4.2 DEVELOPMENTS IN COMMONWEALTH-STATE FINANCIAL RELATIONS

Overview

This chapter outlines developments in the ACT's financial relations with the Australian Government and States and Territories[1] that occurred in 2004-05, identifies expected outcomes in 2005-06, and highlights possible occurrences in the forward years.

Key Points

- Australian Government funding accounts for approximately 42% of the ACT's General Government Sector revenues for 2005-06.
- Most State and Territory Governments, including the ACT, have presented proposed schedules for the removal of certain taxes on business transactions to the Australian Government. A final agreement has not yet been reached on this matter. This Chapter provides further details of the taxes to be abolished and the estimated cost to the ACT budget.
- The ACT expects to receive GST revenue totalling $721.4m in 2005-06 or approximately $39.4m above 2004-05.
- Three major Specific Purpose Payments programs are under negotiation in 2004-05, namely, the replacement program for the former Vocational Educational and Training; the Supported Accommodation Assistance Program; and AusLink.
- The ACT will lose revenue in the order of $18m over the next four years following the Australian Government's refusal to compensate for revenue foregone for the regulation of companies and securities.

Australian Government Funding to the ACT

State government services are funded through own source revenue and Australian Government grants. Australian Government funding accounts for approximately 42% of the ACT's General Government Sector revenues for 2005-06.

Table 4.2.1 below summarises the expected level of Australian Government funding to the ACT across the budget and forward estimates period. These estimates are based on the Australian Government Treasurer's March 2005 Statement of Estimated Payments as presented at the 2005 Treasurers' Conference.

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[1] Henceforth, the word States refers to both States and Territories unless otherwise stated.

Table 4.2.1
Australian Government Funding to the ACT

Payment	2004-05 Est. Out. $m	2005-06 Budget $m	Var $m	Var %	2006-07 Estimate $m	2007-08 Estimate $m	2008-09 Estimate $m
GST Revenue Grants	682.0	721.4	39.4	6.0	754.3	790.6	830.1
National Competition Payments	13.6	12.6	-1.0	-7.0	0.0	0.0	0.0
Total General Revenue Assistance	**695.6**	**734.0**	**38.4**	**6.0**	**754.3**	**790.6**	**830.1**
Specific Purpose Payments:							
Health (inc Health Care Grants)	115.6	120.1	4.5	4.0	126.2	131.3	131.5
Social Security and Welfare	23.6	25.2	1.5	6.0	25.7	26.0	25.9
Education	131.1	145.1	13.9	11.0	155.0	164.9	175.4
Public Order and Safety	3.2	3.2	0.0	0.0	3.2	3.2	3.2
Housing	18.6	18.8	0.2	1.0	19.0	19.1	19.3
Local Government	55.2	57.0	1.8	3.0	58.2	59.7	61.3
Other	14.6	15.9	1.3	10.0	14.1	14.3	14.5
Special Revenue Assistance to the ACT	14.2	0	-14.2	-100	0	0	0
Total Specific Purpose Payments	**376.1**	**385.3**	**9.2**	**2.0**	**401.3**	**418.6**	**431.1**
Other Aust. Govt. Payments							
Vocational Education and Training (inc ANTA)	20.7	21.1	0.4	2.0	21.6	22.0	22.5
Other	10.9	7.8	-3.1	-28.0	5.1	5.2	5.2
Total Other Aust. Govt. Payments	**31.6**	**28.9**	**-2.7**	**-8.0**	**26.7**	**27.2**	**27.6**
Total Aust. Govt. Funding	**1 103.2**	**1 148.1**	**44.9**	**4.0**	**1 182.4**	**1 236.4**	**1 288.8**

Note: Totals may not add due to rounding.

General Revenue Assistance (GRA) to the ACT

The *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999* sets out the mechanism for the transfer of the 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.

The ACT expects to receive continued benefits from these arrangements in the future. That is, the Territory's GST funding is expected to exceed its Guaranteed Minimum Amount (GMA) or more simply, the amount receivable had tax reform not taken place. However, this does not take account of the fact State Governments are facing increasing pressures, particularly in areas such as health, that require substantial additional funding. For example, in the last Australian Health Care Agreements, the Australian Government cut the rate of growth in its health care grants to the States.

Under the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (IGA), it was agreed that the Ministerial Council for Commonwealth-State Financial Relations would, by 2005, review the need for the retention of a number of business related stamp duties listed under the IGA. The revenue raised from these taxes for the ACT is approximately $50m in 2005-06. Table 4.2.2 below illustrates the stamp duties subject to review.

