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 2001-02. Likely flow-on effects into 2002-03 and possible developments in the forward years have also been identified.

The Commonwealth-State financial relations environment changed dramatically in 2000-01 with the implementation of the *A New Tax System* (ANTS), which included a Goods and Services Tax (GST). From 2000-01, all GST revenue is passed to the States[1], in place of Financial Assistance Grants (FAGs). At this time, the Commonwealth guaranteed that no State would be worse off under the new arrangements.

The ANTS remains in a transitional phase, with the Commonwealth providing funding in addition to the GST revenue to ensure that States are not worse off under the ANTS.

General purpose funding continues to be distributed on the basis of Horizontal Fiscal Equalisation (HFE). In December 2001, New South Wales, Victoria and Western Australia commissioned an independent review of HFE. This review is yet to be reported on. Additionally, the ACT has found itself in a position of having to defend the share of assistance it receives from the Commonwealth after direct criticism by some States.

Overall, the ACT's immediate outlook for Commonwealth assistance continues to be positive.

Commonwealth funding accounts for approximately 46% of the ACT's General Government Sector revenues. This stream of funding is unlikely to deteriorate over 2002-03 and 2003-04. Assuming the continued adoption of the Commonwealth Grants Commission's (the Commission) 1999 Review methodology, the ACT is expected to continue to receive an above equal per capita share of GST revenue.

Commonwealth Funding to the ACT

Table 4.2.1 summarises the expected level of Commonwealth funding to the ACT in 2001-02, 2002-03 and the forward years. These estimates are based on the 2002-03 Commonwealth Budget, updated to reflect revised population estimates, arising from the subsequent release of 2001 Census data.

The Commission will complete its review of the current methodology in February 2004. In the absence of any clear indication of the outcome of this review, the ACT revised the outyear estimates by:

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

- estimating the 2003-04 relativities based on trends inherent in the Commission's 2002 Update of relativities; and
- assuming no further change in the relativity for 2004-05 and 2005-06.

Table 4.2.1
Commonwealth Funding to the ACT

	Payment	2001-02 Est. Out. $m	2002-03 Budget $m	Var $m	Var %	2003-04 Estimate $m	2004-05 Estimate $m	2005-06 Estimate $m
	Financial Assistance Grants [2]	*-415.4*	*-440.7*	*25.3*	*6.1*	*-462.3*	*-479.2*	*-496.8*
	GST Revenue Grants	548.0	600.0	52.0	9.5	639.2	675.0	712.8
	Sub Total [3]	548.0	600.0	52.0	9.5	639.2	675.0	712.8
Plus	**Budget Balancing Assistance** [4]	58.2	19.7	-38.5	-66.2	8.6	n/a	0.9
Equals	**Guaranteed Minimum Amount**	**606.2**	**619.7**	**13.5**	**2.2**	**647.8**	**675.0** [5]	**713.7**
Plus	**Special Fiscal Needs:**							
	Family law matters	0.2	0.0	-0.2	-100.0	0.0	0.0	0.0
	Corporate affairs compensation	3.9	4.0	0.1	2.6	4.1	4.2	4.3
	Police	10.1	10.7	0.6	5.9	11.0	11.3	11.6
	Net Special Fiscal Needs	14.2	14.7	0.5	3.5	15.1	15.4	15.8
Plus	**National Competition Payments**	11.6	11.9	0.3	2.6	12.2	12.4	12.7
	Total General Revenue Assistance	**632.0**	**646.3**	**14.3**	**2.3**	**675.1**	**702.8**	**742.2**
Plus	**Specific Purpose Payments:**							
	Health (inc Health Care Grants)	100.3	103.5	3.2	3.2	105.1	105.2	105.5
	Social Security and Welfare	20.0	19.5	-0.5	-2.5	20.2	21.1	22.0
	Education	103.5	109.0	5.5	5.3	114.9	121.2	128.0
	Public Order and Safety	3.7	3.2	-0.5	-13.5	3.3	3.2	3.2
	Housing	24.8	24.6	-0.2	-0.8	18.7	18.7	18.7
	Local Government	50.2	52.1	1.9	3.8	54.7	56.2	57.7
	Other	29.2	17.0	-12.2	-41.8	15.2	14.5	10.6
	Total Specific Purpose Payments	**331.6**	**328.8**	**-2.8**	**-0.8**	**332.1**	**340.1**	**345.7**
Plus	**Other Commonwealth Payments**							
	Vocational Education and Training	18.0	19.7	1.7	9.4	20.1	20.1	20.5
	Other	12.4	8.0	-4.4	-35.5	6.6	6.8	6.9
	Total Other Commonwealth Payments	**30.4**	**27.8**	**-2.6**	**-8.6**	**26.8**	**26.9**	**27.4**
	Total Commonwealth Funding	**993.9**	**1,002.9**	**9.0**	**0.9**	**1,034.0**	**1,069.8**	**1,115.0**
less	State Budget Impacts	190.8	179.1	-11.7	-6.1	185.6	193.8	216.8
	Net Commonwealth Funding	**803.1**	**823.8**	**20.7**	**2.6**	**848.4**	**876.0**	**898.2**

2 Although FAGs were replaced by GST Revenue Grants on 1 July 2000, notional estimates of FAGs foregone are included to reflect the funding that the ACT would be expected to receive if tax reform had not been implemented.

3 The sub total estimate relates to GST Revenue Grants only.

4 Additional payments made by the Commonwealth to the ACT to ensure the Territory is no worse off due to the effects of national tax reform.

5 The GMA represents the ACT's pre tax reform financial position. In 2004-05, as the Territory's GST Revenues ($675.0m) are higher than its GMA ($673.1m), the Territory will receive GST Revenues and the GMA will not be relevant.

(excluding State Budget Impacts)

Note: Totals may not add due to rounding

ANTS Arrangements

Since 2000-01, payments of untied funding are governed by the Intergovernmental Agreement (IGA). Under the IGA, the Commonwealth has guaranteed that the new arrangements will not make any State worse off than under the previous arrangements.

The mechanism to ensure that States are not financially worse off is the Guaranteed Minimum Amount (GMA). The GMA is comprised of FAGs and other revenue forgone, and additional expenditure incurred by States under 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.

2001-02 Outcome

In 2001-02, the Territory achieved increased grant funding from the Commonwealth. Compared to the 2001-02 ACT Budget estimates, the ACT is expected to receive an additional $22.1m in General Revenue Assistance (GRA) for 2001-02 over the original budget. This additional funding arises in the main, from revisions to the ACT's GMA due to:

- an increase in the ACT's FAGs revenue forgone an increase of ($14.1m), resulting from:
  - revised population estimates (arising from the 2001 census) which increased the mean resident population estimate by 2.6%; and
  - use of the 2002-03 Commonwealth Budget CPI estimates; and
- a combination of revisions to other components of the GMA including:
  - First Home Owner Grant scheme an increase of ($4.5m);
  - Gambling Revenue forgone an increase of ($1.5m); and
  - Commonwealth re-calculation of Revenue Replacement Payments an increase of ($1.3m).

