heads of Treasuries (HoTs) agreed on four indicative measures to determine whether this commitment is being met by the Commonwealth as illustrated in the following table.

Table 4.2.3
SPP Comparative Growth Rates

Comparative Growth Rates	1999-00	1999-00	1999-00	1999-00	1999-00
	to 2000-01 Actual	to 2001-02 Actual	to 2002-03 Estimate	to 2003-04 Estimate	to 2004-05 Estimate
<u>CPI growth</u>	3.25%	6.24%	9.53%	12.00%	14.24%
<u>Population growth</u>	1.20%	2.60%	3.90%	5.10%	6.40%
SPPs "to" growth (real) ^(a)	3.10%	8.30%	9.25%	12.07%	15.73%
SPPs "to" growth (real per capita) ^(a)	1.85%	5.56%	5.12%	6.63%	8.78%
SPPs "through" growth (real) ^(b)	9.33%	23.04%	17.68%	27.25%	31.89%
SPPs "through" growth (real per capita) ^(b)	8.00%	19.93%	13.23%	21.07%	23.97%

(a) Excluding debt redemption assistance and natural disaster relief.

(b) SPPs "through" are primarily for the First Home Owners Scheme, local government and private schools.

The SPP estimates are based on information provided by the Commonwealth Department of Finance and Administration in a SPP Database, and reflect the Commonwealth's 2003-04 Mid Year Economic and Financial Outlook (MYEFO).

The table indicates that while the Commonwealth met its SPP commitment in 2002-03, and will again meet it in 2003-04 and 2004-05 (if MYEFO projections are adhered to) for all four benchmarks agreed by HoTs, there remain a number of worrying trends.

Of most concern, in terms of the Commonwealth's likely future approach to SPP renegotiations, is the push by some Commonwealth agencies to have the States accept greater financial responsibilities, such as matching arrangements, as jurisdictions become positive under the IGA.

This is a threshold issue. Under current Commonwealth-State financial arrangements, there is no link between the quantum of GST revenue received by the States and the level of SPPs paid by the Commonwealth.

SPP Negotiations and other Commonwealth Initiatives

Negotiations for three major SPPs were finalised in 2003-04 with intended commencement dates, namely:

- Commonwealth State/Territory Disability Agreement (CSTDA), 1 July 2002;
- Commonwealth/State Housing Agreement (CSHA), 1 July 2003; and
- Australian Health Care Agreement (AHCA), 1 July 2003.

The duration of each agreement is for five years from the initial date of commencement.

The CSTDA and CSHA are each underpinned by a multilateral agreement between all jurisdictions and the Commonwealth, which sets the broad strategic framework of the Agreement and specifies the respective roles, responsibilities and funding contributions.

Subsequent bilateral agreements are negotiated which specify performance measures and key projects for individual jurisdictions. While bilateral agreements are generally not concerned with financial aspects and the size of the funding pool, some additional funding can be made available to an individual jurisdiction for specific projects under the Agreement.

In contrast, AHCA negotiations traditionally commence from a multilateral approach. However, unlike the CSTDA and the CSHA, the final AHCA consists only of bilateral agreements between States and the Commonwealth.

The ACT shares a number of common concerns with the other States and continues to seek reform from the Commonwealth regarding the:

- renewed focus on input controls, attempt to interfere with States’ budgetary priorities, and considerable ‘cost shifting’ to the States, in both financial terms and economic risks;
- States having to meet the costs of the Commonwealth’s reform agenda, with the Commonwealth retaining the benefits of such reform. For example, the CSHA Multilateral Agreement advances the Commonwealth’s preference to break the link between income earned and rent paid by public housing tenants as part of welfare reform and removing work disincentives. The rent foregone costs will be borne by States; and
- apparent systematic effort to use inappropriate growth rates in seeking financial commitments from States. A focus on the growth rate alone as a measure of Commonwealth input is misleading, particularly if the Commonwealth’s growth is from a small base, or based on growth in programs for which it has sole responsibility, such as employment services.

Commonwealth-State/Territory Disability Services Agreement (CSTDA)

The CSTDA is an agreement for the funding and provision of disability employment services and disability support services (including accommodation support, respite support, and community access services).

**Table 4.2.4
Roles and Responsibilities under the CSTDA**

Services	Policy and Administration	Funding
Disability Employment Services	Commonwealth	Commonwealth
Disability Support Services	States	Joint responsibility.
Accommodation Support		States (80%) and Commonwealth (20%)
Respite Support		
Community Access		

The States are the major contributors of funds under the Agreement. While in previous agreements no matching provisions have existed, historically the funding share for support services has been approximately 80% States and 20% Commonwealth respectively. Once funding for employment services is included, the overall funding share has been approximately 70% States and 30% Commonwealth respectively.

