

4.2 DEVELOPMENTS IN COMMONWEALTH-STATE FINANCIAL RELATIONS

Introduction

This chapter outlines developments in the ACT's financial relations with the Commonwealth, States and the Northern Territory that occurred in 2002-03, likely flow-on effects into 2003-04, and possible developments in the forward years.

The Commonwealth-State financial relations environment changed in 2000-01 with the implementation of the A New Tax System (ANTS), with a Goods and Services Tax (GST) as its cornerstone, from which all revenue is passed to the States¹ in place of the preceding Financial Assistance Grants (FAGs). This reform is now well entrenched.

Since the commencement of the ANTS, an *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (IGA) has governed the payment of untied funding to the States. Through this IGA, the Commonwealth has guaranteed that no State will be financially worse off from the new funding arrangements than under the previous ones. This guarantee has been fully met to date.

The mechanism to ensure that States are not financially worse off is the Guaranteed Minimum Amount (GMA), which represents each State's pre tax reform funding position. The GMA is primarily comprised of FAGs and other revenue forgone and additional or reduced State expenditures resulting from the introduction of the ANTS. Further detail about the GMA is provided later in this chapter.

Accordingly, where the GST revenue payment is less than the GMA, the Commonwealth is required to make a Budget Balancing Assistance (BBA) payment to meet its commitment. In 2003-04 for the first time, the ACT, in company with Queensland and the Northern Territory, will receive a GST revenue grant higher than its GMA.

GST grant funding continues to be distributed to the States on the equitable basis of Horizontal Fiscal Equalisation² (HFE). However, in August 2002, a review of Commonwealth-State funding commissioned by New South Wales, Victoria and Western Australia has proposed in its place, a structure that provides for an increase in funding for those States, and an effective departure from the current system of HFE.

The ACT and a majority of States, continue to be supporters of the equity of HFE and have rejected the review.

The distribution of GST revenues for 2003-04 is based on the HFE principle in accordance with the findings of the Commonwealth Grants Commission. The forward estimates contained in this Budget assume the continuation of HFE as the basis for distribution.

¹ The term 'States' refers to the States and Territories unless otherwise stated.

² HFE is based upon the idea that each State should have the capacity to provide an Australian average level of service at an average level of efficiency. The Commonwealth Grants Commission defines HFE as: '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'.

General Revenue Assistance to the ACT

Commonwealth funding accounts for approximately 43% of the ACT's General Government Sector revenues.

Table 4.2.1 below, summarises the expected level of 2002-03, 2003-04 and forward years Commonwealth funding for the ACT. These estimates are based on the Commonwealth Treasurer's 28 March 2003 *Statement of Estimate Payments* (SEP), updated to reflect revised population estimates for 2001-02 and corrected relativities released after the publication of the Commonwealth Grants Commission's (the Commission) *Report on State Revenue Sharing Relativities 2003 Update*.

**Table 4.2.1
Commonwealth Funding to the ACT**

Payment	2002-03 Est. Out. \$m	2003-04 Budget \$m	Var \$m	Var %	2004-05 Estimate \$m	2005-06 Estimate \$m	2006-07 Estimate \$m
GST Revenue Grants	598.4	626.5	28.1	4.7	653.4	684.2	716.5
Budget Balancing Assistance	21.4	n/a	-21.4	-100	n/a	8.7	1.9
Guaranteed Minimum Amount/GST Revenue Grants³	619.8	626.5	6.7	1.1	653.4	692.9	718.4
Special Fiscal Needs:							
Corporate affairs compensation	4.0	4.1	0.1	2.5	4.2	4.3	4.4
Police	10.7	10.9	0.2	1.9	11.2	11.5	11.7
<i>Net Special Fiscal Needs</i>	14.7	15.0	0.3	2.0	15.4	15.8	16.2
National Competition Payments	12.4	12.3	-0.1	-0.8	12.6	12.9	13.2
Total General Revenue Assistance	646.9	653.8	6.9	1.1	681.4	721.6	747.8
Specific Purpose Payments:							
Health (inc Health Care Grants)	103.8	104.3	0.6	0.5	104.0	104.2	104.4
Social Security and Welfare	21.3	22.3	1.0	4.8	23.4	24.5	24.7
Education	108.7	115.0	6.4	5.9	121.3	128.0	131.1
Public Order and Safety	3.2	3.3	0.1	1.0	3.2	3.2	3.2
Housing	24.7	18.7	-6.0	-24.3	18.7	18.7	18.7
Local Government	52.4	53.5	1.1	2.1	55.2	56.6	58.2
Other	14.2	15.2	1.0	7.0	14.5	12.7	10.8
Total Specific Purpose Payments	328.2	332.3	4.1	1.2	340.2	348.0	351.0
Other Commonwealth Payments							
Vocational Education and Training (inc ANTA)	19.9	20.4	0.4	2.2	20.8	21.3	21.7
Other (inc NDRA)	21.6	14.4	-7.2	-33.3	7.0	7.1	7.2
Total Other Commonwealth Payments	41.5	34.8	-6.7	-16.3	27.9	28.4	28.9
Total Commonwealth Funding	1 016.6	1 020.9	4.2	0.4	1 049.5	1 098.0	1 127.7

Note: Totals may not add due to rounding.