2002-03 Outlook

Total Commonwealth funding is estimated to increase by $9.0m or 0.9% in 2002-03. This increase is the net impact of an increase of $14.3m in untied funding and a decrease of $5.4m in SPPs and other Commonwealth payments.

The increase in untied funding is due to an improvement in the per capita relativity applicable to 2002-03, arising from the Commission's 2002 Update Report, and an increase in the notional FAGs pool due to CPI and population growth. This is partially offset by a reduction in the estimated funding required to meet the First Home Owners Grant Scheme obligations.

Forward Estimates

The forward years indicate strong growth in total Commonwealth payments. This is due to:

- anticipated improvement in the per capita relativity for 2003-04 which will increase the ACT's share of the total GST pool;
- estimated strong growth in the GST revenue pool; and
- small increases in SPPs.

Commonwealth Funding Arrangements

GST Revenue Grants

In accordance with the IGA, GST revenues are divided amongst the States in line with the principle of HFE. That is, GST revenue will continue to be distributed using the Commission's recommendations of 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. For the first three years of the reform process, the Commission reflected, in its calculations of the 2000, 2001 and 2002 Update relativities, the arrangements highlighted in Table 4.2.2.

Table 4.2.2
State Taxes and Expenditures Affected by ANTS between 2000-01 and 2002-03

Revenues Forgone by the States from 1 July 2000 • Financial Assistance Grants • Revenue Replacement Payments • Accommodation Taxes (Bed Taxes) • WST Payments by GBEs	***Additional Costs incurred by the States from 1 July 2000*** • Interest Costs ***Additional Expenditures of the States from 1 July 2000*** • First Home Owners Scheme • GST Administration Costs
Revenues Forgone by the States from 1 July 2001 • Financial Institutions Duty • Stamp Duty on Marketable Securities – listed shares	***Reduced Expenditures of the States from 1 July 2002*** • National Low Alcohol Beer Subsidy Scheme
Reduced Expenditures by the States from 1 July 2000 • Off-Road Diesel Subsidies • Savings from Indirect Tax Reform	***Reduced Revenues to the States from 1 July 2000*** • Gambling Taxes ***Increased Revenues to the States from 1 July 2000*** • Growth Dividend

The Commission's 2002 Update recommended that the ACT's GST relativity increase from 1.14778 in 2001-02 to 1.15216 in 2002-03. When applied to the GST funding pool, the ACT is expected to receive GST revenue totalling $600.0m in 2002-03, an increase of $52.0m or 9.5% as compared to 2001-02.

The reasons for the increases in both the 2002 GST and FAGs relativities are discussed in more detail in the *Commonwealth Grants Commission's Report on State Revenue Sharing Relativities 2002 Update – Outcome* section of this chapter.

The following chart highlights the impact of tax reform on the ACT's finances.

Figure 4.2.1
Estimated Impact of Tax Reform on the ACT

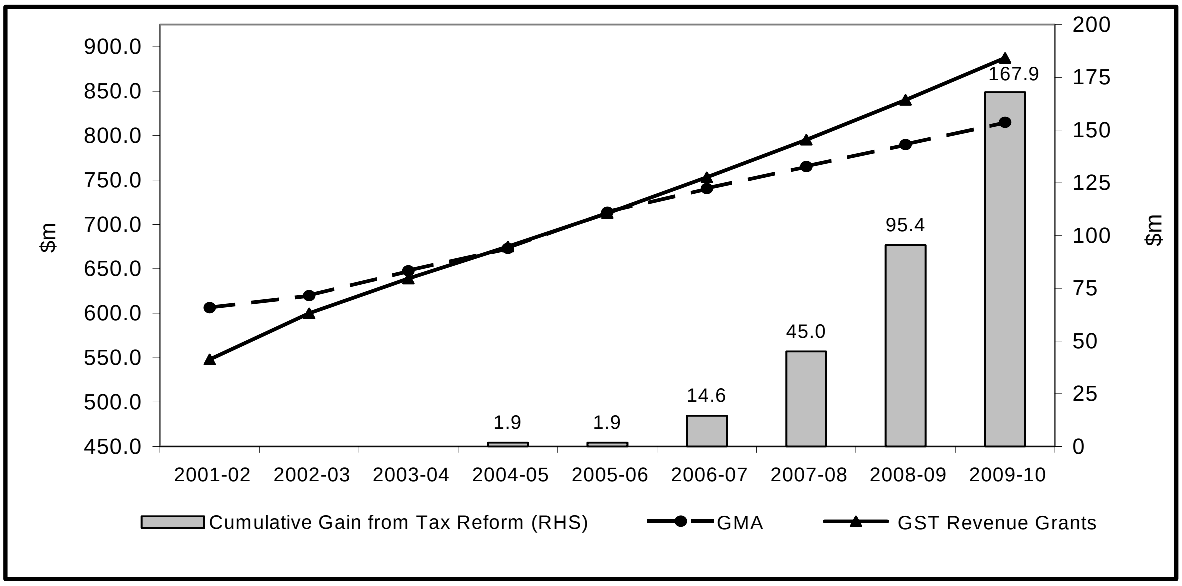

Figure 4.2.1 illustrates that from 2001-02 to 2003-04, and in 2005-06, the ACT's GST revenues are lower than its GMA (left hand scale). During this period the Commonwealth will 'top up' the difference with BBA, ensuring that the ACT is not financially disadvantaged.

By 2006-07, however, the ACT's GST revenue grants will be higher than its GMA, with the difference being the financial gains to the Territory. Figure 4.2.1 shows the positive gap growing significantly between 2006-07 and 2009-10.

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

The GMA is the position that the Commonwealth and the States have agreed represents 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
2001-02 to 2005-06

