

Executive Summary

- The States will receive goods and services tax (GST) revenue totalling an estimated \$31.7 billion in 2003-04. This amount is distributed between the States in accordance with recommendations of the Commonwealth Grants Commission (Chart 1).
- The States are realising the benefits of a broad, growing GST revenue base. Current estimates show that Queensland, Western Australia, Tasmania, the Australian Capital Territory and the Northern Territory will not require Budget Balancing Assistance in 2003-04. Their GST revenue will exceed their Guaranteed Minimum Amounts by a combined estimated total of \$269.6 million in 2003-04.
- In addition, the Government will provide the States with payments including National Competition Policy Payments, Specific Purpose Payments and Budget Balancing Assistance totalling an estimated \$24.5 billion in 2003-04. Specific Purpose Payments comprise a significant proportion of these funds (Chart 2).
- The Government is seeking improved accountability in Specific Purpose Payment agreements with the States. This reflects the importance of these payments, which the Commonwealth Government provides to the States as a contribution to areas of state responsibility, such as hospitals and schools.
- Fiscal developments in the States indicate a trend towards both cash and fiscal balance surpluses in almost all States by 2005-06. Over the past decade, most States have also reduced their levels of net debt.

Chart 1: GST revenue provision to the States, 2003-04 (estimated)

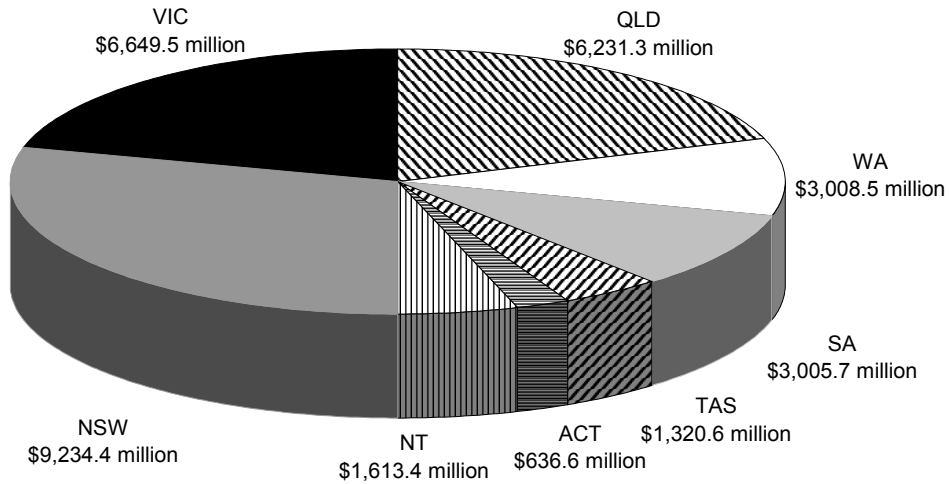
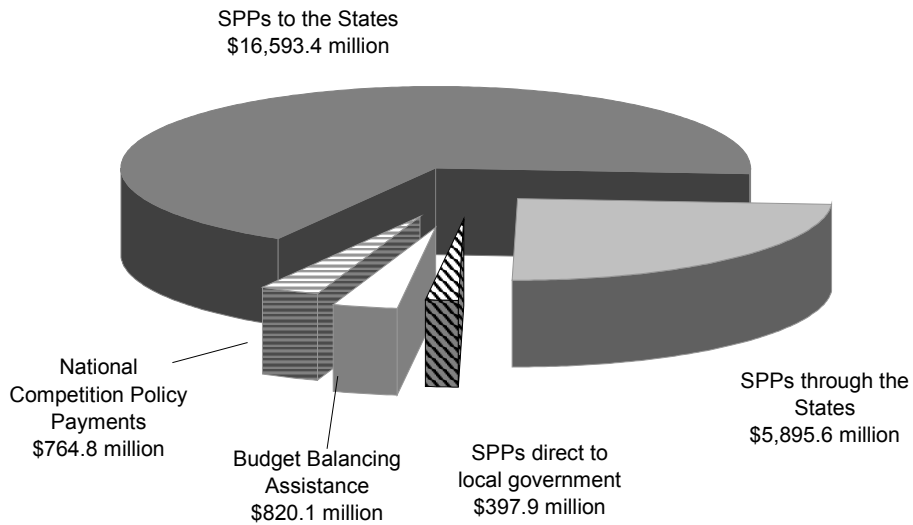


Chart 2: Commonwealth payments to the state/local sector, 2003-04 (estimated)



Note: Specific Purpose Payments through the States are payments to state governments to be passed on to local governments and others.

Commonwealth-State Financial Relations

The States will receive revenue and payments totalling an estimated \$54.2 billion in 2002-03 (Table 1) and \$56.2 billion in 2003-04 (Table 2). These amounts include GST revenue, Budget Balancing Assistance, National Competition Policy Payments and Specific Purpose Payments including payments direct to local government.

All GST revenue is paid to the States under the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*. The GST revenue pool is distributed to the States on the basis of recommendations by the Commonwealth Grants Commission, which applies the principles of Horizontal Fiscal Equalisation to help determine state revenue shares.

The Government pays the States Budget Balancing Assistance to cover any difference between GST revenue and States' Guaranteed Minimum Amounts. This is designed to ensure that States' budgetary positions are no worse off after the changes made to Commonwealth-State financial relations as part of the Commonwealth Government's implementation of *The New Tax System* in 2000-01.

In addition, the Government provides the States with National Competition Policy Payments to implement National Competition Policy and related reforms, as well as Specific Purpose Payments, including Financial Assistance Grants to local government, to contribute towards the costs of state and local government responsibilities.

Other features of Commonwealth-State financial relations include the First Home Owners Scheme and mirror tax arrangements.

Table 1: GST revenue provision and total Commonwealth payments to the state/local sector, 2002-03 (estimated)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
(1) Provision of GST revenue to the States(a)	9,076.8	6,361.8	5,880.8	2,911.2	2,859.6	1,245.2	617.3	1,512.4	30,465.1
(2) Budget Balancing Assistance	608.1	227.8	0.0	43.2	86.5	33.6	4.7	0.0	1,004.0
(3) National Competition Policy Payments	251.8	182.4	138.9	72.0	57.1	17.7	12.4	7.5	739.9
(4) Total Specific Purpose Payments (4.1)+(4.2)+(4.3)	7,156.8	5,255.8	3,957.0	2,591.1	1,723.4	544.2	386.2	369.8	21,984.3
(4.1) Specific Purpose Payments to the States	5,263.1	3,772.6	2,916.2	1,987.2	1,297.9	403.8	266.6	296.2	16,203.5
(4.2) Specific Purpose Payments through the States	1,809.6	1,406.8	990.4	564.2	406.1	128.5	116.3	69.4	5,491.2
(4.3) Specific Purpose Payments direct to local government	84.2	76.4	50.4	39.7	19.5	11.9	3.3	4.2	289.5
(5) Total Commonwealth payments to the state/local sector (2)+(3)+(4)	8,016.8	5,666.1	4,095.9	2,706.3	1,867.1	595.6	403.3	377.3	23,728.3
(6) GST revenue and total Commonwealth payments (1)+(5)	17,093.6	12,027.9	9,976.7	5,617.4	4,726.7	1,840.8	1,020.6	1,889.7	54,193.3

(a) The GST estimate has been adjusted to account for the final 2001-02 outcome, reflecting that GST payments in 2001-02 exceeded final collections in that year. Further details are provided under 'Adjustments' on page 15.