³ In 2003-04 and 2004-05 GST Revenue Grants are expected to be greater than the ACT's calculated GMA and as a result, the ACT will not require BBA during these years. In 2005-06 and 2006-07 BBA will be required to offset the expected abolition of Bank Accounts Debits Tax in accordance with the IGA.

2002-03 Estimated Outcome

The Territory will receive \$0.6m more General Revenue Assistance (GRA) from the Commonwealth in 2002-03 compared to the original budget estimate. This minor increase in funding arises from a \$0.5m population related adjustment to the 2001-02 National Competition Payment outcome, to be paid in 2002-03, and a variety of revisions to the ACT's GMA, including:

- decreased ACT population estimates, as advised by the ABS and resulting from the 2001 Census; and
- a combination of small revisions to other components of the GMA including:
 - First Home Owner Grant scheme;
 - Gambling Revenue forgone; and
 - Commonwealth re-calculation of Revenue Replacement Payments.

2003-04 Budget Year

In 2003-04 the ACT will receive an amount of GST funding that is greater than its estimated GMA and as such, the Territory has no requirement for BBA. The 2003-04 GRA is estimated to increase by \$6.9m or 1.1% over the 2002-03 estimated outcome. The increase in untied funding is due to an improvement in the size of the total GST revenue grant pool and other offsetting revisions discussed later.

Forward Estimates for Total Commonwealth Funding

The Commission is in the final stages of its 2004 Review of methodology, to be completed in February 2004, and in the absence of a clear outcome from the Review, a degree of uncertainty exists in regard to the GST revenue forward estimates. The ACT nevertheless expects to continue to receive an above equal per capita (EPC) share of GST revenue.

As a consequence, the forward year GST revenue estimates contained in Table 4.2.1 are based on the trends inherent in the Commission's 2003 Update relativities.

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

- estimated growth in the GST revenue pool; and
- small increases in Specific Purpose Payments (SPPs).

Funding Mechanisms Underpinning General Revenue Assistance to the ACT

GST Revenue Grants

As noted above, GST revenues are divided amongst the States in line with the principle of HFE. This is reflected in each State's share of GST revenue being distributed on the basis of the Commission's recommended per capita relativities, which ensure that each State is able to provide an average level of government services to its residents.

The GST relativities used to distribute GST revenue grants reflect the post tax reform arrangements. Table 4.2.2 outlines State taxes and expenditures affected by these arrangements.

**Table 4.2.2
State Taxes and Expenditures Affected by the ANTS**

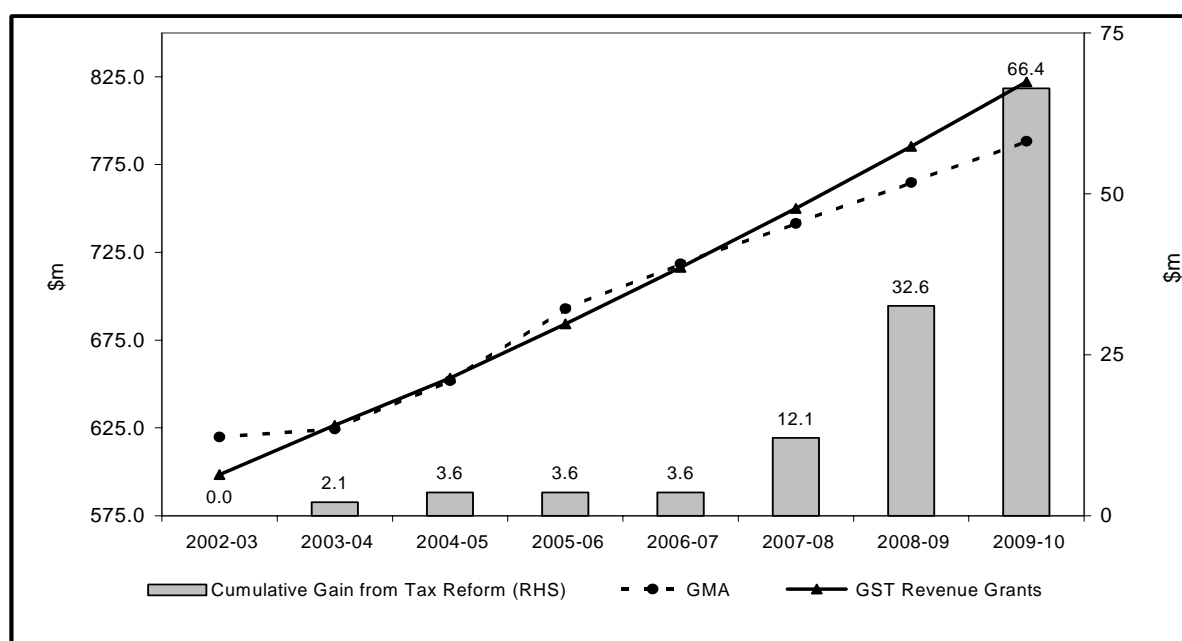
<p>Revenues Forgone by the States from 1 July 2000</p> <ul style="list-style-type: none"> • Financial Assistance Grants • Revenue Replacement Payments • Accommodation Taxes (Bed Taxes) • Wholesale Sales Tax Payments by Government Business Enterprises <p>Revenues Forgone by the States from 1 July 2001</p> <ul style="list-style-type: none"> • Financial Institutions Duty • Stamp Duty on Marketable Securities – listed shares <p>Reduced Expenditures by the States from 1 July 2000</p> <ul style="list-style-type: none"> • Off-Road Diesel Subsidies • Savings from Indirect Tax Reform 	<p>Additional Costs incurred by the States from 1 July 2000</p> <ul style="list-style-type: none"> • Interest Costs <p>Additional Expenditures of the States from 1 July 2000</p> <ul style="list-style-type: none"> • First Home Owners Scheme • GST Administration Costs <p>Reduced Expenditures of the States from 1 July 2002</p> <ul style="list-style-type: none"> • National Low Alcohol Beer Subsidy Scheme <p>Reduced Revenues to the States from 1 July 2000</p> <ul style="list-style-type: none"> • Gambling Taxes <p>Increased Revenues to the States from 1 July 2000</p> <ul style="list-style-type: none"> • Growth Dividend
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The Commission’s (corrected) 2003 Update recommended that the ACT’s GST relativity decrease from **1.15216** in 2002-03 to **1.14979** in 2003-04. When applied to the estimated 2003-04 GST funding pool, the ACT expects to receive GST revenue totalling **\$626.5m**, an increase of \$28.1m or 4.7% as compared to 2002-03.