	2001-02 $m	2002-03 $m	Var $m	Var %	2003-04 $m	2004-05 $m	2005-06 $m
State Revenue Forgone							
Financial Assistance Grants	415.4	440.7	25.3	6.1	462.3	479.2	496.8
Revenue Replacement Payments	106.1	108.3	2.2	2.1	111.2	114.2	117.3
Financial Institutions Duty	17.4	19.5	2.1	12.1	20.0	20.5	21.0
Debits Tax	0.0	0.0	0.0	n/a	0.0	0.0	17.7
Marketable Securities Duty	21.6	24.2	2.6	12.0	24.8	25.4	26.0
Marketable Securities Duty – Needs	-4.0	-11.0	-7.0	175.0	-10.9	-6.6	-5.3
Plus Reduced Revenue							
Gambling Revenues	21.3	21.8	0.5	2.3	22.3	22.9	23.5
Plus Interest Costs							
Interest Costs	0.4	0.5	0.1	25.0	0.0	0.0	0.0
Loan Repayment	0.0	0.0	0.0	n/a	0.0	0.0	0.0
Plus Additional Expenditure							
First Home Owners Scheme	25.9	15.7	-10.2	39.4	23.2	23.8	24.2
GST Administration Costs	8.3	9.0	0.7	8.4	9.2	9.3	9.5
Plus Other Items							
Wholesale Sales Tax Payments	4.0	4.0	0.0	0.0	0.0	0.0	0.0
Minus Reduced Expenditure							
Off Road Diesel Subsidies	0.0	0.0	0.0	n/a	0.0	0.0	0.0
Savings from Tax Reform	9.0	9.5	0.5	5.6	10.1	10.7	11.3
Low Alcohol Beer Subsidy	0.0	1.0	1.0	n/a	1.0	1.1	1.1
Minus Growth Dividend							
Remaining State Taxes	1.8	2.4	0.6	33.3	3.1	3.9	4.7
Plus 2000-01 BBA Adjustment	**0.6**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**
ACT Guaranteed Minimum Amount	**606.2**	**619.7**	**13.5**	**2.2**	**647.8**	**673.1**	**713.7**

Note: Totals may not add due to rounding

On current modelling, the ACT is expected to 'go positive', or in other words, not require BBA for the first time in 2004-05, although this is expected to be short lived with the Territory requiring marginal BBA again in 2005-06. The ACT will require BBA in 2005-06 due to the assumption that Debits Tax will cease on 1 July 2005.

Increases in the out-years 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 proposal that, as part of ANTS, State Governments will abolish Debits Tax and the revenue forgone will be met by the Commonwealth within the GMA.

Special Fiscal Needs

In its 2002 Update Report, the Commission also recommended funding to the ACT for special fiscal needs, which the Commonwealth funds outside of the GST pool. This funding takes account of differences in financial arrangements between the Commonwealth and the

ACT and the Commonwealth and the States for a number of services including police, corporate affairs compensation and family law matters.

Despite the cessation of the family law matters payment, special fiscal needs will increase by $0.5m in 2002-03, due to indexation of the police and corporate affairs compensation.

National Competition Payments

As specified in the *Agreement to Implement the National Competition Policy and Related Reforms*, the ACT is expected to receive National Competition Policy Payments in three tranches. The first tranche ($200m per annum) was paid in to the States in 1997-98 and 1998-99, and the second tranche ($400m per annum in 1999-2000 and 2001-02). The third tranche payment for all States of $600m per annum, is to be paid over the period 2001-02 to 2005-06. The third tranche amount is indexed by inflation annually, and distributed on the basis of a State's population share.

In 2002-03, the Commonwealth is expected to pay the ACT $11.9m, 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.

General Revenue Assistance

The 2002-03 GRA estimates are expected to provide an increase of $14.3m above the estimated outcome for 2001-02. This arises from a number of factors which are outlined below.

Increases to the ACT's GMA for 2002-03 reflect:

- an increase in the ACT's FAGs relativity in the Commission's *Report on State Revenue Sharing Relativities 2002 Update;*
- an increase in the FAGs pool due to:
  - CPI indexation; and
  - a revision of the population estimate; and
- an increase in Revenue Replacement Payments, due to revisions to parameters such as CPI and volumes of usage.

Specific Purpose Payments (SPPs)

The States continued to seek reform in the administration and negotiation of SPPs during the course of 2001-02. The Heads of Treasuries (HoTs) SPPs Working Group, with ACT representation, progressed a number of items including:

- further development of an SPPs database, comprising comprehensive financial and descriptive data on all SPPs;
- introduction of best practice principles and guidelines for effective SPP agreements; and
- review of indexation arrangements.

SPPs Database

The data collection for the 2002 edition of the SPPs database was completed, and work on the new database model, endorsed at the November 2001 HoTs meeting, commenced. The new database will be created electronically to allow greater flexibility than the current model, which will enhance the value of the database as an analytical tool and assist all jurisdictions in preparing for the renegotiation of SPP agreements.

SPPs Best Practice Principles and Guidelines

The Commonwealth agreed to give further consideration to the adoption of the best practice principles and guidelines, which have now been endorsed by all States.

Amongst other things, the States are proposing that the extent of budget inflexibility and efficiency disincentives caused by input controls would be lessened if:

- States could spend less on a program from their own sources than the input controls otherwise demand, where they are able to demonstrate efficiency improvements or a likely improvement in outcomes for the community by switching State funds to other programs; and
- matching or maintenance of effort conditions could be varied to recognise differences between States in their existing effort.

Indexation of SPPs

The Commonwealth agreed, at the 30 November 2001 HoTs meeting, to consider the SPP Working Group's proposal for a Commonwealth review of current indexation arrangements for SPPs.

State Treasuries have noted that indexation arrangements are likely to be an important issue in the forthcoming renegotiation of three of the largest SPPs (discussed in detail later in this section), and remain firmly convinced of the need for a general review of indexation arrangements.

SPPs due for Renegotiation

A number of major SPPs will be coming up for renegotiation over the next 18 months. Together, these SPPs comprise over 50% of total SPP funding to the States. The following is a summary of the status of these negotiations, and the major issues from a State perspective.

Commonwealth-State Disability Agreement (CSDA)

The current CSDA is due to expire on 30 June 2002. CSDA administrators are negotiating a new agreement with a number of issues outstanding including:

- the replacement of the current indexation arrangements - including the use of "Wage Cost Index 2" (90% Safety Net Adjustment plus 10% Treasury Measure of Underlying Inflation) with a more accurate measure of earnings in the sector;
- uncertainty about the Commonwealth's commitment to continue providing funding in the new agreement; and

- the requirement for States to maintain State-sourced expenditure in real terms and to at least match the Commonwealth's "unmet need" funding.

Australian Health Care Agreement (AHCA)

The States have not commenced direct negotiations with the Commonwealth on the AHCA, which is due to expire at the end of 2002-03. However, an interstate AHCA Implementation Working Group has met regularly since the signing of the current AHCA in 1998, and has been monitoring the performance of the health system under that agreement.

In addition to the issue of overall funding levels, key issues for the new agreement include links to private health insurance utilisation, and the interface with aged care and GP services.

Commonwealth-State Housing Agreement (CSHA)

The current CSHA expires in June 2003. While a Housing Ministers' Advisory Committee has been formed to progress renegotiation of the CSHA, the Commonwealth has not yet given any clear direction or preferences for the new agreement.

Nevertheless, major issues are likely to include linkages between the CSHA and other social programs (eg Supported Accommodation Assistance Program (SAAP), disability services etc), the adequacy of Commonwealth funding for social housing (particularly in light of the annual decline in funding from the 1% "efficiency dividend" applied by the Commonwealth under the current agreement), and the requirement for States to match the Commonwealth's base funding.