Table 2: GST revenue provision and total Commonwealth payments to the state/local sector, 2003-04 (estimated)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
(1) Provision of GST revenue to the States	9,234.4	6,649.5	6,231.3	3,008.5	3,005.7	1,320.6	636.6	1,613.4	31,700.0
(2) Budget Balancing Assistance	563.3	209.2	0.0	0.0	47.6	0.0	0.0	0.0	820.1
(3) National Competition Policy Payments	257.2	189.5	146.2	75.2	58.5	18.1	12.5	7.6	764.8
(4) Total Specific Purpose Payments (4.1)+(4.2)+(4.3)	7,635.8	5,344.4	4,210.8	2,574.1	1,809.5	547.6	394.9	370.0	22,886.9
(4.1) Specific Purpose Payments to the States	5,578.3	3,741.2	3,063.1	1,914.4	1,347.2	394.4	263.5	291.3	16,593.4
(4.2) Specific Purpose Payments through the States	1,942.7	1,504.1	1,073.3	604.3	434.4	137.4	126.4	72.9	5,895.6
(4.3) Specific Purpose Payments direct to local government	114.8	99.0	74.3	55.3	27.9	15.8	5.0	5.8	397.9
(5) Total Commonwealth payments to the state/local sector (2)+(3)+(4)	8,456.4	5,743.1	4,357.0	2,649.2	1,915.6	565.7	407.3	377.6	24,471.9
(6) GST revenue and total Commonwealth payments (1)+(5)	17,690.8	12,392.5	10,588.3	5,657.8	4,921.3	1,886.3	1,043.9	1,991.0	56,171.9

GST REVENUE PROVISION TO THE STATES

All GST revenue collected is received by the States. Consequently, the States have a secure, growing and broad-based revenue source. States can spend the GST revenue according to their own budgetary priorities. Table 3 shows the growth in the States' GST revenue since tax reform in 2000-01.

Table 3: GST revenue provision to the States (cash), 2000-01 to 2003-04 (estimated)

	2000-01	2001-02	2002-03	2003-04	Increase from 2000-01 to 2003-04	Increase	Average annual increase
	\$m	\$m	\$m	\$m	\$m	%	%
NSW	7,257.6	8,132.0	9,076.8	9,234.4	1,976.8	27.2	8.5
VIC	5,099.3	5,593.1	6,361.8	6,649.5	1,550.2	30.4	9.3
QLD	4,658.2	5,018.6	5,880.8	6,231.3	1,573.1	33.8	10.3
WA	2,374.6	2,518.1	2,911.2	3,008.5	633.9	26.7	8.3
SA	2,278.9	2,476.6	2,859.6	3,005.7	726.8	31.9	9.7
TAS	988.1	1,059.8	1,245.2	1,320.6	332.4	33.6	10.3
ACT	472.6	543.9	617.3	636.6	164.0	34.7	10.6
NT	1,225.6	1,289.8	1,512.4	1,613.4	387.8	31.6	9.7
Total	24,354.9	26,632.0	30,465.1	31,700.0	7,345.1	30.2	9.3

GST revenue

GST revenue is estimated in accrual terms for the years 2002-03 to 2005-06 (Table 4). These estimates have been revised since the 2002-03 Budget and the *Mid-Year Economic and Fiscal Outlook 2002-03* (MYEFO) to account for policy decisions and parameter variations. GST revenue is also estimated in cash terms (Table 5).

Table 4: Reconciliation of GST revenue (accrual), 2002-03 to 2005-06 (estimated)

	2002-03	2003-04	2004-05	2005-06
	\$m	\$m	\$m	\$m
GST revenue at 2002-03 Budget	29,690	31,310	33,090	34,970
<i>Changes from 2002-03 Budget to MYEFO</i>				
Effect of policy decisions	-14	-11	-5	-5
Effect of parameter and other variations	264	-69	-165	-255
Total variations	250	-80	-170	-260
GST revenue at 2002-03 MYEFO	29,940	31,230	32,920	34,710
<i>Changes from MYEFO to 2003-04 Budget</i>				
Effect of policy decisions	0	-3	-1	-1
Effect of parameter and other variations	1,290	823	896	971
Total variations	1,290	820	895	970
GST Revenue at 2003-04 Budget	31,230	32,050	33,815	35,680

Table 5: GST revenue (cash), 2003-04 to 2006-07 (estimated)

	2003-04 \$m	2004-05 \$m	2005-06 \$m	2006-07 \$m
GST revenue	31,700.0	33,450.0	35,300.0	37,280.0

Since the 2002-03 MYEFO, estimates of GST receipts have been revised up in all years, reflecting stronger than expected growth in the revenue base.

Estimated GST revenue in 2002-03 has been revised upwards by around \$1.3 billion in accrual terms, due to higher than anticipated collections in the year to date primarily as a consequence of continued strength in the dwellings sector. Although dwelling investment is still forecast to weaken, the slowdown is now expected to be later and more moderate than anticipated at MYEFO – providing the States with an additional fillip to GST revenue in the forward years.

GST revenue measures

Policy decisions affecting GST revenue estimates include: the decision to make Languages Other Than English courses provided by non-profit ethnic schools GST-free; amendments to the application of GST to Compulsory Third Party insurance; and the Government's response to the report of the *Inquiry into the Definition of Charities*. The revenue effect of these GST measures is estimated for 2003-04 to 2006-07 (Table 6). Detailed information on each measure is in Appendix A.

Table 6: GST revenue measures since the 2002-03 Budget (estimated)

	2003-04 \$m	2004-05 \$m	2005-06 \$m	2006-07 \$m
GST determination to make Languages Other Than English courses provided by non-profit ethnic schools GST-free	-3.0	-1.0	-1.0	-1.0
Application of GST to Compulsory Third Party Insurance	-11.3	-3.8	-3.9	-4.1
Government response to the Report of the <i>Inquiry into the Definition of Charities and Related Organisations</i>	0.0	-1.0	-1.0	-1.0
Total impact of GST revenue measures	-14.3	-5.8	-5.9	-6.1

GST revenue provision

The Government will distribute 2003-04 GST revenue among the States in accordance with the 2003 recommendations of the Commonwealth Grants Commission.

