8.2 INTERGOVERNMENTAL FINANCES

Overview

- The ACT expects to receive $758.3 million in Goods and Services Tax (GST) revenue grants in 2006-07, an increase of $40.3 million from the 2005-06 estimated outcome.
- The ACT received its final National Competition Policy (NCP) payment of $12.8 million in 2005-06. From 2006-07, NCP payments to the States will be redirected to fund the National Water Initiative (NWI). To date, the ACT has not been allocated funding from the NWI.
- As agreed between the ACT and Australian Governments, the ACT will abolish duty on non-real core business assets from 1 July 2006. The remaining three taxes subject to review under the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations (IGA), namely duty on hiring arrangements, leases and non-quotable marketable securities, will be abolished over a three year period from 1 July 2007.
- The ACT will receive Specific Purpose Payment (SPP) funding of $441.7 million in 2006-07, an increase of $37.1 million over the 2005-06 estimated outcome.
- The ACT's GST relativity has been revised upwards from 14.3 per cent above an equal per capita share of the GST pool in 2005-06 to 14.6 per cent in 2006-07 following the release of the Commonwealth Grants Commission's (CGC) Report on State Revenue Sharing Relativities 2006 Update (2006 Update Report).

Australian Government Funding to the ACT

Australian Government grant funding will account for approximately 42 per cent of the ACT's General Government Sector (GGS) revenues in 2006-07.

Table 8.2.1 below summarises the expected level of Australian Government funding to the ACT across the budget and forward estimates. These estimates are based on the Australian Government's 2006-07 Budget, released on 9 May 2006.

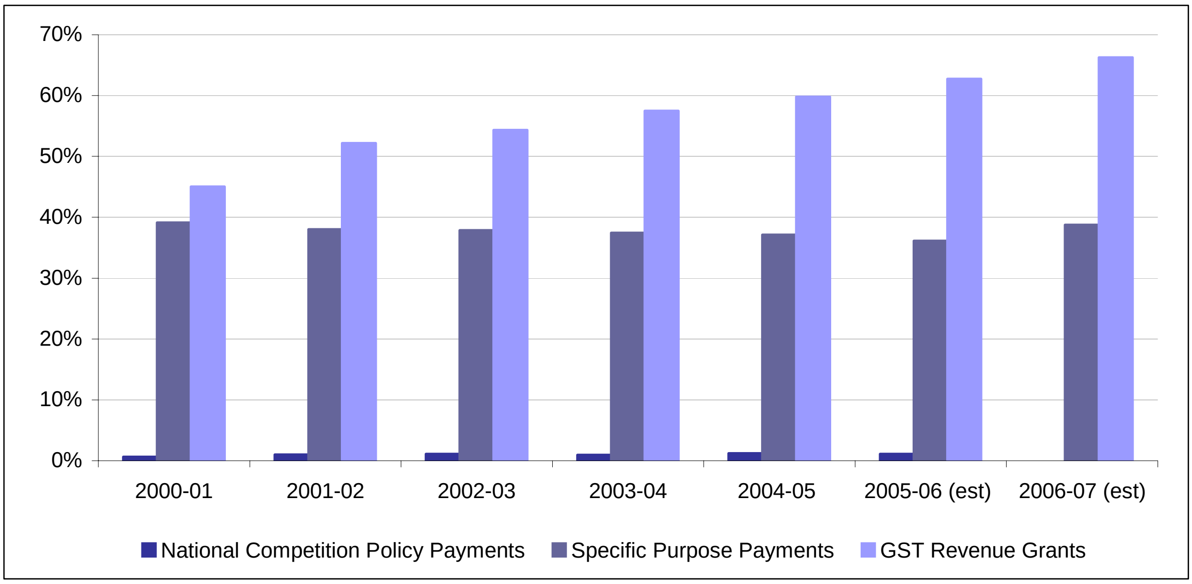
Table 8.2.1
Australian Government Funding to the ACT

Payment	2005-06 Est. Out. $m	2006-07 Budget $m	Var $m	Var %	2007-08 Estimate $m	2008-09 Estimate $m	2009-10 Estimate $m
GST Revenue Grants	718.0	758.3	40.3	5.6	796.6	834.9	873.2
National Competition Payments	12.8	0.0	-12.8	-100	0.0	0.0	0.0
Total General Revenue Assistance	**730.8**	**758.3**	**27.5**	**3.8**	**796.6**	**834.9**	**873.2**
Specific Purpose Payments:							
Health (inc Health Care Grants)	121.7	131.3	9.6	7.9	134.0	140.2	146.6
Social Security and Welfare	26.4	27.4	1.0	3.8	28.5	29.4	30.6
Public Order and Safety	3.2	3.2	0.0	-1.5	3.2	3.2	3.2
Education	132.1	154.5	22.3	16.9	163.2	172.1	176.4
Vocational Education and Training	21.1	21.8	0.7	3.5	22.3	22.7	23.2
Housing	18.6	19.1	0.5	2.8	19.5	19.3	19.5
Local Government	62.3	69.1	6.9	11.0	65.7	67.4	63.7
Other	10.8	11.4	0.7	6.2	11.6	11.8	12.0
Total Specific Purpose Payments	**396.2**	**437.8**	**41.6**	**10.5**	**447.9**	**466.2**	**475.1**
Other Aust. Govt. Payments	**11.0**	**7.5**	**-3.5**	**-31.6**	**6.2**	**3.4**	**2.8**
Total Australian Government Funding	**1,138.0**	**1,203.6**	**65.7**	**5.8**	**1,250.7**	**1,304.5**	**1,351.1**

Note - *Totals may not add due to rounding.*

As a share of total Australian Government funding to the ACT, the relative importance of GST revenue grants has continued to grow as the tax matures and consumption increases. At the same time, SPPs have slowly declined as a proportion of total Australian Government funding to the Territory. The relative share of GST, SPP and NCP payments as a proportion of total Australian Government funding to the ACT is illustrated in Figure 8.2.1 below.