Council of Australian Governments (COAG) Deliberations

In the past a number of SPPs have been initiated through COAG forums:

- the National Action Plan on Salinity and Water Quality (NAP):
  - the Commonwealth is seeking to accelerate the implementation of NAP, including signing of the remaining bilateral agreements and progressing the regional planning process for all priority areas; and
- Foot and Mouth Disease:
  - consideration is being given to a Memorandum of Understanding between Heads of Government on a national framework for responding to any outbreaks of Foot and Mouth disease, including a range of cost sharing principles.

Other issues considered recently by COAG include the arrangements for the extension of the Natural Heritage Trust to be developed by the Natural Resource Management Ministerial Council.

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. There are no major changes to this form of Commonwealth funding from 2001-02 to 2002-03.

Total Commonwealth Funding

As demonstrated in Table 4.2.1, total Commonwealth funding to the ACT is expected to increase by $9.0m between 2001-02 to 2002-03, a rise of 0.9%. This comprises a rise in General Revenue Assistance (GRA) of $14.3m and a decrease in SPPs and other Commonwealth payments of $5.4m.

State Budget Impacts (SBIs)

The SBIs provide an estimate of the impact on the ACT of changes to the Territory's sources of revenue and expenditure responsibilities as a result of tax reform. The removal of SBIs allow a comparison to be made across the years not affected by tax reform and the years affected by tax reform, as they place estimates on like terms. In essence, removal of SBIs from GRA is equal to FAGs plus Special Fiscal Needs plus National Competition Policy Payments. This is equivalent to the amounts which would have been paid if tax reform had not occurred.

As seen in Table 4.2.1, the increase in GRA between 2001-02 and 2002-03, once discounted by the change in SBIs, results in a gain in the ACT's GRA of $26.0m. After subtracting the $5.4m decrease in SPPs and other Commonwealth funding, net Commonwealth funding increased by $20.7m.

Commonwealth Grants Commission's Report on State Revenue Sharing Relativities 2002 Update - Outcome

The FAGs and GST relativities from the Commission's *Report on State Revenue Sharing Relativities 2002 Update* are used in determining the estimates of Commonwealth funding in Table 4.2.1.

Table 4.2.4 provides a comparison of the 2001 and 2002 Update GST and FAGs relativities for all States.

Table 4.2.4
Comparison of States' Relativities: 2001 and 2002 Updates
(5 year averages)

	GST Relativities 2001-02	GST Relativities 2002-03	Movement (Percentage Points)	FAGs Relativities 2001-02	FAGs Relativities 2002-03	Movement (Percentage Points)
NSW	0.92186	0.90631	-0.016	0.88490	0.86037	-0.025
VIC	0.87625	0.86824	-0.008	0.84657	0.83401	-0.013
QLD	1.00470	1.01174	+0.007	1.02151	1.04008	+0.019
WA	0.96275	0.97592	+0.013	0.90765	0.92858	+0.021
SA	1.18043	1.19447	+0.014	1.27464	1.29035	+0.016
TAS	1.50109	1.55419	+0.053	1.68714	1.75186	+0.065
ACT	**1.14778**	**1.15216**	**+0.004**	**1.19118**	**1.20906**	**+0.018**
NT	4.02230	4.24484	+0.223	4.93450	5.22670	+0.292

The latest relativities calculated by the Commission were positive for the ACT. Changes in the revenue and expenditure standards, on which the relative assessment weights are based, increased the Territory's share of Commonwealth funding. The largest change was in the debt charges category where the falling standard (weight) reflecting large repayments of debt by other States, reduced the relative advantage attributed to the ACT in recognition of the low level of debt transferred at self-government. The reduction in that advantage translated into higher per capita funding needs.

2002 Treasurers' Conference - Ministerial Council for Commonwealth-State Financial Relations Outcome

The Council, which replaced the annual Premier's Conference as the forum for discussion of Commonwealth-State financial relations matters, met in Canberra on 22 March 2002.

At the Council, Commonwealth and State Treasurers noted the level of expected revenue payments to the States in 2001-02 and 2002-03 and discussed a range of other issues. In this context, the most important outcome from the meeting was the Council's decision to approve the distribution of GST revenues amongst the States in accordance with the final recommendations of the Commission's *Report on State Revenue Sharing Relativities 2002 Update*.

The Treasurers also confirmed that the Commonwealth delivered on the SPP funding guarantee provided in the IGA. Under Clause 5(v) of the IGA, the Commonwealth is required to:

- continue to provide SPPs to the States; and
- not reduce aggregate SPPs as part of the ongoing process of tax reform.

To ensure that the Commonwealth complied with these commitments, clause 42(vi) of the IGA directed the Council to monitor future Commonwealth policy regarding SPPs.

HoTs also agreed that the WA Treasury, on behalf of all States, would prepare a compliance report for the Treasurers' consideration. The State Treasurers subsequently endorsed this report, as it indicated that the Commonwealth would meet its SPP commitment in 2000-01 and 2001-02.

The Council also considered a range of other topics including:

- Revenue Replacement Payments;
- a National Excise Scheme for Low Alcohol Beer; and
- the GST Administration Performance Agreement.

Revenue Replacement Payments (RRPs)

Following the 1997 High Court rulings that State franchise fees on petroleum products, and hence tobacco and alcoholic products, were invalid, the Commonwealth increased its taxation of these items, with the increase paid to the States as RRPs. Upon introduction of the ANTS, these payments were incorporated into the GMA as RRPs forgone.

The Commonwealth decided to cease the bi-annual indexation of petroleum excise on 1 March 2001. As a consequence, the Commonwealth determined that the petroleum RRPs forgone by the States should no longer be indexed, on the basis that consumers were no longer paying an indexed excise. The impact of this change on the ACT's GMA is a decrease of $2.1m in 2002-03.

National Excise Scheme for Low Alcohol Beer

The Council agreed to the implementation, from 1 July 2002, of a national excise scheme for low alcohol beer to replace the existing State subsidy schemes. States will continue to contribute an amount similar to their current subsidy, approximately $1.0m for the ACT from 2002-03 onwards, with the Commonwealth funding any shortfall. States will only contribute to the national scheme while they receive BBA after which the Commonwealth will fully fund the scheme. The ACT will contribute $1.0m in 2002-03 and 2003-04 respectively, with the Commonwealth meeting the costs of the scheme from 2004-05 onwards.

GST Administration Performance Agreement

As the Australian Tax Office (ATO) collects GST revenue on behalf of the States, section 38 of the IGA required a Performance Agreement to be determined. The signing of the *GST Administration Performance Agreement* by State Treasurers' fulfilled the requirement in the IGA.

The Council also agreed to provide the ATO with additional compliance funding of $45m in 2002-03, $47m in 2003-04, $48m in 2004-05 and $50m in 2005-06. As GST administration costs, and the additional compliance costs are attributed to States on their population share, the ACT will contribute $0.7m in 2002-03 and $0.8m in 2003-04, 2004-05 and 2005-06.

