7.2 INTERGOVERNMENTAL FINANCES

Overview

- Following the introduction of the Goods and Services Tax (GST) in 2000 and the abolition of a number of state taxes, the States[1] have become increasingly reliant on Australian Government funding. Approximately 42 per cent of the ACT's revenue will be sourced from Australian Government funding in 2007-08.
- GST revenue grants are expected to be $822.6 million in 2007-08, an increase of $60.7 million from the 2006-07 estimated outcome.
- As agreed between the ACT and the Australian Government, the ACT will abolish duty on hiring arrangements from 1 July 2007. Duty on non-real core business assets was abolished from 1 July 2006. The remaining two taxes subject to review under the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations (IGA), namely duty on leases and non-quotable marketable securities, will be abolished from 1 July 2009 and 1 July 2010 respectively.
- Specific Purpose Payment (SPP) funding of $452.4 million will be received in 2007-08, an increase of $15.8 million over the 2006-07 estimated outcome.
- The ACT's GST relativity has been revised upwards from 14.6 per cent above an equal per capita share of the GST pool in 2006-07 to 16.3 per cent in 2007-08 following the release of the Commonwealth Grants Commission's (CGC) Report on State Revenue Sharing Relativities 2007 Update (2007 Update Report) in February 2007.

Commonwealth-State Financial Relations

Commonwealth-State financial relations are characterised by a mismatch between the revenue-raising capacity and the expenditure responsibilities of the Australian and State governments. This mismatch is known as vertical fiscal imbalance (VFI). The Australian Government collects the major share of taxation revenues and, increasingly, States must rely on grants from the Australian Government to meet expenditure requirements.

A major area of concern with regards to VFI is the sharing of roles and responsibilities between the tiers of government in key service delivery areas such as health and education. Even though States are inherently responsible for the planning and development of health and education programs, they rely on Australian Government funding for financial support.

The Australian federation has become an issue of major significance in the political arena, with several States commissioning independent reviews of the fiscal relations between the Australian and State Governments. The most recent report, *Australia's Federal Future*, was commissioned by the recently formed Council for the Australian Federation (CAF)[2] to raise public awareness of the current problems with the Australian system of intergovernmental relations, in particular, the high level of VFI and the unclear delineation of roles and responsibilities between the State Governments and the Australian Government.

1. States refers to the Australian States and Territories, unless otherwise specified.
2. CAF consists of Premiers and Chief Ministers from all Australian States and Territories, and is currently chaired by the Premier of South Australia.

The Report concluded that there was an opportunity for the Australian and State Governments to work towards a cooperative form of federalism, rather than the current 'opportunistic' model. Under the current model the Australian Government has used its array of financial and legislative powers to intervene selectively in areas of traditional State responsibility.

Given that both sides of the political debate, and all tiers of government, have flagged this issue for significant review, fiscal federalism, and associated VFI, will likely remain on the national agenda for some time.

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 2007-08.

Table 7.2.1 below summarises the expected level of Australian Government funding to the ACT across the Budget and forward estimates.

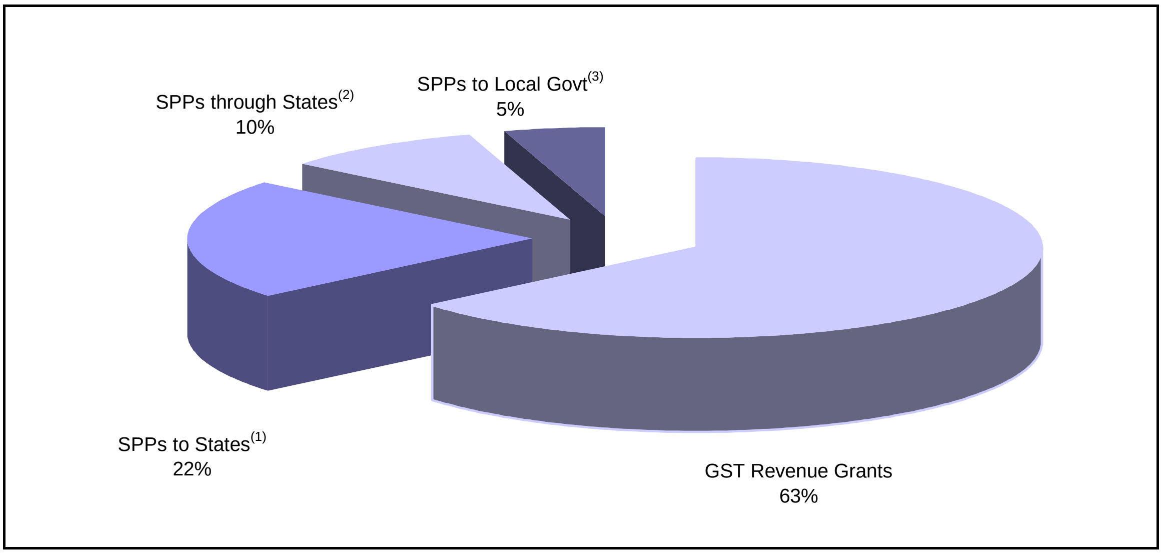
Table 7.2.1
Australian Government Funding to the ACT