Table 4.2.2
2005-06 Estimated ACT revenue from IGA stamp duties subject to review

Stamp Duty on:		Estimated ACT Revenue 2005-06 $m
Non-Residential Conveyancing		33.2
Non-Quotable Marketable Securities		8.3
Leases		4.4
Rental Arrangements (Hiring)		3.4
Mortgages, Bonds, Debentures and other Loan Securities		n/a
Credit Arrangements and Instalment Purchase Arrangements		n/a
Cheques, Bills of Exchange and Promissory Notes		n/a
	Total	**49.3**

NB: n/a—not imposed by the ACT.

The Australian Government has advised that it would entertain the abolition of the IGA stamp duties on a staged basis over a number of years.

In responding to the Australian Government, the States have noted that they have met all of the obligations under the IGA, and that the ability to abolish the IGA taxes rests on affordability, which should be measured by more than the amount by which the GST revenue exceeds States' GMAs. The States have noted that:

- the GMA understates the net revenue forgone by the States as a result of the GST tax reforms (this is because the GMA formula does not properly reflect the true cost of some State taxes that have already been abolished);
- the ability to implement sustainable tax reform is dependent on maintaining acceptable fiscal outcomes. The aggregate State fiscal balance for the general governmental sector is estimated to be in deficit in 2005-06, with some improvement expected in 2006-07 and 2007-08;
- the excess of GST over GMA is not a measure of the fiscal capacity of the States to implement tax cuts, as it does not take into account the broader fiscal pressures on State budgets;
- since the tax reforms, State government total revenues have done no better than keeping pace with Gross Domestic Product (GDP) growth and are expected to grow only modestly in the period ahead;
- the Australian Government's increasing use of Specific Purpose Payment (SPP) input controls restricts State and Territory budget flexibility;
- the Australian Government's decision to redirect National Competition Payments to the Australian Water Fund has resulted in direct cuts to State budgets and an increased call on GST revenue to fund government spending; and

- States have experienced considerable pressure on government expenditure in recent years, primarily in health and education, and this is expected to continue.

The Australian Government has indicated that it considers that a failure to abolish the designated taxes would result in a breach of the IGA, which could have implications for future GST payments to the States.

In response, the State Treasurers (excluding NSW and WA) wrote to the Australian Government Treasurer on 20 April 2005 with a combined proposal. While reiterating that all States have met all obligations to date under the IGA, the letter indicated that - in some instances - several jurisdictions had gone further by removing taxes specified only for review in 2005. In total, States are expected to deliver around $4b of tax relief in 2005-06.

The proposal, which the relevant States believe is fully consistent with the objectives of the IGA, outlines a commitment to abolish a further range of taxes over the next five years to 2010-11.

The taxes to be removed in full by 2010-11 are:

- stamp duty on non-quotable marketable securities;
- stamp duty on leases;
- stamp duty on mortgages, bonds, debentures and other loan securities;
- stamp duty on credit arrangements, instalment purchase arrangements and rental arrangements;
- stamp duty on cheques, bills of exchange and promissory notes; and
- stamp duty on business conveyances other than real property (such as goodwill, supply rights of a business and intellectual property) listed at clause A3(ii) of the original IGA.

The ACT Government has put forward a schedule for the abolition of these taxes that takes account of the Territory's capacity to afford further tax cuts. This schedule is summarised in Table 4.2.3 below.

In considering this schedule, it should be noted that, unlike most other States, the ACT does not impose stamp duties on mortgages. If this tax was collected in the ACT it would raise around $16.7m per annum for mortgage stamp duty and $0.8m for cheque stamp duty. Consequently, ACT taxpayers are already benefiting from this tax not being applied in the ACT.

Table 4.2.3
Revenue foregone under preferred timetable including taxes already abolished ($m)

	Description	Impact of Tax Removed*	Accumulated Impact *
Already Not Applied in the ACT	Mortgage Duty Cheque Duty		
2005-06			
2006-07	By 1 July 2006 abolish stamp duty on non-residential conveyances business assets – non real	2	2
2007-08	By 1 July 2007 abolish stamp duty on credit arrangements, instalment purchase arrangements and rental arrangements	3	7
2008-09		0	13
2009-10	By 1 July 2009 abolish stamp duty on leases	4	22
2010-11	By 1 July 2010 abolish stamp duty on non-quotable marketable securities	10	41

* Note: Sum of the annual and accumulated impacts do not align due to rounding.

The total gross cost of the taxes foregone by the ACT would be $13m over the budget forward estimates period. It is expected that this cost would be partly offset by changes in the Commonwealth Grants Commission's GST funding relativities. The net cost would depend on when the Commission assesses each tax as no longer being "standard policy". It is not clear exactly when the Commission would make this assessment, but past practice suggests that it will be made when a majority of States (four or five) no longer collect the particular tax.

