

1998-99 BUDGET PAPER No. 3

FEDERAL FINANCIAL  
RELATIONS  
1998-99

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ON THE OCCASION OF THE BUDGET 1998-99  
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## PREFACE

This Budget Paper presents information on the Commonwealth Government's financial relations with State, Territory and local governments.

Figures for 1997-98 and 1998-99 are estimates.

### RELATIONSHIP WITH OTHER BUDGET PAPERS AND TERMINOLOGY

In examining government finances, the most relevant aggregates for economic analysis are usually those relating to payments on a net basis — that is, after recoveries or repayments. In *Budget Paper No. 1*, this distinction is evident in the use of the term 'payment' as a gross measure and the term 'outlay' as a net measure, an approach that is also adopted in other budget papers and the national accounts. However, repayments lag the initial advances and, in many cases, are made in respect of programmes which have already terminated. Moreover, the direct relationship between payments and the programmes to which they nominally relate is not always clear. Largely for these reasons, this Paper focuses on payments made on a gross basis, although some tables showing repayments are also included.

Consistent with the focus in *Budget Paper No. 1* on the underlying rather than the headline budget balance, Chapter I of this Paper examines trends in the States' underlying deficits. This measure closely approximates the national accounts net lending measure and hence provides a good estimate of the savings-investment gap for the relevant sector. As explained in Statement 7 of *Budget Paper No. 1*, the definition of the underlying deficit differs from the Australian Bureau of Statistics' (ABS) definition of the adjusted deficit in the treatment of provisions.

The Appendix to this Paper provides information on the level and interstate distribution of specific purpose payments, repayments, advances and interest. Information on the level and interstate distribution of Commonwealth payments to local government authorities is also included.

### PARAMETER ESTIMATES USED IN THIS PAPER

Table 1 sets out the population series and index factors used in this Budget Paper.

**Table 1: Parameters**

	Index Factors (per cent)			Population By State (000's)								
	CPI	Popul- ation	Real Per Capita	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
1997-98	-0.06	1.12	1.06	6305	4627	3431	1811	1483	472	309	189	18626
<b>1998-99</b>	<b>1.84</b>	<b>1.12</b>	<b>2.98</b>	<b>6371</b>	<b>4670</b>	<b>3489</b>	<b>1840</b>	<b>1490</b>	<b>471</b>	<b>310</b>	<b>193</b>	<b>18835</b>

The population series which underlie per capita estimates in this Budget Paper for 1997-98 and 1998-99 are projections at 31 December 1997 and 31 December 1998 respectively. These projections were prepared by the ABS and are on the basis of assumptions agreed to by the Treasury. The index factors for population in 1997-98 and

1998-99 are based on the estimated annual growth in the Australian population to 31 December 1997 and 31 December 1998 respectively.

The index factors for prices in 1997-98 and 1998-99 are based on estimated year-average growth in the headline consumer price index (CPI) in the year to the March quarter 1998 and in the year to the March quarter 1999, respectively.

## **FURTHER INFORMATION**

A number of ABS publications also provide information that is relevant to analysing Commonwealth financial relations with other levels of Government, including:

- *Government Financial Estimates, Australia* (Cat. No. 5501.0);
- *Taxation Revenue, Australia* (Cat. No. 5506.0);
- *Government Finance Statistics, Australia* (Cat. No. 5512.0);
- *Public Sector Financial Assets and Liabilities, Australia* (Cat. No. 5513.0);
- *Government Finance Statistics — Concepts, Sources and Methods* (Cat. No. 5514.0); and
- *Information Paper: Developments in Government Finance Statistics, Australia* (Cat. No. 5516.0).

Some of the data presented in this Paper are drawn from ABS government finance statistics (preliminary) data and the Commonwealth Grants Commission *Report on General Revenue Grant Relativities — 1998 Update*.

## **STYLE CONVENTIONS**

The following style conventions are employed in this Paper.

- The Australian Capital Territory and the Northern Territory are referred to as ‘the Territories’. References to the ‘States’ or ‘each State’ include the Territories.
- The State and local government sector is denoted as the ‘State/local sector’. References to the ‘State/local sector’ include the Australian Capital Territory and the Northern Territory unless otherwise stated.
- Figures in tables, and generally in the text, have been rounded. Discrepancies in tables between totals and sums of components reflect rounding. Percentage changes in all tables are based on the underlying unrounded amounts and not the rounded amounts.
- The following notations are used in the tables.

na     not available

..     zero, or rounded to zero

- indicating negative amounts

- The following abbreviations are used for the names of the States, where appropriate, in tables:

NSW New South Wales

VIC Victoria

QLD Queensland

WA Western Australia

SA South Australia

TAS Tasmania

ACT Australian Capital Territory

NT Northern Territory

*Budget Paper No. 3* is one of a series of Budget Papers, the purpose of which is to provide information supplementary to that in the Budget Speech. A full list of the series is printed on the inside cover of this Paper.

## CHAPTER I: RECENT DEVELOPMENTS

This chapter provides a summary of the Commonwealth's financial assistance to the States for 1998-99 and recent Loan Council developments. The chapter also summarises the *National Fiscal Outlook* and provides a brief discussion of fiscal developments in the States.

### COMMONWEALTH FINANCIAL ASSISTANCE TO THE STATES

The Commonwealth will maintain financial assistance grants (FAGs) to the States in real per capita terms in 1998-99 and extend the real per capita guarantee of FAGs to 2000-01. On the basis of current estimates, Commonwealth general revenue assistance to the States is expected to be \$17,096.3 million in 1998-99, an increase of \$420.6 million or 2.5 per cent on the previous year, as shown in Table 2.

The payment of FAGs to the States will be conditional upon the States making fiscal contribution payments of \$313.4 million in 1998-99, the last year of the payments which were agreed to at the 1996 Premiers' Conference. State fiscal contributions in 1998-99 will be around half their 1997-98 level. Commonwealth general revenue assistance to the States net of State fiscal contributions is expected to be \$16,782.8 million in 1998-99, an increase of \$733.8 million or 4.6 per cent on the previous year, as shown in Table 2.

At this year's Premiers' Conference, the Commonwealth indicated that although specific purpose payments (SPPs) will be subject to consideration as part of the budget process, there will be no overall cut to SPPs to the States against the forward estimates in 1998-99. In the event, the measures contained in the Budget resulted in an increase in SPPs to the States of around \$71.0 million in 1998-99 excluding the Australian Health Care Agreements (AHCAs).

Other elements of the Commonwealth's financial assistance to the States in 1998-99 include the following.

- The pool of FAGs and unquarantined Health Care Grants (HCGs) in 1998-99 will be distributed using:
  - the 'equalisation' per capita relativities calculated by the Commonwealth Grants Commission (CGC) and contained in its *Report on General Revenue Grant Relativities – 1998 Update*; and
  - estimates of HCGs based on the Commonwealth's funding to the States under the proposed AHCAs.
- The Commonwealth intends to provide National Competition Payments (NCPs) to the States as specified in the Agreement to Implement National Competition Policy and Related Reforms. NCPs of up to \$217.2 million will be made in 1998-99 and will be determined after the National Competition Council (NCC) reports in June 1998. These payments, like the per capita component of the guarantee for FAGs, are conditional on the States achieving satisfactory progress in the implementation of National Competition Policy reforms.



- The Commonwealth will provide the Australian Capital Territory with special revenue assistance of \$25.0 million, in the form of transitional allowances of \$11.1 million and \$13.9 million as special fiscal needs. These amounts are in accordance with the CGC's recommendations and will be funded directly by the Commonwealth.

Estimates of general revenue assistance to be provided to the States in 1997-98 and 1998-99 are shown in Table 2.

Further details of the Commonwealth's financial assistance to the States are contained in Chapter III.

**Table 2: General Revenue Assistance to the States, 1997-98 and 1998-99 (estimated)**

	Financial Assistance Grants		Special Revenue Assistance		Competition Payments		General Revenue Assistance		State Fiscal Contributions		General Revenue Assistance Net of State Fiscal Contributions	
	(a)	Total	(b)	Other (c)	(d)	Change		(e)	Change	State Fiscal Contributions	Change	
						\$m	Per cent				\$m	Per cent
<b>1997-98</b>												
NSW	4548.7	190.1	190.1	..	72.2	4811.0	137.5	2.9	216.6	4594.3	130.6	..
VIC	3341.7	242.2	242.2	..	53.0	3636.8	83.7	2.4	159.0	3477.8	78.7	..
QLD	3100.6	..	..	..	39.3	3139.9	86.8	2.8	117.9	3022.0	82.3	..
WA	1567.7	..	..	..	20.7	1588.4	9.6	0.6	62.2	1526.2	7.2	..
SA	1551.1	..	..	..	17.0	1568.1	32.8	2.1	50.9	1517.2	31.4	..
TAS	680.2	..	..	..	5.4	685.6	5.8	0.9	8.1	677.5	13.6	..
ACT	236.7	..	34.5	34.5	3.5	274.8	-4.7	-1.7	5.3	269.5	0.4	..
NT	969.0	..	..	..	2.2	971.1	25.9	2.7	6.5	964.6	25.6	..
Total	15995.7	432.3	432.3	34.5	213.2	16675.7	377.3	2.3	626.6	16049.1	369.7	..
<b>1998-99</b>												
NSW	4757.0	..	..	..	73.5	4830.5	19.5	0.4	101.5	4729.0	134.7	..
VIC	3544.7	..	..	..	53.8	3598.5	-38.3	-1.1	74.4	3524.1	46.3	..
QLD	3205.7	..	..	..	40.2	3246.0	106.1	3.4	55.6	3190.4	168.4	..
WA	1616.2	..	..	..	21.2	1637.4	48.9	3.1	29.3	1608.1	81.9	..
SA	1678.4	..	..	..	17.2	1695.6	127.5	8.1	23.7	1671.9	154.7	..
TAS	736.3	..	..	..	5.4	741.8	56.2	8.2	15.6	726.1	48.7	..
ACT	281.8	..	25.0	25.0	3.6	310.4	35.6	13.0	10.2	300.2	30.7	..
NT	1033.9	..	..	..	2.2	1036.2	65.0	6.7	3.1	1033.1	68.4	..
Total	16854.1	..	25.0	25.0	217.2	17096.3	420.6	2.5	313.4	16782.8	733.8	..

(a) These FAGs estimates do not include offsets for State fiscal contributions.

(b) Medicare guarantee payments (MCG).

(c) Transitional allowances and special fiscal needs paid to the ACT in accordance with CGC recommendations.

(d) The Agreement to Implement the National Competition Policy and Related Reforms specifies that \$200 million in 1994-95 prices is to be distributed between the States on an equal per capita basis in 1997-98 and 1998-99. The receipt of the payment is conditional on a State meeting the obligations of the Agreement.

(e) Estimated distribution based on equal per capita contributions but with deferral of half of Tasmania's and the ACT's 1997-98 contribution to 1998-99 as agreed at the 1997 Premiers' Conference.



## **LOAN COUNCIL**

The Loan Council Allocations (LCAs) nominated by the Commonwealth and each State for 1998-99 were endorsed by Loan Council without change.

Loan Council agreed in March 1998 that the publication of monthly and year to date budget sector data ('Niemeyer' statements), required under a 1930 Commonwealth-State agreement, no longer be mandatory. The decision reflects the view of some jurisdictions that their monthly 'Niemeyer' statements do not add significantly to the information available to the markets under the revised framework for the uniform presentation of government financial information, agreed by Loan Council last year.

Loan Council issues — including the Commonwealth's 1998-99 budget time LCA and the estimated 1997-98 LCA outcome — are discussed further in Chapter IV.

## **NATIONAL FISCAL OUTLOOK**

The sixth *National Fiscal Outlook* (NFO) report was published on 12 March 1998. It was prepared by a working group of Commonwealth and State Treasury officials as an input to the deliberations of the 1998 Premiers' Conference and to assist public understanding of trends in public sector finances.

The NFO presents medium-term projections of general government sector finances of the Commonwealth and the States. The 1998 NFO provides estimates for 1997-98 and projections for each of the three years to 2000-01 on the basis of policy settings as at February 1998.

The 1998 NFO projects an improvement in the combined Commonwealth and State general government sector from an underlying deficit of 0.4 per cent of gross domestic product (GDP) in 1997-98 to a surplus of 1.9 per cent of GDP in 2000-01. This mainly reflects the projected improvement in the Commonwealth's position over this period, from a deficit of 0.5 per cent of GDP to a surplus of 1.6 per cent of GDP. The State general government sector is expected to record small underlying surpluses over this period. Net debt for the combined sector is projected to decline over the outlook period, mainly as a result of developments at the Commonwealth level.

The improvement in prospect for the combined general government sector will narrow the gap between general government saving and investment, and hence reduce the sector's direct impact on the current account deficit. The achievement of underlying surplus will move the combined sector into a net lending position for the first time since 1989-90.

Statement 7 of *Budget Paper No. 1* updates the NFO estimates for developments since February 1998 (primarily the Commonwealth Budget, available State budgets, and Government Finance Statistics data published in April 1998) and extends the projection period by one year to 2001-02.

- The total general government sector is now expected to be in underlying surplus in 1997-98 at 0.2 per cent of GDP. This surplus is projected to increase to 2.4 per cent of GDP in 2001-02.

- The Commonwealth's position is projected to improve from a deficit of 0.2 per cent of GDP to a surplus of 2.1 per cent over this period, while the State general government sector is expected to remain in small surplus.