Figure 8.2.1
Australian Government Funding to the ACT



General Revenue Assistance (GRA) to the ACT

The *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999* (ANTS) sets out the mechanism for the transfer of federally collected GST revenues to the States. In establishing these arrangements, the Australian Government guaranteed that no State would be financially worse off when compared with the previous arrangements.

GST payments to the ACT have exceeded its Guaranteed Minimum Amount (GMA) since 2003-04 - that being the amount receivable had the national tax reforms of 1 July 2000 not taken place.

2005-06 Estimated Outcome

The Territory will receive $730.8 million, or $3.2 million less GRA[1] from the Australian Government in 2005-06 compared to the original budget estimate of $734.0 million. This decrease in funding reflects:

- a decrease in the 2005-06 GST revenue pool estimate of $60 million, plus the recovery of $287 million in 2005-06 for the overpayment of GST in 2004-05; and
- a partially offsetting increase in the ACT's relative share of the Australian population, which had flow on effects to the ACT's share of the GST revenue and NCP payment pools.

[1] In 2004-05 GRA to the ACT comprised of GST revenue grants and National Competition Policy Payments.

2006-07 Budget Year

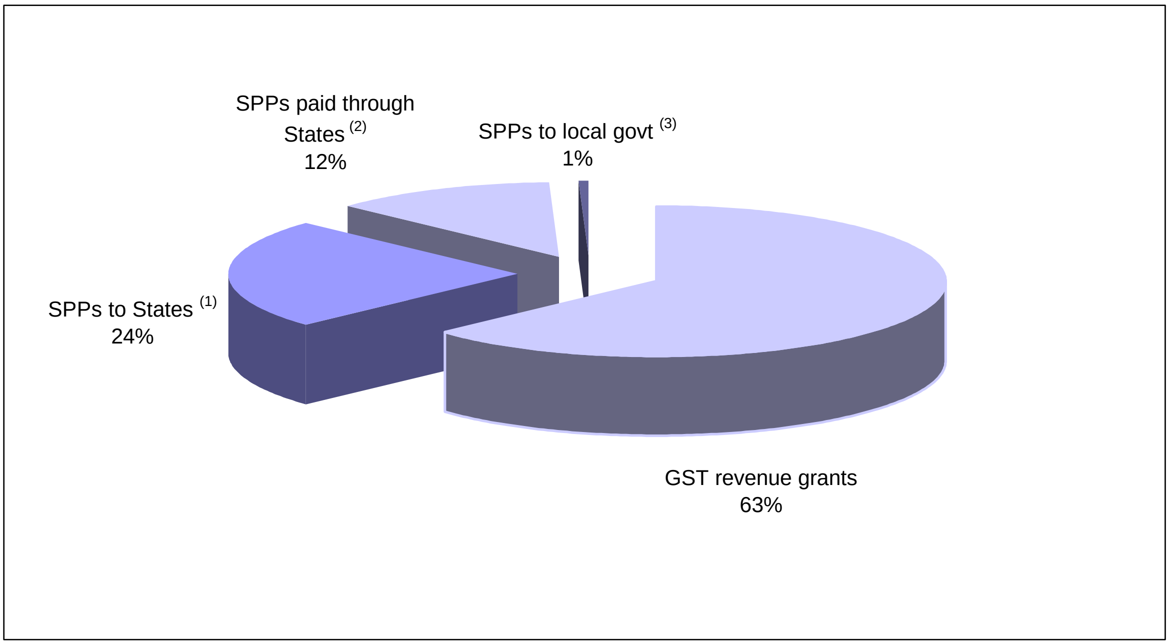
Following the cessation of NCP payments from 2005-06, the only source of untied funding, or GRA, to the ACT from 2006-07 will be GST revenue grants. GST revenue grants to the ACT in 2006-07 are estimated at $758.3 million, this represents an increase of $27.5 million over the 2005-06 estimated GRA outcome of $730.8 million. The increase primarily reflects:

- an increase of $2,030 million over the 2005-06 GST pool to $39,130 million; and
- the CGC's 2006 Update Report recommendation to increase the ACT's GST relativity from 1.14300 in 2005-06 to 1.14575 in 2006-07.

These increases are partially offset by:

- the cessation of NCP payments from 2006-07; and
- a decrease in the ACT's relative share of the Australian population.

Figure 8.2.2
2006-07 Australian Government Funding to the ACT



1. *SPPs to States - paid to a State Government for the provision of government services.*
2. *SPPs through States – paid to a State Government for on-passing to third parties such as non-government schools.*
3. *SPPs to local government – paid to a State for on-passing to local governments.*

Forward Estimates of Australian Government Funding

A degree of uncertainty exists with regards to calculating forward year estimates for Australian Government funding. Uncertainty surrounding the GST estimation process arises from two factors, namely, the difficulty involved in predicting the size of future GST collections due to economic expectations, and the fact that the CGC recalculates States' GST relativities each year based on the latest available data.

As a federally collected tax, the Australian Government is best placed to estimate the GST revenue pool. The use of the Australian Government's GST revenue pool estimates is a nationally adopted approach by all States to ensure a degree of consistency across State budgets. The Territory's relative share of the GST revenue pool is determined according to the CGC's latest recommended GST relativities and the Australian Bureau of Statistics' (ABS) population estimates. Based on ongoing advice from these three sources, the ACT regularly updates its estimates to reflect parameter variations. Since the 2005-06 Budget the ACT has updated its GST revenue grant estimates six times on advice from the Australian Government. A reconciliation of these updates and the bases underpinning the changes are illustrated in Table 8.2.2 below.