The proposed schedule for the abolition of State taxes presented to the Australian Government was determined after the ACT's 2005-06 Budget estimates were finalised. Accordingly, the costs have not been reflected in the forward budget estimates. This adjustment will be made when the Australian Government has formally responded to the ACT's proposal.

With respect to stamp duty on business conveyances of real property, on both administrative and public policy grounds, all States have stated that they do not support having different treatment of residential and business property. Accordingly, it is proposed that the removal of stamp duty on business conveyances other than real property will complete the review of business conveyances under the IGA.

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

2004-05 Estimated Outcome

The Territory will receive $695.6m, or $25.6m more GRA[2] from the Australian Government in 2004-05 compared to the original budget estimate of $670m. This increase in funding arises from:

- an upward revision to the 2004-05 GST Revenue Pool estimate partially offset by a negative adjustment for the overpayment of GST revenue in 2003-04;
- an upward revision to the ACT's December 2004 population estimate by the Australian Bureau of Statistics (ABS); and
- the reinstatement of $1.2m in National Competition Policy (NCP) Payments, suspended in 2003-04.

2005-06 Budget Year

The 2005-06 GRA of $734.0m is estimated to increase by $38.4m over the 2004-05 estimated outcome of $695.6m. The increase reflects:

- an increase in the GST Pool ($37.2b) of $2.0b over the 2004-05 pool of $35.2b; and
- the Commonwealth Grants Commission's 2005 Update Report recommendation to increase the ACT's GST relativity from 1.12930 in 2004-05 to 1.14300 in 2005-06:
  - a hallmark of the A New Tax System, underpinned by the IGA, is that the distribution of GST revenues between jurisdictions is based on the application of the *Horizontal Fiscal Equalisation* (HFE) principle in accordance with the findings of the Commission. The estimates for 2005-06 and forward years are based on the Commission's recommendations outlined in the Report on State Revenue Sharing Relativities 2005 Update (2005 Update Report);

These increases are partially offset by:

- a decrease in National Competition Policy (NCP) Payments ($1.0m); and
- the decision by the Australian Government to cease Special Revenue Assistance to the ACT from 2005-06, instead having the ACT's fiscal needs considered through the Commission's processes.

Forward Estimates for Australian Government Funding

A degree of uncertainty always exists in regards to GST forward year estimates. This volatility arises from two factors, namely, the difficulty involved in predicting the size of future GST collections, and the fact that the Commission recalculates States' GST relativities each year based on the latest available data.

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

Against this background, the forward estimates for the ACT's share of the GST are based on the Commission's 2005 Update GST relativity factor for the Territory. This assumption in turn has been applied to nationally adopted estimates of the total estimated GST pools for each year, as agreed by all jurisdictions to ensure a degree of consistency in State Budgets. It should be noted that the Australian Government will be publishing updated forecasts of the national GST pool in its Budget to be released on 10 May 2005.

National Competition Policy Payments

The NCP agreements of April 1995 - the Competition Principles Agreement (CPA), the Conduct Code Agreement and the Agreement to Implement the National Competition Policy and Related Reforms (the Implementation Agreement) - establish the program of NCP and related reforms. Under the Implementation Agreement, the Australian Government agreed to make NCP payments to the States as compensation for the costs of implementing the NCP and related reforms. The payments recognise that while the States have responsibility for significant elements of the NCP, the Australian Government accrues, through the taxation system, much of the financial dividend from the economic growth arising from the NCP reforms. Therefore, the payments are a means of distributing across the community the gains that arise from NCP reform.

Subject to making satisfactory progress against the NCP and related reform obligations, as assessed by the National Competition Council (NCC), the States have received competition payments on an annual basis. Table 4.2.6 shows the payments received by the ACT from the inception of NCP in 1997-98 to the latest NCP payment in 2004-05.

Table 4.2.4
Estimated NCP Payments to the ACT 1997-98 to 2005-06

Year	Amount ($m)
1997-98	6.4
1998-99	6.3
1999-00	7.2
2000-01	7.5
2001-02	11.6
2002-03	12.4
2003-04	11.0
2004-05	13.6
2005-06	12.6
Total	**88.6**

In the most recent assessment, the NCC determined that the ACT had fully met reform requirements and the Australian Government agreed to the ACT receiving $12.4m, representing 100% of the allocated payment for 2004-05. A previously suspended amount of $1.2m, held over due to a perceived lack of reform progress in 2002-03, was also paid to the ACT in 2004-05. In 2005-06, the ACT's estimated competition payment is $12.6m. The exact amount is yet to be finalised as it is calculated on a per capita basis derived from future population estimates and indexed to the Consumer Price Index (CPI).