2002 Australian Loan Council Meeting

The Loan Council met on 22 March 2002 following the Treasurers' Conference. The role of the Council is to determine the appropriateness of each jurisdiction's Loan Council Allocation (LCA), its sustainability and consistency with national economic policy.

All members agreed to the proposed 2001-2002 LCAs nominated by the Commonwealth and the States, in a report from HoTs to the Council on the basis that the aggregate of LCA nominations were consistent with current macroeconomic policy objectives.

Included in the report, was the ACT's LCA at -$28m with a tolerance limit of +/- $44m as shown in Table 4.2.5. This implies, on a GFS basis, that the ACT is a net lender, or in other words, the ACT contributes surplus funds to the financial markets rather than relying on those markets as a source of additional funds.

Table 4.2.5
Loan Council Allocations – 2002-03 Estimates ($m) (a) (b)

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Cwlth	Aggregate
General Government sector cash deficit(+)/surplus(-)	-366	-1	-365	198	109	-115	17	72	-991	
PNFC sector cash deficit(+)/surplus(-)	813	-87	736	261	5	42	-19	-4	-133	
Non-financial public sector cash deficit(+)/surplus(-) (c)	448	-87	371	460	113	-73	-3	68	-1,124	
Minus Net cash flows from investments in financial assets for policy purposes	52	69	0	15	10	0	19	-24	-1,169	
Plus memorandum items (d)	-180	181	17	-172	-269	29	-6	0	-259	
Loan Council Allocation	**216**	**25**	**388**	**272**	**-166**	**-45**	**-28**	**92**	**-215**	**539**
2002-03 Tolerance Limit (+/-)	895	545	483	300	178	54	44	44	4,376	

Figures have been rounded. Discrepancies between totals and sums of components reflect rounding.

(a) Loan Council Allocation Nominations for 2002-03 reflect best estimates, at the March 2002 Loan Council meeting, of non-financial public sector deficits/surpluses. Nominations have been provided on the basis of policies announced up to and included in jurisdictions' mid-year reports. Nominations are based on preliminary estimates of general government finances provided by jurisdictions for the purposes of their mid-year reports, and projected bottom lines for each jurisdiction's PNFC sector.

(b) The LCAs of Tasmania and the Northern Territory are not strictly comparable with those of other jurisdictions, as Tasmania and the Northern Territory continue to report on a cash basis, while other jurisdictions report on an accrual basis.

(c) The sum of the surpluses of the general government and PNFC sectors may not directly equal the non-financial public sector surplus due to intersectoral transfers.

(d) Memorandum items are used to adjust the non-financial public sector deficit/surplus to include in LCAs certain transactions — such as operating leases — that have many of the characteristics of public sector borrowings but do not constitute formal borrowings. They are also used, where appropriate, to deduct from the non-financial public sector deficit/surplus certain transactions that the Loan Council has agreed should not be included in LCAs — for example, the funding of more than emerging costs under public sector superannuation schemes, or borrowings by entities such as statutory marketing authorities. Where relevant, memorandum items include an amount for gross new borrowings of government home finance schemes.

NB Governments' contractual financial liabilities under infrastructure projects with private sector involvement are excluded from LCAs. These liabilities, measured as governments' liability in the event of project termination, are unlikely to be realised and are materially different from actual borrowings undertaken to finance the public sector deficit. Government outlays under these projects, such as equity contributions and ongoing commercial payments to the private sector, are included in the general government cash deficit and the LCA.

In addition to the matters discussed above the Loan Council considered a proposal in relation to the Uniform Presentation Framework (UPF).

In 1991, Commonwealth and State Governments agreed to a UPF to provide a common core of financial information in their budget papers. The uniform presentation was deemed to enable a clearer understanding of individual budget papers and the capacity to allow meaningful comparisons across jurisdictions.

The Loan Council agreed to the proposal to extend the reporting requirements to include more detailed information from 2002-03. States have until 2003-04 to publish data at the more detailed level. The ACT currently provides financial information at the more detailed level, and will publish it in 2002-03.

Commonwealth Grants Commission 2004 Review

The former Minister for Finance, John Fahey wrote to the Chairman of the Commonwealth Grants Commission, Mr Alan Morris, during late 1999 conveying Part 1 of the Terms of Reference (ToR) for the Commission's 2004 Review.

In essence, the preamble and Part I of the ToR state:

> '*I am writing to convey to you Part 1 of the terms of reference for the Commonwealth Grants Commission to review the methods used to determine and report upon the question of the per capita relativities for distribution of GST revenue grants and health care grants which the Commission would regard as appropriate to apply after 2003-04.*

The ToR are as follows:

> 1. *Pursuant to sections 16, 16A and 16AA of the Commonwealth Grants Commission Act 1973, I hereby refer to the Commission for inquiry into and report upon, by 25 February 2004 at the latest, the question of per capita relativities which the Commission would regard as appropriate to apply after 2003-04 for the distribution of the combined pool of GST revenue grants and health care grants among the States, the Northern Territory and the Australian Capital Territory.*
> 2. *The Commission should review whether the allowances for special circumstances granted to the Australian Capital Territory continue to be necessary and, if so, make appropriate assessments.*
> 3. *The Commission should commence a work programme for improving methods of assessment and consult with the States and the Commonwealth in deciding the priorities for the work programme'.*

The Commission and the States have subsequently agreed that the ToR should be interpreted as asking the Commission to review the methods used to determine the per capita relativities with paragraph 3 stating 'The Commission should commence a work programme for improving the *methods of assessment*'.

However, the ToR for the 2004 Review differ from those for the 1999 Review, the last time the Commission reported on methods. Part I of the current ToR does not mention the principle of HFE. Instead, it refers to 'the per capita relativities for distribution of GST revenue grants'. Guidance on the principles on which the relativities are to be based must therefore be obtained from past reviews and the context in which the 1999 Inter Governmental Agreement on Commonwealth State Financial Arrangements was signed.

The definition and interpretation of HFE in Australia has remained much the same since the very early days of the Commission, though its expression has varied from time to time. In the 1999 Review, the Commission defined 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 standard'.*

The *A New Tax System (Commonwealth-State Arrangements) Act 1999*, specifies in Schedule 2 (which is the IGA) that GST revenue is to be distributed among the States on the basis of the principle of HFE. Thus the Commission and States have agreed that the relativities the Commission is asked to recommend in this review should be based on the HFE principle as articulated in the 1999 Review Report.

The ACT has implemented a whole-of-government strategy in preparing its Main Submission to the 2004 Review. All 40 expenditure and 20 revenue category assessments used by the Commission to derive each State's relative share of the GST pool have been systematically reviewed by the Treasury in conjunction with relevant ACT Departments and Agencies.

The ACT will be allocating further resources during the review timeframe to enhance several of the claims outlined in this submission as well as responding to the many other issues expected to arise from other State submissions. This task is a priority of the ACT Treasury over the next year or so.