The 2003 GST and FAGs relativities are discussed in more detail in the Commonwealth Grants Commission *Report on State Revenue Sharing Relativities 2003 Update – Outcome* section of this chapter.

Figure 4.2.1 below highlights the estimated impact of tax reform on the ACT’s finances.

**Figure 4.2.1
Estimated Impact of Tax Reform on the ACT**



The Figure illustrates that in 2002-03 and again in 2005-06 and 2006-07, the ACT's GST revenues are lower than its GMA (left hand scale). During this period it is expected that the Commonwealth will 'top up' the difference with BBA, ensuring that the ACT is not financially disadvantaged.

In 2003-04, 2004-05 and from 2007-08 onwards the ACT's GST revenue grants are expected to be higher than its GMA. The ACT is expected to require BBA in 2005-06 and 2006-07 due to the assumption that Debits Tax will cease on 1 July 2005 in line with agreed national tax reform objectives.

The bar chart (right hand scale) shows the cumulative gains. These gains are, however, broadly indicative and subject to further revision. These projections incorporate the ACT adjustments outlined earlier, extrapolated across the forward years to 2009-10.

Guaranteed Minimum Amount (GMA)

The GMA is the position that the Commonwealth and the States have agreed, and reflects the financial position that States would have faced had the ANTS reforms not been implemented. Table 4.2.3 illustrates the calculation of the ACT's GMA for each year.

Table 4.2.3
Calculation of the ACT's Guaranteed Minimum Amount
2002-03 to 2006-07

	2002-03	2003-04	Var	Var	2004-05	2005-06	2006-07
	\$m	\$m	\$m	%	\$m	\$m	\$m
State Revenue Forgone							
Financial Assistance Grants	440.6	450.4	9.8	2.2	465.5	481.9	499.1
Revenue Replacement Payments	107.7	110.6	2.9	2.7	113.9	117.2	120.5
Financial Institutions Duty	19.5	20.0	0.5	2.6	20.5	21.0	21.5
Debits Tax	0.0	0.0	0.0	0.0	0.0	17.7	19.8
Marketable Securities Duty	24.2	24.8	0.6	2.5	25.4	26.0	26.6
Marketable Securities Duty – Needs	-11.0	-12.2	-1.2	-10.9	-6.9	-5.5	-4.3
Plus Reduced Revenue							
Gambling Revenues	23.1	23.6	0.5	2.2	24.2	24.8	25.5
Plus Interest Costs							
Interest Costs	0.5	0.0	-0.5	-100	0.0	0.0	0.0
Plus Additional Expenditure							
First Home Owners Scheme	15.8	12.2	-3.6	-22.8	15.5	17.2	17.3
GST Administration Costs	9.1	9.3	0.2	2.2	9.4	9.6	9.8
Plus Other Items							
Wholesale Sales Tax Payments	4.0	0.0	-4.0	-100	0.0	0.0	0.0
Minus Reduced Expenditure							
Savings from Tax Reform	9.5	10.1	0.6	6.3	10.7	11.3	10.9
Low Alcohol Beer Subsidy	1.0	1.0	0.0	0.0	1.1	1.1	1.1
Minus Growth Dividend							
Remaining State Taxes	2.4	3.1	0.7	29.2	3.9	4.7	5.5
Plus 2001-02 BBA Adjustment	-0.7	n/a	n/a	n/a	n/a	n/a	n/a
ACT Guaranteed Minimum Amount	619.8	624.4	4.6	0.7	651.9	692.9	718.4

NB. Tables may not add due to rounding

Forward year increases to the ACT's GMA, shown in Table 4.2.3 reflect, in the main, increases in FAGs arising from forecasts of relativities, population and CPI. The table further illustrates consistent growth across components of the GMA. The large increase in 2005-06 reflects the current intention that as part of the ANTS, State Governments will abolish Debits Tax and the revenue forgone will be met by the Commonwealth within the GMA.