The Commission recommends state revenue sharing relativities for distributing the GST revenue pool by applying the principles of Horizontal Fiscal Equalisation. Broadly, the Commission recommends relativities so that if each State made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each State could provide services at the same standard.

The Commission takes into account differences in States' capacities to raise revenues and differences in the costs incurred by the States in providing an average standard of government services. The Commission's recommended state revenue sharing relativities reflect these differences. GST relativities, which help determine the distribution of the GST pool, are shown for 2002-03 and 2003-04 (Table 7).

The Commission also estimates Financial Assistance Grants forgone relativities (Table 7), used for the calculation of States' Guaranteed Minimum Amounts (Table 11).

Table 7: GST relativities and Financial Assistance Grants relativities, 2002-03 and 2003-04

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT
GST relativities								
2002-03	0.90631	0.86824	1.01174	0.97592	1.19447	1.55419	1.15216	4.24484
2003-04	0.89117	0.87010	1.01902	0.96946	1.21215	1.59948	1.14979	4.38638
FAGs relativities								
2002-03	0.86037	0.83401	1.04008	0.92858	1.29035	1.75186	1.20906	5.22670
2003-04	0.84317	0.84030	1.04870	0.92093	1.30919	1.79057	1.19727	5.34163

The GST relativities are applied to state populations to determine a weighted population for each State. The Government uses the weighted populations to distribute the GST revenue pool. Each State receives a share of the GST revenue pool equal to its weighted population share of combined GST revenue and unquarantined Health Care Grants, less its unquarantined Health Care Grants. This calculation determines the distribution of GST revenue in 2002-03 and 2003-04 (Tables 8 and 9).

Table 8: Distribution of GST revenue, 2002-03 (estimated)

Projected population as at 31 December 2002	Per capita relativities	Weighted population (1)×(2)	Share of weighted population (%)	GST revenue/HCGs pool according to (4)	Unquarantined HCGs	Distribution of GST revenue (5)-(6)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
		(a)		(\$m)	(\$m)	(\$m)
NSW	0.90631	6,047,040	30.6	11,488.8	2,412.0	9,076.8
VIC	0.86824	4,256,929	21.5	8,087.8	1,726.0	6,361.8
QLD	1.01174	3,792,514	19.2	7,205.4	1,324.6	5,880.8
WA	0.97592	1,895,034	9.6	3,600.4	689.2	2,911.2
SA	1.19447	1,821,550	9.2	3,460.8	601.2	2,859.6
TAS	1.55419	736,823	3.7	1,399.9	154.7	1,245.2
ACT	1.15216	372,743	1.9	708.2	90.9	617.3
NT	4.24484	837,048	4.2	1,590.3	77.9	1,512.4
Total	na	19,759,681	100	37,541.6	7,076.5	30,465.1

(a) Total weighted population differs from the total population in column 1 as the per capita relativities are calculated by the Commonwealth Grants Commission using population numbers for the period 1996-97 to 2000-01 and are then rounded.

Table 9: Distribution of GST revenue, 2003-04 (estimated)

Projected population as at 31 December 2003	Per capita relativities	Weighted population (1)X(2)	Share of weighted population (%)	GST revenue/HCGs pool according to (4)	Unquarantined HCGs	Distribution of GST revenue (5)-(6)	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	
NSW	6,735,979	0.89117	6,002,902	30.0	11,656.6	2,422.3	9,234.4
VIC	4,963,273	0.87010	4,318,544	21.6	8,385.9	1,736.4	6,649.5
QLD	3,828,095	1.01902	3,900,905	19.5	7,574.9	1,343.6	6,231.3
WA	1,968,408	0.96946	1,908,293	9.5	3,705.6	697.0	3,008.5
SA	1,532,801	1.21215	1,857,985	9.3	3,607.9	602.2	3,005.7
TAS	474,925	1.59948	759,633	3.8	1,475.1	154.5	1,320.6
ACT	326,039	1.14979	374,876	1.9	727.9	91.4	636.6
NT	198,566	4.38638	870,986	4.4	1,691.3	77.9	1,613.4
Total	20,028,086	na	19,994,125	100.0	38,825.2	7,125.2	31,700.0

(a) Total weighted population differs from the total population in column 1 as the per capita relativities are calculated by the Commonwealth Grants Commission using population numbers for the period 1997-98 to 2001-02 and are then rounded.

The Effect of Horizontal Fiscal Equalisation

To view the effect of the Commonwealth Grants Commission's application of Horizontal Fiscal Equalisation, compare the distribution of the GST revenue/Health Care Grants pool with the distribution on an equal per capita basis for each State. In 2003-04, approximately \$2,747.2 million (7.1 per cent) of the total GST revenue/Health Care Grants pool will be redistributed among the States, compared with an equal per capita distribution (Table 10).

Table 10: Effect of Horizontal Fiscal Equalisation, 2003-04 (estimated)

	GST/HCG pool distributed under HFE (\$m)	Equal per capita distribution of GST/HCG pool (\$m)	Difference (1) - (2) (\$m)	Population (million)	Per capita redistribution (3) / (4) (\$)
	(1)	(2)	(3)	(4)	(5)
NSW	11,656.6	13,057.9	-1,401.3	6.7	-208.0
VIC	8,385.9	9,621.5	-1,235.6	5.0	-249.0
QLD	7,574.9	7,420.9	154.0	3.8	40.2
WA	3,705.6	3,815.8	-110.3	2.0	-56.0
SA	3,607.9	2,971.4	636.5	1.5	415.3
TAS	1,475.1	920.7	554.4	0.5	1,167.4
ACT	727.9	632.0	95.9	0.3	294.2
NT	1,691.3	384.9	1,306.4	0.2	6,579.1
Total	38,825.2	38,825.2	0.0	20.0	0.0

New South Wales, Victoria and Western Australia receive less than equal per capita shares under the Horizontal Fiscal Equalisation arrangements because the Commission has assessed their fiscal capacity to be relatively strong. For example, the Commission assessed that New South Wales has a relatively stronger capacity to raise revenue from land tax and stamp duty on property transfers; Victoria has a relatively lower cost of providing state government services; and Western Australia has a relatively strong capacity to raise revenue from mining activities. The remaining States receive more than an equal per capita share of funding because the Commission has assessed their fiscal capacity to be lower and/or their costs of service delivery to be higher.

BUDGET BALANCING ASSISTANCE

The Government also provides the States with Budget Balancing Assistance. On the basis of current estimates, the States will receive total Budget Balancing Assistance of \$1,004.0 million in 2002-03 and \$820.1 million in 2003-04 (Tables 11 and 12).