After long and difficult negotiations, all jurisdictions including the ACT reached agreement with the Commonwealth on the new CSTDA. The most contentious issue for all States was the Commonwealth's insistence that States match growth in total Commonwealth funding under the Agreement, although this condition is not set out in the Agreement itself.

Due to significant growth in the Commonwealth's funding of disability employment programs, total Commonwealth outlays are projected to increase by 6% per annum over the life of the Agreement, while funding to the States (i.e., for accommodation and specialist disability services) will increase by approximately 3.7% per annum.

All States have reportedly agreed to provide growth of 5% or more per annum. The Commonwealth's strict application of matching requirements is considered particularly burdensome in view of its minority contribution to the cost of the services for which the States are responsible. In addition, there is a concern that the Commonwealth has not recognised differences in States' pre-existing levels of effort in this area.

Commonwealth – State Housing Agreement (CSHA)

The CSHA is an agreement for the funding and provision of public, community, affordable and crisis housing. The 1999 Agreement expired on 30 June 2003. The Commonwealth's offer for the new CSHA to operate from 2003-04 to 2007-08 had the following features:

- provision for the development of alternative opportunities for maintaining and enhancing social housing service – the scope of CSHA has been expanded to the provision of affordable housing, rather than a funding mechanism for public housing. The expansion in scope, however, has not been accompanied by any increase in financial commitment by the Commonwealth;
- an efficiency dividend of 1% to continue to apply each year;
- notwithstanding the efficiency dividend, indexation to apply from 2004-05;
- GST compensation payments to cease;
- the option for the Commonwealth to withhold 5% of CSHA funds from States not cooperating with the Commonwealth's welfare reforms or with encouraging private sector involvement; and
- the present matching arrangements to continue.

Over the life of the Agreement the total Commonwealth offer nationally is around \$4.75b. The ACT's share of this amount is in the order of \$94m, with a matching requirement of \$42m.

There is no growth funding on offer from the Commonwealth under the CSHA. With indexation and the continuation of a 1% efficiency dividend, the value of Commonwealth funding continues to fall in real terms.

All States accepted the multilateral agreement despite concerns at the low level of funding offered by the Commonwealth, reflective of the discontinuation of GST compensation payments. In this regard, the Prime Minister rejected an approach by State Premiers to continue the GST compensation payments. The discontinuation of GST compensation in the new agreement represents a loss of revenue to the Territory of \$5.9m per annum.

Australian Health Care Agreements (AHCAs)

The AHCA is a five-year agreement between the ACT and Commonwealth for the funding of health services, predominantly hospital services. Under the agreement, the ACT receives base funding on a per capita basis, weighted by age distribution.

The primary objective of this Agreement is to secure access for the community to public hospital services based on the following principles:

- eligible persons are to be given the choice to receive, free of charge as public patients, health and emergency services of a kind or kinds that are currently, or were historically, provided by hospitals;
- access to such services by public patients free of charge is to be on the basis of clinical need and within a clinically appropriate period; and
- arrangements are to be in place to ensure equitable access to such services for all eligible persons, regardless of their geographic location.

The Commonwealth offered up to \$42b over five years, which was some \$1b less than would have been received if the existing agreements were rolled over unchanged.

Issues of particular concern for States, relative to the existing agreements, included:

- the reduction in funding;
- the absence of provision for a health reform agenda (e.g., involving the interfaces between public hospitals and primary and aged care) – the Commonwealth has now signalled that it is interested in health reforms undertaken within existing resources;
- the imposition of matching and the requirement for public forward dollar commitments in this context; and
- the setting of the matching requirement in percentage terms which imposes a disproportionately larger financial burden on the States (States contribute some two thirds of public hospital funding, and their revenue growth is considerably more limited).

Against this background, the ACT signed the 2003-2008 AHCA on 27 August 2003, the first jurisdiction to do so, on the indication from the Commonwealth that it would not alter the offer. By doing so, it gained concessions from the Commonwealth in the areas of general practice and aged care, thereby addressing two of the main problems in the original Commonwealth offer.

Both these are areas of Commonwealth responsibility that have not been adequately resourced in the past, and have had a direct impact on the ACT's residents and hospitals.

The Territory will receive \$553m as compared to approximately \$407m for the previous 1998-2003 AHCA.

AusLink – Towards the National Land Transport Plan

AusLink is a new strategic Commonwealth proposal for national land transport infrastructure funding, designed to deliver an integrated, high-performing land transport network. When introduced, the proposal will have implications for future transport SPPs.

All States, including the ACT, have made their submissions to the Commonwealth on the AusLink Green Paper and they are generally supportive of the Commonwealth's initiative to develop a National Land Transport Plan under AusLink. Common issues and concerns raised by the States include:

- the potential for the Commonwealth to back away from fully funding and maintaining the national highway network;
- the narrow focus on freight at the expense of urban passenger transport and consideration of seaports and airports; and
- lack of clarity regarding the responsibilities of the three tiers of government under AusLink.