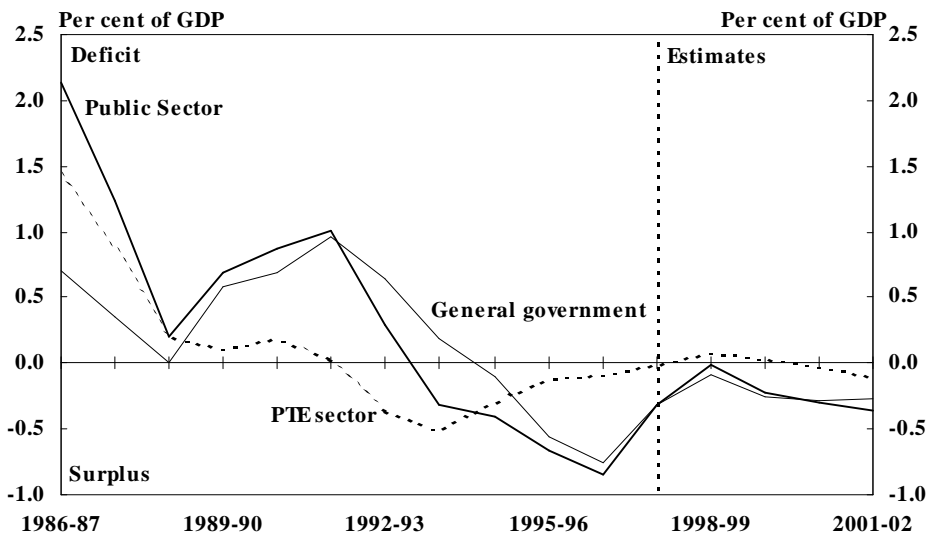
The Commonwealth's fiscal strategy is set out in *Budget Paper No. 1*.

## FISCAL DEVELOPMENTS IN THE STATES

The State public sector — which includes both the general government and public trading enterprise (PTE) sectors — is expected to record a small underlying surplus of \$1.7 billion, or 0.3 per cent of GDP, in 1997-98. This compares with a surplus of \$4.3 billion, or 0.8 per cent of GDP, in 1996-97. The expected deterioration mainly reflects developments in the general government sector. In particular, Victoria is estimating a significantly lower general government surplus in 1997-98, due mainly to lower receipts of privatisation-related revenues. Queensland also expects to record a significantly lower general government surplus in 1997-98 reflecting a fall in revenue as a share of gross state product (GSP).

The State public sector is expected to record small surpluses over the period to 2001-02, in line with expected trends in the general government sector. Trends in the underlying deficit of the State general government, PTE and total public sectors are shown in Chart 1.

**Chart 1: State Underlying Deficit by Sector<sup>(a)</sup>**

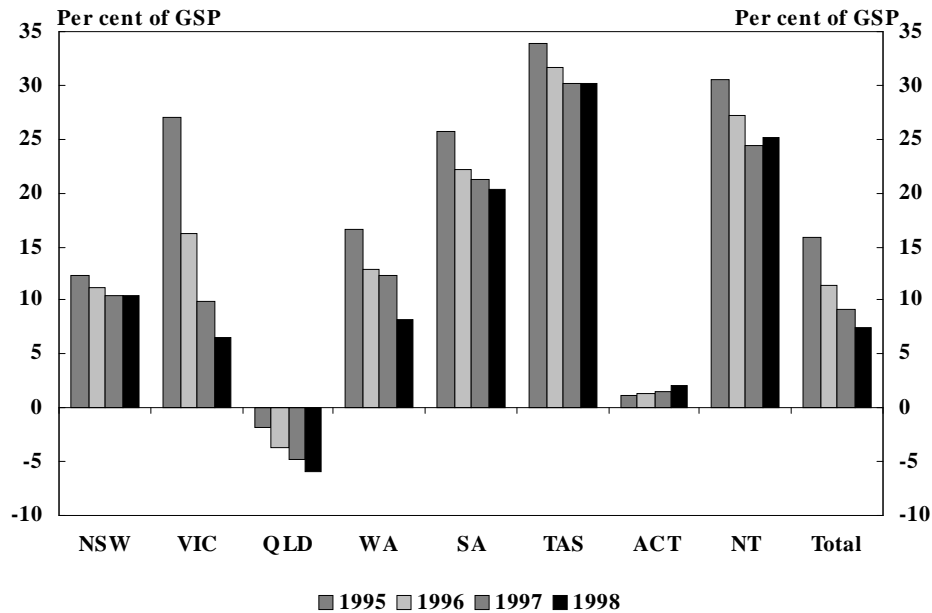


(a) The State public sector underlying deficit is the sum of the general government and PTE underlying deficits. The general government sector underlying deficit is defined as outlays less revenue less net advances paid.

Source: 1998 NFO data provided by the States, Government Finance Statistics (ABS Catalogue No. 5512.0), 1998-99 State budgets where available, and Commonwealth Treasury estimates.

The ratio of State net debt to GDP has been declining since the early 1990s reflecting underlying surpluses and the application of the proceeds of equity asset sales to debt reduction. This trend is expected to continue over the projection period. Chart 2 shows recent trends in the net debt to GSP ratio of each State.

**Chart 2: State Public Sector Net Debt  
as at 30 June<sup>(a)</sup>**



(a) Net debt is defined as gross debt less financial assets. Estimates of net debt at 30 June 1998 are taken from 1998-99 State budgets where available. Otherwise, they are calculated by adding to the ABS figure for net debt at 30 June 1997 (ABS Catalogue No. 5513.0) the sum of general government and PTE headline deficits less net advances paid to PTEs. The total is the total of State debt as a percentage of GDP.

Source: Unpublished ABS data, 1998-99 State budgets where available, and Commonwealth Treasury estimates.

A number of States continue to carry relatively high public sector debt servicing burdens. These States will require further fiscal consolidation measures to reduce their debt to more sustainable levels.

Fiscal developments in individual jurisdictions are summarised below.

**New South Wales** has maintained a relatively sound fiscal position, although its net debt to GSP ratio is now above the State average. The 1997-98 budget position has deteriorated significantly from budget time last year due to higher current outlays.

New South Wales' 1998 NFO projections show a general government underlying deficit for 1997-98 of 0.2 per cent of GSP, improving to small surpluses in 1998-99 and the following two years. The achievement of these outcomes will require the containment of pressures on current outlays.

New South Wales expects to record a small public sector underlying surplus in 1998-99, following a small underlying deficit in 1997-98.

New South Wales has a short term fiscal target of achieving a sustainable general government surplus by restraining the growth in outlays while improving service delivery, and a long term objective of eliminating general government net debt by 2020.

**Victoria's** fiscal position has strengthened significantly in recent years due to public sector reforms and the application of major asset sale proceeds to debt reduction. The total public sector net debt to GSP ratio is expected to fall below the State average in 1997-98.

Victoria's 1998-99 budget shows a decline in its general government underlying surplus from 1.0 per cent of GSP in 1997-98 to 0.3 per cent in 1998-99, with surpluses of around 0.3 per cent of GSP projected for the outyears.

The total public sector underlying surplus is expected to decline in 1998-99, in line with developments in the general government sector.

Victoria has a strategy of maintaining a sustainable budget operating surplus sufficient to fully fund infrastructure investment, maintaining State debt at levels consistent with its AAA credit rating, and bringing its tax rates into alignment with the national average.

**Queensland** remains in the strongest financial position of all the States, despite pressures associated with relatively rapid population growth. It is the only jurisdiction in a net asset position (that is, with financial assets exceeding financial liabilities). This in part reflects its policy of not borrowing for recurrent expenditure, restricting infrastructure borrowings to projects able to service the debt, and fully funding employer liabilities.

Queensland's general government underlying surpluses have declined in recent years. Its NFO projections show a trough of 0.3 per cent of GSP in 1998-99, improving to 0.8 per cent in 2000-01. Underlying outlays are projected to fall as a share of GSP after 1997-98, mainly reflecting the unwinding of high capital expenditure associated with infrastructure improvement.

The total Queensland public sector is expected to remain in moderate underlying surplus in 1997-98 and 1998-99.

**Western Australia** remains in a sound fiscal position, with a net debt to GSP ratio at around the State average. This reflects strong economic growth and public sector reforms.

Western Australia's 1998-99 budget shows a general government underlying deficit of 0.2 per cent of GSP in 1998-99, following surpluses in each of the previous four years. The general government underlying balance is expected to improve in the outyears, returning to small surplus in 2001-02.

A total public sector underlying deficit of 0.6 per cent of GSP is estimated for 1998-99, following a surplus of 2.9 per cent of GSP in 1997-98 which includes fixed asset sale proceeds of \$2.3 billion for the Dampier-Bunbury natural gas pipeline.

Western Australia has a financial strategy which incorporates a range of financial targets. These include an underlying surplus in the general government sector and declining net interest cost as a proportion of gross own source revenue for the total public sector.

Although **South Australia** continues to face difficult economic circumstances, it has made good progress in repairing its financial position since it was severely affected in the early 1990s by the need to provide assistance to the State Bank.

The public sector net debt to GSP ratio remains high relative to most other States but continues to decline gradually, reflecting the narrowing of deficits through cuts in real outlays and the application of asset sales proceeds to debt reduction.

South Australia's NFO projections show the general government underlying deficit as a share of GSP declining from 0.7 per cent in 1996-97 to 0.1 per cent in 2000-01. South Australia identifies public sector wage pressures as a risk to an expected reduction in underlying outlays as a share of GSP.

The total South Australian public sector is expected to be in small underlying deficit in 1997-98 and 1998-99.

The Government's fiscal objectives are to eliminate its underlying deficit in the non-commercial sector by 1997-98 and further reduce public sector net debt.

**Tasmania** continues to face significant budgetary pressures, including as a result of slow economic growth and expenditure requirements associated with demographic trends.

Although expected to decline to 30 per cent of GSP by June 1998, Tasmania's public sector net debt to GSP ratio remains the highest of any jurisdiction. This large debt burden reflects the State's reliance on public sector borrowings through the 1980s, partly associated with investment in hydro-electricity. A part sale of the Hydro Electric Corporation is planned for 1999-2000, with the proceeds to be directly applied to debt reduction.

Tasmania's NFO projections show a general government underlying deficit of 0.2 per cent of GSP in 1997-98, with similar deficits in the outyears. The total public sector is expected to be in underlying deficit in 1997-98 and 1998-99 at about 0.5 per cent of GSP.

Tasmania is in the third year of its latest fiscal strategy which focuses on public sector reforms and continued reduction of net debt, debt servicing costs and State taxes.

While the **Australian Capital Territory** remains in a relatively good financial position with low public sector net debt, it is the only jurisdiction showing a rising net debt to GSP ratio.

Its NFO projections show that the recent trend of general government underlying deficits of around 0.5 per cent of GSP is expected to continue (with the exception of 1998-99 when temporary factors are expected to result in a modest surplus).

The Territory's public sector underlying deficit is expected to increase sharply in 1998-99 due to developments in the PTE sector.

The Territory is in the third year of a budget strategy introduced in 1995-96 with the aim of reducing the Territory's operating loss, funding non-income producing capital works



without the need for borrowings, limiting overall increases in taxes to CPI changes or increases in New South Wales, and maintaining the Territory's AAA credit rating.

The **Northern Territory's** 1998-99 budget shows a substantial general government underlying deficit of 1.4 per cent of GSP in 1998-99, followed by approximate balance in each of the three years to 2001-02.

The total public sector deficit is expected to fall from \$132 million in 1997-98 to \$109 million in 1998-99, reflecting small improvements in both the general government and PTE sectors. However, the Territory's public sector net debt to GSP ratio continues to be well above the State average.

The Territory relies heavily on Commonwealth funding. Under the horizontal fiscal equalisation principles, the Territory continues to receive a relatively large share of the pool of Commonwealth general revenue assistance, reflecting the fiscal disabilities associated with its small and widely dispersed population.

The Northern Territory's fiscal strategy aims to ensure that current expenditure per capita does not increase in real terms, infrastructure is maintained at appropriate levels, its own source revenue effort is broadly comparable with the States, and the debt to GSP ratio declines over time.

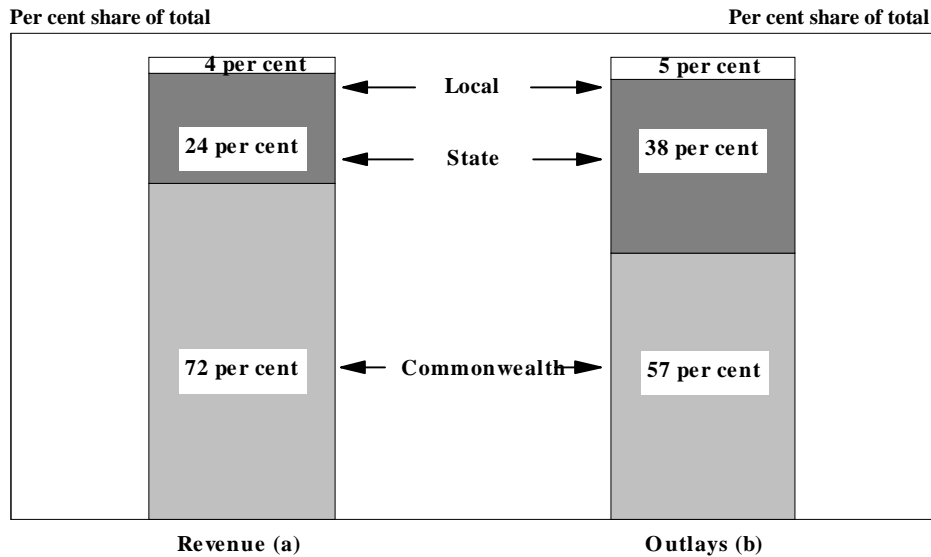
## CHAPTER II: OVERVIEW OF FEDERAL FINANCIAL RELATIONS

This chapter begins by providing an overview of Commonwealth payments to the State/local general government sector. The second part of the chapter describes the process of horizontal fiscal equalisation which underlies the interstate distribution of the bulk of Commonwealth general revenue assistance.