Special Fiscal Needs (SFN)

The 2003 Update report also recommends Special Fiscal Needs (SFN) funding for the ACT of \$15m in 2003-04. 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 Chief Minister has taken this matter up directly with the Prime Minister and the ACT is seeking the reinstatement of SFN funding separate to any additional assistance.

SFN funding consists largely of an allowance to assist the ACT with costs incurred in the provision of police services. This is assessed outside the GST/HCG pool because the Commonwealth is responsible for the additional costs. SFN also includes allowances equivalent to the funding provided to the States for functions outside the scope of the assessments. As shown in Table 4.2.1, SFN funding is estimated to increase by \$0.3m in 2003-04, due to growth in police expenditure and corporate affairs compensation.

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 (AFP) officers employed in ACT policing. These needs are calculated as the current value of:

- the estimated salary costs for a notional ACT police force based on the 1995-96 Australian average number of police per 100,000 people and the actual ACT salary cost per police officer; less
- the estimated salary costs that would have been paid to a force of that size based on the Australian average salary per officer, adjusted for some disabilities.

On this basis, SFN for police services in 2003-04 have been estimated at \$9.5m. However, the Territory's higher police expenditures have flow-on effects for superannuation and debt charges expenses. An allowance of \$1.4m has been granted to cover these expenses in 2003-04. In total, special fiscal needs attributable to Police equate to \$10.9m in 2003-04.

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.

These needs are estimated using expenditure from 1989-90 inflated to 2002-03 prices and have been assessed at \$4.1m for 2003-04.

National Competition Payments (NCP)

As specified in the *Agreement to Implement the National Competition Policy and Related Reforms*, the ACT is expected to receive National Competition Policy (NCP) Payments in three tranches. The first tranche (\$200m per annum) was paid to the States in 1997-98 and 1998-99, and the second tranche (\$400m per annum) in 1999-2000 and 2001-02. The ongoing 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 2003-04, third tranche NCP pool size is expected to be \$758.6m.

In 2003-04, the ACT expects to receive \$12.3m, however, each jurisdiction's final receipt of its per capita share of Competition Payments will be finalised once the National Competition Council has released its assessment of progress under the Agreement.

The ACT and all States have expressed concern with the Federal Treasurer's recent statements linking the continuation of NCP to issues such as water reform. This issue has yet to be resolved.

Specific Purpose Payments (SPPs)

With the introduction of the ANTS, the IGA guaranteed that the aggregate level of SPPs paid to the States would not be reduced in real terms. It is expected that the Commonwealth will meet this obligation in 2002-03 and again in 2003-04.

During the past year, the ACT has had continued active involvement with the Commonwealth, State and Territories SPPs 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 major issues progressed by the group during the year include:

- SPPs reform;
- updating of the SPPs database;
- issues relating to the re-negotiation of the:
 - Commonwealth-State/Territory Disability Agreement (CSTDA);
 - Commonwealth-State Housing Agreement (CSHA); and
 - Australian Health Care Agreements (AHCAs);
- Natural Heritage Trust 2 (NHT2) negotiations;
- review of the *AusLink – Towards the National Land Transport Plan Green Paper*; and
- review of the preliminary discussion paper resulting from the *Inquiry into Local Government and Cost Shifting*.

SPPs Reform

At the November 2002 Heads of Treasuries (HoTs) meeting, it was agreed that the Commonwealth, State and Territory Treasuries would continue to work closely in developing a new SPP agreements policy framework while addressing generic SPP accountability issues.

Essentially, improvements are to be identified to progress national discussion on the development of an agreed outcome/output SPP accountability framework.

SPPs Database

The November 2001 HoTs meeting endorsed the development of an SPPs Database by the Commonwealth Department of Finance. All States received the final database in February 2003. The specifications of the database have been agreed by the States and the Commonwealth, and the database should prove to be a useful tool for all States in analysing SPP issues and trends.

The costs involved with the creation of the database are shared between the Commonwealth and the States on a 50/50 basis, with the States dividing their share on an equal per capita basis.

Renegotiation of SPPs

Negotiations began between the States and Commonwealth for a number of major SPPs in 2002-03. The following is a summary of the status of these negotiations, and the major issues from the ACT's perspective.