The Australian Government has advised that 2005-06 will be the final year of the current NCP program. A Council of Australian Governments (COAG) review of NCP is required prior to September 2005. In the meantime, the Australian Government has announced that NCP payments will no longer be provided to the States from 2006-07 and will be used instead to fund water reform projects, with the States to provide matching funding. This effectively amounts to a $12m per annum funding cut to the ACT from 2006-07 onwards.

As part of the current deliberations surrounding further State tax reform, the States remain of the view that continuing microeconomic reform is a vital ingredient in driving ongoing productivity gains. All States have expressed the view that they want to be part of a further cooperative reform agenda to drive ongoing productivity gains and growth in Australia, but support must be on the basis of appropriate recognition for performance if there is to be a fair sharing of the ongoing fiscal benefits of reform.

Specific Purpose Payments

Specific Purpose Payments (SPPs) constitute a significant amount of Australian Government funding to the States. They are paid as a contribution to important areas of State responsibility and are used by the Australian Government to achieve national objectives.

Importantly, under Clause 5(v) of the IGA, the Australian Government has guaranteed that it:

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

Important developments in inter-governmental relations include:

- a propensity for Australian Government agencies to have the States accept greater financial responsibilities. This includes matching obligations which may be well in excess of the Australian Government's contribution; and
- calls by the Prime Minister to find national solutions in areas like health, education and training and indigenous affairs.

2004-05 Estimated Outcome

The Territory will receive $376.1m or, $7.9m more in SPPs from the Australian Government in 2004-05 compared to the original budget estimate of $368.2m. This slight increase in funding arises from a higher than estimated amount for education funding, largely influenced by increases in Non-Government Schools funding.

2005-06 Budget Year

In 2005-06, SPPs are estimated to increase by $9.2m over the 2004-05 estimated outcome of $376.1m. This increase reflects a rise in funding under the Australian Health Care Agreement (AHCA) of $5.4m, representing a 5.3% increase due to CPI and population indexation, and the implementation of the COAG Illicit Drug Diversion Package of $1.3m. Non-Government Schools (recurrent) funding is estimated to increase by to $11.3m, representing a 12.3% rise.

The 2005-06 budget estimates also include the ACT's loss of Special Revenue Assistance following the Australian Government's decision in the 2004-05 Budget to have claims assessed by the Commission as part of the GST distribution.

Developments in SPPs across Budget Years

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

Public Health Outcome Funding Agreements (PHOFAs)

PHOFAs are outcome-based funding agreements providing broad-banded and specific purpose funding for a range of public health programs. The previous five-year agreements expired on 30 June 2004 and were extended until 28 February 2005 pending further negotiations.

The ACT agreed in March 2005 to the complete set of performance indicators incorporated into the PHOFAs and the Australian Government announced on 7 April 2005 that all States had now agreed.

National Code of Practice for the Construction Industry

The Prime Minister wrote to Premiers and Chief Ministers on 14 September 2003 advising that the Australian Government will require all significant construction projects (from 1 January 2004), to which it contributes funds, to be subject to the National Code of Practice for the Construction Industry (the code) and the Australian Government's Implementation Guidelines.

Funding will be conditional on the code and guidelines being applied where the Australian Government's contribution is either:

- at least $5m and represents 50% of the total project value; or
- $10m or more.

To date, the following proposed agreements with capital components, all currently under negotiation, include a clause requiring the States to adopt the Code and Implementation Guidelines for capital projects above the defined thresholds:

- Government Schools Funding 2005-2008; and
- AusLink.

It is expected that the new replacement Vocational Education and Training (VET) Agreement will also include this requirement, given that it was previously flagged in the draft 2004-2006 Agreement.

The States have expressed concerns with the Code and the consequential intrusion by the Australian Government's industrial relations policy into areas of State responsibility.

This issue is scheduled for discussion at the Australian Procurement and Construction Ministerial Council meeting in June 2005.

Current SPP Negotiations

Negotiations for three major SPPs are in the process of being finalised in 2004-05 with intended commencement dates, namely:

- the new Vocational Educational and Training agreement – and the abolition of the Australian National Training Authority (ANTA), 1 July 2005;
- Supported Accommodation Assistance Program (SAAP), 1 July 2005; and
- AusLink, 2004-05.