### COMPOSITION OF PUBLIC SECTOR REVENUES AND OUTLAYS

Federal fiscal arrangements in Australia are characterised by a significant difference between the relative revenue and expenditure responsibilities of the Commonwealth and the States, often referred to as vertical fiscal imbalance (VFI). The amount of own-source revenue raised by the Commonwealth is considerably larger than its own-purpose outlays. In contrast, the States' own-purpose outlays outweigh the amount which they raise in own-source revenue, with Commonwealth grants to the States forming a considerable portion of total State revenues. Chart 3 shows the estimated composition of general government own-source revenue and own-purpose outlays in Australia in 1997-98. Own-purpose outlays have been adjusted to include Commonwealth grants 'through' the States (other than for local government purposes) and grants to the multi-jurisdictional sector and to exclude net advances.

**Chart 3: Composition of General Government Own-Source Revenue and Adjusted Own-Purpose Outlays, 1997-98 (estimated)**



(a) Own-source revenue excludes the receipt of payments from other levels of government.

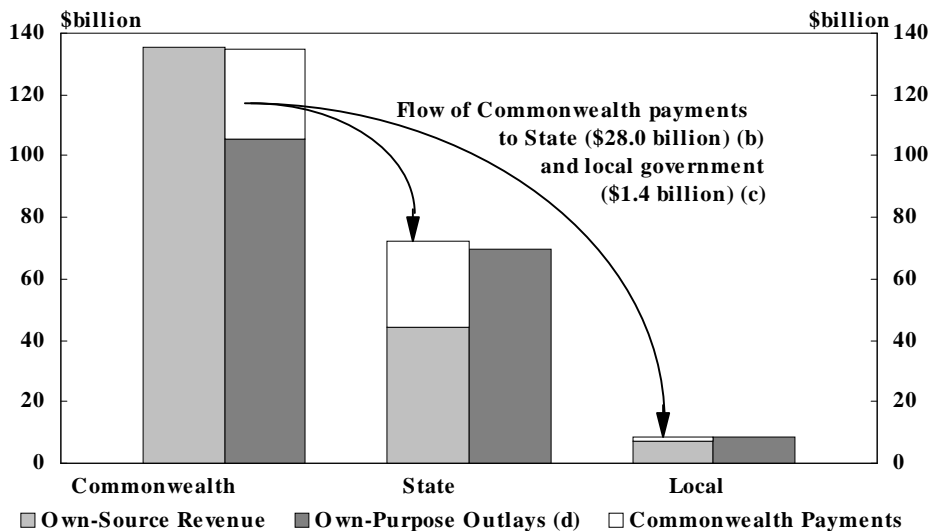
(b) The ABS measure of general government own-purpose outlays excludes payments to other levels of government and public trading enterprises (PTEs), such as general revenue assistance, SPPs and advances and subsidies, and interest payments on borrowings for other governments and PTEs. The adjusted measure employed here adds back in to Commonwealth outlays SPPs 'through' the States (other than those for local government purposes) and includes grants to the multi-jurisdictional sector. A corresponding adjustment is made to the State/local series. The adjusted measures for both Commonwealth and State levels of government abstract from all net advances, which is consistent with measures of the underlying deficit.

Source: ABS, *Government Finance Statistics*, unpublished data.

As noted above, there is a substantial flow of funds from the Commonwealth to supplement the own-source revenues of State/local government. The significance of this

flow for Commonwealth general government outlays and State/local general government revenue is shown in Chart 4. Payments to other levels of government (excluding SPPs 'through' the States except for local government general purpose assistance grants) accounted for around 22 per cent of the total outlays of the Commonwealth general government sector in 1997-98. These payments also accounted for around 39 per cent of the total revenue of the State general government sector and for around 17 per cent of the total revenue of the local general government sector.

**Chart 4: Impact of Commonwealth General Government Payments to Other Levels of Government, 1997-98 (estimated)<sup>(a)</sup>**



- (a) Commonwealth payments comprise general purpose payments and SPPs.
  - (b) Excludes grants 'through' the States.
  - (c) Comprises grants made 'through' the States to local government and direct payments to local government.
  - (d) Commonwealth grants 'through' the States, except grants for local government purposes, and grants to the multi-jurisdictional sector have been treated as Commonwealth government own-purpose outlays.
- Source: ABS, *Government Finance Statistics*, unpublished data.

The pattern of Commonwealth and State revenue raising and expenditure responsibilities is longstanding. The most significant difference is in relation to taxation and results primarily from the introduction of uniform Commonwealth income taxation in 1942. Both the Commonwealth and the States have the legal capacity to levy taxes, the only exception being customs and excises which the Australian Constitution reserves for the Commonwealth. The States derive own-source revenue from a range of sources, the most important of which are payroll taxes and taxes on property, including stamp duty.

A degree of imbalance between the revenue raising and expenditure responsibilities of different tiers of government is characteristic of the fiscal arrangements of most federal systems of government. There are considerable advantages to Australia as a whole, from both an economic and an administrative perspective, from the maintenance of a national taxation system. In Australia, a certain level of VFI is also necessary if the Commonwealth is to distribute payments to the States in accordance with the principle of horizontal fiscal equalisation. The provision of grants to the States in the form of SPPs is a means for the Commonwealth to pursue its policy objectives in areas where the States are the primary service providers.

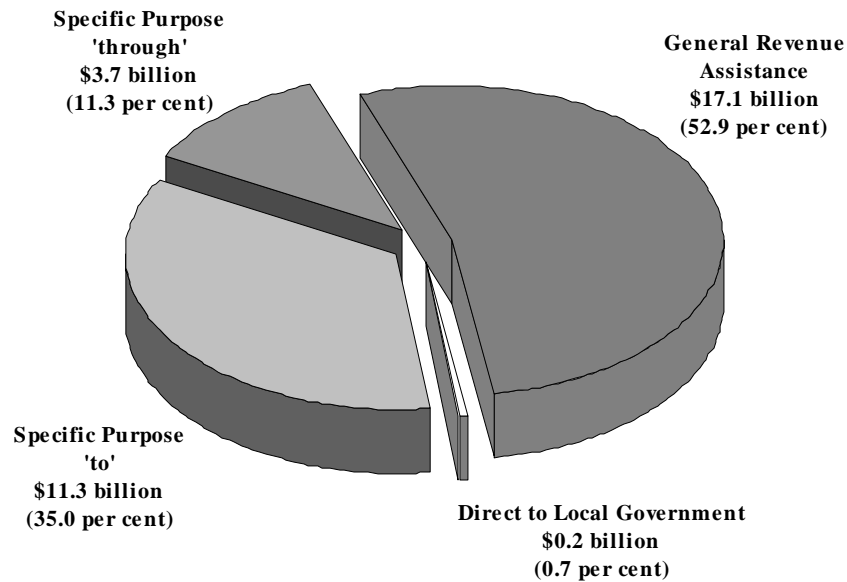
The extent of VFI has often been criticised on the grounds that it reduces government accountability. Accountability is considered to be best served when the level of government responsible for expenditure is also responsible for funding that expenditure through taxes. However, in practice, State governments are accountable for their budgetary decisions at the margin. The States raise around 58 per cent of their total revenue, and increases in State expenditures have to be financed largely through increased State taxation. Financial market scrutiny also has a bearing on a government's accountability for its spending decisions.

The Government announced on 13 August 1997 that a Taxation Task Force would prepare options for fundamental reform of the taxation system. At their meeting of 6 November 1997, Commonwealth and State leaders agreed that tax reform was necessary and that such reform should not involve any increase in the overall tax burden.

### **Composition of Commonwealth Payments to State/Local Sector**

Chart 5 shows the composition of Commonwealth payments to the State/local sector in 1998-99. Chapter III discusses these payments in detail.

**Chart 5: Payments to the State/Local Sector in 1998-99 (estimated)**  
**Total Gross Payments \$32.3 billion**



## HORIZONTAL FISCAL EQUALISATION

The general revenue assistance provided to the States by the Commonwealth is largely distributed on the basis of the horizontal fiscal equalisation (HFE) principles which are embodied in the per capita relativities recommended by the Commonwealth Grants Commission (CGC). The CGC is an independent statutory authority established by the *Commonwealth Grants Commission Act 1973*. The objective of HFE is to improve equity for all Australian residents.

In its assessments, the CGC uses a complex methodology that takes account of differences in the per capita capacities of the States to raise revenues and differences in the per capita amounts required to be spent by the States in providing an average standard of government services. A State's actual per capita expenditure or revenue generally differs from the average of all States for two reasons:

- influences that are beyond a State's control (referred to as 'disabilities') affect the cost at which it can provide services and its capacity for raising revenue; and
- a State's policies, practices and operating efficiency differ from those of other States.<sup>1</sup>

HFE requires that only those factors beyond a State's control be taken into account in determining a State's relative needs and hence the distribution of Commonwealth general revenue grants. The CGC's recommendations seek to ensure that each State has the capacity to provide the average standard of State-type public services if it makes the same effort to raise revenue as the States on average and operates at an average level of efficiency.

An update of the relativities is conducted annually by the CGC in response to terms of reference provided to it each year by the Commonwealth Government. Since 1990-91, the CGC's assessments have been based on data for the five financial years preceding the year in which the assessment is made. Accordingly, the review period for the per capita relativities to be applied in 1998-99 spans the years 1992-93 to 1996-97. The CGC also conducts broader methodology reviews every five years, with the current review (the '1999 Review') due to be completed in February 1999 — see Box 1.

By international standards, the extent of HFE in Australia is pronounced and the methodology is complex. The complexity of the CGC's processes has arisen in response to the requirements of the States and the Commonwealth over time for a comprehensive and rigorous approach to HFE. For its part, the CGC has sought to maximise the transparency of its methodology and to provide the opportunity for input and comment by the States and the Commonwealth.

Further information on HFE is provided in the CGC's *1998 Update* report.

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<sup>1</sup> Commonwealth Grants Commission, *Report on General Revenue Grant Relativities — 1998 Update*, February, 1998.

### **BOX 1: COMMONWEALTH GRANTS COMMISSION'S 1999 METHODOLOGY REVIEW**

- Every five years, the Commonwealth Grants Commission (CGC) conducts a comprehensive review of its methodology for assessing the per capita relativities for the distribution of the pool of FAGs and HCGs. The CGC is nearing the completion of the '1999 Review'.
  - These longer term reviews contrast with the annual updates of relativities which revise the data upon which the CGC's assessments are based.
- The terms of reference for the Review were developed in consultation with the States. The terms of reference give the CGC a wide-ranging brief to review aspects of its methodology. The resulting changes may produce a significant redistribution of FAGs among the States.
  - The Commonwealth and the States have made submissions to the CGC on the Review and have attended conferences to discuss specific issues.
- Issues under consideration by the CGC as part of the 1999 Review include:
  - the possible widening of the scope of its assessments;
  - the implications of microeconomic reform for State service delivery and hence State expenditure needs and revenue raising capacities; and
  - whether a five year or three year assessment period for the calculation of the relativities is more consistent with achieving the objectives of HFE.
- The CGC will release preliminary relativities in mid-1998 ahead of a further round of consultations with the States and Commonwealth. The CGC's final recommendations, including the recommended per capita relativities for 1999-2000, will be released in February 1999.

### **Effects of Horizontal Fiscal Equalisation**

The CGC first reported on per capita relativities for the six States simultaneously in 1981. Prior to that time, the CGC's major task was to assess applications by 'claimant States' for special financial assistance from the Commonwealth under section 96 of the Constitution. The scope of the CGC's assessments was widened to include the Northern Territory in 1985 and the Australian Capital Territory in 1993.

The distribution of the pool of FAGs and HCGs in accordance with the relativities means that New South Wales, Victoria, Western Australia and the Australian Capital Territory receive less than an equal per capita share of the pool, and the other States (particularly the Northern Territory and Tasmania) receive more. This reflects the CGC's assessment that the 'donor' States have greater relative revenue capacities and/or less significant expenditure disabilities than the other States.

Table 3 shows the amount of FAGs and HCGs received by each State under HFE relative to the amount that they would receive on the basis of an equal per capita distribution or a distribution based on personal income tax collections. The table shows that, in 1998-99, around \$1,638 million (or 7.4 per cent) of the FAGs/HCGs pool is to be redistributed among the States as a result of the application of the CGC's relativities, compared with an equal per capita distribution.

**Table 3: Impact of Horizontal Fiscal Equalisation on the Distribution of the Pool of Financial Assistance Grants and Health Care Grants in 1998-99 (\$million)<sup>(a)</sup>**

	Distribution Using CGC Relativities(b)		Distribution on an Equal Per Capita Basis(c)		Difference in Distribution (1)-(2)	Distribution on the Basis of Personal Income Tax Paid(d)		Difference in Distribution (1)-(4)
	(1)	(2)	(2)	(3)	(3)	(4)	(5)	(5)
	\$m	Per cent	\$m	Per cent	\$m	\$m	Per cent	
NSW	6546	29.7	7467	33.8	-920	8084	36.6	-1538
VIC	4814	21.8	5474	24.8	-660	5518	25.0	-704
QLD	4174	18.9	4089	18.5	85	3496	15.8	678
WA	2117	9.6	2157	9.8	-40	2199	10.0	-82
SA	2131	9.7	1746	7.9	385	1554	7.0	577
TAS	855	3.9	552	2.5	303	471	2.1	384
ACT	345	1.6	363	1.6	-18	545	2.5	-200
NT	1091	4.9	227	1.0	865	206	0.9	885
Total	22074	100.0	22074	100.0		22074	100.0	

(a) The pool consists of \$16,854.1 million in FAGs and \$5,219.9 million in HCGs — see Table 11 in Chapter III.