Payment	2006-07 Est. Out. $m	2007-08 Budget $m	Var $m	Var %	2008-09 Estimate $m	2009-10 Estimate $m	2010-11 Estimate $m
GST Revenue Grants	761.9	822.6	60.7	8.0	864.3	902.3	942.6
Specific Purpose Payments:							
Health (inc Health Care Grants)	135.1	140.7	5.6	4.2	143.2	148.8	155.0
Social Security and Welfare	27.6	28.7	1.1	4.0	29.7	31.0	32.2
Public Order and Safety	3.8	3.9	0.1	2.5	4.0	4.1	4.2
Education	147.7	164.7	17.0	11.5	171.8	180.6	185.1
Vocational Education and Training	22.5	22.8	0.3	1.2	23.3	23.8	24.8
Housing	18.7	19.3	0.6	3.1	19.6	19.5	19.7
Local Government	69.9	60.8	-9.1	-13.0	62.5	64.3	66.1
Other	11.4	11.6	0.2	1.8	11.8	12.0	12.2
Total Specific Purpose Payments	**436.6**	**452.4**	**15.8**	**3.6**	**465.9**	**483.9**	**499.2**
Other Aust. Govt. Payments	**4.3**	**9.9**	**5.6**	**130.2**	**3.1**	**0.9**	**0.9**
Total Australian Government Funding	**1,202.8**	**1,284.9**	**82.1**	**6.8**	**1,333.3**	**1,387.1**	**1,442.7**

Note - Totals may not add due to rounding.

The relative proportions of Australian Government funding are shown in Figure 7.2.1

Figure 7.2.1
2007-08 Australian Government Funding to the ACT



Notes:

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 local government functions.

General Revenue Funding 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. In 2007-08, no State will require Budget Balancing Assistance (BBA), as all States' GST payments are expected to exceed their respective GMA.

2006-07 Estimated Outcome

The Territory will receive $761.9 million in GST in 2006-07, an increase of $3.6 million, compared to the 2006-07 budget estimate of $758. million. This increase in funding reflects:

- an increase in the 2006-07 GST revenue pool estimate of $260 million as a result of stronger underlying consumption than previously thought; and
- a small increase in the ACT's share of the Australian population, which had a flow on effect on the ACT's share of the GST revenue pool.

2007-08 Budget Year

GST revenue grants to the ACT in 2007-08 are estimated at $822.6 million, reflecting an increase of $60.7 million over the 2006-07 estimated outcome of $761.9 million. The increase primarily reflects:

- an increase of $2,328 million over the 2006-07 GST revenue pool to $41,850 million;
- a small increase in the ACT's share of the Australian population; and
- the CGC's 2007 Update Report recommendation to increase the ACT's GST relativity from 1.14575 in 2006-07 to 1.16293 in 2007-08.

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 circumstances, and the fact that the CGC recalculates the States' GST relativities each year based on the latest available data.

As it is a federally collected tax, the Australian Government is best placed to estimate the GST revenue pool. The Australian Government's GST revenue pool estimate is adopted 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 variations. Since the 2006-07 Budget, the ACT has updated its GST revenue grant estimates five times following advice from the Australian Government. A summary of these updates and the bases underpinning the changes are provided in Table 7.2.2 below.

Table 7.2.2
Reconciliation of GST Revenue Grants to the ACT

GST Revenue Grants to the ACT (including GST Deferral Compensation)		2006-07 $m	2007-08 $m	2008-09 $m	2009-10 $m
2006-07 ACT Budget	**June 06**	**758.3**	**796.6**	**834.9**	**873.2**
	Variation (1)	1.0	0.0	0.0	0.0
2006-07 GST Payment Profile	**Jul 06**	**759.3**	**796.5**	**834.9**	**873.2**
	Variation (2)	4.7	0.0	0.0	0.0
2005-06 Final Budget Outcome	**Oct 06**	**764.0**	**796.5**	**834.9**	**873.2**
	Accumulated variation 1-2	5.7	0.0	0.0	0.0
	% change	0.8	0.0	0.0	0.0
2006-07 ACT Mid-Year Review (MYR) [(a)]	**Dec 06**	**764.0**	**796.5**	**834.9**	**873.2**
	Variation (3)	-0.8	10.9	17.0	17.9
2006-07 MYEFO	**Dec 06**	**763.2**	**807.4**	**851.9**	**891.1**
	Variation (4)	1.2	15.3	15.6	14.0
2007 Statement of Estimated Payments	**Mar 07**	**764.4**	**822.7**	**867.5**	**905.1**
	Variation (5)	3.3	-0.1	-3.1	-2.8
2007-08 Federal Budget	**May 07**	**767.7**	**822.6**	**864.3**	**902.3**
	Accumulated variation 1-5	9.4	26.1	29.5	29.1
	% change	1.2	3.3	3.5	3.3
2007-08 ACT Budget [(b)]	**Jun 07**	**761.9**	**822.6**	**864.3**	**902.3**
Change from 2006-207 to 2007-08		3.6	26.0	29.4	29.1