The New Commonwealth-State Agreement on VET - and the superseded ANTA Agreement

On 22 October 2004, the Prime Minister announced the abolition of ANTA from 30 June 2005. The ANTA Agreement 2001-2004 has been rolled over for a further six months (to 30 June 2005) to allow time to work through the details of new arrangements to apply from July 2005. The Australian Government proposes bilateral agreements with each State, in addition to a multilateral agreement. The intention of the bilateral agreements is to provide flexibility to implement national priorities and establish performance levels that are relevant to each jurisdiction.

From 1 July 2005, the responsibilities and functions of ANTA will be transferred to the Department of Education, Science and Training (DEST).

The Australian Government released a discussion paper *Skilling Australia – New Directions for Vocational Education and Training* on 18 February 2005.

The discussion paper sets out a range of possible models for the future operation of the national training system. The Australian Government is currently undertaking consultations on the paper with key stakeholders including industry, training providers and State Governments.

Following the consultation process, a model for the new national training system will be put in place, and the Australian Government will begin a separate process with the States to finalise a new Commonwealth-State Training Funding Agreement. Legislation abolishing ANTA and establishing the new regime will need to be passed through Federal Parliament before July 1 2005.

The Australian Government proposes to maintain the current funds distribution formulae in the new agreement, and will explore options for a revised allocation model as part of a broader examination of the funding of vocational education and training during the life of the new Agreement.

Supported Accommodation Assistance Program (SAAP)

SAAP has been implemented through five-year agreements between the Australian Government and the State and Territory Governments since 1 January 1985. The SAAP IV Agreement expires on 30 June 2005.

The program was established following a 1983 review of responses to the needs of homeless people and women escaping domestic violence. The review recommended that programs be integrated into a single cost-shared initiative administered by the States and Territories.

Funding under the SAAP IV Agreement totalled $50.7m in the ACT over five years. Of this, the ACT Government contributed $22.8m (45%) and the Australian Government contributed $27.9m (55%).

In July 2004, the Community and Disability Services Ministerial Conference agreed to enter into negotiations to establish a SAAP V Agreement for 2005-2010.

Ministers also agreed to three new strategic themes to underpin SAAP V. These are:

- increased involvement in early intervention and prevention strategies;
- providing better assistance to people who present with a number of support needs; and
- providing ongoing assistance to ensure stability for clients post-crisis.

The States are currently negotiating the Multilateral Agreement with the Australian Government.

AusLink – Towards the National Land Transport Plan

The Australian Government released the AusLink White Paper on 7 June 2004 detailing a proposed reform of land transport planning and funding. AusLink became operational from 1 July 2004. The Australian Government plans to introduce new legislation to provide for the administration of the program, including transitional arrangements (e.g., for national highway projects already approved under the *Australian Land Transport Development Act 1988*).

It is proposed that each State enter into a bilateral infrastructure and funding agreement. The agreement would cover the full package of proposed projects for the States, identify proposed funding contributions, and identify planning and other responsibilities of each party. This includes requirements for reporting and provision of data about network condition and performance. The White Paper indicates that the proposed level of State funding contributions could vary significantly from project to project.

AusLink is divided into six main categories:

- National Projects (National Land Transport Network);
- Transport Development and Innovation Project (National Land Transport Network);
- Strategic Regional Projects;
- Black Spot Projects;
- Roads to Recovery Program; and
- Land Transport Research Entities.

The Australian Government has allocated $11.8b for road and rail transport over the five years to 2008-09, split between AusLink and untied local government grants.

Components of this funding include:

- $9.3b to AusLink over the next five years;

- $7.7b to the National Land Transport Network, including Interstate Road Transport;
- $1.5b for the Roads to Recovery program, including the National Highway System;
- $90m under the National Black Spot program; and

- $2.6b in untied local road grants.

In 2004-05 the ACT was allocated $4.2m under the Roads to Recovery program, $0.2m for Interstate Road Transport and $0.6m for the National Black Spot Program. In addition, $15.1m has been set aside for untied local roads grants for the five years to 2008-09, which is financed in the category of Local Government funding.

The ACT was also allocated $2.4m for work on the Queanbeyan Bypass, however, the funding is being directed to NSW in order to undertake the construction.

Currently there are ongoing discussions between the ACT and the Department of Transport and Regional Services with regards to the Roads to Recovery program, and in particular, the strategic regional network and how this program is intended to operate.

Future SPP Negotiations

Negotiations for some other major SPPs are underway, however, no defined deadlines have been agreed with negotiations likely to continue into 2005-06.

Legal Aid Agreement

Legal Aid funding from the Australian Government allows each State Legal Aid Commission to provide basic legal advice, representation and education to the public. The Legal Aid Agreement expired on 30 June 2004, however, it has been rolled over pending negotiation of a new agreement by the States and the Australian Government. Formal negotiations for a new agreement commenced in March 2004.