Table 8.2.2
Reconciliation of GST Revenue Grants to the ACT

GST Revenue Grants to the ACT (including GST Deferral Compensation)		**2005-06 $m**	**2006-07 $m**	**2007-08 $m**	**2008-09 $m**
2005-06 ACT Budget	**May 05**	**721.4**	**754.3**	**790.6**	**830.1**
	Variation (1)	3.4	-0.2	+0.4	-0.3
2005-06 Federal Budget	**May 05**	**724.8**	**754.1**	**791.0**	**829.8**
	Variation (2)	1.2	0.0	0.0	0.0
2005-06 GST Payment Profile	**Jul 05**	**726.0**	**754.1**	**791.0**	**829.8**
	Variation (3)	0.7	0	0	0
Residual Adjustment for 2003-04 BBA	**Nov 05**	**726.7**	**754.1**	**791.0**	**829.8**
	Variation (4)	-11.5	1.8	1.2	0.6
2005-06 MYEFO	**Dec 05**	**715.2**	**755.9**	**792.2**	**830.4**
	Variation (5)	1.4	4.4	5.7	5.7
2006 Statement of Estimated Payments	**Apr 06**	**716.6**	**760.3**	**797.9**	**836.1**
	Variation (6)	1.4	-2.0	-1.3	-1.2
2006-07 Federal Budget	**May 06**	**718.0**	**758.3**	**796.6**	**834.9**
	Accumulated variation	-3.4	4.0	6.0	4.8
	% change	-0.5%	0.5%	0.8%	0.6%

Parameter variation:

(1) **2005-06 Federal Budget**
Revised GST revenue pool and population estimates.

(2) **2005-06 GST Payment Profile**
Upward revision to the ACT's relative share of 2005-06 Australian population.

(3) **Residual Adjustment for 2003-04 Budget Balancing Assistance** (BBA) [2]
Compensation for underpayment of BBA in 2003-04.

(4) **2005-06 Mid Year Economic and Fiscal Outlook (MYEFO)**
Revised GST revenue pool and population estimates.
2005-06 GST revenue pool revised down by $340 million, plus adjustment (-$287 million) for overpayment of GST in 2004-05.

(5) **2006 Statement of Estimated Payments**
Release of 2006-07 GST relativities and revised population estimates. ACT GST relativity revised up from 1.14300 (2005-06) to 1.14575 (2006-07).

(6) **2006-07 Federal Budget**
Revised GST pool estimates.

In relation to SPP funding, Australian Government estimates are used where available. Where the Australian Government has not provided advice regarding forward estimates of SPP funding, current year estimates are extrapolated for indexation arrangements and user population estimates across the forward years.

[2] Budget Balancing Assistance (BBA) – transitional assistance paid to the States following the introduction of the GST. Where a State's GST revenue share falls below its GMA, BBA is paid in conjunction with GST revenue grants to achieve the GMA level of funding.

National Competition Policy (NCP) Payments

The program of NCP and related reforms were established under a trio of NCP agreements in April 1995. Under these Agreements, the Australian Government agreed to make NCP payments to the States as compensation for the costs of implementing the NCP reform program. These payments recognised that although the States have responsibility for significant elements of the NCP reform program, the Australian Government has accrued, through its taxation system, much of the financial dividend from the economic growth arising from these reforms.

Annual payments of States' NCP entitlements have been subject to the National Competition Council's (NCC) assessment of each State's progress against the NCP and related reform obligations. In the most recent assessment (2005) the NCC determined that the ACT had fully met its NCP reform requirements to date. The States' 2005-06 NCP payments were also subject to the National Water Commission's assessment of States' progress in relation to water reforms. Subsequent to passing both these assessments, the Australian Government agreed to the ACT receiving its full entitlement under ANTS of $12.8 million in 2005-06.

Table 8.2.3 shows the payments received by the ACT from the inception of NCP in 1997-98 to 2005-06.

Table 8.2.3
Estimated NCP Payments to the ACT 1997-98 to 2005-06

Year	Amount ($m)
1997-98	6.4
1998-99	6.3
1999-00	7.2
2000-01	7.5
2001-02	11.6
2002-03	12.4
2003-04	11.0
2004-05	13.6
2005-06	12.8
Total	**88.8**

To date, NCP payments have been paid in three tranches, with the third tranche concluding in 2005-06. The Australian Government has advised that this will be the final tranche under the current NCP program and that from 2006-07 the funding will instead be used to fund water reform projects under the National Water Initiative. This effectively amounts to a $13 million per annum funding reduction to the ACT from 2006-07 onwards.

Review of State taxes under the IGA

Under the IGA it was agreed that the Ministerial Council for Commonwealth-State Financial Relations would, by 2005, review the need for the retention of a number of business related duties, namely duty on:

- non-quotable marketable securities;
- leases;
- mortgages, bonds, debentures and other loan securities;

- credit arrangements, instalment purchase arrangements and rental arrangements;
- cheques, bills of exchange and promissory notes; and
- business conveyances of real property and non-real core business assets.

The Australian Government presented the States with a schedule of abolition of duties at the Ministerial Council meeting in March 2005. This schedule called for the abolition of the majority of the duties from 1 July 2006.