Development of an Intergovernmental Agreement on national transport planning has been deferred until after the release of the AusLink White Paper expected in May 2004.

In further developments regarding transport funding, the Commonwealth has:

- proposed extending the local government Roads to Recovery program with \$1.2b of funding over four years (2005-06 to 2008-09), to be paid directly to local government under a new distribution mechanism – a number of States have already expressed concerns with this proposal; and
- confirmed the Fuel Sales Grant Scheme will be abolished and that the \$810m savings over three years (2006-07 to 2008-09) will be directed to AusLink.

National Building Code Issue

In response to the recommendations of the Cole Royal Commission, the Commonwealth will require all significant construction projects to which it contributes funds to be subject to the National Code of Practice for the Construction Industry and the Commonwealth Implementation Guidelines. Funding will be conditional on the Code and Guidelines being applied where the Commonwealth's contribution is either at least \$5m and represents a 50% or more of the total project value, or \$10m or more.

Any delays or reduction in capital works expenditure in the ACT will have a direct and immediate impact on Territory based construction firms and constrain the timely provision of services to the ACT community.

Government Schools Grant

The Government Schools (Primary and Secondary) SPP is due to expire on 31 December 2004. Funding is provided on a calendar year basis and is specified in quadrennial legislation. The current quadrennium is from 2001 to 2004. Formal agreements are required under the legislation, with specific reference to the Guidelines, which are published annually. The Guidelines set out the amounts of funding available to education authorities and the accountability requirements attached to grants.

The Australian Government recently released the level of Commonwealth grants for schools for the 2005-2008 quadrennium. Under the package, States would have secured \$31b over the four years if they adopted a number of measures including:

- national student testing;
- a common age for starting school; and
- to deliver to parents 'plain language' report cards by 2010.

The ACT Government, along with other States, has expressed disappointment in the level of funding set out in the Commonwealth's 2005-08 quadrennial funding offer. Schools in the ACT will receive negligible additional funding apart from indexation based on the Australian Government School Recurrent Cost index. Negotiations are continuing.

Indigenous Education Funding

The current Indigenous Education Strategic Initiatives Programme (IESIP) Agreements are due to expire on 31 December 2004.

The Commonwealth has indicated its intention to focus Indigenous education funding on areas of need, and to redirect resources to comparatively successful programs. Negotiations over the 2005-2008 IESIP Agreements have recently commenced.

Other Developments

The five-year Public Health Outcome Funding Agreements, which mainly cover vaccines and broad-banded funding for a number of public health initiatives, are due for renegotiation before the 30 June 2004 expiry. Discussions have occurred between Commonwealth and State Officials, and it is envisaged that new agreements will be signed before 1 July 2004.

The Commonwealth is progressing its Review of Community Care in Australia. The Review, commissioned by the Minister for Health and Ageing, investigates reform of the community care system, with the aim of establishing an easily accessible, streamlined and cost effective health and aged care system.

The review of the Supported Accommodation Assistance Program (SAAP) is awaiting input from the National Evaluation. The Evaluation of SAAP five-year bilateral agreements (which expire on 30 June 2005) between the Commonwealth and State Governments is required to be completed and presented to Commonwealth and State Community Service Ministers at least 12 months before the end of the SAAP Agreements.

Inquiry into Local Government Cost Shifting

In May 2002, the then Minister for Regional Services, Territories and Local Government referred an inquiry into local government and cost shifting by State governments to the House of Representatives Standing Committee on Economics, Finance and Public Administration (the Committee).

The terms of reference charged the Committee with the examination of cost shifting onto local government by State government and the capacity of local governments to meet existing obligations, in light of the Financial Assistance Grants (FAGs) to Local Government paid by the Commonwealth.

The Committee tabled its report *Rates and Taxes: A Fair Share for Responsible Local Government* in October 2003. The Report contains 18 recommendations that look to address

issues pertaining to local government funding mechanisms and the management of financial relationships between the three tiers of government.

In response to the Inquiry, the Commonwealth Government has established the Local Government Policy Taskforce within the Department of Transport and Regional Services (DoTaRS). The Commonwealth is expected to respond to the Committee's findings during the first half of 2004.

While the ACT does not recognise local government in the context of the city-state model, the ACT government is entitled to assistance for the municipal functions it performs under the *Local Government (Financial Assistance) Act 1995*. In this context, it is difficult for the ACT to embrace the bulk of the Committee's findings.

Council of Australian Governments (COAG)

The 29 August 2003 COAG meeting agreed to develop a National Water Initiative before breaking up over the AHCA negotiations. A date for the next COAG meeting has not been set.

It has been argued by all jurisdictions that certain outstanding agenda items from COAG 29 August 2003 be progressed out of session:

- natural disaster relief and mitigation arrangements;
- Indigenous child protection;
- the development of a national plan to respond to possible future mass casualty and terrorism incidents involving Australians overseas; and
- the adoption of the inaugural Annual Report of the National Counter-Terrorism Committee.