Signing of the new agreement has been delayed due to issues surrounding Intellectual Property rights, and the outcome of a private Australian Tax Office (ATO) ruling over input tax credits.

Home and Community Care (HACC)

The Australian Government has been progressing work towards the reform of community care. In 2003 it published a consultation paper titled *A New Strategy for Community Care*. Subsequently, in 2004, it published a paper titled *The Way Forward*, in which it suggested a number of areas for possible reform of the HACC Amending Agreement.

States have agreed to use the areas described in the paper as a basis for review of the HACC Amending Agreement. A working group with representatives from each jurisdiction and the Department of Health and Ageing has been established to develop a new agreement. The current agreement remains in place until a new agreement has been reached.

Government Schools Grant

The Government Schools (Primary and Secondary) SPP expired on 31 December 2004. Funding is provided on a calendar year basis and is specified in quadrennial legislation. In the 2001-2004 quadrennium, 32.9% of recurrent funds went to government schools. Of the total $30b in Australian Government recurrent funding being offered to States for the 2005-2008 quadrennium, approximately 30.5% will be made available to government schools.

At the 23 April 2003 Ministerial Council on Education, Employment, Training and Youth Affairs (MCEETYA) meeting, the States held a common position opposing the Australian Government's funding offer for not providing additional funding to public education above indexation.

State Education Ministers have continued to express reservations about various aspects of conditions the Australian Government has proposed with the new grant. These conditions do not appear to take into account current State initiatives - undertaken either unilaterally or through MCEETYA - to improve the efficiency, effectiveness and quality of schools.

At this stage, no State has signed the Agreement pending their consideration of the final guidelines and regulations developed by the Australian Government.

The major SPPs that are scheduled for negotiation in the years beyond 2005-06 and 2006-07 include:

- National Heritage Trust, expires 30 June 2006;
- National Landcare Program, expires 30 June 2006; and
- Commonwealth State Territory Disability Agreement, expires 30 June 2007.

The Abolition of Special Revenue Assistance to the ACT

In response to past terms of reference, the Commission has previously made an annual assessment of the Territory's unique fiscal needs (estimated at $14.2m in 2004-05) as a result of its status as the nation's capital. These needs have been paid by the Commonwealth from outside the GST revenue pool, most recently as the SPP Special Revenue Assistance (SRA) to the ACT.

The requirement for the Commission to assess the Territory's fiscal needs has its origins in the *Australian Capital Territory (Self-Government) Act 1988*. The Act establishes the intention of the Commonwealth Parliament to avoid the ACT community incurring costs arsing from national capital influences. This intent is supported by Section 5 of the *Commonwealth Grants Commission Act 1973*. Successive Federal Governments, Commissions and State leaders have recognised and honoured these obligations.

A matter of major concern for the ACT therefore arose from the Australian Government's 2004-05 Budget decision to cease paying SRA to the ACT with effect from 1 July 2005. The Australian Government instead proposed that, subject to assessment by the Commission, the Territory's fiscal needs would be funded from the GST revenue pool.

However, as foreshadowed by the ACT in subsequent correspondence to both the Prime Minister and Federal Treasurer, the Commission's 2005-06 terms of reference were deficient in this respect and would not allow the Commission to assess all the components of the Territory's fiscal needs from within the GST revenue pool.

This has proven to be the case and in its 2005 Update Report, the Commission recommended that the previous allowances for Policing and Roads be met from the GST pool, but that it was precluded from including the third component for Corporate Affairs Compensation, as the equivalent SPP, paid to the States and Northern Territory, is specifically quarantined from its assessments.

As such, the ACT no longer receives compensation following the introduction of the national scheme for the regulation of companies and securities. In contrast, the States and the Northern Territory continue to be compensated annually by way of an SPP pursuant to subclause 701 (1) and (2) of the Corporations Agreement 2002.

The revenue loss to the ACT is in the order of $18m over the budget and forward estimates period. This is a significant loss to the ACT (in per capita terms it is equivalent to a loss of $373m for New South Wales), however, it is relatively minor in the context of the total amount of funding made available to the States and Northern Territory.

The ACT Government continues to seek agreement from the Australian Government to have the SPP funding to the ACT for Corporate Affairs Compensation reinstated in the 2005-06 Federal Budget.

Commonwealth Grants Commission Report on State Revenue Sharing Relativities 2005 Update

Background

The Commission's 2005 Update Report on State Revenue Sharing Relativities was publicly released on 2 March 2005.