(b) 1998 'equalisation' relativities as recommended by the CGC — see Table 4 below.

(c) Based on ABS population projections — see Table 1.

(d) Based on each State's contribution to personal income tax paid in 1995-96, sourced from Table 16 of Australian Taxation Office, *Taxation Statistics 1995-96*.

Table 4 shows the per capita relativities used to distribute the combined pool of FAGs and HCGs since 1993.

- Western Australia and Queensland have experienced the largest declines in per capita relativities, reflecting relatively strong economic growth in those States which has contributed to an increase in their assessed fiscal capacities.
- The per capita relativities of the remaining States have increased, particularly those of the Australian Capital Territory, Victoria and Tasmania.
  - The recent increase in the ACT's relativity primarily reflects a decline in its relative revenue raising capacity as a result of falling property values in 1996-97.

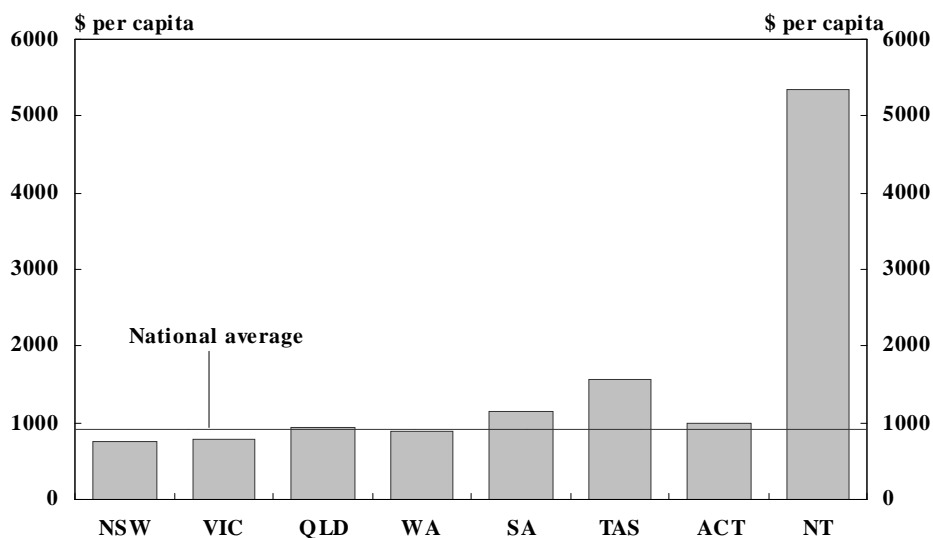
**Table 4: Commonwealth Grants Commission Relativities, 1993 to 1998**

	1993 Review (a)	1994 Update	1995 Update	1996 Update (b)	1997 Update	1998 Update (c)	Per cent Change 1993 to 1998
NSW	0.854	0.8756	0.8743	0.87472	0.87819	0.87765	2.8
VIC	0.835	0.8374	0.8506	0.87577	0.87835	0.88042	5.4
QLD	1.093	1.0441	1.0435	1.04176	1.03737	1.02186	-6.5
WA	1.117	1.0839	1.0521	1.01409	0.99589	0.98252	-12.0
SA	1.221	1.2186	1.2047	1.18772	1.19100	1.22194	0.1
TAS	1.480	1.5173	1.5437	1.54644	1.54974	1.55086	4.8
ACT	0.865	0.8968	0.8916	0.88883	0.88435	0.95145	10.0
NT	4.784	4.9863	5.0332	4.87829	4.89353	4.81869	0.7

- (a) Supplementary relativities calculated by the CGC to take into account the Medicare Agreements and Commonwealth policy in respect of State stamp duty exemptions for corporate reconstructions.  
 (b) The 1996 Update relativities as amended by the CGC's subsequent alternative calculation of 29 May 1996 relating to the treatment of Section 130 payments to Western Australia by deduction.  
 (c) The 1998 Update 'equalisation' relativities.

The estimated State distribution of general revenue assistance on a per capita basis for 1998-99 is shown in Chart 6. It indicates that New South Wales, Victoria and Western Australia receive less than average per capita payments. Although the ACT has a per capita relativity of less than one, it receives a per capita share of general revenue assistance that is greater than the national average. This reflects the non-pool funded special revenue assistance the ACT receives from the Commonwealth in the form of transitional allowances and special fiscal needs. The Northern Territory receives five times the national average and Tasmania, South Australia and Queensland also benefit from above average per capita payments.

**Chart 6: General Revenue Assistance, 1998-99**



Source: Tables 1 and 6 of this Budget Paper.



## Fiscal Equalisation and Specific Purpose Payments

In determining per capita relativities for the distribution of general revenue assistance, the CGC takes account of the interstate distribution of most current SPPs. Within the CGC's methodology there are four approaches to dealing with SPPs.

- **Inclusion** is used for SPPs which are considered to go towards meeting the States' expenditure needs as assessed by the CGC (for example, SPPs for funding government schools). In general, while the effect of the inclusion method on the overall distribution of funding depends on a number of factors, a State receiving a higher (lower) share of an 'included' SPP than the CGC considers appropriate to satisfy its relative 'needs' in the area will be assessed as requiring a commensurately lower (higher) share of the FAGs/HCGs pool.
- **Absorption** is a variant of the inclusion approach with the main difference being that SPPs treated by this method are added to the pool of FAGs and the CGC's recommended per capita relativities are determined with regard to the combined pool in that year. Unquarantined HCGs are treated in this manner.
- **Deduction** is used where an SPP is considered to finance expenditure in addition to that which the States would otherwise have undertaken or where an SPP is distributed in accordance with the CGC's assessment of State needs. Under this approach, the SPP does not enter into the CGC's calculation — only the State-funded portion of expenditure is included in the CGC's assessments. The deduction approach seeks to quarantine the distribution of FAGs from the interstate distribution of SPPs.
- **Exclusion** is used for SPPs which are directed to areas in which the Commonwealth has largely accepted financial responsibility (for example, most SPPs 'through' the States) or which are outside the scope of the CGC's assessment. Under this method all expenditure in the particular area is excluded from the assessments.

The distribution of SPPs treated by inclusion or absorption (about half of SPPs by value) affects the distribution of FAGs. Concerns have been expressed that this may in some instances result in the Commonwealth's policy objectives with respect to SPPs being overridden. The Commonwealth attempts to balance the objectives of SPPs with the objectives of fiscal equalisation. Accordingly, the Commonwealth has sometimes instructed the CGC to treat certain SPPs in a different way from how the CGC may otherwise have treated them. For example, the financial assistance provided under the South Australian Assistance Package has been excluded from the CGC's assessments to ensure that the benefit of the assistance is not redistributed to the other States by a change in the distribution of FAGs.

It is not necessarily the case that the Commonwealth's policy objectives will be forgone where an SPP's distribution may be overridden over time in a financial sense. The objective of an SPP may be achieved by the fulfilment of the related conditions which the Commonwealth has agreed with the State receiving the payment.

## CHAPTER III: COMMONWEALTH PAYMENTS TO THE STATES AND TERRITORIES

This chapter discusses trends in Commonwealth payments to the States and outlines the arrangements for payments to the States and local government in 1997-98 and 1998-99.

Table 5 shows estimated Commonwealth total payments to the States through the forward estimates period after allowing for State fiscal contributions to the Commonwealth and some payments associated with the Guns Buyback Scheme in 1997-98.

- Total payments to the States are estimated to be \$31.7 billion in 1998-99. General revenue assistance is expected to account for around 53 per cent of total payments to the States and SPPs for around 47 per cent.
- Total payments are estimated to increase by \$957 million or 3.1 per cent in 1998-99. Total payments are projected to increase in both nominal and real terms by around 16.3 per cent and 5.5 per cent, respectively, over the forward estimates period.

**Table 5: Commonwealth Payments to the States, 1997-98 to 2001-02 (\$million, estimated)**

	General Revenue Assistance	Specific Purpose Payments	State Fiscal Contributions	Total Payments	Change		
					(a)		(b)
					Nominal	Real	
(1)	(2)	(3)	(1)+(2)-(3)	\$m	Per cent	Per cent	
1997-98	16675.7	14708.3	626.6	30757.4	436.1	1.4	1.4
<b>1998-99</b>	<b>17096.3</b>	<b>14931.5</b>	<b>313.4</b>	<b>31714.3</b>	<b>957.0</b>	<b>3.1</b>	<b>0.8</b>
1999-00	17952.2	15318.5	na	33270.6	1556.3	4.9	2.3
2000-01	18591.9	15806.9	na	34398.8	1128.2	3.4	0.9
2001-02	19485.2	16281.9	na	35767.1	1368.3	4.0	1.4

- (a) Data excludes SPPs direct to local government authorities, deductions for State fiscal contributions and the Guns Buyback Scheme (\$125 million in 1997-98 and \$40 million in 1998-99).
- (b) 1989-90 prices, based on forecast CPI growth.

Table 6 shows estimated total Commonwealth payments for each State in 1997-98 and 1998-99.

In net terms, Commonwealth payments to the States are also estimated to be \$31.7 billion in 1998-99, an increase of \$1,742.5 million or 5.8 per cent on 1997-98. The estimated net increase incorporates SPPs direct to local government authorities (\$204.9 million in 1997-98 and \$224.5 million in 1998-99) and total repayments to the Commonwealth by the States of \$962.0 million in 1997-98 and \$196.0 million in 1998-99.

**Table 6: Total Commonwealth Payments to the States, 1997-98 and 1998-99 (\$million, estimated)**

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
<b>1997-98</b>									
(1) General Revenue Assistance	4811.0	3636.8	3139.9	1588.4	1568.1	685.6	274.8	971.1	16675.7
(2) Total Specific Purpose Payments	4673.1	3274.6	2661.7	1679.0	1382.5	457.1	259.5	320.8	14708.3
Specific Purpose Payments 'to' the States (a)	3553.4	2379.6	2015.9	1316.5	1105.3	363.7	180.8	263.4	11178.6
Specific Purpose Payments 'through' the States (b)	1119.7	895.0	645.9	362.4	277.2	93.4	78.7	57.4	3529.7
(3) Gross Payments to the States (1) + (2)	9484.0	6911.4	5801.6	3267.4	2950.6	1142.6	534.3	1292.0	31383.9
(4) State Fiscal Contributions	216.6	159.0	117.9	62.2	50.9	8.1	5.3	6.5	626.6
(5) Total Payments to States (3) - (4)	9267.4	6752.4	5683.7	3205.2	2899.6	1134.5	529.0	1285.5	30757.4
<b>1998-99</b>									
(1) General Revenue Assistance	4830.5	3598.5	3246.0	1637.4	1695.6	741.8	310.4	1036.2	17096.3
(2) Total Specific Purpose Payments	4870.2	3439.2	2711.8	1671.2	1292.8	420.4	248.4	277.6	14931.5
Specific Purpose Payments 'to' the States (a)	3707.9	2500.1	2039.0	1292.8	1014.7	324.8	166.0	224.4	11269.8
Specific Purpose Payments 'through' the States (b)	1162.3	939.0	672.8	378.4	278.1	95.5	82.3	53.2	3661.7
(3) Gross Payments to the States (1) + (2)	9700.7	7037.7	5957.7	3308.6	2988.4	1162.1	558.8	1313.8	32027.7
(4) State Fiscal Contributions	101.5	74.4	55.6	29.3	23.7	15.6	10.2	3.1	313.4
(5) Total Payments to States (3) - (4)	9599.2	6963.3	5902.1	3279.3	2964.7	1146.5	548.5	1310.7	31714.3
<b>Change in Total Payments, 1997-98 to 1998-99</b>									
\$million	331.8	210.9	218.4	74.1	65.0	12.0	19.5	25.2	957.0
Nominal change, per cent	3.6	3.1	3.8	2.3	2.2	1.1	3.7	2.0	3.1

(a) Data excludes SPPs direct to local government authorities, deductions for State fiscal contributions in 1997-98 and SPPs for the Gums Buyback Scheme (\$125 million in 1997-98 and \$40 million in 1998-99).

(b) Payments 'through' are payments which are made to the States to be passed on to local government, other bodies and individuals.

## GENERAL REVENUE ASSISTANCE

In 1998-99, general revenue assistance to the States will take the form of FAGs, SRA and NCPs. In contrast to most SPPs, general revenue assistance is 'untied', that is, it is not required to be spent by the States in a specified area.

General revenue assistance is estimated to amount to \$17.1 billion in 1998-99, an increase of 2.5 per cent on the previous year. The estimates of general revenue assistance for 1998-99 have varied from those presented at the 1998 Premiers' Conference in line with movements in the CPI.

- **FAGs** account for nearly all of general revenue assistance. The level of FAGs is indexed to movements in the CPI in the year to the March quarter and in accordance with projections of the population as at 31 December each year. The indexation of FAGs is guaranteed on a rolling three year basis subject to the States complying with obligations under the Agreement to Implement the National Competition Policy and Related Reforms.
- **SRA** in 1998-99 will comprise payments to the Australian Capital Territory for transitional allowances and special fiscal needs.
- **NCPs** are provided in accordance with the Agreement to Implement the National Competition Policy and Related Reforms. A State's receipt of NCPs is conditional on compliance with the obligations of the Agreement.

Table 7 sets out general revenue assistance by type of payment and State for the period 1994-95 to 1998-99.