In addition, out of session agreement has been reached on the Ministerial Council on Energy report to COAG on Energy Market Reform.

Relevant Ministerial Councils, Departments and agencies are attending to the progression of the specified items.

Special Revenue Assistance to the ACT

The Commission's 2004 Review Report recommends Special Fiscal Needs (SFN) funding for the ACT of \$14.2m in 2004-05. The payment is recommended by the Commission annually in response to their Terms of Reference, and is funded by the Commonwealth from outside the GST revenue and Health Care Grant (HCG) pool.

At the 2003 Treasurers' Conference, the Commonwealth Treasurer indicated that SFN funding would be combined with any additional assistance that the Commonwealth was intending to pay the ACT for the January 2003 Bushfires. The Commonwealth Budget in May 2003 subsequently saw \$4.1m, of the recommended \$15m, held over in a contingency reserve subject to natural disaster relief payments by the Commonwealth. The remaining \$10.9m was then paid to the ACT as the SPP Special Revenue Assistance.

The 2004 Statement of Estimated Payments tabled at the 2004 Treasurers' Conference contains the reinstatement of the \$4.1m for 2003-04, and incorporates the Commission's

latest recommendation of \$14.2m for SFN to the ACT in 2004-05, which this year includes a new allowance for Roads in addition to the assistance the ACT receives for Police and Corporate Affairs Compensation as highlighted below.

Police

The ACT is assessed as having SFN for police services because the Territory does not have control over the terms and conditions of Australian Federal Police officers employed in ACT policing. The allowance is calculated as the additional amount paid to an Australian average number of police officers and unsworn staff due to above average salaries and superannuation on-costs.

On this basis, SFN for police services in 2004-05 have been assessed at \$7.4m.

Corporate Affairs Compensation

SFN include Corporate Affairs Compensation because the ACT was excluded from the arrangements agreed between the States and the Commonwealth for payments to replace revenue foregone following the establishment of the national scheme of companies' regulation. The ACT is expected to receive Corporate Affairs Compensation of \$4.2m in 2004-05.

Roads

The newly assessed allowance for roads recognises that at the time of self-government the ACT inherited roads that are significantly wider than the Australian average and thus are more costly to maintain. This allowance will be paid annually for a period of fifteen years, indexed by the Consumer Price Index.

The Roads allowance has been assessed at \$2.6m in 2004-05.

SPP Database

The November 2001 HoTs meeting endorsed the development of a SPP Database by the Commonwealth Department of Finance and Administration. All States received the first completed database in February 2003. The States and the Commonwealth agreed the specifications of the database and it has since proved to be a useful tool for all States in analysing SPP issues and trends.

An updated version of the SPP Database was forwarded to all jurisdictions in March 2004. Considerable improvements have been made in the Database's technical features, as well as the integrity of the data itself.

The Database has assisted in the compilation the 2003-04 SPPs Monitoring Report presented to the 2004 Treasurers' Conference to gauge compliance by the Commonwealth of the guarantee to not reduce SPPs following ANTS.

Other Commonwealth Payments

Other Commonwealth Funding usually takes the form of a direct payment for services from the Commonwealth to the ACT Government agency delivering the service. The largest

payment for the ACT under this category is that made by the Australian National Training Authority Agreement.

Other Commonwealth Funding also includes Natural Disaster Relief Arrangements (NDRA) funding, provided as a result of the January 2003 Bushfire. This is discussed in Chapter 7.

Australian National Training Authority (ANTA) Agreement

Negotiations for a new ANTA Agreement 2004-2006 broke down at the end of 2003.

On 15 December 2003, the Commonwealth Minister for Education, Science and Training issued States an ultimatum to accept the Commonwealth offer for the new Agreement or face financial penalties. The penalties were the withdrawal of the Commonwealth's offer for indexation on growth funding, additional funding for Australians Working Together (AWT) and funding for Recognising and Improving the Work Capacity of People with Disabilities (RICP), totalling \$109.5m for the three years 2004 to 2006. The RICP funding is contingent on the passage of disability reform legislation in the Senate.

All States rejected the Commonwealth's offer (citing the proposed application of the Commonwealth's Construction Code as one of the reasons for doing so), expressing a preference, if issues could not be resolved, to rollover the 2001-2003 Agreement for a further year while negotiations continued on a new Agreement.

In January 2004, the Commonwealth responded to States agreeing to rollover the 2001-2003 Agreement and imposing the threatened financial penalties. The ANTA Agreement 2004 is now in place.

The Commonwealth will use the funding offer withdrawn for 2004, amounting to \$29.4m including RICP, to directly purchase training places for people with a disability, parents returning to work and older workers.

Negotiations on a new Agreement have not continued. The Commonwealth has indicated its intentions commence negotiations in late October 2004 regarding a new Agreement for 2005 onwards. All States have sought an earlier return to negotiations.