Notes:

(a) The impact of variations 1 – 2 was reflected in the ACT's 2006-07 Mid-Year Review, released in December 2006.

(b) The 2006-07 estimate factors in a possible $5.8 million overpayment by the Australian Government via a GST Deferral Compensation Payment, which is expected to be recovered.

Parameter variation:

(1) **2006-07 GST Payment Profile:** Upward revision to the ACT's relative share of 2006-07 Australian population.

(2) **2005-06 Final Budget Outcome (FBO):** Adjustment to 2006-07 GST pool (+$260 million) arising from base effect of higher than expected 2005-06 FBO. These estimates fed into the 2006-07 ACT Mid-Year Review (MYR).

(3) **2006-07 Mid Year Economic and Fiscal Outlook (MYEFO):** Revised GST revenue pool and population estimates.

(4) **2007 Statement of Estimated Payments:** Release of 2007-08 GST relativities and revised population estimates. ACT GST relativity revised up from 1.14575 (2006-07) to 1.16293 (2007-08).

(5) **2007-08 Federal Budget:** Release of the 2007-08 Federal Budget Papers on 8 May 2007

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 user population estimates and indexation arrangements.

Specific Purpose Payments

SPPs constitute a significant amount (approximately 37 per cent) of Australian Government funding to the States. In general, SPPs are paid to States on the condition that 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 2007-08.

2006-07 Estimated Outcome

The Territory will receive $436.6 million in SPPs and other Australian Government payments in 2006-07. This is a slight decrease on the original budget estimate of $443.7 million.

2007-08 Budget Year

In 2007-08, SPPs and other Australian Government payments to the ACT are estimated at $452.4 million. This represents an increase of $15.8 million over the 2006-07 estimated outcome. In general, this increase reflects the application of indexation arrangements to funding payments and the ACT Government's agreement to participate in the Australian Water Fund 'Water Smart Australia Program'. Through this program, the Australian Water Commission will provide funding for activities that help implement the Intergovernmental Agreement on a Natural Water Initiative.

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.

COAG – Young People with Disabilities (YPWD) in Residential Aged Care

The Council of Australian Governments (COAG) meeting held in February 2006 agreed to a range of health-related initiatives, including a program to reduce the number of YPWD living in residential aged care facilities. The program aims to move YPWD into more appropriate accommodation (subject to their agreement), improve care for YPWD who remain in aged care, and reduce future admissions of YPWD who can be better cared for elsewhere.

Following COAG, the Australian Government, in its *2006-07 Budget,* announced that it would provide $122 million over five years, to be matched by the States, to reduce the number of young people with a disability being forced to reside in aged care institutions.

All States have signed the multilateral, and associated bilateral agreements, underpinning the YPWD program. Under the Agreement, each State will have a target range for the net reduction in YPWD in residential aged care.

Furthermore, there will be mid-term evaluation of the program commencing in 2008, and a final evaluation commencing in 2010. These evaluations are to be undertaken by the Australian Government in collaboration with each State.

The final evaluation, to be completed by 31 October 2010, will advise on the way forward for funding of the program beyond 2010-11. It will focus on how well States have achieved a net reduction of the number of YPWD in residential aged care.

The bilateral agreements state that it is the intention of the Australian Government and the States that, subject to satisfactory achievement of the performance targets, ongoing funding at the end of the five years will be rolled into a future funding arrangement.

In 2007-08, it is estimated that the ACT will receive $0.230 million for YPWD initiatives.

Current SPP Renegotiations

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

Home and Community Care (HACC)

HACC provides for basic community care services to frail aged and younger people with disabilities, and their carers, so that they are able to remain in their own homes and communities.

Funding to the ACT is allocated through a bilateral negotiation process, which specifies the current and proposed HACC programs eligible for Australian Government grants. In general, HACC programs receive 60 per cent of funding from the Australian Government and 40 per cent of funding from the ACT.

The new HACC bilateral agreement was signed on 23 April 2007 and will apply from 1 July 2007. The main development with regards to the new HACC is that the Australian Government has introduced a 2 per cent funding penalty for States who fail to adhere to agreed funding conditions. Furthermore, States will now have the option to negotiate funding on a three-year basis, rather than year to year.