Budget Balancing Assistance is paid under the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* to ensure that, in the transitional years following the introduction of *The New Tax System* in 2000-01, each State's budgetary position will be no worse off than had the reforms to Commonwealth-State financial relations not been implemented.

The Guaranteed Minimum Amount is an estimate of the amount of funding each State would have had if tax reform had not been implemented. Components of the Guaranteed Minimum Amount comprise estimates of state taxes abolished by tax reform and other items (Tables 11 and 12). Narrow and inefficient state taxes that were abolished include Financial Institutions Duty, stamp duty on quoted marketable securities, and accommodation taxes (bed taxes).

To meet its guarantee, the Government pays the States Budget Balancing Assistance to cover any shortfall of GST revenue compared with each State's Guaranteed Minimum Amount.

The GST is a strong, growing revenue base and already, in some States, GST revenue exceeds the Guaranteed Minimum Amount. Current estimates show that in 2002-03, Queensland and the Northern Territory do not require Budget Balancing Assistance. Their GST revenue will exceed their Guaranteed Minimum Amounts by a combined total of \$88.7 million in 2002-03 (Table 11).

Even more States will benefit in 2003-04. Current estimates show that Queensland, Western Australia, Tasmania, the Australian Capital Territory and the Northern Territory will not require Budget Balancing Assistance in 2003-04. Their GST revenue will exceed their Guaranteed Minimum Amounts by a combined total of \$269.6 million in 2003-04 (Table 12).

Table 11: Guaranteed Minimum Amount components, GST revenue provision and Budget Balancing Assistance, 2002-03 (estimated)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
State Revenues Forgone									
Financial Assistance Grants	5,388.0	3,830.2	3,972.8	1,760.8	2,072.6	973.8	440.6	1,322.5	19,761.3
Revenue Replacement Payments	2,460.6	1,646.7	1,493.4	1,030.9	640.5	217.6	109.4	139.1	7,738.3
Financial Institutions Duty	671.0	386.7	na	145.8	96.6	23.6	19.5	15.3	1,358.5
Marketable Securities Duty	429.0	223.1	27.0	27.6	14.7	0.7	24.2	1.1	747.4
Marketable Securities Duty Needs	-21.6	11.3	12.9	2.6	2.9	2.4	-11.0	0.5	0.0
Accommodation Taxes	77.0	na	na	na	na	na	na	na	85.5
plus Reduced Revenues									
Gambling Taxes	581.8	380.3	224.7	63.0	92.1	24.5	23.1	17.4	1,406.9
plus Interest Costs									
Interest Costs	3.9	4.2	5.0	1.2	1.4	0.6	0.5	0.9	17.7
plus Additional Expenditures									
First Home Owners Scheme	283.9	223.5	201.7	104.3	64.9	27.6	16.2	8.2	930.3
GST Administration Costs	188.4	138.4	105.8	54.8	43.1	13.4	9.1	5.6	558.6
plus Other Items									
WST Payments	38.0	5.0	18.0	19.0	12.7	13.0	4.0	3.0	112.7
minus Reduced Expenditures									
Off-road Diesel Subsidies	138.2	57.5	132.2	172.9	37.0	2.2	0.0	3.9	543.9
Savings from Tax Reform	167.9	115.0	95.3	56.9	41.4	13.9	9.5	14.0	514.0
Low Alcohol Beer Subsidies	24.7	17.1	4.8	7.8	4.6	1.7	1.0	1.2	62.9
minus Growth Dividend									
Remaining State Taxes	77.4	49.9	26.2	15.6	12.5	3.2	2.4	1.7	189.0
Plus Adjustments									
2001-02 BBA Adjustment (a)	-6.8	-20.3	-1.7	-2.4	0.3	2.7	-0.7	2.0	-26.8
Total Guaranteed Minimum Amount (1)	9,684.9	6,589.7	5,801.3	2,954.4	2,946.1	1,278.9	622.0	1,503.2	31,380.4
GST Revenue Provision (2) (b)	9,076.8	6,361.8	5,880.8	2,911.2	2,859.6	1,245.2	617.3	1,512.4	30,465.1
Budget Balancing Assistance (1)-(2) (b)	608.1	227.8	0.0	43.2	86.5	33.6	4.7	0.0	1,004.0

(a) Reflects revisions to components of the 2001-02 GMA of each State made after the 2001-02 financial year, but exclusive of the \$204.9 million GST overpayment.

(b) Adjusted for the \$204.9 million GST overpayment in 2001-02.

Table 12: Guaranteed Minimum Amount components, GST revenue provision and Budget Balancing Assistance, 2003-04 (estimated)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
State Revenues Forgone									
Financial Assistance Grants	5,455.4	4,048.3	4,224.7	1,817.3	2,181.2	1,025.0	450.1	1,393.3	20,595.2
Revenue Replacement Payments	2,544.5	1,702.7	1,543.3	1,063.1	662.1	224.8	113.1	143.7	7,997.3
Financial Institutions Duty	703.0	398.3	na	150.7	100.1	24.2	20.0	16.7	1,413.0
Marketable Securities Duty	456.0	236.5	27.0	29.3	15.6	0.8	24.8	1.1	791.1
Marketable Securities Duty Needs	-22.7	11.2	13.6	2.8	3.9	2.6	-12.2	0.9	0.0
Accommodation Taxes	82.0	na	na	na	na	na	na	9.0	91.0
plus Reduced Revenues									
Gambling Taxes	600.2	409.1	236.4	64.5	96.8	25.4	23.6	18.3	1,474.3
plus Interest Costs									
Interest Costs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
plus Additional Expenditures									
First Home Owners Scheme	231.4	174.0	156.5	75.7	52.4	19.7	12.4	5.8	727.9
GST Administration Costs	192.0	141.5	109.1	56.1	43.7	13.5	9.3	5.7	570.9
plus Other Items									
WST Payments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
minus Reduced Expenditures									
Off-road Diesel Subsidies	140.6	58.6	136.0	176.6	37.4	2.2	0.0	4.0	555.5
Savings from Tax Reform	179.1	122.9	101.6	60.6	44.1	14.9	10.1	14.8	548.0
Low Alcohol Beer Subsidies	25.4	17.6	4.9	8.0	4.7	1.8	1.0	1.2	64.8
minus Growth Dividend									
Remaining State Taxes	99.1	64.0	33.5	20.0	16.1	4.1	3.1	2.2	242.0
Total Guaranteed Minimum Amount (1)	9,797.7	6,858.6	6,034.6	2,994.2	3,053.3	1,313.1	626.8	1,572.1	32,250.5
GST Revenue Provision (2)	9,234.4	6,649.5	6,231.3	3,008.5	3,005.7	1,320.6	636.6	1,613.4	31,700.0
Budget Balancing Assistance (1)-(2)	563.3	209.2	0.0	0.0	47.6	0.0	0.0	0.0	820.1

Adjustments in 2002-03

GST revenue provision in 2002-03 has been adjusted to account for the final 2001-02 outcome (Table 1). In 2001-02 the final GST cash collections outcome was \$204.9 million lower than the amount determined by the Commissioner of Taxation in June 2002 and provided to the States in 2001-02 under the terms of the *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999* (the Act).