Total Commonwealth Funding

As demonstrated in Table 4.2.1, total Commonwealth funding to the ACT is expected to increase by \$17.4m or 1.7% between 2003-04 and 2004-05. This comprises a rise in GRA of \$13.9m and an increase in SPPs of \$10.3m, offset by a reduction in other Commonwealth payments of -\$6.8m.

Commonwealth Grants Commission Report on State Revenue Sharing Relativities 2004 Review

Background

The Commission undertakes an extensive review of its underpinning assessment methods every five years. The latest review, the Report on State Revenue Sharing Relativities 2004 Review was publicly released on 3 March 2004.

The assessment methods are based on HFE principles, that is, States are provided with GST funding to enable them to provide an average level of service assuming they operate at an average level of efficiency and make an average level of taxation effort. The methods examine all State government services and revenues and determine the relative cost of service provision faced as well as the relative revenue raising capacity.

The 2004 Review Terms of Reference required the Commission to inquire into, and report the per capita relativities to be applied from 2004-05 for the distribution of the GST funding pool estimated at \$34.1b in 2004-05 amongst the States, and another \$6b in SPPs. The adopted methods are 'locked in' until the finalisation of the next Review, scheduled for 2009.

The Commission's work is critical to the financial well-being of the ACT given that the GST and related payments comprise nearly 26% of ACT revenue (\$671.8m in 2004-05), and a Review provides the opportunity to gain (or lose) considerable amounts of untied financial assistance. The financial consequences of a Review have the capacity to affect the ability of a government to deliver services, impact on State taxation levels and, in the long term, affect the standard of living of the community.

The ACT implemented a whole of government strategy in preparing its submissions to the 2004 Review process. All 40 expenditure and 20 revenue category assessments used by the Commission to derive each State's relative share of the GST pool were systematically reviewed by the ACT Treasury in conjunction with relevant ACT departments and agencies.

Four major formal submissions as well as a host of other submissions on specific items were provided to the Commission. The former included the:

- main submission of May 2002;
- follow-up rejoinder submission of February 2003;
- final submission which was presented to the Commission on 10 October 2003; and
- final comments submission of 23 December 2003.

The ACT also invited the Commonwealth Grants Commissioners, Commission Officers and the other jurisdictions to participate in the Territory's Workplace Discussions in

November 2002 to see first hand the circumstances of the Territory. Additionally, the Treasury argued the ACT's case at a number of high level conferences and working parties.

Outcome for the ACT and Other States

Assessed GST Relativities and Funding Effects

The Commission's 2004 Review Report recommends a reduction in the ACT's GST relativity from 1.14979 (2003 Update) to 1.12930 (2004 Review), which results in the ACT's grant share falling from 1.87% to 1.83% between 2003-04 and 2004-05.

The 2004 Review outcome resulted in a decline of \$13.4m for the ACT arising from the adoption of the new relativity.

It should be noted that the above figures, and a number of the figures provided in the following tables, are sourced from the Commission's 2004 Review Report, and should be considered as being indicative only. They do not exactly align with figures used earlier in this Chapter, which are more contemporary and have been updated to include population changes.

A comparison of the 2003 Update and 2004 Review relativities, as highlighted in the following table, shows that Queensland and WA will receive increased relativities and all other States will receive reduced relativities.

The largest four declines in per capita terms were for the NT (\$240.75), Tasmania (\$79.86), NSW (\$47.59) and the ACT (\$41.59).

Table 4.2.5
Comparison of GST Relativities and their impact on Untied Funding ¹

	GST Relativity			Impact of 2004 Review Relativity Change in GST funding	
	1999 Review	2003 Update	2004 Review	\$m	\$ per capita
NSW	0.89948	0.89117	0.86750	-\$317.0	-\$47.59
Victoria	0.86184	0.87010	0.86534	-\$51.2	-\$10.48
Queensland	1.00687	1.01902	1.05504	+\$262.7	+\$69.99
WA	0.94793	0.96946	1.03054	+\$230.9	+\$119.16
SA	1.20680	1.21215	1.20407	-\$26.3	-\$17.27
Tasmania	1.60905	1.59948	1.55939	-\$37.9	-\$79.86
ACT	1.10270	1.14979	1.12930	-\$13.4	-\$41.59
NT	4.84429	4.38638	4.26538	-\$47.7	-\$240.75

Despite a fall in the ACT's relativity between the 2003 Update and 2004 Review, the result represents good news for the ACT as the:

- relativity still provides an above equal per capita share of GST funding – this time totalling \$82.5m;

¹ Excluding the effects of population and GST pool growth.

- ACT is one of four States (Victoria, Queensland, WA and the ACT) to have received a higher relativity in the 2004 Review compared to the 1999 Review; and
- technical arguments put forward to the Commission have offset, to a large degree, influences which the ACT has no control over, such as socio-demographic composition (SDC) changes which redistributed by itself -\$95.0m away from the ACT.