Commonwealth-State/Territory Disability Agreement (CSTDA)

The CSTDA expired on 30 June 2002, however, rollover arrangements continue to operate until negotiations are finalised on a new agreement. All jurisdictions have found the re-negotiation of the CSTDA a difficult task, with the major concern being the Commonwealth position with regard to the provision of State growth funding estimates. As a sign of goodwill and in an effort to finalise the new agreement, the ACT has been one of the few jurisdictions to provide the Commonwealth five years of forward estimates for funding of disability services.

There is continuing discussion amongst all jurisdictions to develop an equitable formula for the distribution of the growth funding being offered by the Commonwealth.

In addition, the ACT is also continuing negotiations with the Commonwealth seeking its commitment to additional growth funding, based on the ACT's level of funding commitment.

Australian Health Care Agreements (AHCAs)

At the November 2002 meeting of Health Ministers, all States indicated a desire to commit to a reform agenda with regard to the AHCAs, but not in the absence of a commitment to funding such an agenda from the Commonwealth. As an outcome of this meeting, all States agreed to the preparation of a joint paper outlining a State agenda for reform. The resulting paper, *Facing the Future, Opportunities for Better Health Services* has since been completed and provided to the Commonwealth.

The paper identified a variety of issues that the States deemed appropriate to be incorporated in any new agreement and in the main, reflects the view that the funding arrangements should be based on patient numbers and also be adequately indexed to reflect the real growth in both patient demand and cost for health services.

In late April 2003, the Prime Minister announced an offer which essentially continues the previous levels of effort over the life of next ACHAs, subject to matching commitments by the States. Further negotiations on the funding offer, and the systemic reform are expected to commence shortly.

Commonwealth-State Housing Agreement (CSHA)

In November 2002, the Commonwealth wrote to the States with its proposal for the new five year CSHA to replace the current one that expires in June 2003. The new CSHA comprises an overarching multilateral agreement between the Commonwealth and the States, that sets the parameters within which separate bilateral agreements between each State and the Commonwealth can be established.

The Commonwealth's offer to the States continues to decrease CSHA funding levels in real terms over the life of the Agreement. A specific additional pressure for the ACT relates to the cessation of compensation for increased costs resulting from the introduction of GST, amounting to approximately \$6m per year.

Within the context of reducing funding from the Commonwealth, the continued sustainability of social housing is a major issue for all states. The proposed new agreement provides for the development of alternative opportunities for maintaining and enhancing social housing services.

Discussions between the Commonwealth and States are continuing, and a formal endorsement of the new CSHA is expected in 2003.

Natural Heritage Trust 2 (NHT2)

In May 2001, the Commonwealth extended the Natural Heritage Trust program for a further five years from 2002-03 to 2006-07. NHT2 is a more strategic and regional based model with an emphasis on natural resource management activities and community involvement.

States have raised some concerns with the Commonwealth regarding various conditions placed on natural resource management and the apparent intention of the Commonwealth to use approximately 10% of NHT2 funds for its own administrative costs, while requiring States to fund State administration themselves, effectively reducing the size of the pool.

The agreements are bilateral in nature, with Western Australia and New South Wales having formalised their agreement with the Commonwealth and most other States being close to finalisation. The ACT finalised its bilateral agreement with the Commonwealth in March 2003 and will receive approximately \$1.750m in funding over the next three years, matched by the ACT. This funding will be used for a variety of initiatives, including managing future fire risks and maintaining water quality.

Auslink – Toward 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. If introduced, the proposal would have implications for future transport SPPs.

While the objectives of the proposal and the likely establishment of a single flexible road transport funding program are likely to be supported in principle by all States, there is some concern over the lack of detail as regarding the program development and implementation.

Inquiry into Local Government Cost Shifting

In May 2002, the Minister for Regional Services, Territories and Local Government referred an inquiry into local government and cost shifting by State Governments to a House of Representatives Committee. On 18 February 2003, the Committee released its preliminary findings, which amongst other things, examine the roles, responsibilities and financial capacity of local government and also its relationship with State and Commonwealth governments. A final report of the Committee will be released in the second half of 2003.

Other Commonwealth Funding

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 (ANTA) Agreement.

The 2001-2003 ANTA Agreement is due to expire on 31 December 2003, and there has been some discussion on altering the existing State funding shares from an historical basis to one based on population share. The ACT is considering this possible reform in conjunction with all other States and the issue is likely to be raised at the ANTA Ministerial Council meeting in June 2003.

Other Commonwealth funding also includes Natural Disaster Relief Arrangements (NDRA) funding, provided as a result of the January 2003 bushfire. Estimated payments from the Commonwealth are \$11m in 2002-03 and \$6m in 2003-04.

Total Commonwealth Funding

As demonstrated in Table 4.2.1, total Commonwealth funding to the ACT is expected to increase by \$4.2m or 0.4% between 2002-03 and 2003-04. This comprises a rise in GRA of \$6.9m and an increase in SPPs of \$4.1m, offset by a reduction in other Commonwealth payments of \$6.7m.