Consistent with the provisions of the Act, the amount of GST revenue determined by the Commissioner and provided to the States in 2002-03 will take account of this variation. The Budget Balancing Assistance entitlements for 2002-03 have also been calculated to account for this variation (Table 11).

Adjustments in 2003-04

Consistent with the terms of the Intergovernmental Agreement, the Government has advanced Budget Balancing Assistance to the States in four quarterly instalments in 2002-03. These advances were based on the estimated Budget Balancing Assistance entitlements of the States at the time of each advance. The upward revision to GST revenue estimates in the Budget has resulted in lower than previously estimated Budget Balancing Assistance entitlements of the States. On the basis of the current estimates, the advances to the States in the year to date exceed the States' entitlements to Budget Balancing Assistance in 2002-03 by \$534.8 million (Table 13).

Consistent with the provisions of the Act, the Commonwealth will deduct the amount of excess Budget Balancing Assistance paid in 2002-03 from payments to be made to the States under the Act in 2003-04. The final amount to be deducted from State payments in 2003-04 will be known when the final determination of each State's Budget Balancing Assistance entitlement is made under the Act in June 2003.

Table 13: Overpayment of Budget Balancing Assistance (BBA) in 2002-03 (estimated)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Payments to Date	810.6	361.5	37.9	93.9	144.5	56.7	16.2	17.5	1,538.8
BBA entitlement	608.1	227.8	0.0	43.2	86.5	33.6	4.7	0.0	1,004.0
BBA overpayment	202.5	133.7	37.9	50.7	58.0	23.1	11.5	17.5	534.8

First Home Owners Scheme

Eligible home buyers have received over \$3.5 billion through original and additional First Home Owners Scheme grants since July 2000.

The First Home Owners Scheme, introduced on 1 July 2000, is funded out of GST revenues and guaranteed by the Commonwealth Government through Budget Balancing Assistance. The scheme provides all eligible first home buyers with a \$7,000 grant. The scheme is administered by the States and has provided over 450,000 grants since its introduction. The First Home Owners Scheme is ongoing and the cost of the scheme to the States is part of the Guaranteed Minimum Amount (Tables 11 and 12).

In March 2001, the Commonwealth made an additional \$7,000 grant available to first home owners building or purchasing new homes before 31 December 2001. The Commonwealth fully funds the additional First Home Owners Scheme with a Specific Purpose Payment through the States to meet the cost of grants. The Government extended the additional First Home Owners Scheme at a rate of \$3,000 for new homes built or purchased between 1 January and 30 June 2002. The additional First Home Owners Scheme has provided over 65,000 grants to eligible home buyers.

Although the additional First Home Owners Scheme has ended, some payments continue to be made to eligible applicants. Estimates of payments are shown in the Specific Purpose Payments tables (Appendix B).

NATIONAL COMPETITION POLICY PAYMENTS

The Government makes National Competition Policy Payments to the States for implementing National Competition Policy and related reforms. These reforms include a commitment to review legislation that restricts competition, to apply competitive neutrality to government business activities and to introduce specific reforms in electricity, gas, water and road transport.

National Competition Policy Payments commenced in July 1997 with the first of three tranches of payments. The third tranche commenced in July 2001 at an annual level of \$600 million in 1994-95 prices. The payments are subject to States' satisfactory progress in implementing reform commitments. Before the payments are made, the National Competition Council assesses whether each State has met the specified conditions and provides a report for consideration by the Government.

National Competition Policy Payments are estimated for 2003-04 and the forward years (Table 14).

Table 14: National Competition Policy Payments (estimated maximum)

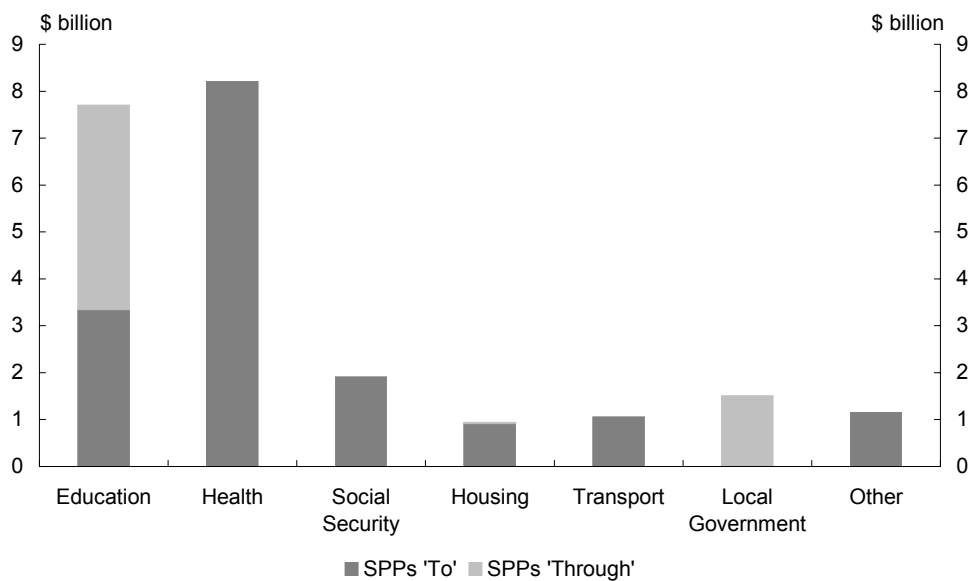
	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
2002-03	251.8	182.4	138.9	72.0	57.1	17.7	12.4	7.5	739.9
2003-04	257.2	189.5	146.2	75.2	58.5	18.1	12.5	7.6	764.8
2004-05	262.4	193.7	150.7	77.0	59.4	18.4	12.7	7.7	782.0
2005-06	268.5	198.5	155.6	79.2	60.5	18.6	13.0	7.9	801.9
2006-07(a)									

(a) Provision has been made for National Competition Policy Payments in 2006-07, however the final amounts will not be disclosed until after the conclusion of negotiations.

SPECIFIC PURPOSE PAYMENTS

Specific Purpose Payments constitute a significant amount of Commonwealth funding to the States. In 2003-04, the Government will provide the States with \$22.9 billion in Specific Purpose Payments. The Government makes Specific Purpose Payments to the States as a contribution to areas of state responsibility. In 2003-04, there are over 80 different payments covering a broad range of policy areas such as education, health, social security, housing, safety, transport and communication (Chart 3).