**Table 7: General Revenue Assistance to the States, 1994-95 to 1998-99 (\$million)**

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
Financial Assistance Grants (a)									
1994-95	4010	2795	2700	1511	1458	612	217	827	14131
1995-96	4225	2997	2884	1546	1501	651	227	891	14921
1996-97	4372	3220	2981	1538	1503	666	233	921	15435
1997-98 (b)	4549	3342	3101	1568	1551	680	237	969	15996
<b>1998-99 (b)</b>	<b>4757</b>	<b>3545</b>	<b>3206</b>	<b>1616</b>	<b>1678</b>	<b>736</b>	<b>282</b>	<b>1034</b>	<b>16854</b>
Special Revenue Assistance									
1994-95	164	215	41	15	4	8	107	29	584
1995-96	182	232	..	..	..	..	61	10	485
1996-97	188	240	..	..	..	..	42	10	480
1997-98 (b)	190	242	..	..	..	..	35	..	467
<b>1998-99 (b)</b>	<b>..</b>	<b>..</b>	<b>..</b>	<b>..</b>	<b>..</b>	<b>..</b>	<b>25</b>	<b>..</b>	<b>25</b>
National Competition Payments									
1994-95	..	..	..	..	..	..	..	..	..
1995-96	..	..	..	..	..	..	..	..	..
1996-97	..	..	..	..	..	..	..	..	..
1997-98	72	53	39	21	17	5	4	2	213
<b>1998-99 (b)</b>	<b>73</b>	<b>54</b>	<b>40</b>	<b>21</b>	<b>17</b>	<b>5</b>	<b>4</b>	<b>2</b>	<b>217</b>
Identified Road Grants (c)									
1994-95	104	103	63	43	23	9	1	4	350
1995-96	110	99	68	43	28	11	3	9	371
1996-97	113	93	72	41	33	13	4	14	383
1997-98	..	..	..	..	..	..	..	..	..
<b>1998-99</b>	<b>..</b>	<b>..</b>	<b>..</b>	<b>..</b>	<b>..</b>	<b>..</b>	<b>..</b>	<b>..</b>	<b>..</b>
Total General Revenue Assistance									
1994-95	4278	3113	2804	1570	1485	629	326	859	15066
1995-96	4517	3328	2952	1589	1529	662	291	910	15777
1996-97	4673	3553	3053	1579	1535	680	279	945	16298
1997-98 (b)	4811	3637	3140	1588	1568	686	275	971	16676
<b>1998-99 (b)</b>	<b>4830</b>	<b>3599</b>	<b>3246</b>	<b>1637</b>	<b>1696</b>	<b>742</b>	<b>310</b>	<b>1036</b>	<b>17096</b>

(a) The table shows the gross level of FAGs to the States, without deductions for State fiscal contributions.

(b) Estimates — final figures (except for transitional allowances and special fiscal needs for the ACT) will depend on the actual increase in the CPI of the four quarters to March 1998 and March 1999, and the Statistician's determination of the population as at 31 December 1997 and 31 December 1998. Final figures for FAGs will also depend on final figures for HCGs.

(c) In 1997-98, these payments were absorbed into FAGs.

## Level of Financial Assistance Grants

At the 1998 Premiers' Conference, the Commonwealth extended the real per capita indexation arrangement of FAGs to 2000-01. This continues the three year rolling guarantee of FAGs real per capita indexation which was introduced in April 1995 for the forthcoming financial year and the following two years.

In 1998-99, FAGs to the States are expected to total \$16,854.1 million, with the real terms adjustment and the per capita adjustment estimated to contribute \$301.2 million and \$186.7 million respectively. Final amounts will depend on the actual increase in the CPI for the four quarters to March 1998 and March 1999, the Statistician's determination of the population at 31 December 1997 and 31 December 1998 and final figures for HCGs.

**Table 8: Derivation of the Level of Financial Assistance Grants (FAGs) 1998-99 (\$million)<sup>(a)</sup>**

(1)	1997-98 base FAGs (b)	15828.4
(2)	Plus real terms adjustment (c)	-9.9
(3)	Plus per capita terms adjustment (d)	177.1
(4)	Equals 1997-98 FAGs	15995.7
(5)	Plus 1997-98 NSW SRA (pool funded Medicare guarantee) (e)	154.3
(6)	Plus 1997-98 VIC SRA (pool funded Medicare guarantee) (e)	216.2
(7)	Equals base to calculate 1998-99 pool of FAGs	16366.2
(8)	Plus real terms adjustment (f)	301.2
(9)	Plus per capita terms adjustment (g)	186.7
(10)	Equals estimate of 1998-99 FAGs	16854.1

- (a) The table shows the gross level of FAGs to the States. The actual payments made to some States in 1997-98 and 1998-99 will be reduced by the amount of their fiscal contributions to the Commonwealth.
- (b) This is the amount set by the *States Grants (General Purposes) Act 1994* as base assistance for 1997-98.
- (c) This indexes the 1997-98 base FAGs for estimated year average CPI growth to the March quarter 1998 of - 0.06 per cent.
- (d) Based on a projection (prepared by the ABS on the basis of assumptions agreed to by Treasury) of an increase in the Australian population between 31 December 1996 and 31 December 1997 of 1.1 per cent. The final figure will depend on the Statistician's determination of the population at those dates.
- (e) Estimates – final figures will depend on the Statistician's determination of the population as at 31 December 1997.
- (f) Assumes year average CPI growth of 1.8 per cent in the year to the March quarter 1999. Final figures will depend on the actual increase in the CPI.
- (g) Based on a projection (prepared by the ABS on the basis of assumptions agreed to by Treasury) of an increase in the Australian population between 31 December 1997 and 31 December 1998 of 1.1 per cent. The final figure will depend on the Statistician's determination of the population at those dates.

The 1996 Premiers' Conference agreed that the untied funds which were previously paid to the States as identified road grants (IRGs) would be absorbed into the FAGs pool from 1997-98. Table 9 shows the equivalent amount of each State's FAGs in 1998-99.

**Table 9: Addition to FAGs from the Absorption of Untied Identified Road Grants (\$million, estimated)**

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
1998-99	118.3	87.0	75.4	38.3	38.5	15.4	6.2	19.7	399.0

## **Distribution of Financial Assistance Grants**

The distribution of FAGs among the States is based on the States' populations as at 31 December of each year and the 'equalisation' per capita relativities assessed by the Commonwealth Grants Commission (CGC) in the *Report on General Revenue Grant Relativities 1998 Update* (the 1998 Update).

The per capita relativities are applied to the State populations in order to arrive at a weighted population share for each State. A State's FAGs are equal to its weighted population share of the combined pool of FAGs and unquarantined HCGs, less the unquarantined HCGs it receives.

Tables 10 and 11 set out the estimated distribution of FAGs for 1997-98 and 1998-99, respectively.

For the past five years, the Commonwealth has required the CGC to adjust its assessments for the operation of the Medicare Agreements (giving rise to 'Medicare-adjusted' relativities). The Commonwealth's terms of reference for the 1998 Update directed the CGC to prepare relativities using the same general principles and methods as it used in the 1997 Update, except for the assessment of hospital expenditures and revenues, which were to be assessed on the basis of equalisation. The adoption of the CGC's 'equalisation' relativities in 1998-99 recognises that the Medicare Agreements will conclude at the end of 1997-98 and be replaced by the proposed AHCA's.

The redistribution of the combined pool of FAGs and HCGs among the States implied by the 1998 Update 'equalisation' relativities reflects two broad influences.

- Changes in States' grants shares arise from routine updating of the CGC's assessments, incorporating revisions and corrections to data within the 1997 Update review period and the advancement of the review period to replace 1991-92 data with 1996-97 data. These adjustments can affect both the composition of the CGC's standard budget and the assessment of revenue raising and expenditure disabilities by the CGC.
- Changes in States' grants shares also arise from the new hospital funding arrangements to begin in 1998-99. The new arrangements affect the structure of the CGC's standard budget and its assessments of disabilities. In addition, the pool-funded Medicare Guarantee payments and the Medicare Bonus Pool payments are returned to the FAGs/HCGs pool and distributed according to the per capita relativities.

**Table 10: Financial Assistance Grants to the States, 1997-98 (estimated)**

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	T <sub>c</sub>
(1) Estimated population as at 31 December 1997 (000's) (a)	6305.1	4627.0	3430.5	1811.0	1482.6	471.7	308.7	189.2	1862
(2) Per capita relativities (b)	0.87819	0.87835	1.03737	0.99589	1.19100	1.54974	0.88435	4.89353	
(3) Weighted populations (000's) - (1) times (2)	5537.1	4064.1	3558.7	1803.5	1765.8	731.1	273.0	925.7	1865
(4) Share of each State in weighted population (per cent) (c)	29.7	21.8	19.1	9.7	9.5	3.9	1.5	5.0	10
(5) Pool of FAGs and unquarantined HFGs distributed according to (4) (\$m) (d)	5963.5	4377.0	3832.8	1942.4	1901.8	787.4	294.1	996.9	2009
(6) Unquarantined HFGs (\$m) (d)	1414.8	1035.4	732.2	374.7	350.7	107.2	57.3	28.0	410
(7) Total FAGs - (5) less (6) (\$m) (e)	4548.7	3341.7	3100.6	1567.7	1551.1	680.2	236.7	969.0	1599

(a) The projected population as at 31 December 1997 has been prepared by the ABS on the basis of assumptions agreed to by Treasury. These projections are subject to revision.

(b) The per capita relativities adopted at the 1997 Premiers' Conference.

(c) For ease of presentation, weighted population shares rounded to one decimal place are shown. However, in calculating row (5) unrounded shares are used in accordance with the *States Grants (General Purposes) Act 1994*.

(d) Estimated unquarantined hospital funding grants (HFGs) — that is, total HFGs less the incentives package, the bonus pools, Medicare benefit adjustments and the other health services component.

(e) The table shows the gross level of FAGs to the States. The actual payments made to some States will be reduced by the amount of their fiscal contribution to the Commonwealth.

**Table 11: Financial Assistance Grants to the States, 1998-99 (estimated)**

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	T <sub>c</sub>
(1) Estimated population as at 31 December 1998 (000's) (a)	6371.1	4670.4	3489.0	1840.0	1489.7	470.8	310.1	193.5	1883
(2) Per capita relativities (b)	0.87765	0.88042	1.02186	0.98252	1.22194	1.55086	0.95145	4.81869	
(3) Weighted populations (000's) - (1) times (2)	5591.6	4111.9	3565.3	1807.9	1820.3	730.1	295.0	932.3	1885
(4) Share of each State in weighted population (per cent) (c)	29.7	21.8	18.9	9.6	9.7	3.9	1.6	4.9	10
(5) Pool of FAGs and unquarantined HCGs distributed according to (4) (\$m) (d)	6546.4	4814.1	4174.1	2116.6	2131.2	854.7	345.4	1091.5	2207
(6) Unquarantined HCGs (\$m) (d)	1789.4	1269.4	968.4	500.4	452.8	118.4	63.6	57.5	521
(7) Total FAGs - (5) less (6) (\$m) (e)	4757.0	3544.7	3205.7	1616.2	1678.4	736.3	281.8	1033.9	1685

(a) The projected population as at 31 December 1998 has been prepared by the ABS on the basis of assumptions agreed to by Treasury. These projections are subject to revision.

(b) The equalisation per capita relativities recommended by the CGC in the *Report on General Revenue Grant Relativities 1998 Update*.

(c) For ease of presentation, weighted population shares rounded to one decimal place are shown. However, in calculating row (5) unrounded shares are used in accordance with the *States Grants (General Purposes) Act 1994*.

(d) Estimated unquarantined HCGs to be paid to the States according to the Commonwealth's proposed AHCAs.

(e) The table shows the gross level of FAGs to the States. The actual payments made to some States will be reduced by the amount of their fiscal contribution to the Commonwealth.



Table 12 shows the redistribution of the FAGs and HCGs pool between the States implied by the equalisation relativities in the 1998 Update report is \$108.0 million. This is significantly larger than the redistribution of \$49.3 million implied by the 1997 Update Report, but is still well within the range established in recent years (\$126.6 million in the amended 1996 Update and \$80.6 million in the 1995 Update).

Relative to 1997, the 1998 equalisation relativities redistribute grants away from Victoria, Queensland, Western Australia and the Northern Territory to the other States.

- The decline in Western Australia's grant share was due both to routine Update changes and the effect of the change in hospital funding arrangements. The former mainly reflects an increase in the share of SPPs received by Western Australia arising from the substitution of 1996-97 data for 1991-92 data in the review period.
- The decline in Queensland's grant share is largely attributable to changes arising from the routine Update changes. Queensland's revenue raising capacity increased in relation to payroll tax. In addition, growth in States' revenue from stamp duties on conveyances and tobacco business franchise fees contributed to a reduction in Queensland's grant share, reflecting its relative revenue raising advantage in these areas.
- The decline in the Northern Territory's grant share is attributable to changes arising from the impact of the new hospital funding arrangements, which more than offset the beneficial changes arising from the routine update of the CGC's assessments.
- While Victoria received an increase in its grant share due to the effects of the new hospital funding arrangements, this was more than offset by the routine Update changes. In particular, Victoria's revenue raising capacity increased, including in relation to payroll taxation.
- New South Wales gained the largest increase in grant share, benefiting most from the impact of the proposed AHCAs. This was complemented by routine Update changes, primarily a decline in its assessed capacity to raise payroll taxation revenue.

Further information is provided in Table 12 below and in the CGC's 1998 Update report.