Commonwealth State Territory Disability Agreement (CSTDA)

The CSTDA is a five-year agreement providing the overarching framework for the delivery, funding and development of specialist disability services. The expiry date of the current CSTDA is 30 June 2007. The Australian Government and State Disability Ministers have agreed to develop a new CSTDA.

While negotiations over the new agreement are continuing, the Australian Government has outlined an offer to the States, which comprises:

- indexation to remain at the current Australian Government contribution;
- a requirement for increased reporting from the State; and
- the introduction of a new third-party quality assurance accreditation scheme for all providers of disability services.

The Australian Government Minister for Families, Community Services and Indigenous Affairs has indicated that the Australian Government is prepared to offer additional funding for unmet need, but has not indicated the amount of funding. Instead, each State must put forward plans for additional 'new money' funding of accommodation and respite services. The Australian Government would then consider matching the plans on a dollar-for-dollar basis. The Australian Government has indicated a distinct preference for separate bilateral agreements with the pursuit of a national CSTDA as a fallback position.

The States are continuing to negotiate with the Australian Government for a national agreement to deal with national disability, including unmet need.

The ACT is currently seeking to overcome a serious disparity in base funding. Currently the ACT receives 17 cents from the Australian Government for every $1 it spends on specialised disability services. This is significantly less than the Australian average of 24 cents from the Australian Government for every $1 spent.

Australian Health Care Agreement (AHCAs)

The AHCAs provide for the joint funding of public hospital services. The current AHCAs is due to expire on 30 June 2008.

In 2007, the NSW Minister for Health, as the Chair of the Australian Health Ministers' Conference and on behalf of State and Territory Health Ministers, wrote to the Australian Government Minister for Health and Ageing. This correspondence highlighted key issues in relation to the continued and adequate funding of comprehensive health services, including:

- relevant developments from the COAG National Reform Agenda (NRA), including agreement that funding models should be designed to support contemporary models of care;
- opportunity presented by AHCAs to reinforce the COAG reform process and improve relationships between health sectors and all levels of government;
- recent reforms proposed by the Australian Government Minister for Health and Ageing with implications for AHCAs (eg changes to reporting, Medicare Benefits Scheme for outpatient services and private health insurance);
- opportunities to address rigidities in current AHCAs which militate against efficient, effective care, including requirements related to shifting services from hospital settings and the scope of services clause; and
- the critical role of indexation in ensuring AHCAs reflect cost pressures on the States.

In addition to these issues, States have a range of other concerns with the AHCAs. These include the impact of growth matching requirements and matching base on States' own budget flexibility, scope for flexibility across preventative and acute boundaries, and reporting arrangements.

The Australian Government Health Minister has indicated that formal negotiations may not begin until after the Federal election, and flagged the possibility of extending the AHCAs for a period (beyond 1 July 2008) while negotiations continue.

Commonwealth-State Housing Agreement (CSHA)

The purpose of the CSHA is to provide funding to assist those whose needs for appropriate housing cannot be met by the private market. The current CSHA agreement will expire on 30 June 2008.

The 2003-08 CSHA has provided $4.75 billion of Australian Government funding for housing assistance over the period of the agreement with the ACT receiving approximately $93 million. The CSHA comprises four funding streams - CSHA block assistance, Aboriginal Rental Housing Program, Crisis Accommodation Program and Community Housing Program.

In accordance with the CSHA timetable for renegotiation, as agreed by Housing Ministers in September 2006, the Australian and State Governments are currently researching ways to improve the four funding streams of CSHA. As part of this process, parties are looking at the linkages between the CSHA and other funding agreements such as Commonwealth Rental Assistance (CRA) and the Supported Accommodation Assistance Program.

It is envisioned that State Housing Ministers will be in a position to recommend a common position on CSHA to the Australian Government at the Housing Ministers' Conference in July 2007. The Australian Government has yet to formally set out its CSHA policy position.

Natural Resource Management Agreement

The Natural Heritage Trust (NHT) and National Action Plan for Salinity and Water Quality (NAP) agreements expire on 30 June 2008. These agreements fall under the broad umbrella of Natural Resource Management (NRM).

The successor agreement to the current NHT and NAP programs will be the *NHT Phase Three* program, which will commence in 2008 and will be reviewed in 2012-13.

On 24 November 2006, the NRM Ministerial Council agreed on a *Framework for Future NRM Programmes*. Some of the key elements of the Framework include:

- continuing recognition and support for the regional approach used to deliver the NHT and NAP;
- enhancing the role of local government;
- the potential introduction of regional block funding arrangements; and
- enhancement of monitoring and evaluation, standards and targets, and reporting arrangements.