In April 2005 six State Governments (excluding New South Wales and Western Australia) made a counter offer to the Australian Government. Each State proposed its own timetable for reform according to its budget capacity. The ACT's schedule is summarised in the following table:

Table 8.2.4
ACT schedule of abolition for IGA taxes, including revenue forgone[1]

Date of Abolition	Duty on:	Annual impact of duty removed $m	Annual impact of revenue foregone $m
Not collected in the ACT	Mortgages, bonds, debentures and other loan securities	na	na
	Cheques, bills of exchange and promissory notes	na	na
1 July 2006	Non-real core business assets	1.5	1.5
1 July 2007	Credit arrangements, instalment purchase arrangements and rental arrangements	3.3	4.9
1 July 2009	Leases	4.9	10.0
1 July 2010	Non-quotable marketable securities	3.8	14.0

1. Sum of impacts do not align due to rounding.

With respect to duty on business conveyances of real property, all States stated that they did not support the differential treatment of residential and business property. Accordingly, the States sought the removal of duty on business conveyances of real property from the reform agenda. The Australian Government, however, indicated that it believed this duty should be retained on the agenda for review at a time to be determined.

To ensure no financial disadvantage going forward, the States also proposed that once a duty was abolished by all States it should be included in the calculation of the GMA, that is, the GMA safety net should continue as long as there is a risk that a State's GST payment could fall below its GMA as a result of the IGA tax reforms.

The Australian Government accepted the States' counter offer at the Ministerial Council meeting in March 2006, on the condition that duty on business conveyances of real property remain for future consideration, although with no set date for abolition.

In accordance with the agreed schedule, duty on non-real core business assets will be abolished in the ACT from 1 July 2006 at a cost of approximately $1.5 million per annum. When the final phase of the ACT's schedule is implemented from 1 July 2010, the abolition of the IGA taxes will result in a combined loss in revenue of $14.0 million per annum. Over the budget period the total gross cost of the duties forgone by the ACT is estimated at $21.4 million.

Specific Purpose Payments

SPPs constitute a significant amount (approximately 40 per cent) of Australian Government funding to the States. In general, SPPs are paid to the States on the condition that the funds are used for a specified program and are applied in accordance with the objectives of that program. In addition, the States are also generally required to contribute funding to these programs.

Under Clause 5(v) of the IGA, the Australian Government has guaranteed that it will not cut aggregate SPPs as part of the ongoing process of tax reform. To date, this commitment has been met and current estimates indicate it will again be met in 2006-07.

2005-06 Estimated Outcome

The Territory will receive $403.2 million in SPPs and other Australian Government payments in 2005-06. This is a slight decrease on the original budget estimate of $414.2 million.

2006-07 Budget Year

In 2006-07 SPPs and other Australian Government payments to the ACT are estimated at $445.4 million. This represents an increase of $38.2 million over the 2005-06 estimated outcome. In general, this increase reflects the application of indexation arrangements to funding payments - no new SPPs have been identified for 2006-07 following the release of the 2006-07 Australian Government Budget. However, the Australian Government has announced a number of new programs under the auspices of the Council of Australian Governments (COAG), such as the mental health program, which could eventually take on the form of SPP funding.

Developments in SPPs across Budget Years

During the past year, the ACT has continued its involvement with the Australian and State Governments in negotiating a wide range of tied funding agreements. The following summarises the major issues progressed.

Commonwealth-State Agreement for Skilling Australia's Workforce

The *Commonwealth-State Agreement for Skilling Australia's Workforce* replaced the *Australian National Training Authority* (ANTA), after ANTA was abolished on 30 June 2005. Under the new agreement, the Australian Government will provide $4.97 billion to the States from 2005 to 2008, including new funding of $215 million, which the States are required to match.

The States have agreed to a number of activities and objectives under the new agreement, including national targets of 10,000 additional places for New Apprenticeship commencements in traditional trades and a further 10,000 places in other skills shortages areas.

The multilateral agreement is supported by bilateral agreements between the Australian Government and each State, which outline how the States will meet the necessary targets under the agreement. In addition, each State has negotiated an annual Vocational Education and Training (VET) Plan.

The ACT's bilateral agreement and VET Plan were endorsed by the Federal Minister in April 2006 and were immediately followed by the first quarterly payment of approximately $4.7 million.

AusLink

The AusLink programme is administered by the Australian Government under the *AusLink (National Land Transport) Act 2005*, for the purposes of reforming land transport planning and funding.

The current programme will operate for four years from 1 July 2005 to 30 June 2009. During this time, the Australian Government will contribute funding for the development, construction and maintenance of land transport projects on the National Land Transport Network, and to Black Spot projects and roads in areas outside local government jurisdiction.

The Australian Government has allocated $9.6 billion for road and rail transport over the four years to 2008-09. This funding will be split between the:

- National Land Transport Network, including Interstate Road Transport, $7.7 billion;
- Roads to Recovery program, including the National Highway System, $1.8 billion; and
- National Black Spot program, $90 million.

A further $2.6 billion will be distributed in untied local road grants.

The ACT's bilateral agreement was signed in October 2005. This Agreement identifies maintenance funding for the Federal and Barton Highways of $2.66 million over the four year period.

Inquiry into Local Government Cost Shifting (the Hawker Report)

In June 2005, the Federal Minister for Local Government, Territories and Roads delivered a formal response to the House of Representatives' report *Inquiry into Local Government and Cost Shifting* (the Hawker Report). The Hawker Report was tabled in Federal Parliament in November 2003 following an 18 month inquiry.

The key features of the Australian Government's response and further actions to date include:

- support for a tripartite intergovernmental agreement on local government relations;
  - where local government delivers a service for which it does not have responsibility or the power to raise revenue to cover the cost of delivery, the Australian Government agreed that a formal arrangement between relevant levels of government on resourcing would be appropriate.
  - in April 2006 the Intergovernmental Agreement on Establishing Principles to Guide Intergovernmental Relations on Local Government Matters was signed by the Australian Government and State Ministers and the president of the Australian Local Government Association.
- acknowledgement of the apparent disadvantage to South Australia in the current distribution of the Identified Roads Component of the *Financial Assistance Grants to Local Government*. The Australian Government has provided the CGC with terms of reference to review the current interstate distribution of the identified roads component;
  - the CGC are due to report back to the Australian Government by 30 June 2006.
  - the identified local roads component is currently distributed on an historical basis rather than needs any move by the CGC towards a needs-based distribution would likely put at risk a sizeable portion of approximately $16 million per annum funding received by the ACT.
- rejection of the recommendation that the allocation of general purpose funding for local government be handled centrally by the Australian Government using a new national model based on fiscal equalisation principles;
- a proposal to refer to the Productivity Commission to examine policies that arbitrarily limit councils capacity to raise revenue from normal sources; and
- rejection of the recommendation that Federal and State governments should pay rates to local government.