The large gains to Queensland of +\$262.7m and WA of +\$230.9m arising from increased relativities have largely been brought about by their large Indigenous populations, lower SDC profile and the higher cost and demand weights applied to these groups:

- Queensland gained +\$254.4m from SDC factors (97% of its entire funding gain); and
- WA gained +\$236.3m from SDC factors (more than its entire redistribution).

The following table illustrates the gains in GST funding to the States after the impact of the 2004 Review relativity, population changes and growth in the GST pool are included.

Only Queensland, WA and the NT will receive above average per capita gains in GST funding for 2004-05.

Table 4.2.6
Comparison of distribution of GST revenue and HCGs, 2003-04 and 2004-05
(includes the effect of changes in relativity, population and GST pool growth)

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
2004-05 GST revenue and HCGs ^(a)	12 128.0	8 920.3	8 460.4	4 232.6	3 806.2	1 525.4	760.1	1 761.2	41 594.1
2003-04 GST revenue and HCGs ^(b)	11 656.7	8 385.9	7 574.9	3 705.6	3 607.9	1 475.1	727.9	1 691.3	38 825.2
Change in funds \$m	+471.4	+534.4	+885.5	+527.0	+198.3	+50.3	+32.1	+69.9	+2 768.9
Change in funds \$pc ^(c)	+70.77	+109.35	+235.92	+271.96	+130.21	+105.99	+99.62	+352.80	+140.15
	%	%	%	%	%	%	%	%	%
Grant shares 2004-05 ^(d)	29.16	21.45	20.34	10.18	9.15	3.67	1.83	4.23	100
Grant shares 2003-04 ^(d)	30.02	21.60	19.51	9.54	9.29	3.80	1.87	4.36	100

(a) Obtained by applying the 2004 Review relativities to projected populations at December 2004 and the estimated 2004-05 pool of GST revenue and HCGs shown in the 2003 Australian Government MYEFO Version of the State by State Tax Reform Impact Tables (Version 37).

(b) From Australian Government Budget Paper No. 3, Federal Financial Relations, 2003-04.

(c) Based on Mean Resident Population for 2002-03.

(d) Funding for each State as a percentage of the total pool of GST revenue and HCGs being distributed.

Reasons for the ACT's Above Equal Per Capita Share

The rationale underpinning the ACT's above equal per capita (EPC) share of the untied assistance pool of funding are well established and strongly grounded. The ACT's greater than EPC share of the GST revenue pool results almost entirely from its limited revenue sources in comparison to the four largest States and can be primarily attributed to:

a **below average capacity to raise revenue** (which more than offsets below average costs of providing services) which occurs due to:

- a below average value of wages and salaries paid by employers who are subject to payroll tax (the largest employer in the ACT, the Australian Government, is not subject to State taxes);
- a below average value of sales of real estate, although this was mainly evident in the early years of the assessment period;
- below average values of commercial and industrial land and insurance business;
- below average levels of motor vehicle registrations and sales, particularly for heavy vehicles; and
- no mining industry and thus no capacity to collect mining royalties.

a slightly **below average cost of service provision** which occurs due to the ACT having:

- low proportions of its population in groups that make extensive use of some State services or who cost more to service, including Indigenous people, people aged 65 or over, and people with low incomes;
- a compact geographical area, with no people living in remote areas, a low length of arterial roads per capita, and relatively low use of those roads by heavy vehicles; and
- the short period since self-government has resulted in superannuation expenses below the average levels of the other States.

These effects are partly offset by diseconomies of scale in administration and policy tasks, above average wage rates, the use of services by residents of surrounding areas in NSW and the higher costs of some services arising from Canberra's status as the national capital.

Reasons for the ACT's Reduced Relativity (Analysis of Change)

The fall in the ACT's GST relativity primarily arises due to the loss of \$95m in funding from the SDC assessments which the ACT has no control over. In the 2004 Review, the SDC assessment negatively impacted on the ACT, in three major ways:

- the ACT's share of persons captured by the SDC assessments, in the main, fell;
- higher cost and demand weights were applied to the Indigenous, remote/rural and low income persons; and
- new SDC factors were either introduced, such as for the population and preventative health assessment, or refined, in the case of the vocational education and training assessment.

While the outcome is disappointing, a number of technical arguments (mainly relating to debt charges, depreciation, superannuation, input costs i.e., wages, rent and electricity) and a range of other arguments (such as low General Practitioner and specialist numbers) put forward by the ACT to the Commission have offset, to a large degree, the SDC losses – a loss of \$95m has been pared back to just \$13.4m.