Criticism of the ACT-Commonwealth Funding Arrangements

While the ACT enjoys a number of advantages in respect of the delivery of standard services, these advantages are off-set 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.

On 26 March 2001, NSW and Victoria, at a combined meeting of their respective State Cabinets in Albury-Wodonga, issued a joint communique announcing ToR for an Independent Review (IR) of Commonwealth-State Funding.

The IR was officially launched on 11 December 2001, and is designed to review the methods employed by the Commonwealth Government to allocate the GST revenues to the States.

The IR is essentially an attempt to pressure for a redistribution of GST funding towards the sponsoring States.

Accompanying the announcement of the IR were a range of criticisms of the current distribution method, using Queensland and the ACT as targets.

The ACT remains a strong supporter of HFE. The current pattern of GST distribution is fully justified given the strength of the revenue bases in NSW and the significant economies of scale of their operations. The current distribution system, underpinned by the principles of fiscal equalisation should remain.

The Commission's recurring Review process held every 5 years, allows continual refinements to be made.

Importantly, the ACT considers that the Commission's methods are more accurate than ever before. No other federation has such a robust, flexible and comprehensive equalisation system.

The latest Review process for 2004 provides all States with the opportunity to put forward their claims for consideration by the Commission, and for the Commission to reflect the latest policy changes and developments.

The importance of the current HFE arrangements cannot be underestimated as it allows all States to provide basic government services to their residents. The equitable transfer of funds between the States along the current lines achieves this goal. Any attempt to dismantle the current arrangements would contravene the current concept of equity and fairness, an approach that is enshrined in the 'Australian ethos'.

The ACT notes that the Commonwealth Government itself endorses the principles of equity with the HFE process:

"Accordingly, HFE gives practical effect to Australians' concerns about equity and substance to the Federation by giving each State a more equal capacity to provide their citizens with access to essential services (such as health and education) at a standard that is not lower than other States." [7]

If the GST revenues were distributed in the way being requested by some States, the current recipient States could not provide an average level of Government service to their residents without imposing higher levels of taxation, an approach which the ACT considers to be inequitable.

The ACT's Current Relativity

As at the 2002 Update, the ACT's per capita relativity is 1.15216. This means that the ACT receives a per capita share of GST funding which is 15% above the average per capita amount (an Equal Per Capita share). That is, the ACT has been assessed, under HFE principles, as requiring an above per capita share of GST funds to enable it to provide a standard range of services, at an average level of efficiency, while making an average effort to raise revenue from its own sources.

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:

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[7] Federal Financial Relations 2002-03, Commonwealth Budget Paper No 3, page 18.

- 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 property.

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

In relation to the provision of services, the ACT is assessed as being able to provide a standard range of services at an average cost. 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;
- increased costs as a result of Canberra's role as a national capital / seat of government;
- diseconomies of small scale through needing to supply the same range of services as larger States 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.

Importantly, in regard to the inability of the ACT to tax the Commonwealth Government, and because the Commonwealth is the predominant employer in the ACT, the Territory's capacity to raise revenues normally collected from employers is considerably lower than that for the majority of the other States.

An approximate estimate of the potential payroll tax revenue from the Commonwealth is $200.0m. If the ACT were to collect this revenue, the majority would be redistributed through the application of HFE. In this event, the ACT would receive substantially less than an equal per capita (EPC) share of GST funding however, its own source revenues would be much larger.

The reasons for the ACT's current relativity are dealt with in considerably more detail in the ACT's Main Submission to the Commonwealth Grants Commission's 2004 Review. This submission may be accessed on the ACT Treasury website, http://www.act.gov.au/ti/grants_commission/grants.html.

ACT's Contribution to the Federation

Fiscal Subsidies within the Australian Federation

Notwithstanding, the ACT's higher than EPC share of GST funding, its net contribution to the Federation is the largest in per capita terms of all States.

The West Australian Treasury has developed a longstanding paper titled *Fiscal Subsidies within the Australian Federation* which clearly documents the net fiscal subsidies contributed by the States to Australia. The latest available information is for 1998-99.

The net fiscal subsidy is calculated as revenues less outlays plus the deficit. Three components are used to calculate the net fiscal subsidy:

- actual revenue contributions from the States to the Commonwealth (including personal and company income tax);
- outlays from the Commonwealth to the States; and
- an allocation of the Commonwealth deficit between the States as it represents an impost on future taxpayers (based on 50% of a State's expenditure share and 50% of a States' revenue share).

In terms of the outlays, WA has allocated expenditures between States using ABS data on the basis of the location of services, and the destination of grants and cash benefits. Expenditures in the ACT and on defence are special cases:

- Commonwealth Government expenditures in the ACT are allocated among all States on a per capita basis; and
- defence purchases are allocated on a per capita basis, while salaries are allocated according to the location of defence establishments.

As shown in Table 4.2.6, the ACT is the highest net financial subsidiser of the Federation in per capita terms. Its per capita contribution to revenues is significantly higher than other States, and the outlays received from the Commonwealth are relatively lower.

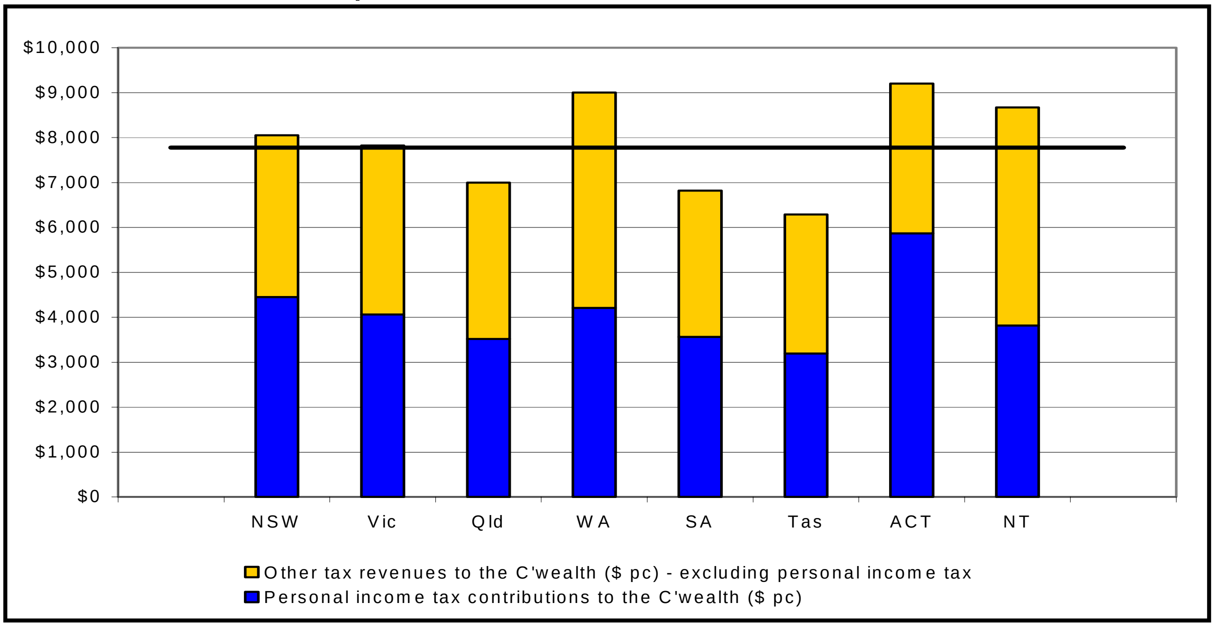
Table 4.2.6
Components of the Net Fiscal Subsidy, 1998-99