Supported Accommodation Assistance Program

The *Supported Accommodation Assistance Program* (SAAP) was established in 1985 to bring together the eight homelessness programs funded by individual State Governments under one nationally coordinated program.

SAAP aims to assist people who are homeless or at risk of becoming homeless to achieve self-reliance and independence by providing transitional supported accommodation and a range of related support services.

The fifth agreement, SAAP V, came into effect on 1 October 2005 and will run through to 30 June 2010. The Australian and State Governments jointly fund SAAP, with the Australian Government to contribute $932 million over the course of SAAP V.

SAAP V incorporates a number of new initiatives, including: the introduction of an Innovation and Investment Fund to drive strategic reform within the SAAP sector; an enhanced accountability, reporting and evaluation framework; and the requirement that all State Governments increase their program funding contributions to match the Australian Government's investment on a 50:50 basis from the second year of the Agreement.

Funding to the ACT under SAAP V is expected to total $60.9 million over the five years. Of this, the ACT Government is expected to contribute $30 million (49.3 per cent) and the Australian Government $30.9 million (50.7 per cent).

Government Schools Quadrennium Funding

The renegotiated Government Schools (Primary and Secondary) SPP was backdated to give effect from 1 January 2005. It is due to expire on 31 December 2008.

Under the agreement, Australian Government recurrent funding to government schools remains set at 8.9 per cent of the average recurrent cost of educating a primary school student and 10 per cent for secondary school students. Of the approximately $30 billion in Australian Government funding offered to the States under the 2005-2008 quadrennium, approximately 30 per cent will be made available to government schools.

The agreement includes a range of new prescriptive non-financial conditions and associated data collection requirements without any commensurate increase in funding. These new conditions include:

- national student report cards;
- a national common starting age for schooling by 2010;
- an increase in national testing;
- the public provision of school performance information at an individual school level; and
- student performance targets.

Legal Aid Agreement

Australian Government funding is provided to State Legal Aid Commissions for the provision of basic legal advice, representation and education to the public. The current Provision of Legal Aid Agreement came into effect on 1 May 2005 and will terminate on 31 December 2008.

Current SPP Renegotiations

Renegotiations for a number of major SPPs are currently in progress, including:

Home and Community Care

The *Home and Community Care* (HACC) SPP provides for basic community care services to frail aged and younger people with disabilities, and their carers. The HACC amending agreements are due for renewal every five years. Negotiations are well advanced and it is anticipated that the negotiations will be completed by December 2006. The current agreement will continue until a new agreement is signed.

The primary aim of renegotiating the agreement is to provide an improved framework and streamlined arrangements to support the delivery of HACC services to the community. In addition, the COAG has agreed to simplify access to care services and to reduce the number of assessments prior to receiving services. These two areas will be included in the new agreement.

Commonwealth State Territory Disability Agreement

The *Commonwealth State Territory Disability Agreement* (CSTDA) is a five year agreement providing an overarching framework for the delivery of specialist disability services. The current CSTDA is due to expire on 30 June 2007.

Under the CSTDA, the Australian Government has administrative responsibility for specialist employment assistance, while the States have responsibility for accommodation support, community access and respite care. The responsibility for advocacy, information and print disability services is shared. The Australian and State Governments contribute approximately 30 per cent and 70 per cent of the total funding respectively. However, in the ACT, the Australian Government's contribution represents only 18 per cent of CSTDA funding.

Future SPP Renegotiations

Major SPP scheduled for renegotiation over the next two years include:

- Youth Health Services, expires 30 June 2007; and
- Australian Health Care Agreement (AHCA), expires 30 June 2008.

In April 2006, the Australian Government announced new funding for mental health ($1.8 billion over five years), and for the training of more doctors and nurses ($250 million over four years). The exact nature of this funding has yet to be negotiated between the State and Australian Governments (this is expected to take place during the next COAG meeting in July 2006), however, the Australian Government is calling on the States to match parts of its funding packages.

At its meeting of 10 February 2006, COAG agreed that SPPs that significantly affect the health system, such as the AHCA, should be reviewed prior to their renegotiation, with the intention of identifying any elements that, if changed, could contribute to better health outcomes. COAG noted that the outcomes of any such reviews should be passed onto Heads of Government prior to the commencement of renegotiations on health SPPs. Further, in light of these outcomes, consideration should be given to whether the design of major SPPs in other areas would benefit from a similar process.

Future SPPs negotiations are expected to be interlinked with developments in COAG's National Reform Agenda, and considered against the background of the National Reform Agenda's objectives to increase participation and productivity.

Abolition of Special Revenue Assistance to the ACT

As of 1 July 2005 the Australian Government ceased funding for the ACT's unique fiscal needs. Funding for these needs had been determined, outside the equalisation process, by the CGC on an annual basis. The Australian Government instead proposed that the Territory's fiscal needs should be funded from within the equalisation process, that is, the GST pool.

The CGC's 2005 Update Report[3] recommended that the fiscal need allowances for Policing and Roads be met from the GST pool, but noted that it was precluded from including the third component of the Territory's fiscal needs, Corporate Affairs Compensation, as the equivalent SPP, paid to the other States, is specifically quarantined from its assessments.