Overall, the major reasons for the decrease in the ACT's relativity between the 2003 Update and 2004 Review are: ²

² The following figures represent the gain (+) or loss (-) in funding between the 2003 Update and the 2004 Review, not the total redistribution.

a **decline in the relative cost of service provision** (decrease in expenditure and SPP needs of \$15.1m), brought about by the loss of funding of:

- **-\$95.0m** arising from the socio-demographic composition assessment - higher cost and demand weights applied to the Indigenous, remote/rural and low income persons hurt the ACT given its very low share of these persons;
- **-\$10.7m** for inpatient services (hospitals) – increased allowances for Indigenous and Cultural and Linguistically Diverse persons moved funding away from the ACT;
- **-\$13.2m** for urban transit – the focus on higher capital costs and urbanisation effects redistributed large levels of funding to NSW and Victoria;
- **-\$11.5m** for revisions to SPPs - the ACT's above average per capita payments for some SPPs, particularly the CSHA, were reduced down to the average;
- **-\$11.1m** for general public services – the decision to significantly reduce the proportion of the assessment attributable to diseconomies of small scale redistributed funds away from the ACT; and
- **-\$10.2m** for dispersion – the lack of a geographically dispersed population, a new information and communication technology component and increased allowances and costs attributable to dispersion redistributed funding away from the ACT.

offset in part by gains of:

- **+\$20.7m** for input costs (wages, salaries, electricity and accommodation costs) - acceptance of the ACT's claims that wage related service delivery costs were underestimated (especially in relation to the flow-on effects of Commonwealth wages to the ACT), an inconsistent approach to electricity costs and flaws with the accommodation cost methods;
- **+\$16.2m** for debt charges - acceptance of the ACT's arguments for the inclusion of a cross border allowance, inclusion of capital SPPs, a timing of capital expenditure factor and a cost of borrowing factor reflective of higher borrowing costs;
- **+\$14.5m** for depreciation – acceptance of the ACT's arguments for the inclusion of a cross border allowance, the removal of cost disabilities, the overestimation of socio-demographic effects and changes to the plant and equipment factor;
- **+\$9.0m** for non-inpatient services – recognition of the ACT's arguments concerning the need to provide compensation for low per capita General Practitioner (GP) numbers which are equivalent to the supply occurring in remote Australia;
- **+\$11.5m** for national parks and wildlife services due mainly to the acceptance of revisions to the contiguous population factor reflective of the management and service delivery costs imposed by a relatively large population co-located with national parks;
- **+\$7.0m** in superannuation needs partly arising from the ACT's argument that the Commission's past cash-based assessment was deficient and changes to the CSS adjustment reflective of higher CSS costs; and
- **+\$5.0m** in national capital allowances due to evidence provided by the ACT and an increase in cross border allowances (not quantified at this point).

a ***decline in the relative revenue raising capacity*** (increase in revenue needs of +\$1.7m), brought about by the gain in funding of:

- +\$4.7m in stamp duty on shares and marketable securities;

offset in part by losses of:

- -\$3.2m in stamp duty on conveyances.

Review of Commonwealth State Financial Relations

Pressure for Change

A major issue for consideration at the 2004 Treasurers' Conference of 26 March 2004 was the 2004 Review relativities and the Commission's proposal for a two year work program.

In the lead-up to the Conference, NSW and Victoria applied increased pressure to the Commonwealth to review the current Commonwealth-State funding arrangements, and in particular, the principle of fiscal equalisation.

Since August 2002, and the release of the Review of Commonwealth-State Funding commissioned by NSW, Victoria and WA, these States have been seeking a national review of Commonwealth-State funding arrangements. Their claim is that they are unfairly subsidising the smaller jurisdictions and are seeking what they believe is a more equitable distribution of the GST revenue pool to the States.

Importantly, chapter 7 of the Commission's 2004 Review Report supported a review of the current intergovernmental financial arrangements, which at its broadest level of interpretation, included a review of the principle of fiscal equalisation. Indeed, the Commission stated that:

"...[it is] supportive of a far-reaching review of equalisation, including its underlying purposes and objectives"; and

"We think there would be benefit in a review of equalisation principles, but whether such a review is initiated is a matter for governments".

As a strong supporter of HFE, the ACT maintained its view that the current approach to the GST distribution is justified given the strength of the revenue bases in NSW, Victoria and WA and the significant economies of scale of their operations.

The importance of the current HFE arrangements cannot be underestimated as they allow all States to provide basic government services to all residents. It is fundamental to the concept of equity which provides for individuals to pay tax according to their capacity and to receive assistance according to need.

The ACT considered that the Commission's justification for a review did not warrant the time and resources required as the 2004 Report itself has already dealt with the areas of contention and outlines the Commission's majority view. It is highly unlikely that a review can clarify, or 'ring fence' issues which should be appropriately included as part of fiscal equalisation.

The ACT accepted the Commission's suggestion for several matters, and in particular, an examination of data robustness. However, the view was held that separate terms of reference were not required for this to occur.