**Table 12: Effects of the Commonwealth Grants Commission's 1998 Update Equalisation Relativities and Different Hospital Funding Arrangements (\$million)<sup>(a)(b)</sup>**

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT
<b>Routine Update Changes (c)</b>								
Updating data for the 1997 Update period (1991-92 to 1995-96)	15.8	-28.0	-10.1	6.1	4.5	2.6	-1.7	10.6
Advancing the Review Period (substituting 1996-97 for 1991-92)	-5.9	3.0	-11.2	-33.3	16.5	11.6	17.7	1.6
Change in the Composition of the Standard Budget	-13.7	12.2	-7.7	-28.4	20.9	7.9	3.4	5.5
Changes in Disabilities	0.5	-10.7	-10.5	1.1	1.7	5.2	11.0	1.6
Interactions	7.3	1.5	7.0	-6.1	-6.1	-1.5	3.3	-5.5
Sub-Total	10.0	-25.0	-21.3	-27.2	21.0	14.2	16.0	12.2
<b>Changes due to new hospital funding arrangements (d)</b>								
Change in the Composition of the Standard Budget	29.1	17.3	-6.1	1.6	-8.2	-9.2	-0.7	-23.8
Change in Disabilities	-38.1	22.9	-28.1	1.2	40.5	-3.8	7.9	-2.4
Interactions	1.1	-0.6	1.0	0.0	-1.4	0.1	-0.2	0.0
Equalisation Distribution of Bonus Pools and Guarantees	59.3	-18.9	32.5	-36.8	-37.7	5.6	2.5	-6.4
Sub-Total	51.4	20.6	-0.7	-34.0	-6.8	-7.3	9.4	-32.6
Total Change	61.4	-4.4	-22.0	-61.2	14.2	6.9	25.5	-20.4

(a) From Tables 3-6, 3-7 and 3-8 of the CGC's Report on General Revenue Grant Relativities 1998 Update.

(b) Based on estimates of the level and distribution of the 1997-98 combined pool of FAGs and unquarantined HFGs, pool-funded Medicare Guarantees and Medicare Bonus Pool payments.

(c) Differences in the distribution of the 1997-98 combined pool of FAGs/HFGs, when the 1997 Medicare-adjusted relativities are replaced by the 1998 Medicare-adjusted relativities. Each State's share of the Medicare Guarantee and Bonus Pool payments remains unchanged.

(d) Differences in the distribution of the 1997-98 combined pool of FAGs/HFGs, based on the 1998 equalisation relativities compared with the 1998 Medicare-adjusted relativities. Also includes the differences in the distribution of the 1997-98 Medicare Guarantee and Bonus Pool payments when distributed on the basis of the 1998 equalisation relativities.

### National Competition Payments

At the April 1995 Council of Australian Governments (COAG) meeting, the Commonwealth and the States concluded the Agreement to Implement the National Competition Policy and Related Reforms. Under the Agreement the States are eligible for three tranches of ongoing NCPs. The NCPs commenced in July 1997 at an annual level of \$200 million and are scheduled to increase to \$400 million and \$600 million in July 1999 and July 2001 respectively, in 1994-95 prices. The Agreement specifies that the NCPs be paid quarterly and be distributed to the States on an equal per capita basis.

Each State's NCPs are subject to the State making satisfactory progress with the implementation of specified reform conditions in the Agreement. Prior to the scheduled payment of NCPs in 1998-99, the NCC will assess whether each State has met these conditions and provide a report for consideration by the Commonwealth.

Subject to satisfactory progress in the areas to be reviewed by the NCC, the Commonwealth will provide the States with NCPs estimated to total \$217.2 million in 1998-99. Table 13 shows the allocation of NCPs in 1997-98 and 1998-99.

**Table 13: National Competition Payments, (\$million, estimate)<sup>(a)</sup>**

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
1997-98	72.2	53.0	39.3	20.7	17.0	5.4	3.5	2.2	213.2
<b>1998-99</b>	<b>73.5</b>	<b>53.8</b>	<b>40.2</b>	<b>21.2</b>	<b>17.2</b>	<b>5.4</b>	<b>3.6</b>	<b>2.2</b>	<b>217.2</b>

(a) Estimates. Figures will depend on actual increases in the CPI and the Statistician's determination of population as at 31 December 1997 and 31 December 1998.

### **Special Revenue Assistance**

In 1998-99 special revenue assistance will comprise funding to the Australian Capital Territory in the form of transitional allowances and special fiscal needs. The level of these payments will reflect the recommendations of the CGC in its 1998 Update report.

Transitional allowances are designed to assist with the Australian Capital Territory's transition to 'State-like' funding from the generous levels of Commonwealth funding which existed before self-government. In 1998-99, transitional allowances will amount to \$11.1 million, a decrease of \$9.6 million from 1997-98. This amount incorporates additional transitional allowances for education and hospital services of \$5 million which the Commonwealth agreed to provide to the Australian Capital Territory in accordance with the CGC's 1997 Update report.

Special fiscal needs are payments to the Australian Capital Territory in recognition that certain functions (for example, the Family Court) are not funded by the Commonwealth, whereas in other States funding arrangements exist between the Commonwealth and the State. In 1998-99, special fiscal needs will amount to \$13.9 million, an increase of \$0.1 million from 1997-98.

### **Changes in the Distribution of General Revenue Assistance**

Table 14 sets out the impact on the distribution of general revenue assistance of revised population figures for 1998-99, the 1998 per capita relativities, changes in the level of NCPs, changes in the distributions of HCGs and special revenue assistance.

**Table 14: Factors Affecting the Change in General Revenue Assistance, 1997-98 to 1998-99 (estimated, \$million)**

	FAGs Pool Redistributions										1998-99 General Revenue Assistance
	1997-98 General Revenue Assistance	Equalisation Relativities(a)	New Population Estimates	Change in Distribution of Health Care Grants(b)	Cessation of Medicare Guarantee Payments(c)	FAGs Indexation	Other Special Revenue Assistance(d)	National Competition Payments			
NSW	4811.0	2.2	-5.9	-42.6	-80.2	144.7	..	1.3			4830.5
VIC	3636.8	14.6	-9.0	10.2	-161.4	106.4	..	0.9			3598.5
QLD	3139.9	-53.6	20.8	-24.4	70.1	92.3	..	1.0			3246.0
WA	1588.4	-24.2	8.7	-18.4	35.5	46.8	..	0.5			1637.4
SA	1568.1	51.3	-12.9	6.0	35.8	47.1	..	0.2			1695.6
TAS	685.6	1.3	-10.6	32.1	14.3	18.9	..	..			741.7
ACT	274.8	22.6	-2.2	11.3	5.8	7.6	-9.5	..			310.5
NT	971.1	-14.3	11.0	25.8	18.3	24.1	..	0.1			1036.2
Total	16675.7	..	..	..	-61.8	487.9	-9.5	3.9			17096.3

(a) Total impact of change from Medicare Adjusted Relativities in 1997-98 to Equalisation Relativities in 1998-99. This data may differ from Table 12 due to the use of the most recent estimates of the 1998-99 FAGs/HCGs pool.

(b) Estimated distribution of unquantified HCGs based on the Commonwealth's health funding to the States under the proposed AHCA's.

(c) Net effect of reallocation of pool funded component of Medicare Guarantee Payments (MCGs) and the cessation of the component of MCGs funded by the Commonwealth from outside the FAGs pool.

(d) Reduction in transitional allowance and special fiscal needs payments to the ACT.

## REVENUE REPLACEMENT PAYMENTS

On 5 August 1997 the High Court ruling on tobacco franchise fees in New South Wales (*Ha and Lim v. New South Wales* and *Walter Hammond & Associates Pty Ltd v New South Wales*) cast into doubt the constitutional validity of all State business franchise fees (BFFs). BFFs on tobacco, alcohol and petroleum generated State revenues of around \$5 billion annually.

On 6 August 1997, at the unanimous request of the States, the Commonwealth announced 'safety net' arrangements to protect State finances. These arrangements provided for:

- an increase in the rate of Commonwealth customs and excise duty on tobacco and petroleum products and an increase in the rate of wholesales sales tax on alcoholic beverages; and
- a 100 per cent windfall gains tax to protect the States from claims for refunds of past BFF payments.

All revenue collected by the Commonwealth under these arrangements is returned to the States (less administrative costs) as revenue replacement payments (RRPs).

The States have acknowledged that these arrangements would represent State taxes imposed and collected by the Commonwealth at the request and on behalf of the States. The distribution of RRP between the States was agreed among the States.

Details of estimated RRP for 1997-98 and 1998-99 are set out in Table 15. Actual RRP in 1997-98 and 1998-99 will be in accordance with formal determinations to be made by the Commissioner of Taxation and the Chief Executive Officer of the Australian Customs Service under the *States Grants (General Purposes) Act 1994*.

**Table 15: Revenue Replacement Payments, 1997-98 and 1998-99 (\$million, estimated)**

		NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
<b>1997-98</b>										
Tobacco	Share (Per cent)	0.32492	0.21803	0.19065	0.11100	0.08988	0.03226	0.01456	0.01870	1.00000
	Amount (\$m)	781.4	524.3	458.5	266.9	216.1	77.6	35.0	45.0	2404.8
Petroleum	Share (Per cent)	0.30039	0.20153	0.19593	0.17118	0.07549	0.02453	0.01291	0.01804	1.00000
	Amount (\$m)	583.6	391.5	380.7	332.6	146.7	47.7	25.1	35.0	1942.8
Alcohol	Share (Per cent)	0.33796	0.22332	0.19314	0.11147	0.07857	0.02415	0.01569	0.01569	1.00000
	Amount (\$m)	255.6	168.9	146.1	84.3	59.4	18.3	11.9	11.9	756.4
<b>Total</b>		<b>1620.6</b>	<b>1084.8</b>	<b>985.2</b>	<b>683.8</b>	<b>422.2</b>	<b>143.5</b>	<b>72.0</b>	<b>91.9</b>	<b>5104.1</b>
<b>1998-99</b>										
Tobacco	Share (Per cent)	0.32492	0.21803	0.19065	0.11100	0.08988	0.03226	0.01456	0.01870	1.00000
	Amount (\$m)	951.8	638.7	558.5	325.1	263.3	94.5	42.6	54.8	2929.2
Petroleum	Share (Per cent)	0.30039	0.20153	0.19593	0.17118	0.07549	0.02453	0.01291	0.01804	1.00000
	Amount (\$m)	766.9	514.5	500.2	437.0	192.7	62.6	33.0	46.1	2553.1
Alcohol	Share (Per cent)	0.33796	0.22332	0.19314	0.11147	0.07857	0.02415	0.01569	0.01569	1.00000
	Amount (\$m)	337.2	222.8	192.7	111.2	78.4	24.1	15.7	15.7	997.7
<b>Total</b>		<b>2055.9</b>	<b>1376.0</b>	<b>1251.4</b>	<b>873.4</b>	<b>534.4</b>	<b>181.2</b>	<b>91.3</b>	<b>116.5</b>	<b>6480.0</b>

## FISCAL CONTRIBUTIONS BY THE STATES

At the 1996 Premiers' Conference it was agreed that the States would make payments to the Commonwealth of \$619 million in 1996-97, \$640 million in 1997-98 and \$300 million in 1998-99 as a contribution to the Commonwealth's deficit reduction programme. The States decided that the payments would be shared among them on an equal per capita basis.

The need for the States to make these fiscal contributions was reviewed at the 1997 Premiers' Conference. It was agreed to maintain the existing schedule of fiscal contributions other than for Tasmania and the Australian Capital Territory. In recognition of the difficult economic circumstances faced by these jurisdictions, it was agreed that they should defer half of their scheduled 1997-98 fiscal contributions, of \$16.2 million and \$10.6 million respectively, until 1998-99. This reduced the total fiscal contribution from the States in 1997-98 to \$626.6 million and increased the 1998-99 fiscal contribution to \$313.4 million. The payment of FAGs to the States in 1998-99 will be conditional upon the States making fiscal contributions payments.

Table 16 shows the estimated contributions of each State in the three years to 1998-99 and the method of payment by each State in 1997-98.

**Table 16: Fiscal Contributions by the States**

	1996-97	1997-98 (a)		1998-99 (a)
	\$m	\$m	Method of Payment	\$m
NSW	209.7	216.6	Direct payment	101.5
VIC	153.9	159.0	Direct payment	74.4
QLD	113.4	117.9	Offset to CSHA (b)	55.6
WA	59.9	62.2	Deduction for financial assistance grants	29.3
SA	49.6	50.9	Part direct payment (\$30.9m) and part offset to CSHA (b) (\$20m)	23.7
TAS	15.9	8.1	Deduction from financial assistance grants	15.6
ACT	10.4	5.3	Direct payment	10.2
NT	6.2	6.5	Offset to CSHA (b)	3.1
Total	619.0	626.6		313.4

(a) The final distribution of State fiscal contributions will depend on the Statistician's determination of the population as at 31 December 1997 and 31 December 1998.

(b) Payments provided under the Commonwealth-State Housing Agreement.

The Commonwealth will continue to provide the States and Territories with flexibility on the method of payment for fiscal contributions. This may take the form of direct weekly payments to the Commonwealth, weekly deductions from general revenue assistance or reductions in the Commonwealth's payment of an SPP. The Commonwealth is prepared to accept payment by reductions in an SPP where this is consistent with its policy objectives and decisions underlying the payment and on the basis that any conditions attached to the SPP, including the level of the State's matching commitments prior to the reduction, will continue unchanged.

## GENERAL PURPOSE ASSISTANCE TO LOCAL GOVERNMENT

General purpose assistance to local government has been provided by the Commonwealth since 1974-75. Under current arrangements, the Commonwealth provides general purpose assistance to local government in the form of local government financial assistance grants and local government untied road funding. This assistance is paid to the States as an SPP on the condition that the funds are passed on to local government.