As such, the ACT no longer receives compensation following the introduction of the national scheme for the regulation of companies and securities. This represents an annual loss in funding of approximately $4.5 million. In contrast, the other States continue to be compensated annually by way of an SPP under the *Corporations Agreement 2002*.

The ACT has continued to pursue the reinstatement of Corporate Affairs Compensation with the Australian Government throughout 2005-06. This has included:

- seeking admission to the pool of compensation under the Corporations Agreement;
  - The Australian Treasurer advised that he would agree to the inclusion of the ACT in the compensation pool if the other States were to agree, noting, however, that the Australian Government would not increase the size of the pool under these circumstances.
  - Nonetheless, the ACT's membership of the Ministerial Council for Corporations (sanctioned in November 2005) was endorsed on the proviso that the Territory was not party to the States' pool of compensation under the Corporations Agreement.
- requesting a revision to the CGC's terms of reference to allow the assessment of corporate affairs related fiscal needs in the 2006 Update: As per the previous attempt during the 2005 Update process, the Australian Government again stated that the CGC's terms of reference, in its view, fulfilled the Australian Government's commitment to seek the assessment of the Territory's fiscal needs as part of the GST relativities, and therefore it was not inclined to amend them.
- seeking State support for supplementary terms of reference to the 2006 Update, to allow the CGC to rule on the totality of the Territory's fiscal needs.
  - While sympathetic to the ACT's position, the States did not support the cost shifting of these fiscal needs onto the equalisation process.
  - As an alternative, a number of States offered support for the inclusion of the Territory into the Corporations Agreement compensation pool, albeit on the proviso that the size of the pool was increased by the Australian Government by an amount equal to the size of the ACT's entitlement.

[3] Report on State Revenue Sharing Relativities 2005 Update, February 2005.

The Australian Government's decision to cease the funding of Corporate Affairs Compensation to the ACT has created an inequality in the treatment of the Territory alongside its State counterparts. Thus far, the ACT has pursued all reasonable options for the reinstatement of Corporate Affairs Compensation but to no avail.

Commonwealth Grants Commission Report on State Revenue Sharing Relativities 2006 Update

The CGC annually advises the Australian Government on the appropriate per capita relativities for distributing the GST revenue and Health Care Grants (collectively known as the GST pool) among the States. The distribution is made in accordance with the principles of horizontal fiscal equalisation (HFE) and is designed to provide all States with the same fiscal capacity to provide services to their populations.

Under HFE, State governments receive funding from the GST pool such that, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the capacity to provide services at the same standard. In applying the principles of HFE to its assessment of States' per capita relativities, the CGC examines all State government services and revenues and determines each State's relative cost of service provision and revenue raising capacity.

Since 1988, the methods used to calculate relativities have been reviewed every five to six years. The next Review is due to report in 2010. Between major Reviews, the relativities are updated annually to ensure that they reflect the latest circumstances of the States.

Outcome of Report on State Revenue Sharing Relativities 2006 Update

The 2006 Update Report was publicly released on 1 March 2006.

Following the release of the Report, the South Australian Government advised the CGC of an error in the conveyancing stamp duty data they provided during the Update process. This resulted in a minor revision to the published relativities. These revised relativities were agreed by the Ministerial Council for Commonwealth-State Financial Relations on 31 March 2006, and will be used to distribute the 2006-07 GST pool.

A comparison of the 2005 Update and 2006 Update (revised) relativities, as illustrated in Table 8.2.5 below, shows that, similar to the outcome of the 2005 Update Report, New South Wales, Victoria, the ACT and the Northern Territory all received increased relativities. All other States received reduced relativities. In particular, the relativities of both Queensland and Western Australia have been moving towards an equal per capita share (relativity of one) in recent years due to strong economic growth, in particular, the commodity boom. The Northern Territory continues to face significant disabilities due to its Indigenous population - as the relative importance of services to Indigenous communities has increased in the CGC's assessments, so too has the Northern Territory's relativity.

Table 8.2.5
Comparison of GST Relativities

	2005 Update	2006 Update (revised)	Change in GST funding [a] $m	$ per capita [b]
New South Wales	0.86846	0.87332	+70.6	+10.37
Victoria	0.87552	0.89559	+220.3	+43.60
Queensland	1.04389	1.02387	-175.6	-43.88
Western Australia	1.02500	1.00480	-90.0	-44.36
South Australia	1.20325	1.18862	-49.8	-32.19
Tasmania	1.55299	1.54931	-4.1	-8.42
Australian Capital Territory	**1.14300**	**1.14575**	**+1.8**	**+5.51**
Northern Territory	4.26682	4.32755	+26.8	+130.78

Notes
(a) Excluding the effects of population and GST revenue growth.
(b) Based on 2005-06 populations reported in the Australian Government Treasurer's Statement of Estimated Payments, March 2006.

A relativity above one indicates that a State requires more than the Australian average per capita amount of the GST pool to deliver services at Australian average levels. A relativity less than one indicates that a State requires less than the Australian average per capita amount to deliver the same standard of service. For the ACT, a relativity of 1.14575 indicates that it is entitled to a 14.6 per cent above an equal per capita share of the GST pool. With the exception of New South Wales and Victoria, all States require more than an Australian average per capita amount, that is, a relativity above one.

The changes to the relativities between the 2005 and 2006 Updates have been heavily influenced by revisions to historical datasets, which had significant flow on effects to States' relative revenue raising capacities. The biggest redistribution effect came about as a result of the ABS's revision to the compensation of employees dataset, which changed estimates of the amount of payroll tax States could have collected (at average tax levels) over the assessment period. In addition, there were also flow on effects to other revenue categories based on this data, such as the gambling tax assessment.