Deliberations and Outcome

At the 2004 Treasurers' Conference, NSW and Victoria sought the Commonwealth to override the 2004 Review relativities recommended by the Commission. However, the Commonwealth accepted and endorsed the recommendations.

In terms of a review, Queensland, SA and the ACT opposed a review suggested by the Commission – the ACT's reasons for doing so are highlighted above.

The jurisdictions of NSW, Victoria, WA, Tasmania and the NT, along with the Australian Government, supported a review along the lines suggested by the Commission, although Tasmania's support was dependent upon the principle of fiscal equalisation not being revisited.

In light of this majority support, the Commonwealth agreed to a review, however, with the HFE principle remaining intact. The Commission is to consider, and report back to HoTs, whether the current complex method of sharing GST funding between the States can be simplified. The review will consider:

- whether the present approach, which is based on a comprehensive assessment of virtually all States' operating statement receipts and expenses, is appropriate and necessary;
- the size and trend of the redistributions;
- simplification; and
- data issues.

The Task Ahead – a fairer share of the GST pool for the ACT

The ACT's relativity result, while acceptable, is clearly disappointing. While the Commission has accepted a number of the ACT's arguments, it is disappointing that a number of claims that are particularly important to the Territory have been rejected, or not accepted in their entirety. This is particularly the case for the:

- ACT's national capital related expenditure imposts (only \$16m out of a claim for \$74m has been accepted), comprising, for example, the failure to adequately recompense the ACT for the costs of teaching relatively large numbers of diplomats' children; and
- no major change to the 15 year old cross border methodology which sees the ACT only partially compensated for services delivered to NSW residents – the cost-shift to the ACT is estimated to be approximately \$45m per annum.

Given the extent of the cost to the ACT Budget, the Territory is now forced to look at alternative strategies and progress a number of claims through other means.

Other decisions made by the Commission considered to be particularly unsatisfactory include the:

- enhancement of the socio-demographic composition factors, including the greater use of judgements by the Commission when applying cost and demand weights to Indigenous, remote/rural and low income persons, and the introduction of new socio-demographic factors, which has \$95.0m in additional funding away from the ACT (the total loss now stands at \$190m for this factor alone in the 2004 Review ³);
- increased allowances and costs associated with dispersion and the new information and communication technology adjustments – the latter fails to reflect the high maintenance and training costs for non-voice communication in the capital cities (which cost nearly 12 times that of voice communications which dominates rural and remote areas); and
- the failure to revise the household disposable income measure used to determine a State's capacity to raise gambling tax revenues in light of substantial evidence that the propensity to gamble in the ACT is lower than for Australia as a whole.

In this context, if the Territory is to receive a fairer share of the GST funding pool, the Territory will need to work within the current HFE arrangements, and develop and put forward further compelling evidence to the Commission for an increased share of funding. This is particularly relevant for the 'unsatisfactory' items listed above.

2004 Ministerial Council for Commonwealth-State Financial Relations (Treasurers' Conference) – Outcome

The Council met in Canberra on 26 March 2004.

As discussed above, Commonwealth and State Treasurers discussed a range of Commonwealth-State issues including:

- the Commonwealth Grants Commission's recommended 2004-05 GST relativities;
- review of equalisation methodologies;
- the abolition of Bank Account Debits Tax, with all States agreeing to abolish Debits Tax by 1 July 2005 (NSW abolished Debits Tax on 1 January 2002);
- review of State Taxes listed under the IGA;
 - under the IGA the Ministerial Council will review the need for retention of a range of business stamp duties by 2005; and
 - at the 2004 Treasurers' Conference the States and Commonwealth agreed to the terms of reference for a review of stamp duties imposed on business transactions with a report to be presented to the Ministerial Council in 2005;
- GST revenue and Transitional Assistance;
 - Commonwealth and State Treasurers noted the level of expected Commonwealth funding payments to the States in 2003-04 and 2004-05.

³ Comprising -\$25.6m for Indigeneity and -\$164m for 'other socio-demographic composition influences (this was increased from -\$133.2m (as stated by the Commission) to -\$164m to account for cross border services which are not related to SDC effects, assuming cross border needs of around \$31m), page 284, CGC 2004 Review Report, Supporting Information.

2004 Australian Loan Council Meeting

The Australian Loan Council met on 26 March 2004 following the Treasurers' Conference. The role of the Council is to determine the appropriateness of each jurisdiction's Loan Council Allocation (LCA) and its sustainability and consistency with national economic policy. Each State's LCA represents its potential call on the financial markets over the forth-coming year.

The Council agreed to the proposed 2004-05 LCAs nominated by the Commonwealth and the States, on the basis that the aggregate of LCA nominations were consistent with current macroeconomic policy objectives.

The ACT's LCA for 2004-05 is -\$64m with a tolerance limit of +/- \$53m. The ACT's negative LCA value implies the Territory is a net lender, that is, the ACT contributes surplus funds to the financial markets rather than relying on those markets as a source of additional funds.