Commonwealth Grants Commission's Report on State Revenue Sharing Relativities 2003 Update - Outcome

The GST and FAGs relativities recommended by the Commission in its *Report on State Revenue Sharing Relativities 2003 Update* are used in determining the estimates of Commonwealth funding provided to the States in 2003-04, as shown in Table 4.2.1 for the ACT.

Based on the 2003 Update relativities, 2003-04 will be the first year, since the introduction of the ANTS, in which BBA will not be required by all jurisdictions. Queensland, the ACT and the Northern Territory will be the first States to receive Commonwealth funding based on GST relativities, rather than GMAs.

Despite this, the 2003 Update relativities have a negative effect for the ACT, with both sets declining from the 2002 Update report. Table 4.2.4 provides a comparison of the 2002 and 2003 Update GST and FAGs relativities for all States, and highlights the ACT as one of only three States to experience a decline.

Table 4.2.4
Comparison of States' Relativities - 2002 and 2003 Updates
(5 year averages)

	<u>GST Relativities</u>		Movement (Percentage Points)	FAGs Relativities		Movement (Percentage Points)
	<u>2002-03</u>	<u>2003-04</u>		2002-03	2003-04	
NSW	0.90631	0.89117	-0.015	0.86037	0.84317	-0.017
Vic	0.86824	0.87010	+0.002	0.83401	0.84030	+0.006
Qld	1.01174	1.01902	+0.007	1.04008	1.04870	+0.009
WA	0.97592	0.96946	-0.006	0.92858	0.92093	-0.008
SA	1.19447	1.21215	+0.018	1.29035	1.30919	+0.019
Tas	1.55419	1.59948	+0.045	1.75186	1.79057	+0.039
ACT	1.15216	1.14979	-0.002	1.20906	1.19727	-0.012
NT	4.24484	4.38638	+0.142	5.22670	5.34163	+0.115

Following the release of the Commission's Report, the ACT discovered an error in the calculation of its relativities, which subsequently led to a revision of the 2003 Update relativities. The ACT's FAGs relativity was revised upwards from 1.18742 to 1.19727 and the GST relativity from 1.14230 to 1.14979 (although the revised relativities are still a decline on 2002). Based on GST relativities, the error increased the ACT's GST share by approximately \$4.7m in 2002-03, with similar effects in the forward years.

The decrease in the ACT's relativities from 2002 to 2003 can be attributed, in the main, to reductions in the relative costs (as compared to the Australian average cost) of providing some government services, thereby decreasing the 'need' for additional untied assistance. This was compounded by a rise in the Territory's relative revenue raising capacity, which further decreased funding needs.

On the expenditure side:

- the relative costs of providing government funded schools reduced the ACT's grant share, as a result of per capita government student numbers falling by more than the national average, compounded by below average increases in per capita non-government student numbers;
- the relatively large increase in the Australian average expenditure on superannuation had a negative effect for the ACT given its negative needs in this assessment. This change was largely brought about by a move from cash based accounting to accrual based; and

- these downward impacts on the ACT's grant were partially offset, however by changes in debt servicing where the reduced importance of the function within the State budgets reduce the effect on notional grants of the ACT's advantage arising from its lower per capita need to service debt.

On the revenue side:

- the ACT's capacity to raise gambling taxation, stamp duty on conveyances and payroll tax increased. This was attributed to an increase in household incomes and the value of property sold rising at a slightly faster rate than the national average; and
- similarly, with payroll tax decreasing as a proportion of total State taxes (due in the main to strong growth in conveyance duties), the ACT's disability relating to its inability to tax the Commonwealth is diminished, resulting in a further reduction in grant share.

The ACT has been assessed, under HFE principles, as requiring an above per capita share of GST funds to enable it to provide an Australian average range of services while making an average effort to raise revenue from its own sources. The ACT's per capita GST relativity is 1.14979, which means that the ACT receives a per capita share of GST funding which is nearly 15% above the Australian average per capita amount (an EPC share).

The rationale underpinning the ACT's above an 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. The larger States are advantaged in significant ways, including access to, for example:

- substantial business activity associated with large corporations (the ACT cannot tax its predominant employer, the Commonwealth);
- substantial resource wealth, such as minerals, petroleum and gas; and
- locational advantage resulting in high wealth bases, such as that accumulated in real estate.

These advantages translate into higher per capita revenue collections from payroll tax, conveyance duties, land taxes and mining royalties.

The Commission's recommended relativity for the ACT is the net result of:

- cost disadvantages in relation to the provision of services to non-residents, particularly the regional population from NSW;
- increased costs as a result of Canberra's role as the nation's capital;
- diseconomies of small scale through needing to supply the same range of services as larger States but for a much smaller population;
- higher than average socio-economic status, leading to reduced demand for services such as health, welfare, law and order etc; and
- low debt servicing costs, as a result of a low level of debt transferred at the time of self-government.

In regard to the inability of the ACT to tax the Commonwealth Government, the Territory's capacity to raise revenues normally collected from employers is considerably lower than for the majority of the other States.

2003 Ministerial Council for Commonwealth-State Financial Relations - Outcome

The Council, commonly known as the Treasurers' Conference, met in Canberra on 28 March 2003.