The Commission's Report recommended an increase in the ACT's GST relativity from 1.12930 (2004 Review) to 1.14300 (2005 Update). A relativity is a numerical expression of a State's disability relative to the Australian average. It indicates whether a State's needs will be positive or negative. In the case of the ACT, a relativity of 1.14300 indicates that it is entitled to a 14% above an equal per capita share of the combined GST and Health Care Grant pool.

The assessment methods adopted by the Commission in 2005 are based on the principles of HFE, subject to the 2004 Review terms of reference. Under HFE, States are provided with funding to enable each State to provide an average level of service assuming they operate at an average level of efficiency and make an average level of taxation effort. The methods examine all State government services and revenues and determine the relative cost of service provision and the relative revenue raising capacity.

The methods for calculating State relativities are reviewed every five years, the most recent of which was completed in 2004. However, State relativities are updated annually, in what is referred to as the 'Update', based on the last Review methodology. The annual change in relativities reflects the changing circumstances of each State from year to year. The 2004 adopted methods are 'locked in' until the finalisation of the next Review, scheduled for 2010.

Assessed 2005-06 GST Relativities and Funding Effects

The increase in the ACT's relativity is due to an increase in its costs of providing services, partly offset by a small increase in the ACT's revenue raising capacity. This is presented in detail in the following Table 4.2.5.

Table 4.2.5
Reason for the Increase in the Act's GST Funding

Expenditure (+$13.0m)

- special revenue assistance **+$9.4m** - the inclusion in the relativity calculation of police ($6.3m) and roads ($3.1m);
- superannuation +**$11.1m** – a reduction in the negative needs assessment due to a fall in the standard expenditure on this function;
- debt charges +**$4.1m** – resulting from a combination of the fall in the ACT's cost advantages and a fall in the standard expenditure on this function;

offset by:

- scale of service provision **-$12.6m** - the reduced importance of fixed costs in State budgets reduced the effects of the ACT's diseconomies of small scale; and
- general public services **-$4.3m** – a reduction in the relative weights of the category reduced the positive needs arising from diseconomies of small scale in administrative tasks.

Revenue (-$4.1m)

The ACT's capacity to raise revenues increased relative to the Australian average, resulting in a reduction in the ACT's assessed relativity, mainly due to the above average collections (outperformance) from:

- conveyancing duties (-$4.4m); and
- land tax (-$1.1m).

Specific Purpose Payments (+$0.3m)

The ACT received a slightly lower than average share of SPPs which also contributed to the ACT's relativity.

It should be noted that the estimates provided in this section are sourced from the Commission's 2005 Update Report, and should be considered as being indicative only. They do not exactly align with figures used earlier in this Chapter, which are more current and have been updated to include population changes.

A comparison of the 2004 Review and 2005 Update relativities shows that New South Wales, Victoria, the ACT and the Northern Territory all received increased relativities. All other States received reduced relativities.

The largest per capita increases recorded were for the ACT (+$28.55 pc) and Victoria (+$21.73 pc), whilst the largest declines were for Queensland (-$24.96 pc), Tasmania (-$14.33 pc) and Western Australia (-$12.39 pc). It should be noted that the ACT's increase largely reflects the impact of the Commonwealth's decision to no longer provide Special Revenue Assistance to the ACT as a separate payment. In other words, the gain in GST funding is offset by a loss of SRA funding.

Table 4.2.6
Comparison of GST Relativities and their impact on Untied Funding [3]

	2004 Review	2005 Update	Change in GST funding	
			$m	$ per capita [(a)]
NSW	0.86750	0.86846	+12.0	+1.80
Victoria	0.86534	0.87552	+106.2	+21.73
Queensland	1.05504	1.04389	-93.7	-24.96
WA	1.03054	1.02500	-24.0	-12.39
SA	1.20407	1.20325	-3.2	-2.10
Tasmania	1.55939	1.55299	-6.8	-14.33
ACT	**1.12930**	**1.14300**	**+9.2**	+28.55
NT	4.26538	4.26682	+0.3	+1.51

(a) Based on the 2004 Review Report Mean Resident Population (MRP) data for 2002-03.

Reasons for the ACT's Above Equal Per Capita Share

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

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

- a below average value of wages and salaries paid by employers who are subject to payroll tax (the largest employer in the ACT, the Australian Government, is not subject to State taxes);
- below average levels of motor vehicle registrations and sales, particularly for heavy vehicles; and
- no mining industry and thus no capacity to collect mining royalties.

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

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

[3] Excluding the effects of population and GST pool growth.

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

2005 Ministerial Council for Commonwealth-State Financial Relations (Treasurers' Conference) – Outcome

The Council met in Canberra on 23 March 2005.