Chart 3: Composition of Specific Purpose Payments to and through the States, 2003-04 (estimated)



More detailed information, including payments on a state-by-state basis for 2002-03 and 2003-04 is in Appendix B.

Specific Purpose Payments can be classified into three groups:

- Specific Purpose Payments paid to the States – payments direct to state governments, totalling \$16.6 billion in 2003-04;
- Specific Purpose Payments paid through the States – payments to state governments to be passed on to local governments and others, such as payments to non-government schools and Financial Assistance Grants to local government. This category totalled \$5.9 billion in 2003-04; and

- Specific Purpose Payments paid direct to local government to help fund roads, child-care programmes administered by local government, and aged and disabled people's homes. These payments totalled \$397.9 million in 2003-04.

Specific Purpose Payment agreements often include agreed national objectives; however, in making these payments, the Commonwealth does not seek to take over responsibility for state functions.

Specific Purpose Payment agreements generally contain conditions to help ensure the Commonwealth-State objectives are achieved. These may include:

- general policy requirements (for example, the provision of free public hospital access for Medicare patients);
- matching funding arrangements; and
- reporting of performance information (see box).

Accountability for Specific Purpose Payments

The Government is seeking greater accountability in Specific Purpose Payment agreements to improve policy outcomes and deliver better value for money.

All new and renegotiated Specific Purpose Payment agreements will include statements of key objectives and the respective responsibilities of the Commonwealth and the States, combined with agreed reporting of financial information and detailed performance indicators.

To encourage increased accountability, an amount appropriate to each Specific Purpose Payment will be contingent on States' timely reporting of the agreed financial and performance information to the satisfaction of the responsible Commonwealth Minister.

Special Revenue Assistance

In 2003-04, Special Revenue Assistance to the Australian Capital Territory will be paid as a Specific Purpose Payment. Details of this Specific Purpose Payment are in Appendix B.

Financial Assistance Grants to local government

The Commonwealth Government provides financial assistance to local government for roads and other local government services. Assistance is paid in the form of general purpose assistance and untied local road funding. Local governments are able to spend both forms of funding according to their own priorities.

Budget Paper No. 3

The Government is providing a total of \$1,468.6 million in Financial Assistance Grants to local government in 2002-03 and an estimated \$1,508.4 million in 2003-04 (Table 15). The annual increase in funding is based on an escalation factor, which the Treasurer determines with reference to population growth and CPI.

Financial Assistance Grants are paid to the States as a Specific Purpose Payment, on the condition that all of the funds are passed on to local government. In 2003-04, as in previous years, the general purpose component of local government assistance will be distributed between the States on an equal per capita basis and untied local road funding will be distributed on the basis of historical shares (Table 15). State grants commissions determine the intra-state distribution of the grants to local governments.

Table 15: Financial Assistance Grants to local government, 2002-03 and 2003-04 (estimated)(a)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
2002-03									
General Purpose Assistance	346.6	250.6	190.0	99.0	79.0	24.6	17.0	10.4	1,017.2
Untied Local Road Funding	131.0	93.1	84.6	69.0	24.8	23.9	14.5	10.6	451.4
Total Financial Assistance Grants(b)	477.6	343.6	274.6	168.0	103.8	48.5	31.5	21.0	1,468.6
2003-04									
General Purpose Assistance	351.8	258.9	198.3	102.6	80.7	25.1	17.0	10.3	1,044.8
Untied Local Road Funding	134.5	95.6	86.9	70.9	25.5	24.6	14.9	10.9	463.6
Total Financial Assistance Grants(c)	486.3	354.5	285.2	173.5	106.1	49.6	31.9	21.2	1,508.4

(a) Total Financial Assistance Grants are the cash payments that the State receives on behalf of local government. It is equal to the estimated entitlement for a given year adjusted for an over or underpayment from the previous year.

(b) The 2002-03 figure takes into account an underpayment of \$19.5 million in 2001-02. The 2002-03 escalation factor is currently estimated to be 1.0413. The Treasurer will determine the final 2002-03 escalation factor in June 2003.

(c) The 2003-04 figure includes an estimate of the amount necessary to adjust for the difference between the 2002-03 escalation factor estimated in June 2002 and used to calculate payments in 2002-03 and the final factor for 2002-03, to be determined in June 2003. On the basis of the current estimate of the 2002-03 escalation factor, this adjustment is estimated to be an increase of \$2.9 million. The 2003-04 escalation factor is currently estimated to be 1.0368. Financial Assistance Grants in 2003-04 will be paid on the basis of the escalation factor that the Treasurer will estimate in June 2003. The Treasurer will determine the final escalation factor for 2003-04 in June 2004.

MIRROR TAX ARRANGEMENTS

The Government introduced mirror tax arrangements in 1998 to ensure the States are not financially disadvantaged by the High Court decision in *Allders International Pty Ltd v Commissioner of State Revenue* (Victoria), which invalidated state taxes on Commonwealth places.

The Government introduced taxes to mirror certain state taxes, including payroll taxes, debits tax, land tax, and stamp duties on activities on or in Commonwealth places.

The States collect these mirror taxes on behalf of the Government and bear the administrative costs of collection. All mirror tax revenues are automatically credited to the Government and automatically appropriated to the States at the same time. Hence, mirror taxes are recorded as both Commonwealth revenue and negative revenue, with no net impact on the Budget. Accrued mirror taxes are estimated for 2002-03 to 2006-07 (Table 16).

Table 16: Accrued mirror taxes on behalf of the States, 2002-03 to 2006-07 (estimated)

	2002-03	2003-04	2004-05	2005-06	2006-07
	\$m	\$m	\$m	\$m	\$m
Mirror taxes	270.6	284.2	299.6	314.9	331.3

Fiscal developments in the States

The States' fiscal positions vary considerably. Nevertheless, these differences are expected to narrow over the forward estimates, with almost all States forecasting small positive cash and fiscal balances as a per cent of gross state product by 2005-06.

Many States have greatly reduced their non-financial public sector net debt as a per cent of gross state product over the past decade. This trend is primarily attributed to States implementing medium term fiscal strategies and asset sales.

STATE GENERAL GOVERNMENT SECTOR FISCAL BALANCE

The aggregate state fiscal balance for the general government sector in 2003-04 is projected to be -0.1 per cent of GDP, lower than in 2002-03. Over the forecast period, the aggregate state fiscal balance is expected to rise marginally and be in surplus by 2005-06.

A fiscal balance measures in accrual terms the gap between government savings plus net capital transfers, and investment in non-financial assets. A fiscal balance deficit indicates that a government is borrowing.