At the Conference, Commonwealth and State Treasurers noted the level of expected Commonwealth funding payments to the States in 2002-03 and 2003-04 and discussed a range of Commonwealth-State issues. An important outcome from the meeting was the Treasurers' decision to approve the distribution of the GST revenue pool amongst the States in accordance with the (corrected) recommendations of the Commission's *Report on State Revenue Sharing Relativities 2003 Update*.

Based on current estimates, the States will receive \$32 billion in GST revenue and BBA in 2003-04, up from \$31.2 billion in 2002-03.

The Conference also considered a range of other topics including:

- GST administration issues;
- Specific Purpose Payments;
- a review of Commonwealth-State financial relations; and
- Interstate Investment Cooperation.

GST Administration Issues

The Australian Taxation Office (ATO) collects all GST revenue on behalf of the States, administered under the GST Administration Performance Agreement. The Conference endorsed a number of updates and amendments to the Agreement and discussed GST administration costs. The Conference also agreed to the ATO's GST administration budget for 2003-04.

The ATO underspent its budget in 2002-03 by \$29m, primarily due to a shortfall in its recruitment program. The unspent funds will be carried over into the ATO's 2003-04 budget, and the underspent amount will be deducted from the States' GST administration payments for 2003-04. As compliance costs are attributed to the States on a per capita basis, the ATO's underspending will save the ACT around \$0.5m by way of reduced payments in 2003-04.

Specific Purpose Payments

State Treasurers raised concern about the increasing Commonwealth and shrinking State shares of national taxation revenues. The States called on the Commonwealth to maintain SPPs in real terms, while also providing for future growth where relevant.

Based on current preliminary estimates, total SPPs are expected to increase by approximately 4.6 per cent or \$992.5m in 2003-04. Detailed calculations on the proposed level of SPPs and their distribution among the States will be included in the 2003-04 Commonwealth Budget.

Review of Commonwealth State Financial Relations

Following the release of the *Review of Commonwealth-State Funding* commissioned by Victoria, New South Wales and Western Australia, in August 2002, these States have been seeking a national review of Commonwealth-State funding arrangements. These States believe 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.

At the Treasurers' Conference, Victoria requested the Commonwealth overhaul the system of Commonwealth-State finances and, in particular, the application of the principle of fiscal equalisation. However, the majority of States support the current system.

The ACT remains a strong supporter of HFE. The current approach to GST distribution is fully justified given the strength of the revenue bases in New South Wales, Victoria and Western Australia and the significant economies of scale of their operations. The current distribution system is underpinned by the equitable principles of fiscal equalisation and merits retention.

Under current arrangements, the Commission's methodology is reviewed every five years. This process provides the States with an opportunity to suggest refinements to the Commission's methodologies, as well as allowing the Commission to reflect the latest policy changes and developments in State government.

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.

If the GST revenues were distributed in the way suggested by the larger States, those States that currently receive a greater than EPC share of GST revenue, would not be able to provide an average level of Government service to their residents without imposing higher levels of taxation - an approach the ACT considers to be highly inequitable.

On this basis the ACT, supported by the majority of the States, did not support the proposal for a national review of Commonwealth-State funding arrangements.

The Commonwealth Treasurer has stated that the States signed the IGA conditional on the application of HFE, and the Commonwealth will not support a review until all States agree.

Interstate Investment Cooperation

New South Wales and Victoria are party to a bilateral agreement to eliminate cross border competition for investment. South Australia is seeking entry into the agreement, although, it believes the national economy would benefit significantly if the agreement could be extended to cover all jurisdictions.

At the 2003 States-only Treasurers' Conference, South Australia proposed that all jurisdictions give in-principle support to interstate investment cooperation. Under this agreement, States would stop offering financial incentives to corporations and events to relocate between jurisdictions. Although a number of exceptions to the agreement are expected, the agreement would effectively see an end to interstate bidding wars.

All Treasurers, with the exception of Queensland, gave in-principle support to the proposal, with a detailed agreement to be finalised at a later date.

2003 Australian Loan Council Meeting

The Australian Loan Council met on 28 March 2003 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 forthcoming year.

The Council agreed to the proposed 2003-04 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 2003-04 is -\$32m with a tolerance limit of +/- \$47m. 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.

The Loan Council also agreed to four proposals to further increase the transparency of the Uniform Presentation Framework (UPF). The UPF provides a common core of financial information in budget papers, and allows for meaningful comparisons across jurisdictions.

The new proposals focus on the disaggregation of particular items within the UPF Operating Statement and the adoption of guidelines on the publication of 'underlying' budget results in the UPF. These changes are to be included from 2002-03 Outcomes (Actuals) reports.

Commonwealth Grants Commission 2004 Review of Methodology

The Commonwealth Grants Commission undertakes an appraisal of its methodologies every five years, with the next review in 2004. Under the 2004 Review Terms of Reference the Commission is required to inquire into and report on by 25 February 2004, the per capita relativities to be applied from 2004-05 for the distribution of the combined pool of GST revenue grants and health care grants among the States.