The ACT has received $3.211 million in NHT funding under the current arrangements since 2003-04 and while no NAP funding has been received to date, the ACT and Australian Governments signed a bilateral agreement on 20 December 2006 providing $5 million in total to the ACT, comprising equal contributions from the two governments. The NAP funding will address the prevention, stabilisation and reversal of dryland salinity and improvements in water quality and allocation in the Territory

In the 2007-08 Federal Budget, the Australian Government committed $2 billion over seven years to NHT Phase Three, however details of State-by-State allocations are yet to be negotiated between the Australian Government and the States. It is likely that formal negotiations will be scheduled for the latter half of 2007.

Inquiry into Local Government Cost Shifting (the Hawker Report)

Following the tabling of the Inquiry into Local Government and Cost Shifting (the Hawker Report) in November 2003, the Australian Government, in its formal response:

- provided the CGC with terms of reference to review the current interstate distribution of the identified roads component; and
- asked the Productivity Commission (PC) to undertake a study to examine local government's own revenue sources by April 2008.

Identified Roads Component

In May 2006, the CGC presented the Australian Government with its draft report for the review of the interstate distribution of local road grants. The CGC concluded it could present its recommendation for the distribution of the local road grants between States by either:

- providing per person relativities for the distribution of the grants; or
- providing the distribution in the form of State shares.

Nevertheless, the CGC cautioned that better and more consistent local road data would need to be made available before it would progress either of these avenues.

In a 2007-08 Budget media release, the Australian Government cited that as data comparability was an issue, it would not adopt the CGC's recommendations. Therefore, the existing State distribution of road funding will be maintained.

Local Government Funding Arrangements

The Australian Government has asked the PC to examine local government's own revenue sources. The study will examine the capacity of different types of councils to raise revenue, the impact of the various revenue sources available to local government, and the regulatory environment surrounding local government's revenue raising capacity.

The terms of reference for the study focus on the total quantum of funding for local government purposes and hence, given the ACT's unique administrative circumstance combining both State and local government functions, it is unlikely that the PC findings will pose an immediate risk to local government funding to the Territory.

Future SPP Renegotiations

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

- Schools Quadrennial Funding Agreement, expires 30 December 2008;
- Commonwealth-State Agreement for Skilling Australia's Workforce, expires 30 December 2008;
- Legal Aid Agreement, expires 30 December 2008; and
- Auslink, expires 30 June 2009.

Commonwealth Grants Commission Report on State Revenue Sharing Relativities 2007 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 to determine 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 so that they reflect the latest circumstances of the States.

Outcome of Report on State Revenue Sharing Relativities 2007 Update

The 2007 Update Report was publicly released on 27 February 2007.

The relativities were agreed by the Ministerial Council for Commonwealth-State Financial Relations on 30 March 2007, and will be used to distribute the 2007-08 GST pool.

A comparison of the 2006 Update and 2007 Update relativities, as illustrated in Table 7.2.3 below, shows that New South Wales, Victoria, South Australia, the ACT and the Northern Territory all received increased relativities. All other States received reduced relativities. In particular, the relativity of Western Australia has moved below an equal per capita share (relativity less than one) due to strong economic growth. Queensland, which also benefited from strong economic growth moved closer to an equal per capita share. 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 7.2.3
Comparison of GST Relativities

	2006 Update	2007 Update	Change in GST funding [(a)]	
			$m	$ per capita [(b)]
New South Wales	0.87332	0.89079	+277.0	+40.36
Victoria	0.89559	0.90096	+64.0	+12.48
Queensland	1.02387	1.00607	-166.4	-40.68
Western Australia	1.00480	0.94747	-271.6	-131.00
South Australia	1.18862	1.20791	+69.3	+44.38
Tasmania	1.54931	1.54465	-5.1	-10.40
Australian Capital Territory	**1.14575**	**1.16293**	**+13.1**	**+39.61**
Northern Territory	4.32755	4.36824	+19.7	+94.56

Notes

(a) Excluding the effects of population and GST revenue growth.

(b) Based on 2006-07 populations reported in the Australian Government Treasurer's Statement of Estimated Payments, March 2007.

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 1.16293 indicates that it is entitled to a 16.3 per cent above an equal per capita share of the GST pool. With the exception of New South Wales, Victoria and Western Australia, all States require more than an Australian average per capita amount, that is, a relativity above one.

The changes to the relativities between the 2006 and 2007 Updates have been heavily influenced by a change in circumstances for several States. This was caused by updating the data used for the 2007 Update to 2005-06. As a result, $468.4 million of the GST pool was reallocated amongst the States. A large redistribution effect came about as a result of a marked decrease in New South Wales' ability to raise stamp duty on conveyances revenue, due to a 2005-06 downturn in its property market and increases in mining revenues for Western Australian and Queensland.

Drivers of change to the ACT's relativity

The ACT's relativity has been revised upwards from 1.14575 (2006 Update) to 1.16293 (2007 Update). This variation (+$13.1 million) was primarily the result of the phasing out of some State taxes, and was slightly offset by decreases in the ACT's relative cost of providing services.