General purpose assistance is provided to local government authorities under the *Local Government (Financial Assistance) Act 1995*. Under the Act, the Treasurer is responsible for determining the annual increase in Commonwealth general purpose assistance paid to local government. The Act provides for general purpose assistance to be increased each year by an escalation factor which reflects the underlying movement in general revenue assistance provided to the States. The escalation factor reflects the percentage increase in the States' FAGs pool in the current year which in turn reflects indexation for population growth and the CPI.

The Commonwealth will provide \$1,205 million in local government general purpose assistance in 1997-98. These payments have been based upon the estimated escalation factor of 0.8 per cent determined by the Treasurer and take into account an overpayment of \$7.7 million in 1996-97. This outcome reflects the 1997-98 Budget decision that general purpose assistance to local government should be increased in line with the CPI in 1997-98. This increase is more commensurate with underlying payments to the States, taking into account the fiscal contributions being made by the States to the Commonwealth. The final escalation factor for 1997-98 will be determined by the Treasurer in June 1998 on the basis of the actual payments made to the States in 1997-98.

In 1998-99, general purpose assistance to local government will be based upon an estimated escalation factor of 3.0 per cent which has been determined by the Treasurer. The 1998-99 escalation factor reflects both the estimated CPI increase and population growth. General purpose assistance to local government is estimated to be \$1,229 million in 1998-99, after allowing for an estimated overpayment of \$10.0 million in 1997-98. The Treasurer will determine the final escalation factor for 1998-99 in June 1999, on the basis of the actual payments made to the States in 1998-99.

Table 17 sets out the payments of general purpose assistance to local government in 1997-98 and 1998-99.

As in the past, the interstate distribution of local government FAGs for 1998-99 will be on an equal per capita basis, using the State populations at 31 December in the previous financial year. Untied local government road funding is to be distributed between the States on the basis of the criteria established under the *Australian Land Transport Development Act 1988*. In both cases, the intrastate distribution of these payments to local governments is determined by State Grants Commissions on the basis of fiscal equalisation.



**Table 17: General Purpose Assistance for Local Government, 1997-98 and 1998-99, (\$million, estimated)**

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
<b>1997-98</b>									
Financial Assistance Grants	282.8	207.6	152.9	80.8	66.9	21.5	14.0	8.4	834.8
Identified Road Grants	107.5	76.4	69.4	56.6	20.4	19.6	11.9	8.7	370.4
Total General Purpose Assistance (a)	390.2	284.0	222.3	137.4	87.3	41.1	25.9	17.1	1205.2
<b>1998-99</b>									
Financial Assistance Grants	288.1	211.4	156.8	82.8	67.7	21.6	14.1	8.6	851.1
Identified Road Grants	109.6	77.9	70.8	57.7	20.8	20.0	12.1	8.8	377.7
Total General Purpose Assistance (a)	397.7	289.3	227.5	140.5	88.5	41.6	26.2	17.5	1228.8

(a) Total general purpose assistance is the actual cash payment that the State receives on behalf of local government in the given year. It is equal to the estimated entitlement for the given year adjusted for an over or under payment from the previous year.

## SPECIFIC PURPOSE PAYMENTS

### Nature and Purpose

Specific Purpose Payments (SPPs) are payments for policy purposes related to particular functional activities (for example, health and education). SPPs are made under section 96 of the Constitution which states that the Parliament may grant financial assistance to any State on such terms as it sees fit.

There are around 120 SPPs which can be classified into three groups:

- SPPs paid **to** the States — payments direct to State governments, representing 74 per cent of total SPPs;
- SPPs **through** the States — payments to State governments to be passed on to local government, other bodies and individuals, representing 24 per cent of total SPPs. The main payments in this category relate to non-government schools and local government general purpose assistance; and
- a small number of SPPs made direct to local government, representing 2 per cent of total SPPs. The main payments in this category relate to child care programmes administered by local governments on behalf of the Commonwealth and funding for aged and disabled persons' homes and hostels.

SPPs are reviewed each year in the Budget context. Indexation arrangements and the distribution of SPPs among States and Territories vary for each SPP.

In most cases SPPs are subject to conditions reflecting Commonwealth policy objectives or national policy objectives agreed to between the Commonwealth and the States. It is because of the conditions attached to SPPs that they are sometimes called 'tied grants'. Such conditions may include:

- general policy requirements on States (for example, that the States provide free public hospital treatment to Medicare patients as a condition of receiving hospital funding grants);
- a requirement that a payment be expended for a specified purpose (for example, housing assistance for homeless people);
- meeting broad Commonwealth-State agreements covering principles and programme delivery mechanisms (for example, the Commonwealth-State Housing Agreement); and
- conditions of joint expenditure programmes including project approval, matching arrangements (for example, dollar-for-dollar contributions) and performance information.

SPPs also include some payments which are not subject to conditions. These typically relate to revenue sharing arrangements or compensation (either for the transfer of responsibilities or for other Commonwealth action). For example, compensation

payments are made to the States for revenue forgone as a result of the national system of companies and securities regulation.

The conditions attached to SPPs can limit the ability of State governments to set their own spending priorities. The balance to be set between the Commonwealth's policy objectives and the desirability of maximising the States' flexibility on SPPs is not easily resolved and depends on the circumstances pertaining to particular areas of expenditure and policy. For example, the extent to which an SPP may restrict State budget flexibility depends on the degree to which States would have undertaken the expenditure concerned anyway, had they received the same level of funding through general revenue assistance, and the proportion of funding in the functional area coming from SPPs. For some large State expenditure items funded through SPPs, it could be expected that all of these funds would be directed to the same purpose regardless of the form of funding.

### Trends in Level and Composition of Specific Purpose Payments

In 1998-99 SPPs are estimated to total around \$15.0 billion, an increase of \$282.6 million or 1.9 per cent, on 1997-98. SPPs 'to' the States are expected to increase by around \$150.6 million in 1998-99. However, this increase is distorted by large extraordinary SPPs associated with the Guns Buyback Scheme (\$125 million in 1997-98 and \$40 million in 1998-99), deductions from Commonwealth-State Housing Agreement funding for State fiscal contributions (\$144 million in 1997-98) and payments of debt redemption assistance (a non-policy factor) which are expected to fall by \$34.2 million reflecting changes in the volume of debt maturing on behalf of the States. After abstracting from these items, the increase in SPPs 'to' the States in 1998-99 is \$125.4 million or 1.1 per cent.

Table 18 shows estimated SPPs for 1997-98 and 1998-99.

The figures in the table have been adjusted for a classification change to higher education funding by the ABS which reduced SPPs 'through' the States by around \$3.7 billion and increased SPPs 'to' the States by around \$50 million each year. Commonwealth higher education funding is now classified as a grant to the multi-jurisdictional sector rather than as an SPP.

**Table 18: SPPs 'To' and 'Through' the States and Territories, 1994-95 to 1998-99 (\$million)**

	1994-95	1995-96	1996-97	1997-98(a)	1998-99(a)
SPPs 'To'	10276.5	10845.4	11616.0	11159.0	11309.5
SPPs 'Through' (b)	2874.6	3023.7	3193.7	3529.7	3661.7
Total	13151.1	13869.1	14809.6	14688.6	14971.2

(a) Estimates.

(b) Incorporates recent reclassification of higher education funding from SPPs to grants to the multi-jurisdictional sector.

Following the 1998 Premiers' Conference, the Commonwealth indicated that there would not be an overall cut to SPPs to the States against the forward estimates in the 1998-99 Budget. In the event, the measures contained in the Budget resulted in a net increase in SPPs to the States of \$71.0 million in 1998-99 excluding the AHCAs.

SPPs are expected to account for 45.7 per cent of total gross payments to the States in 1998-99. SPPs 'to' the States are expected to total \$11.3 billion or 34.5 per cent of total gross payments, while SPPs 'through' the States are expected to be \$3.7 billion or 11.2 per cent of the total. Chart 7 shows trends in SPPs as a proportion of total gross payments to the States since 1978-79, including trends in payments 'to' and 'through' the States. The chart contains adjustments for a number of classification changes and large one-off factors so as to allow comparisons on a consistent basis.<sup>1</sup>

Chart 7 shows that although SPPs have increased as a percentage of total Commonwealth payments to the States by around 11 percentage points over the last twenty years, most of this increase occurred in the early 1980s. In recent years, SPPs have declined as a percentage of gross payments to the States.

**Chart 7: Specific Purpose Payments as a Percentage of Total Gross Payments to the States, 1978-79 to 1998-99**

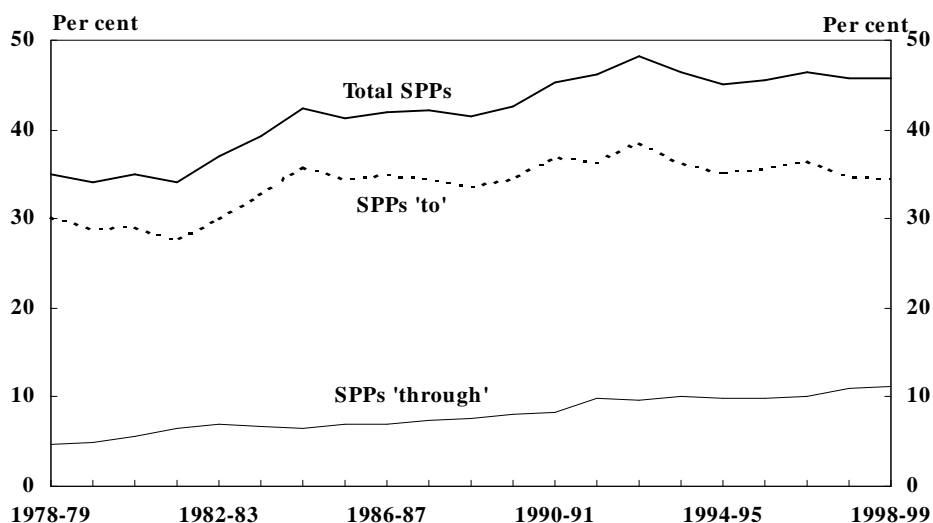
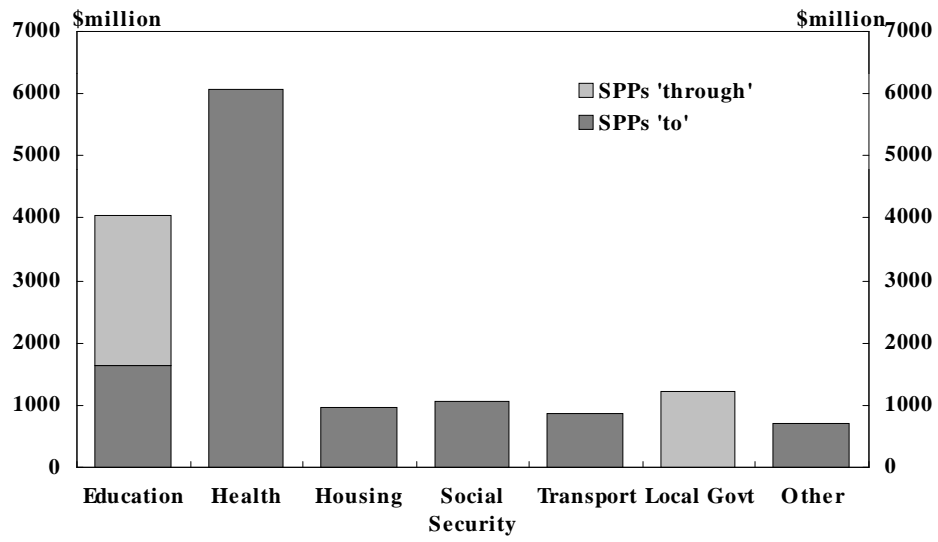


Chart 8 illustrates the composition of major specific purpose programmes ('to' and 'through' the States) in 1998-99. Health accounts for 54 per cent (or around \$6 billion) of SPPs 'to' the States. More detailed information on SPPs including estimated State splits for 1997-98 and 1998-99 and data on repayments, advances and interest are contained in the Appendix.

2 Incorporates recent reclassification of higher education funding from SPPs through the States to grants to the multi-jurisdictional sector. Chart 7 also contains adjustments for the reclassification of programmes such as the transfer in 1989-90 of nominated housing advances into Commonwealth-State Housing Agreement grants; and significant changes in the structure of Commonwealth hospital funding (such as the 1988 decision to combine States' Medicare compensation grants (introduced in 1984) and identified health grants into a single new SPP). Adjustments have also been made to the level of general purpose payments to account for Commonwealth policy decisions which transferred some taxing powers to the States.

**Chart 8: Composition of Estimated Specific Purpose Payments 'To' and 'Through' the States, 1998-99**



## CHAPTER IV: LOAN COUNCIL OVERSIGHT OF COMMONWEALTH AND STATE BORROWINGS

This chapter sets out the Loan Council Allocations (LCAs) nominated by the Commonwealth and each State for 1998-99 and endorsed by Loan Council. It also reports the Commonwealth's 1998-99 Budget time LCA and outlines a decision of Loan Council relating to budget sector reporting. Background on the Loan Council is provided in Box 2.

### **LOAN COUNCIL ALLOCATIONS FOR 1998-99**

Under the Loan Council arrangements, each jurisdiction nominates an LCA comprising:

- the estimated general government deficit/surplus (based on its NFO projections);
- its public trading enterprise (PTE) sector net financing requirement; and
- memorandum items (such as transactions that, while not formally borrowings, have many of the characteristics of borrowings).

These nominations are considered by Loan Council having regard to each jurisdiction's fiscal position and reasonable infrastructure requirements, as well as to the macroeconomic implications of the aggregate figure. LCAs are on a headline rather than an underlying basis as they seek to measure a government's call on financial markets.

The LCAs nominated for 1998-99 are set out in Table 19. In aggregate, they represent a surplus of \$9.4 billion compared with an estimated surplus for 1997-98 of \$14.3 billion. Whereas the latter figure incorporates the proceeds of major asset sales, some jurisdictions have yet to include estimates of such proceeds in their 1998-99 LCAs.