Given the significance of the review process to the future distribution of Commonwealth grant funding, the States are given the opportunity to contribute to the review process and submit requests for methodological changes.

The ACT implemented a whole-of-government strategy in preparing its submissions to the 2004 Review process. The ACT prepared a Main Submission in May 2002 and a follow-up Rejoinder Submission in February 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.

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. The Review process has been a priority of the Treasury over the past eighteen months, with substantial efforts made to ensure that the ACT receives a fair and equitable share of the GST revenue pool during the five years following 2003-04.

In support of more transparent and accountable Government processes, the ACT took the unprecedented step of releasing its submissions publicly. The ACT's submissions to the 2004 Review process can be accessed from the ACT Treasury website at http://www.treasury.act.gov.au/grants_commission/grants.html.

Possible Future Risks in Commonwealth Funding for the ACT

Australia's Commonwealth-State financial arrangements are historically entrenched and have generally been accepted by all levels of government in the past.

The introduction of the GST as a State revenue source entrenched in legislation, grants each State the power of veto over changes to the rate or base of the GST, which effectively means that unless the Federal Government is willing to break the Agreement, it will not be possible to change the GST rate or base, thereby instilling a high degree of predictability in Commonwealth transfers, at least in aggregate terms.

The Intergovernmental Agreement underpinning national tax reform and the GST provides an additional safety net in the shorter term for all jurisdictions so that States' budgets will be no worse off after the implementation of the GST. This will continue until such time as the GST revenue exceeds the funding which would have been available to the jurisdictions under pre-GST arrangements (the GMA). However, the longer term prospects for a continuation of the guarantee are uncertain as States embark on further tax reform.

The application of HFE to the distribution of the GST pool provides essential fiscal capacity to the smaller less populous jurisdictions, including the ACT. Smaller jurisdictions are more likely to face a combination of relatively high per capita costs for the provision of a given level of public services and a relatively low capacity to raise the tax revenue necessary to finance those services.

This paramountcy of HFE has been re-affirmed following the rejection by a majority of jurisdictions of a concerted effort by States receiving less than an EPC share of the GST (donor States) to undermine the current distribution arrangements. The call by the donor States for a major overhaul of fiscal equalisation as currently administered by the Commonwealth Grants Commission, was not successful at the 2003 Treasurers' Conference.

The ACT did not support the call for a review. It remains a strong supporter of HFE. The current pattern of GST distribution is fully justified given the strength of the revenue bases in New South Wales, Victoria and Western Australia and the significant economies of scale of their operations. The importance of the current HFE arrangements cannot be underestimated

as it allows all States to provide basic government services to their residents, through the equitable transfer of funds between all States.

While it is expected donor jurisdictions will continue to seek a review of the application of the principle of fiscal equalisation, the Federal Government has made it very clear that it will not commission any review unless there is unanimous support by all jurisdictions. A change of government at the Federal level might, however, provide the donor States an opportunity.

Of more immediate concern to the ACT is the outcome of the Commonwealth Grants Commission's 2004 Review of methodology due to be released in February 2004. This report will establish the underlying fiscal equalisation methodology for the next five years commencing 2004-05.

The outcome of the 2004 Review is impossible to predict. However, the ACT would not expect to see its relativity drop below an EPC share of the pool of GST funding.

This is predicated on the fact that the ACT's greater than EPC share results almost entirely from its limited revenue sources in comparison to the four largest States. Similarly, while the ACT enjoys a number of advantages in respect of the delivery of standard services, these advantages are offset to a large degree by diseconomies of small scale, cross border consumption of services and additional costs imposed by the ACT's role as the National Capital.

A further guarantee from the Commonwealth that SPPs will not be reduced in aggregate from the 1999-2000 level in the context of national tax reform has been met to date and continues to provide a degree of certainty. Nevertheless, State Treasurers raised their concern at the 2003 Treasurers' Conference about the increasing Commonwealth and shrinking state-territory share of national tax revenues and called on the Commonwealth to maintain SPPs in real terms as well as providing for growth where relevant. This will need to be closely monitored by the States.

From an ACT perspective, the Territory continues to receive a range of unique SPPs reflecting its role as the National Capital and special payments arising from the unique form of self-government imposed on the Territory by the Commonwealth. These latter grants, totalling some \$62m per annum, are not under immediate threat but it could be expected that the Commonwealth will review them within the next 3-5 year period.

Finally, in line with the *Agreement to Implement the National Competition Policy and Related Reforms*, the ACT expects to continue to receive National Competition Policy Payments following the finalisation of the third tranche in 2005-06 with an expectation of their continuation into the future at approximately \$13m per annum. State Treasurers expressed their concern at the 2003 Treasurers' Conference with the Commonwealth Treasurer's recent statements linking the continuation of National Competition Payments to issues such as water reform, which if applied could severely disadvantage the Territory.

Overall, with the abovementioned mechanisms in place, it would be reasonable for the ACT to expect some degree of certainty in its dealings with the current and foreseeable Federal Governments.