Table 7.2.4 below provides a summary of the major drivers of the ACT's relatively change.

Table 7.2.4
Major drivers of the ACT's relativity change

Category	Change $m	Reason for change
Administrative scale	-7.5	As scale affected costs have fallen as a proportion of State budgets, the ACT, which experiences diseconomies of small scale, requires less to provide head office services.
Indigenous Influences	-4.3	The ACT needs less revenue from the pool because expenses on providing services to Indigenous communities have increased as a proportion of State budgets and it has a well below average proportion of its population that is Indigenous.
Stamp Duty on Conveyances	+3.2	As growth in turnover in the ACT property market between 2000-01 and 2005-06 was the second lowest of all States, it requires more revenue from the pool.
SPPs	+4.2	As the ACT's share of SPPs per capita has declined between 2000-01 and 2005-06, it requires more from the pool.
Superannuation	+4.4	The ACT faces higher costs in funding its accrued superannuation expenses and nominal interest on equalised unfunded liabilities. Because State expenses on these items now represent a larger proportion of State budgets, the ACT needs more from the pool to fund them.
Abolition of some State Taxes	+7.2	As the ACT had above average revenue raising capacity for the taxes that are being phased out, it receives additional revenue from the pool.

Note:
Table 7.2.4 summarises major drivers only. All other minor drivers of the ACT's relativity are in the order of +$6.1 million

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 2007 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, per capita private sector wages being below the national average, and a small employment base in mining, agriculture, manufacturing and wholesale trade.
  - 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 2001-02 to 2005-06, 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 characteristics 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 lower per capita share of SPPs;
  - Of those SPPs included in the CGC's assessments, the ACT received slightly less than an average per capita amount over the five year assessment period. In particular, the Territory received lower shares of SPP grants for Government School Education, Home and Community Care, Disability Services, and Roads.

2007 Ministerial Council for Commonwealth-State Financial Relations (Ministerial Council)

The Ministerial Council, which is chaired by the Australian Treasurer, met in Canberra on 30 March 2007.

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

- implementation of commitments to abolish State taxes under the IGA;
- progress on the CGC's 2010 Review of HFE Methodology; and
- GST administration issues.

Review of State taxes under the IGA

Under the IGA, it was agreed that the Ministerial Council would review the need for the retention of a number of business related stamp duties by 2005.

At the 2006 Ministerial Council meeting, the Australian Government and State Treasurers agreed on a set of State-specific timetables with which IGA taxes were to be abolished. It was also agreed that once abolished, the revenue forgone from these taxes would be built into the GMA calculations.

States have since begun to implement the timetable, with the ACT abolishing stamp duty on non-real core business assets on 1 July 2006. The ACT's schedule for abolition of the remaining IGA taxes, and their corresponding revenue impacts, is summarised below:

Table 7.2.5
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[2] $m
Not collected in the ACT	Mortgages, bonds, debentures and other loan securities	na	na
	Cheques, bills of exchange and promissory notes	na	na
Abolished (1 July 2006)	Non-real core business assets	1.4	1.4
1 July 2007	Credit arrangements, instalment purchase arrangements and rental arrangements	3.6	5.0
1 July 2009	Leases	5.1	10.5
1 July 2010	Non-quotable marketable securities	3.0	13.7

Notes:
1. Latest estimates as at May 2007.
2. Sum of annual impact of revenue foregone will not align directly with the annual impact of duty removed due to rounding and changes in the forward estimates for several abolished taxes.

In accordance with the agreed schedule, duty on hiring arrangements will be abolished on 1 July 2007 at a cost of approximately $3.6 million per annum. Together with the now abolished duty on non-real core business assets on 1 July 2006, the accumulated revenue forgone equates to approximately $5.0 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 $13.7 million per annum. Over the budget period the total gross cost of the duties forgone by the ACT is estimated at $35.9 million.

Further Developments

At the 2007 Ministerial Council, the Australian Government Treasurer called on the States to develop a schedule for abolishing stamp duty on non-residential real property.

The Treasurer indicated that the Australian Government would be willing to be flexible as to the timing and phasing of the abolition timetables, and would consider alternative tax reform reductions of equivalent value.

In response the States indicated that they had already met the requirements to review the IGA taxes, and given the growing pressure to deliver more services in the areas of health and education, were not in a position to remove additional taxes at the Australian Government's request.

The Australian Government concluded that it would continue to pursue this matter.

2010 Review of State Revenue Sharing Relativities

As agreed at the 2005 Ministerial Council meeting, the CGC provided a progress report to the 2007 Ministerial Council on the 2010 Review of State Revenue Sharing Relativities.