Drivers of change to the ACT's relativity

The ACT's relativity has been revised upwards from 1.14300 (2005 Update) to 1.14575 (2006 Update). This minor variation was brought about by increases in the relative costs of providing some services, partly offset by small increases in revenue raising capacities - as a result of the revisions to the historical data sets, in particular, compensation of employees data as mentioned above.

As such, the main driver of the change between the ACT's 2005 and 2006 GST revenue grants will be an increase in the GST revenue pool. The relativity increase will have only a very minor (+$1.8 million) effect.

Table 8.2.6
Major drivers of the ACT's relativity change

Category	Change $m	Reason for change
Administrative scale	-9.2	The reduced importance of fixed costs in State budgets reduced the effects of the ACT's diseconomies of small scale.
Payroll tax	-8.1	Revision by the ABS to data on compensation of employees for all years resulted in an increase in the ACT's capacity to raise revenue.
Gambling tax	-2.5	As a consequence of compensation of employees constituting a major part of gross household disposable income (which is the global measure used to approximate a population's propensity to gamble), the revision to this data had a similar effect on the gambling tax assessment as for the payroll tax assessment.
Inpatient services	+2.8	Updated hospital use data indicated that the ACT had a higher proportion of its population in sub-groups that are considered to use hospitals more intensively.
Superannuation	+4.1	Compensational changes to the superannuation assessment resulted in the reduced importance of unfunded liabilities, an area where the ACT has relatively low liabilities due to its short period of self-government.
Economic environment	+4.8	This impact arose mainly from increased assessed expenses for Non-inpatient and Community Health Services due to a decline in the ACT's supply of medical practitioners relative to the national average.

Reasons for the ACT's above equal per capita share — CGC's assessment of the ACT's fiscal capacity

Fiscal capacity is a measure of the difference between what a State could raise from its tax base at Australian average tax rates, plus its relative receipt of SPP funding, and what a State would need to spend to provide average levels of services to its residents. The fiscal capacity measure is intended to show the difference from the Australian average based solely on State circumstances and not policy. These different circumstances include the size and scope of State economies, resource endowments, physical geography and population characteristics.

The ACT is assessed as having the fourth lowest fiscal capacity of all States, that is the fourth highest relativity in the 2006 Update. Factors influencing the Territory's fiscal capacity include:

- below average capacity to raise revenue;
  - Payroll tax - due to the dominance of the public service within the ACT labour market, the ACT has significantly higher per capita payrolls than the Australian average but below average per capita payroll collections, due to the inability to tax the Australian Government.
  - Mining - the absence of a mining industry in the ACT means it lacks a major revenue source available to other resource rich jurisdictions such as Western Australia.

- Land tax - reduced revenue raising capacity stems from the lower than average value of commercial and industrial land in the Territory and the below average proportion of private renters, which limits the collection of land tax from non-principal residential land owners.

- near average requirement for expenses;
  - Over the five year assessment period from 2000-01 to 2004-05, the ACT was assessed as having below average proportions of its population in sub-groups normally associated with higher costs of service delivery, that is, low income earners, pensioner and concession card holders, Indigenous persons, persons living in remote regions and those aged 65 years or older.
  - A number of characteristics of the Territory and its population suggest that the use and cost of many services in the ACT is likely to be below the Australian average, these include the Territory's higher socio-economic status and compact geographical nature, that is, the lack of rural and remote areas. Conversely, several features are likely to bring about higher service costs such as the Territory's relatively small population, leading to diseconomies of small scale, and its status as a regional centre within southeast New South Wales, which inevitably leads to the provision of services to non-ACT residents.
- slightly above average per capita share of SPPs;
  - Of those SPPs included in the CGC's assessments, the ACT received marginally more than an average per capita amount over the five year assessment period. In particular, the Territory received higher than average per capita payments for Vocational Education and Training, the Commonwealth-State Housing Agreement and National Public Health.

2006 Ministerial Council for Commonwealth-State Financial Relations (Treasurers' Conference)

The Ministerial Council, which is chaired by the Australian Treasurer, met in Canberra on 31 March 2006.

The Australian and State Treasurers discussed a range of Commonwealth-State issues with far reaching implications for all jurisdictions, namely:

- the review of State taxes listed under the IGA (as discussed earlier);
- the simplification of HFE methodologies in the lead up to the CGC's 2010 Review;
- NCP payments and the National Reform Agenda; and
- GST administration issues.

Review of Horizontal Fiscal Equalisation Methodology

As agreed at the 2005 Ministerial Council meeting, the CGC provided a progress report to the 2006 Ministerial Council on the 2010 Review of State Revenue Sharing Relativities.

The 2010 terms of reference stipulates the need for the CGC to simplify and improve its methodology to place it on a sounder and more sustainable basis. In 2005, the CGC put in place three essential elements in response to the terms of reference:

- it established how it will approach the task of achieving equalisation with simpler methods;
- it revised and strengthened its assessment guidelines; and
- it established a program for reviewing the reliability of data used in the assessments.

In the next twelve months the CGC aims to have in place the broad assessment structure, that is, the revenue and expenditure categories used to determine the relativities.

The ACT is working with the CGC to achieve these reforms. A further progress report will be provided by the CGC to the Ministerial Council in March 2007.

National Competition Policy Payments and the National Reform Agenda

The Australian Government provided the final scheduled payments under the Agreement to Implement the National Competition Policy and Related Reforms to the States of approximately $820 million in 2005-06 following the National Water Commission's assessment of States' progress in implementing national competition policy related water reforms.

The Council also discussed the National Reform Agenda. The Australian Treasurer advised that the Australian Government would provide funding to the States for economic reforms on a case-by-case basis, once specific implementation plans have been developed. Payments to the States and, where appropriate, to local government, will be linked to achieving agreed progress measures and demonstrable economic benefits.