	Revenues $pc	Outlays $pc	Deficit $pc	TOTAL $pc	Revenues $m	Outlays $m	Deficit $m	TOTAL $m
NSW	8,052.29	7,348.61	-293.84	410	51,299	48,816	-1872	2,612
Vic	7,818.61	7,166.68	-285.92	366	36,615	33,562	-1339	1,714
Qld	6,995.54	7,349.72	-274.10	-628	24,373	25,607	-955	-2,188
WA	9,004.59	7,390.94	-312.65	1301	16,618	13,640	-577	2,401
SA	6,815.76	8,144.81	-285.95	-1615	10,154	12,134	-426	-2,406
Tas	6,288.75	8,995.75	-292.99	-3000	2,962	4,237	-138	-1,413
ACT	9,197.03	7,423.02	-317.25	-1460	2,841	2,293	-98	451
NT	8,666.19	14,339.17	-438.79	-6117	1,659	2,745	-84	-1,171

Source: Fiscal Subsidies within the Australian Federation, West Australian Treasury, 1998-99.

Figure 4.2.2 highlights the per capita revenues contributed by the States to the Commonwealth and compares this with an EPC contribution.

Figure 4.2.2
State Per Capita Revenue Contributions to the Federation, 1998-99



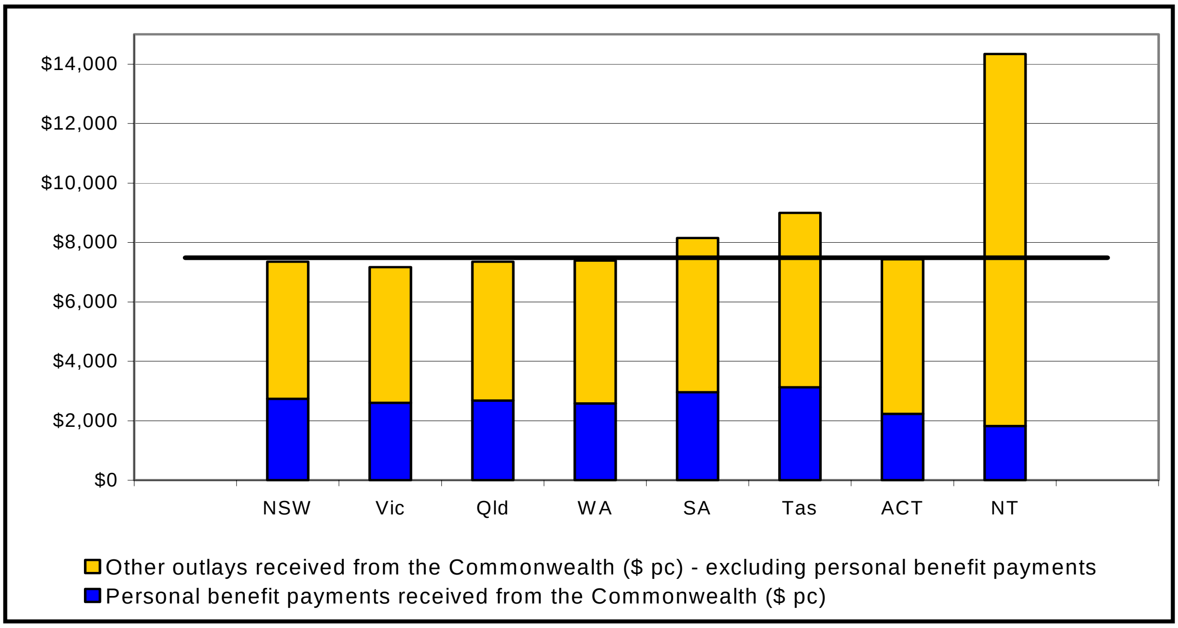
Source: Fiscal Subsidies within the Australian Federation, West Australian Treasury, 1998-99.

Figure 4.2.2 also shows that NSW, Victoria, WA, ACT and the NT all make a positive contribution to the Federation. That is, they provide a greater than EPC share of taxation revenues to the Commonwealth.

The ACT's contribution is the highest in per capita terms, reflecting its very high per capita personal income tax contribution stemming from the Territory's relatively high average weekly earnings and high numbers of Pay As You Earn tax payers.

Figure 4.2.3 highlights the per capita outlays received by the States from the Commonwealth and compares this with an EPC contribution.

Figure 4.2.3
State Per Capita Outlay Contributions to the Federation, 1998-99



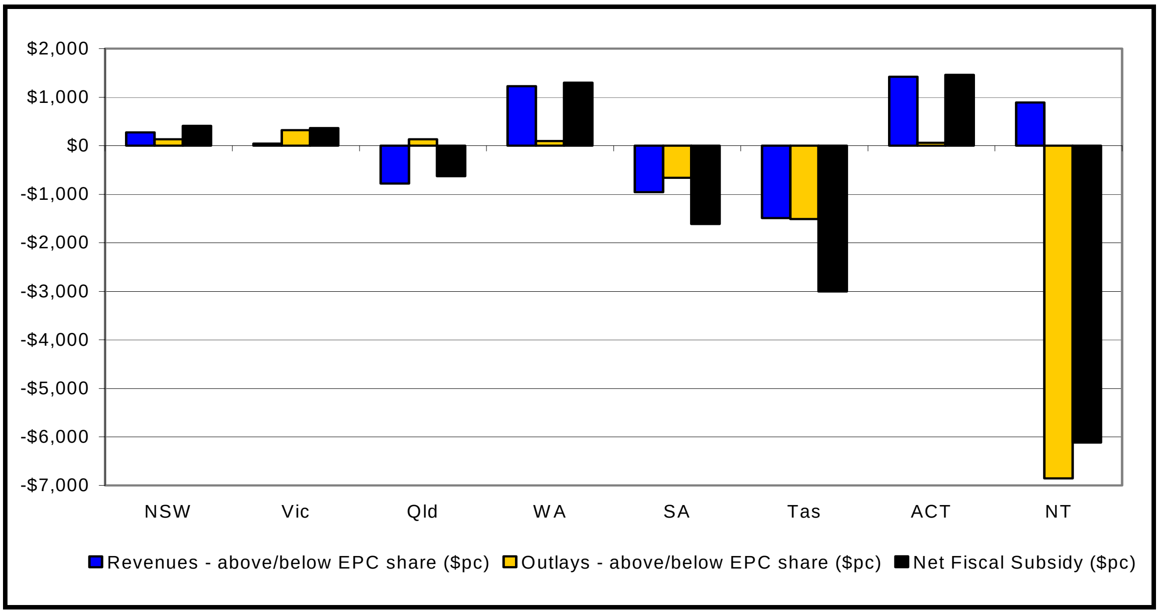
Source: Fiscal Subsidies within the Australian Federation, West Australian Treasury, 1998-99.