The report outlined the CGC's progress in 2006, including:

- consultations on the principles and architecture of HFE;
- preliminary conclusions on simpler assessments, including how State revenues and expenses should be disaggregated and broader indicators of revenue capacity and expense requirements developed;
- preliminary conclusions relating to the quality and fitness for purpose of data reviewed during the year; and
- the implementation of quality assurance plan and progress on other issues raised in the terms of reference for the 2010 Review.

In consultation with the States, over the next twelve months the CGC aims to:

- develop assessment methods for the categories of expenses and revenue identified;
- develop assessments for those inherent differences across the States, which impact on all expenses; and
- establish the conceptual framework for equalisation by setting out views on the equalisation principle, pillars and their interpretation.

Under the 2010 Review's terms of reference, the CGC has now met its interim reporting requirements.

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 2007 Ministerial Council meeting 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 $636 million for 2007-08, a 2.7 per cent or $17 million increase on 2006-07, consistent with the requirement of the IGA that the States compensate the Australian Government for the costs of administering the GST.

The Ministerial Council also agreed to suspend compensation payments to the States for the revenue impact of allowing some taxpayers to voluntarily register for the GST to pay and report GST annually until final tax return data for 2005-06 and 2006-07 became available, due to a perceived overpayment.

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 change to the GST base under the ANTS requires the unanimous approval of the Ministerial Council. Throughout 2006-07 GSTAS considered a number of proposals that affect the GST revenue base, some of which were agreed to out of session by the Ministerial Council. The proposals considered by GSTAS included:

- amendments to the Tourist Refund Scheme;
- the GST treatment of prescription frames;
- the GST treatment of oat milk;
- the GST treatment of orthoptic services;
- the GST treatment of emergency equipment on recreational boats;
- the GST treatment of members of the Psychotherapy and Counselling Federation of Australia; and
- GST concessions provided or extended to diplomatic and consular missions, staff and other employees.

States-only Treasurers' Conference

The State Treasurers met on the eve of the Ministerial Council meeting of 29 March 2007 to discuss a number of State-specific issues, including the decision by all States to commit to achieving consistency in eight key areas of payroll tax administration.

146th 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 chair and a representative of each of the States (a role also usually delegated to Treasurers).

The Australian Loan Council met on 30 March 2007, immediately following the 2007 Treasurers' Conference, 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 2007-08 is $29 million with a tolerance limit of +/-$60 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. In the past twelve months COAG has met in Canberra in July 2006 and April 2007. The main items for discussion at both of these meetings included: the National Reform Agenda; Climate Change; Infrastructure Reports; Health, Human Influenza Pandemic Prevention and Preparedness; Skills; Indigenous Issues; the Lockhart Review; Counter-terrorism Issues; Double Jeopardy Law Reform; Inter-Jurisdictional Exchange of Criminal History Information for People working with Children; Local Government Funding, Review of the Food Regulation Agreement and World Heritage Ministerial Councils.

National Reform Agenda (NRA)

Following from COAG's 2006 commitment to progress the NRA encompassing human capital, competition and regulatory reforms to help underpin Australia's future prosperity, COAG tasked officials with completing specific reform proposals for its consideration over the coming twelve months. These reform proposals will include, as necessary and appropriate, agreed policy directions, outcomes and commitments, multilateral and jurisdictional specific actions, progress measures and milestones. Each reform proposal would specify actions to be undertaken jointly, and actions that will be undertaken by individual jurisdictions. Specific reform proposals will recognise the importance of jurisdictional diversity and flexibility for policy innovation.

The ACT's comprehensive Human Capital Plan responds to the call by COAG for an increased investment in the health and education of the Australian population in the interests of improved productivity and greater workforce participation. In the area of literacy and numeracy, where ACT outcomes are already amongst the highest in the country, the emphasis is on targeted services designed to lift the performance of those with relatively lower levels of proficiency, and supporting marginal and disadvantaged groups.

In addressing the rise of Type II Diabetes, the emphasis within the Plan is on improving early diagnosis and support for the recently diagnosed and those with established diabetes. This will complement COAG's multilateral program, with its focus on primary prevention.

Finally, in the area of early childhood education and care, the ACT already provides 12 hours free preschool to four year olds, which represents a higher level of service than that offered in most jurisdictions. Therefore, the ACT's additional investments in this area will be focused around engaging children 'at risk'. This includes the establishment of the integrated Indigenous service delivery program and new investments in antenatal care for mothers and children at risk, and a pilot project to provide prevention and early intervention services through Child and Family Centres for children aged between 0 and two.

COAG agreed in principle to establish a COAG Reform Council (CRC). It was envisaged that the CRC would be an independent body to replace the National Competition Council (NCC) and that the primary role of the CRC would be to report to COAG annually on progress towards the achievement of agreed reform milestones and progress measures across the broad NRA.