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

- Review of State taxes listed under the IGA;
- Review of Horizontal Fiscal Equalisation methodologies; and
- GST administration issues.

Review of State Taxes

At the Treasurers' Conference, the Australian Government Treasurer handed the States a proposal to eliminate certain indirect State taxes by 1 July 2006 including stamp duties on:

- non-quotable marketable securities;
- leases;
- mortgages, bonds, debentures and other loan securities;
- credit arrangements, instalment purchase arrangements and rental arrangements; and
- cheques, bills of exchange and promissory notes.

Furthermore, stamp duty on business conveyances other than real property would be abolished on 1 July 2007. This would include the components of business conveyances (such as goodwill, supply rights of a business and intellectual property) listed at Clause A3 (ii) of the original IGA, signed by all States in April 1999.

Stamp duty on business conveyances of real property will be the only remaining tax nominated in the IGA. The Australian Government proposed that this tax cease to apply by a date to be determined by the Ministerial Council on the basis that no State will be worse off in any year.

In response, the States requested four to six weeks to consider putting an alternative proposal on timing and sequencing the elimination of these State taxes.

Review of Horizontal Fiscal Equalisation (HFE) Methodology

The Treasurers' Conference discussed the outcome of a review by the Heads of Treasuries, commissioned at the previous Ministerial Council meeting, which examined aspects of the methodology used by the Commission to distribute GST revenue among the States and

Territories. The review found the Commission's methodology, while generally robust, could be simplified without compromising the underlying principle of HFE.

All States, with the support of the Australian Government, agreed that the Commission be provided with terms of reference to guide it in simplifying its methodology by 2010, and developing a program of continuous improvement, building on the work progressed by the Heads of Treasuries.

The Commission will report back to the 2006 Ministerial Council meeting according to the timetable outlined in the terms of reference on conclusions from its work program, including in respect of implementation.

GST Administration Issues

As the ATO collects all GST revenue on behalf of the States and Territories, the IGA provides that accountability and performance arrangements will be established between the State governments and the ATO. The Ministerial Council endorsed a number of updates to the GST Administration Performance Agreement between the ATO and the States.

The Ministerial Council also discussed GST administration costs and related issues and agreed to the ATO's GST administration budget of $603.6m for 2005-06, consistent with the requirement of the IGA that the States compensate the Australian Government for the costs of administering the GST.

2005 Australian Loan Council Meeting

Established under the *Financial Agreement Act of 1927*, the Australian Loan Council has the objective of managing the call on national savings by the Australian public sector as a whole. The Loan Council consists of an Australian Government representative (usually the Treasurer) as chairman and a representative of each of the States (usually Treasurers).

The Australian Loan Council met on 23 March 2005 following the Treasurers' Conference. The role of the Council is to determine the appropriateness of each jurisdiction's Loan Council Allocation (LCA) and its sustainability and consistency with national economic policy. It in effect 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 or, put simply, the call on national savings by a jurisdiction. It is 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 2005-06 is $22m with a tolerance limit of +/- $54m. The positive figure represents a net call on financial markets.

Council of Australian Governments (COAG)

At the 25 June 2004 COAG meeting, the Chief Minister signed the Intergovernmental Agreement on the National Water Initiative and the Intergovernmental Agreement on addressing water over allocation and achieving environmental objectives in the Murray-Darling Basin. States have indicated support for the appointment of Mr Ken Matthews as the Chair of the National Water Commission and three persons have been nominated by States to serve as part-time Commissioners on the Commission. States have also noted the Australian Government's assurance that funding for water reform of $400m in 2004-05 and 2005-06 will be new money in the Australian Government budget.

With regard to national competition reform, the States have expressed concern that the Australian Government's approach to future competition payments is at odds with the original agreement, and want a resolution of this issue alongside the forthcoming review of NCP.

All jurisdictions agreed to the finalisation of the inter-jurisdictional response to the National Inquiry into Bushfire Mitigation and Management, and the report and response have now been released to the public.

Following the 2004 Federal Election, the Australian Government established a taskforce within the Department of the Prime Minister and Cabinet to review the operation of Australia's health system with particular reference to the roles and responsibilities of the Australian Government and the State Governments. The Australian Government declined to accept any State input into the review and the final report has not been released. Premiers and Chief Ministers have, however, endorsed the proposed terms of reference for the COAG Health Workforce Study and have agreed to the Productivity Commission being asked to undertake the work.

A COAG meeting is scheduled for 3 June 2005 in Canberra. It is anticipated that Australian Government proposals in relation to Australia's health system, skills shortages and vocational education and training, the review of NCP, and workplace relations reform will feature prominently on the agenda.