It shows that NSW, Victoria, Queensland, WA and the ACT receive less than an EPC share of Commonwealth outlays.

The ACT again makes a contribution to the Federation, receiving outlays slightly less than an EPC share due, driven predominantly by the second lowest per capita payment of personal benefit payments.

The following Figure 4.2.4 brings together each of the components to derive the net fiscal subsidy calculation. The deficit contribution is not split given that its effect is marginal. It is, however, included in the total.

Figure 4.2.4
Summary Of Per Capita Contributions to the Federation, 1998-99



Source: Fiscal Subsidies within the Australian Federation, West Australian Treasury, 1998-99.

A positive per capita contribution to the Federation is reflected by a bar being greater than zero, whereas a negative per capita contribution is shown by the bar being below zero.

Figure 4.2.4 shows the ACT having a large revenue contribution and a small outlay contribution. The sum of these components results in the highest per capita net fiscal subsidy.

Other Distributions

Interestingly, if other distributions are used, the ACT's share of funding also increases. This again reflects the extent to which the Territory subsidises the nation.

If the 2002-03 GST pool were to be distributed according to the proportion of personal income tax contributions made to the Commonwealth (a major driver of the ACT's large subsidisation of the Federation), the ACT would receive 2.4% of the pool, as opposed to the recommended 2.0% stemming from a distribution based on the Commission's 2002 Update relativities.

Table 4.2.7 provides a comparison of four alternative per capita distributions of the 2002-03 GST pool:

- an EPC share – based on each person receiving an equal share of the GST pool;
- CGC 2002 Update relativities – based on each person receiving a share of the GST pool distributed according to the relativities;
- total tax contributions – based on each person receiving a share of the GST pool distributed according to the proportion of total tax and non-tax revenue each State has contributed to the Commonwealth's revenues (based on the data contained in the WA Fiscal subsidies report for 1998-99); and

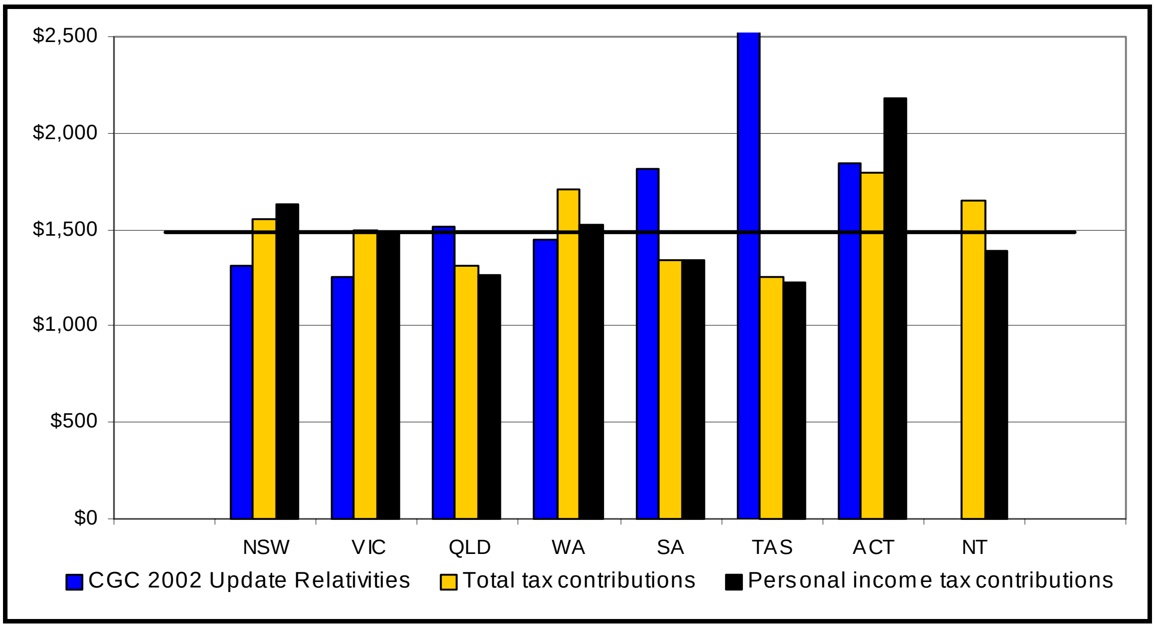
– personal income tax proportions - based on each person receiving a share of the GST pool distributed according to the proportion of personal income tax each State has contributed to the Commonwealth's revenues (based on the data contained in the WA Fiscal subsidies report for 1998-99).

TABLE 4.2.7
ALTERNATIVE STATE DISTRIBUTIONS OF THE 2002-03 GST POOL,

	NSW $ pc	Vic $ pc	Qld $ pc	WA $ pc	SA $ pc	Tas $ pc	ACT $ pc	NT $ pc
Equal per capita share	1,489.23	1,489.23	1,489.23	1,489.23	1,489.23	1,489.23	1,489.23	1,489.23
Percentage share of pool	33.6%	24.9%	18.9%	9.9%	7.7%	2.4%	1.6%	1.0%
CGC 2002 Update Relativities	1,313.93	1,252.61	1,516.65	1,450.44	1,811.52	2,545.89	1,847.91	7,454.32
Percentage share of pool	29.7%	21.0%	19.2%	9.6%	9.3%	4.1%	2.0%	5.1%
Total tax contributions	1,550.40	1,492.08	1,313.37	1,710.41	1,345.72	1,258.67	1,793.66	1,652.61
Percentage share of pool	35.0%	25.0%	16.6%	11.3%	6.9%	2.0%	1.9%	1.1%
Personal income tax contributions	1,635.02	1,480.85	1,261.05	1,525.58	1,342.59	1,221.25	2,184.58	1,388.63
Percentage share of pool	36.9%	24.8%	16.0%	10.1%	6.9%	2.0%	2.4%	1.0%

Figure 4.2.5 graphically illustrates the alternative per capita distributions outlined in the previous table. The large per capita amount distributed to the NT through the Commission's processes has been excluded, given that its inclusion would overwhelm the payments for other States.

Figure 4.2.5
Alternative State Distributions of the 2002-03 GST Pool – $ Per Capita



While the ACT would benefit substantially from some alternative distribution, it considers that HFE represents a robust and equitable method that provides for a distribution of GST to enable all Australians to access similar standards of government services.