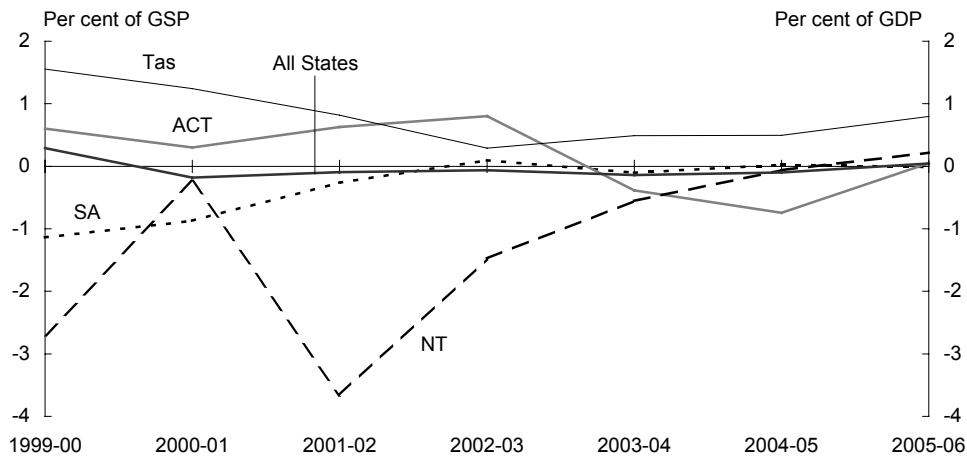
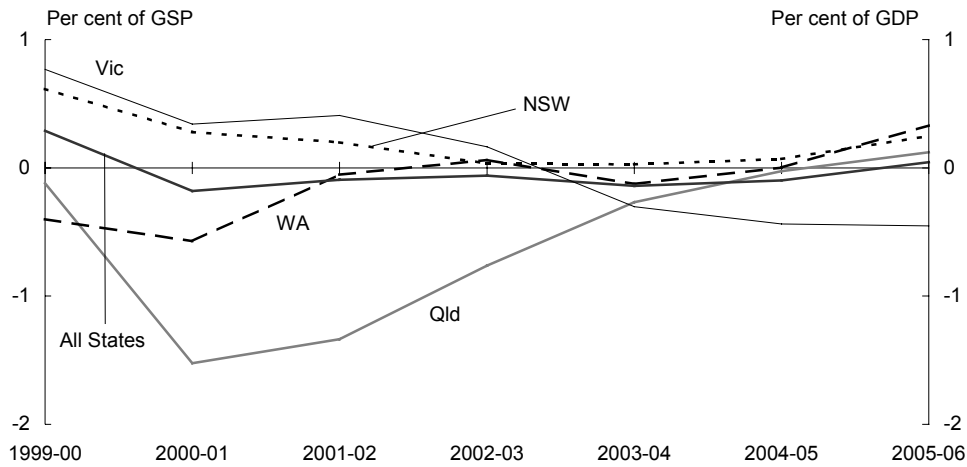
Both New South Wales and Tasmania expect fiscal balance surpluses in 2003-04 and over the forward estimates. The aggregate deficit figure in 2003-04 reflects anticipated deficits in each of the other States.

The fiscal balance positions in individual States vary considerably (Chart 4). However, there is a convergence over the forward estimates period with the majority of States expecting small positive fiscal balances as a per cent of gross state product by 2005-06. The largest deficit reduction is forecast to occur in the Northern Territory.

The Northern Territory's general government fiscal balance deficit as a per cent of gross state product increased significantly in 2001-02. This reflected that capital outlays for the Alice Springs to Darwin railway and Darwin's new East Arm Port were 'at their peak' in 2001-02.¹ However, the Northern Territory estimates its general government fiscal balance will continue to improve over the forward estimates period and become a fiscal balance surplus by 2005-06.

¹ *Northern Territory Budget 2002-03, Paper No.2, Fiscal and Economic Outlook*, p. 25.

Chart 4: Individual State general government sector fiscal balance



Sources: ABS Cat. No. 5512.0, state 2002-03 mid-year reports, Victoria, Western Australia and the Australian Capital Territory 2003-04 Budgets and Treasury estimates.

Trends in the aggregate fiscal balance for state/local general government, public non-financial corporations and the non-financial public sector are presented in Tables 1, 2 and 3, Statement 12, Budget Paper No. 1.

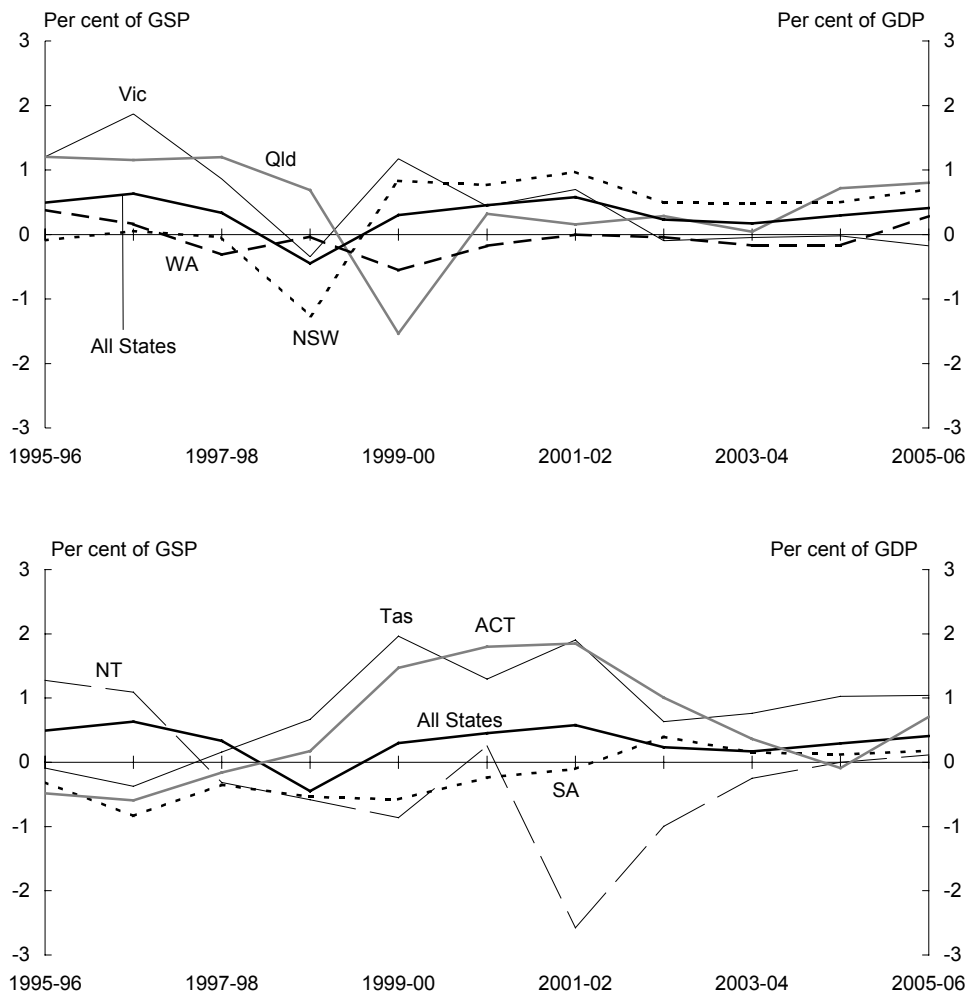
STATE GENERAL GOVERNMENT SECTOR CASH SURPLUS

In aggregate terms, the cash surplus in the general government sector is projected to decrease to 0.2 per cent of GDP in 2003-04, lower than in 2002-03. In the forward estimate years, the aggregate state general government sector surplus is expected to climb, reaching 0.4 per cent of GDP by 2005-06.