Loan Council considered that the aggregate of 1998-99 LCA nominations is consistent with current macroeconomic policy objectives and endorsed each jurisdiction's nomination without change. The agreed nominations were announced by the Treasurer on 7 May 1998.

With the exception of New South Wales and the Northern Territory which included the effects of some budget policy measures, LCA nominations were provided on a no policy change basis. They thus provide an indication of the public sector's likely call on financial markets. The actual call may vary from the nomination primarily because of changes in economic parameters and policy measures. Updated information will be provided to financial markets through publication by each jurisdiction of its budget time LCA and a mid-year update of its expected LCA outcome.

A tolerance limit of 2 per cent of total non-financial public sector revenue applies between the LCA approved by Loan Council and the budget time LCA, and again between the budget time LCA and the LCA outcome. Tolerance limits recognise that LCAs are nominated at an early stage of budget processes and that estimates are likely to change as a result of policy and parameter changes before and after budgets are brought down. If a jurisdiction expects to exceed the upper or lower bound of the tolerance limit around its LCA estimate, it is obliged to provide an explanation to Loan Council and to make this explanation public. While Loan Council would not be required

formally to approve the change, it would have the opportunity to pursue with the particular jurisdiction any concerns raised by the new LCA estimate.

#### **BOX 2: LOAN COUNCIL**

The Australian Loan Council is a Commonwealth-State Ministerial Council which co-ordinates public sector borrowings under voluntarily agreed arrangements. It comprises the Commonwealth Treasurer as Chairman and his counterparts from the States and Territories, and usually meets in conjunction with the annual Premiers' Conference. Loan Council was established in 1927 under the *Financial Agreement between the Commonwealth and the States* and was continued in existence under the *Financial Agreement between the Commonwealth, States and Territories* which came into effect in 1995.

Commonwealth-State cooperation in this area derives from a common interest in ensuring that overall public sector borrowing in Australia is consistent with sound macroeconomic policy and that borrowings by each government are consistent with a sustainable fiscal strategy.

The present Loan Council arrangements, introduced in 1993-94, are designed to enhance the role of financial market scrutiny as a discipline on borrowings by the public sector. In doing so, they build on changes instituted in the late 1980s which gave individual States responsibility for managing their own borrowings, with the aim of making them more accountable to the markets for their actions. The arrangements therefore emphasise transparency of public sector finances rather than adherence to strict borrowing limits.

The Loan Council process is supported by uniform, comprehensive reporting of public sector finances to assist Parliaments, financial markets and the public to make their own judgements about each government's financial performance. Loan Council reporting arrangements form part of the revised framework for the uniform presentation of government financial information which was agreed by Loan Council last year and will be fully implemented from 1998-99.

## **ESTIMATED COMMONWEALTH LCA OUTCOME FOR 1997-98**

At its March 1997 meeting, Loan Council endorsed the Commonwealth's 1997-98 LCA nomination of a \$4.4 billion surplus, provided on a no policy change basis. In considering the aggregate of nominated LCAs, Loan Council noted the Commonwealth Government's announcement that it would continue to work towards the aim of balancing the budget over the term of the current Parliament and that this would require further fiscal tightening in the 1997-98 Budget.

In May 1997 (Chapter IV of *Budget Paper No. 3 1997-98*), the Commonwealth estimated a budget time LCA surplus of \$5.5 billion, incorporating the then estimated headline budget surplus of \$6.4 billion.

In December 1997, a revised LCA estimate was provided in Table 24 of the *Mid-Year Economic and Fiscal Outlook 1997-98* (MYEFO). This showed a surplus of \$10.5 billion, incorporating a revised estimate for the headline budget surplus of \$11.8 billion. The improved budget and LCA estimates in the MYEFO mainly reflected additional proceeds from the one-third sale of Telstra. The MYEFO indicated that, as a result of this improvement, the Commonwealth expected to exceed the lower bound of the 2 per cent of revenue tolerance limit that applies on either side of its budget time LCA estimate.

The current estimate of the Commonwealth's 1997-98 LCA outcome is a \$11.7 billion surplus. The improvement since the MYEFO mainly reflects a higher estimate for the headline budget surplus of \$12.8 billion. Such an LCA outcome would exceed the lower bound of the tolerance limit.

The changes through the course of the year in the Commonwealth's 1997-98 LCA and its main components are shown in Table 20. The Commonwealth's actual LCA outcome will be reported in *Final Budget Outcome 1997-98*.

## **BUDGET TIME COMMONWEALTH LCA FOR 1998-99**

Each jurisdiction is required to take into account its Loan Council approved LCA in formulating its budget, and to report a budget time LCA in its budget papers.

The Commonwealth's budget time LCA estimate for 1998-99 is a \$17.3 billion surplus, compared with the nominated surplus of \$6.9 billion approved by Loan Council. This improvement reflects the increase in the estimated headline budget surplus from the no policy change figure of \$8.9 billion included in the MYEFO to \$18.7 billion as shown in Statement 1 of *Budget Paper No. 1* which is associated with proposed arrangements for the further sale of Telstra. The increase in the LCA surplus exceeds the lower bound of the tolerance limit of 2 per cent of public sector revenue. The components of the Commonwealth's nominated and budget time LCAs for 1998-99 are shown in Table 21.

Under the Loan Council arrangements, jurisdictions are required to disclose, as a footnote to their LCA, government termination liabilities under infrastructure projects with private sector involvement which operate for 10 years or longer and involve gross project liabilities of at least \$5 million. The Commonwealth plans one such project in 1998-99 — the Villawood Immigration Detention Centre. Preliminary information on this project is provided in a footnote to Table 21.



## OTHER LOAN COUNCIL DEVELOPMENTS

In March 1998, Loan Council agreed by correspondence to a proposal by Victoria that the publication of monthly and year to date budget sector data ('Niemeyer' statements), required under a 1930 Commonwealth-State agreement, no longer be mandatory. The decision reflects the view of some jurisdictions that their monthly 'Niemeyer' statements do not add significantly to the information available to the markets under the revised framework for the uniform presentation of government financial information, agreed by Loan Council last year.

The revised uniform presentation framework provides for twice yearly reporting — in budgets and mid-year reports — of full year estimates of outlays, revenue and financing transactions, as well as the reporting of full year outcomes, for the general government and public trading enterprise sectors. From 1998-99, all jurisdictions' budgets and mid-year reports will also include three year forward estimates for the general government sector. These reports use a consistent reporting framework and will enable financial markets and others to assess fully each jurisdiction's fiscal position.

It will be open to individual jurisdictions to continue to publish monthly budget sector statements if they wish. Under the current cash budgeting and reporting arrangements, the Commonwealth will continue publication of a monthly Statement of Commonwealth Financial Transactions, as required by the *Financial Management and Accountability Act 1997*. However, the Commonwealth has foreshadowed the implementation of accrual budgeting from 1999-2000. The timing, nature and extent of reporting under those arrangements have yet to be finalised.

**Table 19: Loan Council Allocations — 1998-99 Nominations (\$million)<sup>(a)</sup>**

	NSW(1)	VIC(2)	QLD	WA	SA(3)	TAS	ACT	NT	C/wlth(4)	Agg
<b>Nominated 1998-99 LCAs</b>										
General government deficit	-116	-376	-1079	-108	19	-33	-47	38	-7887	-9589
PTE net financing requirement	-79	222	134	-63	36	28	177	-14	790	1231
Total public sector deficit	-195	-154	-945	-170	55	-5	130	24	-7097	-8357
Memorandum items(b)(c)	-1283	145	78	133	-334	22	34	0	179	-1026
<b>Loan Council Allocation</b>	<b>-1478</b>	<b>-9</b>	<b>-867</b>	<b>-37</b>	<b>-279</b>	<b>17</b>	<b>164</b>	<b>24</b>	<b>-6918</b>	<b>-9383</b>
1998-99 Tolerance limit	540	353	302	173	126	74	27	36	2930	
<b>1997-98 LCAs — Feb 1998 estimates</b>										
General government deficit	187	-2420	-1533	-215	-14	-23	14	51	-10404	-14357
PTE net financing requirement	435	-1246	938	294	-39	-1	107	-17	370	841
Total public sector deficit	622	-3666	-595	79	-53	-24	121	34	-10035	-13517
Memorandum items(b)(c)	-1111	190	112	292	125	22	3	0	-455	-822
<b>Loan Council Allocation</b>	<b>-489</b>	<b>-3476</b>	<b>-483</b>	<b>370</b>	<b>72</b>	<b>-2</b>	<b>124</b>	<b>34</b>	<b>-10490</b>	<b>-14340</b>
1997-98 Budget time estimate	-880	-581	212	228	-32	22	127	4	-5548	-6448
1997-98 Nomination	-1413	-682	-340	99	-328	18	113	16	-4390	-6907
1996-97 LCA outcome	-2731	-9036	-811	323	-426	-22	79	-38	1233	-11429

(a) LCA nominations for 1998-99 in the main reflect current best estimates of 1998-99 public sector deficits/surpluses on a no policy change basis. In the case of New South Wales and the Northern Territory, some allowance has been made for expected policy measures. Nominations are based on preliminary estimates of general government finances provided by jurisdictions for purposes of the 1998 National Fiscal Outlook Report and projected bottom lines for each jurisdiction's PTE sector. Updated LCA estimates will be provided through publication by each jurisdiction of its budget time LCA as part of its budget documentation. The 2 per cent (of total public sector revenue) tolerance limits around each jurisdiction's 1998-99 LCA are designed, inter alia, to accommodate changes to the LCA resulting from policy change.

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

- (c) From 1997-98, government contingent exposures under infrastructure projects with private sector involvement are disclosed as a footnote to rather than a component of LCAs. These exposures, which are measured as the government's contractual liabilities in the event of termination of the project, are unlikely to be realised and are thus materially different from actual borrowings undertaken to finance the public sector deficit. Government outlays under these projects such as equity contributions and ongoing commercial payments to the private sector continue to be included in the annual ABS deficit/surplus and hence the LCA.
- 1 The New South Wales LCA nomination is reduced by around \$700 million in expected 1998-99 earnings on accumulated employer balances in its public sector superannuation schemes. Not all jurisdictions are able to do so have made similar deductions. New South Wales has five infrastructure projects with private sector involvement for which contracts are expected to be signed in 1997-98 or 1998-99.
  - 2 Victoria expects to favourably exceed the tolerance limit applying to its 1997-98 LCA mainly due to the sale of Power Net Victoria for \$2.555 billion (excluding licence fees) in October 1997 and the sale of Southern Hydro Limited in November 1997 for \$391 million. Victoria has a number of infrastructure projects with private sector involvement for which contracts are expected to be signed in 1998-99.
  - 3 South Australia's 1998-99 LCA nomination excludes the impact of possible asset sales such as electricity generation and distribution. South Australia has provided details of an infrastructure project with private sector involvement for which contracts are expected to be signed in 1997-98.
  - 4 The Commonwealth's 1998-99 LCA nomination incorporates some expected asset sales proceeds, and debt repayments by the States. The nomination does not include a net financing requirement for Telstra as it has been exempted from Loan Council's monitoring and reporting arrangements on commerciality grounds.

**Table 20: Commonwealth's Loan Council Allocation for 1997-98 (\$million)**

	Loan Council Approved March 1997	Budget Time Estimate May 1997	MYEFO Estimate Dec 1997	Current Estimate
General government sector deficit	-4227	-5530	-10404	-11543
PTE sector net financing requirement	-79	-248	370	112
Public sector deficit	-4306	-5740	-10035	-11429
Memorandum items(a)	-84	192	-455	-263
Loan Council Allocation	-4390	-5548	-10490	-11692

- (a) For the Commonwealth, memorandum items comprise the change in the net present value of operating leases (with a net present value greater than \$5 million) of departments and authorities, university borrowings, and an adjustment to exclude the net financing requirement of statutory marketing authorities and Telstra from the LCA.

**Table 21: Commonwealth's Loan Council Allocation for 1998-99 (\$million)**

	Loan Council Approved	Budget Time Estimate May 1998
General government sector deficit	-7887	-17794
PTE sector net financing requirement	790	739
Public sector deficit	-7097	-17055
Memorandum items(a)	179	-287
Loan Council Allocation(b)	-6918	-17342

- (a) For the Commonwealth, memorandum items comprise the change in the net present value of operating leases (with a net present value greater than \$5 million) of departments and authorities, university borrowings, and an adjustment to exclude the net financing requirement of statutory marketing authorities and Telstra from the LCA.

- (b) The Commonwealth expects to sign a contract in 1998-99 for an infrastructure project with private sector involvement. The Government has approved the redevelopment of the Immigration Detention Centre (IDC) at Villawood in Sydney. The initiative will provide a new, more secure and cost-efficient facility which will have a capacity in the order of 300-350 detainees.

The existing Villawood IDC has been operating since 1976 and in recent years occupancy levels have necessitated the use of adjacent former migrant housing as supplementary accommodation. This accommodation will no longer be needed after the proposed redevelopment.

It is intended that the construction work be undertaken by Australasian Correctional Services (ACS), a consortium 50 per cent owned by Thiess Contractors. ACS was selected in 1997 as the result of an exhaustive tender process to provide immigration detention and transport services to the Department of Immigration and Multicultural Affairs. The tender evaluation process specifically covered infrastructure development capabilities.

It is proposed to place the financing, ownership and maintenance of the new facility in the private sector.

The redevelopment cost is estimated to be in the order of \$35 million. The total project cost, the financing and contractual arrangements, and the Government liability under termination provisions of the contract are yet to be determined.