In contrast, the States maintained that without fiscal incentives from the Australian Government there was little likelihood of successful reform outcomes. In recognition of their commitment to the National Reform Agenda, the States called for an early allocation of funding, on the basis that the reforms will deliver substantial national economic growth and benefits to the Australian Government.

Under the direction of the Heads of Treasuries, State Treasuries are developing a set of principles that could be used to underpin the funding arrangements, thus enabling States to effectively pursue the COAG reform agenda.

GST Administration Issues

As the Australian Taxation Office (ATO) collects all GST revenue on behalf of the States, the IGA provides for the establishment of accountability and performance arrangements between the State Governments and the ATO. The Ministerial Council endorsed a number of updates to the GST Administration Performance Agreement.

The Ministerial Council also discussed GST administration costs and related issues and agreed to the ATO's GST administration budget of $619.1 million for 2006-07, consistent with the requirement of the IGA that the States compensate the Australian Government for the costs of administering the GST.

The agreed administration costs include additional funding approved by the Ministerial Council for increased compliance activity, which is expected to return approximately $190 million in additional GST revenues over the next three years.

GST Administration Subcommittee

The ATO's administration of the GST is overseen by the GST Administration Subcommittee (GSTAS), which is comprised of Australian and State Treasury officials.

The role of GSTAS is to:

- monitor the ATO's performance in GST administration;
- assess policy proposals for the modification of the GST base and rate;
- make recommendations to the Ministerial Council on the need for legislation which might significantly affect the GST base; and
- request the ATO to produce draft Public Rulings in specified areas.

Any changes to the GST base under the *A New Tax System (Goods and Services Tax) Act 1999* requires the unanimous approval of the Ministerial Council. Throughout 2005-06 GSTAS considered a number of proposals that affect the GST revenue base, some of which were agreed out of session by the Ministerial Council. The proposals considered by GSTAS included:

- GST concessions provided or extended to diplomatic and consular missions, staff and other employees;
- compulsory third party (CTP) insurance issues in relation to CTP insurers' entitlements to decreasing adjustments;
- a process for considering third party requests for changes to the GST rate and base;
- the GST treatment of real property - addressing some tax integrity concerns raised by the ATO in respect of real property and the margin scheme;
- ensuring the appropriate GST treatment of pre-paid phone vouchers ; and
- the GST treatment of oat milk.

States-only Treasurers' Conference

The State Treasurers met on the eve of the Ministerial Council meeting to discuss a number of State-specific issues including a decision to continue to develop state-based GST forecasts, as an alternative to Australian Government derived estimates, and the signing by all States (except Queensland) of the Interstate Investment Cooperation Agreement for a further five years.

2006 Australian Loan Council Meeting

Established under the *Financial Agreement Act 1927*, the objective of the Australian Loan Council is to manage the call on national savings by the Australian public sector as a whole. The Loan Council consists of a Federal representative (usually the Federal Treasurer) as chairman and a representative of each of the States (a role also usually delegated to Treasurers).

The Australian Loan Council met on 31 March 2006 immediately following the 2006 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. In effect, the Council allocates, by mutual agreement, an annual target for total net financing by each jurisdiction. Each State's LCA represents its potential call on the financial markets over the forthcoming year. LCAs are calculated on the basis of a Government's cash position, and the resulting call on financial markets in any given year required to meet its budgetary obligations.

The ACT's LCA nomination for 2006-07 is $159 million with a tolerance limit of +/-$56 million. The positive figure represents a net call on financial markets.

Council of Australian Governments (COAG)

COAG comprises the Prime Minister, State Premiers, Territory Chief Ministers and the President of the Australian Local Government Association.

COAG's role is to initiate, develop and monitor the implementation of policy reforms that are of national significance and which require cooperative action by Australian governments. COAG meets on an as needed basis at least once a year.

In the past twelve months COAG has met in Canberra on three occasions - in June and September 2005, and February 2006.

At its fifteenth meeting on 3 June 2005, COAG discussed a range of issues including health care delivery, vocational education and training, workplace relations reform and climate change. In particular, COAG noted the findings of the Productivity Commission's research report on *Economic Implications of an Ageing Australia*, which highlighted the budgetary pressures all levels of government will face in the coming decades as the population ages, and the importance of initiatives to raise productivity and labour force participation to enhance income growth and the capacity of governments to meet the costs of an ageing population.

COAG also agreed that each jurisdiction would provide a report on infrastructure to COAG every five years, with the first set of reports due by 31 January 2007. The aim of the exercise is to provide a strategic overview of existing infrastructure, a rational outlook for infrastructure demand and a strategic assessment of future infrastructure needs.

The 27 September 2005 meeting was a special gathering of COAG to consider Australia's national counter-terrorism arrangements.

Most significant, was COAG's 10 February 2006 meeting, which saw Governments embarking on a National Reform Agenda aimed at raising living standards and improving services by boosting Australia's productivity and workforce participation over the next decade. COAG established a number of Senior Officials Working Groups under three broad categories of human capital, competition and regulatory reforms to develop practical initiatives in the areas of improved health services, skills recognition, infrastructure planning and regulation, and reducing the regulatory burden on businesses. These Working Groups are due to report back to COAG at its next meeting in July 2006.

COAG also discussed mental health as an issue of national significance. Subsequently, in April 2006 the Australian Government announced new funding of $1.8 billion over five years to improve mental health services across Australia. The funding is earmarked to expand support programs and counselling services, train 600 more specialists and provide Medicare rebates for people referred to psychologists. The Australian Government has called on the States to match components of its funding package. Mental health reform will again be discussed at the next COAG meeting.

COAG also agreed to develop an *Australian Influenza Pandemic Prevention and Preparedness Action Plan* by mid-2006.