At the July 2006 COAG meeting it was decided that the CRC would be independent and would comprise up to six members. The CRC comprises a Chair appointed by the Australian Government, Mr Paul McClintock, a Deputy Chair appointed by the States, Mr Geoff Gallop, and four members to be agreed by COAG, with at least one member having skill sets with regional and remote experience, Dr Doug McTaggart, John Langoulant, Peter Corish and Helen Silver.

Following receipt of the CRC's assessment of a specific reform, the Australian and State Governments will consider if any 'fair-sharing' payments are required by any government, given the relative costs and benefits of the reforms.

The Australian Government confirmed its commitment to provide funding to the States on a case-by-case basis, if funding is needed to ensure a fair sharing of the costs and benefits of reform. Any Australian Government funding:

- could take the form of either:
  - Australian Government or shared funding towards specific new initiatives undertaken by the Australian Government and the States, at the time COAG agrees a reform proposal, or
  - 'fair sharing' outcome payments linked to achieving tangible results down the track;
- would not include generic up-front payments;
- would be in addition to other Australian Government funding; and
- would be decided by the Australian Government.

National Water Initiative (NWI)

At the July 2006 COAG meeting, the Australian and State Governments reaffirmed their ongoing commitment to the continuing water reform agenda as expressed in the NWI.

COAG agreed that the resources and efforts need to be prioritised to deliver six fundamental reform elements of the NWI:

- conversion of existing water rights into secure and tradable water access entitlements;
- completion of water plans that are consistent with the NWI through transparent processes and using best available science;
- implementation of these plans to achieve sustainable levels of surface and ground water extraction in practice;
- establishment of open and low cost water trading arrangements;
- improvement of water pricing to support the wider water reform agenda; and
- implementation of national water accounting and measurement standards, and adequate systems for measuring, metering, monitoring and reporting on water resources.

On 30 June 2006, the Australian Government increased its funding of the *Living Murray Initiative* to $700 million over five years. The focus of this investment is water recovery for six iconic sites along the River Murray. Water recovery measures to be funded under the Murray Darling Basin Water Agreement include investment in water infrastructure, behavioural change and purchase of water on the market, with recovered water to be set-aside for environmental purposes.

Furthermore, in January 2007 the Australian Government announced a $10 billion program ‘A National Plan for Water Security’ (The Plan) to improve water efficiency and address over-allocation of water in rural Australia. The Plan builds on the work under the Living Murray Initiative and the Australian Government Water Fund and is designed to advance the implementation of the NWI.

In the area of Climate Change, COAG endorsed a National Adaptation Framework, which includes possible actions to assist the most vulnerable sectors and regions, such as agriculture, biodiversity, fisheries, forestry, settlements and infrastructure, coastal, water resources, tourism and health to adapt to the impacts of climate change.

Council for the Australian Federation (CAF)

The inaugural CAF meeting was held in Melbourne on 13 October 2006, and was established by the Premiers and Chief Ministers of the States and Territories as a means of working together to improve the way that States deliver the many key services that affect Australians’ daily lives. These include public education, health and hospitals, police services and emergency management, urban and rural development, the environment, water, transportation infrastructure and services, and cultural and recreational amenities.

Premiers and Chief Ministers signed an intergovernmental agreement to establish the CAF with the agreement emphasising both co-operation between States and also the advantage of a diversity of policy approaches based on regional necessities.

CAF has since held two subsequent meetings in February and April 2007. It was the intention of members of CAF that it would complement the workings of COAG, although a complementary and separate work program is being established.

At the recent CAF meeting held in Canberra on 12 April 2007, a report on Australia's federal future (commissioned by the Victorian Government) was discussed. Areas of the report that generated considerable discussion included:

- the high level of VFI in the Australian federated system;
- analysis of State and Australian revenues as a percentage of GDP, which found that the proportion of intergovernmental fiscal transfers has not changed significantly since the introduction of the GST, while the proportion of Australian Government revenues has increased considerably; and
- a finding that many countries are moving from a unitary system of Government towards a federal system of government, after recognising the potential efficiency generating benefits of a federal structure.

The report recommended a sweeping review via a Constitutional Convention be undertaken to reassign the roles and responsibilities within the Federation and that tax raising capacity be better aligned to reduce VFI.

The Council of the Australian Federation has also released a second federalist paper *The Future of Schooling in Australia*, prepared by State and Territory Education Departments. The paper reasserts the importance of national collaboration to promote high-quality schooling for all Australian students, whatever jurisdiction, school system or individual school is involved. This reassertion builds on the *Adelaide Declaration on National Goals for Schooling in the Twenty-First Century* that was jointly signed by the States and the Australian Government in 1999.

The new statement on the future of schooling in Australia proposes a new national framework for schooling and is based on the axiom that the quality and performance of teachers, schools and jurisdictions are central to the life prospects of every student and to national prosperity.