An underlying cash surplus reflects the extent to which cash is available to a government to either increase its financial assets or decrease its liabilities (assuming no revaluations and other changes occur). An underlying cash deficit measures the extent to which a government requires cash, either by running down its financial assets or by borrowing.

Cash surpluses in New South Wales, Queensland, South Australia, Tasmania and the Australian Capital Territory underpinned the aggregate state general government sector cash surplus forecast for 2003-04. Despite considerable variation in the States' cash positions in recent years, almost all States forecast cash surpluses by 2005-06 (Chart 5).

Chart 5: Individual State general government sector cash surplus



Sources: ABS Cat. No. 5512.0, state 2002-03 mid-year reports, Victoria, Western Australia and the Australian Capital Territory 2003-04 Budgets and Treasury estimates.

Trends in the aggregate cash surplus for state/local general government, public non-financial corporations and the non-financial public sector are illustrated in Chart 3, Statement 12, Budget Paper No. 1.

STATE NET DEBT

In aggregate, state general government sector net debt is expected to remain negative at 0.6 per cent of GDP in 2003-04, a small increase on 2002-03. In the public non-financial corporations sector, net debt is expected to be 4.6 per cent of GDP in 2002-03,² up on the 2001-02 estimate of 4.4 per cent of GDP.

Net debt is defined as the sum of selected financial liabilities minus the sum of selected financial assets. The higher the net debt of a government, the greater the call it will impose on future revenue flows to service that debt.

Many States have greatly reduced their levels of general government net debt over the past decade (Chart 6). For example, between 1995-96 and 2003-04 the South Australian general government sector reduced its net debt by over 13 per cent of gross state product. This primarily reflects South Australia's electricity privatisation process.³ Similarly, Victoria and Tasmania reduced their general government net debt by more than 9 per cent of gross state product over the same period by means of budget surpluses and proceeds from asset sales.

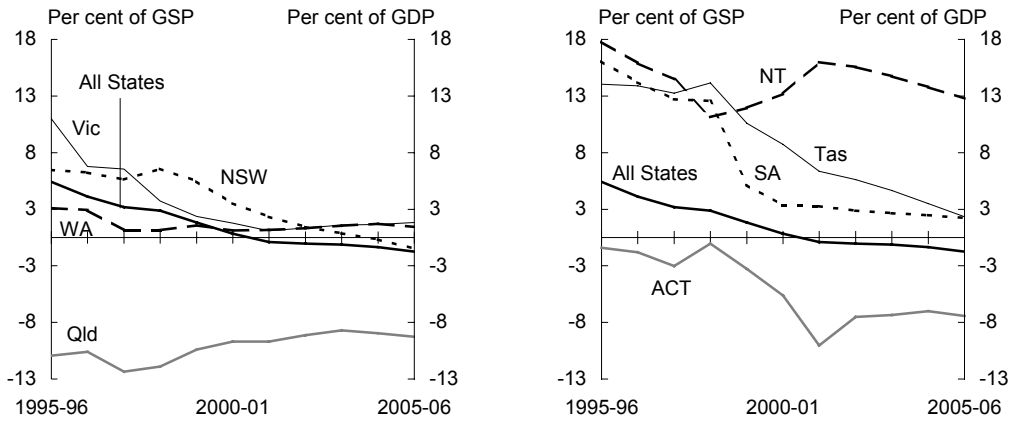
The stock of net debt has also declined in most States' public non-financial corporations sector over the previous decade (Chart 6). The public non-financial corporations sector nearly exclusively owns the stock of state non-financial public sector net debt. Some States continue to record negative net debt, that is, they are in a net financial asset position. For example, the Australian Capital Territory non-financial public sector is expected to have negative net debt from 2000-01 to 2002-03. The Queensland non-financial public sector is expected to return to negative net debt by 2004-05 (Chart 6).

Trends in aggregate net debt for state/local general government, public non-financial corporations and the non-financial public sector are illustrated in Chart 6, Statement 12, Budget Paper No. 1.

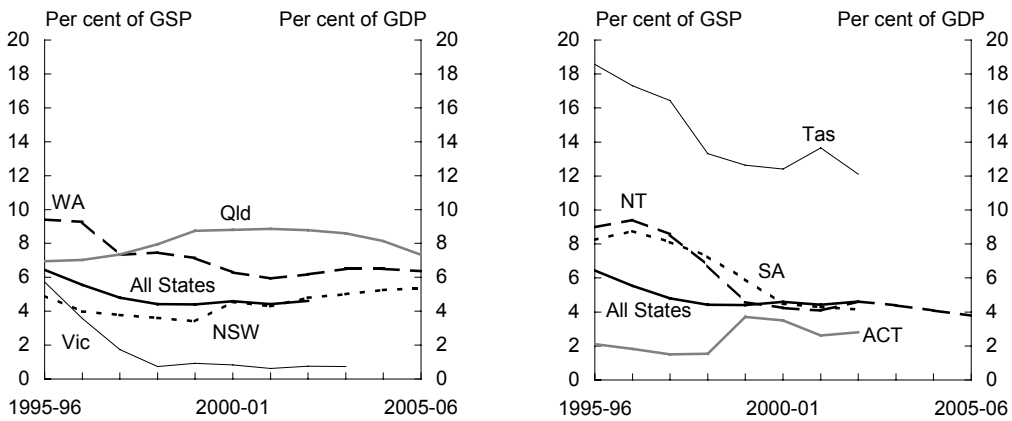
2 Estimates for the public non-financial corporations sector and the non-financial public sector are unavailable after 2002-03 in most States. The public non-financial corporations sector comprises bodies that provide goods and services (such as electricity, gas and water) that are mainly market, non-regulatory and non-financial in nature and are financed predominantly through sales to the consumers of these goods and services.

3 *South Australia Budget Paper 3, Budget Statement 2002-03*, p. 6.3.

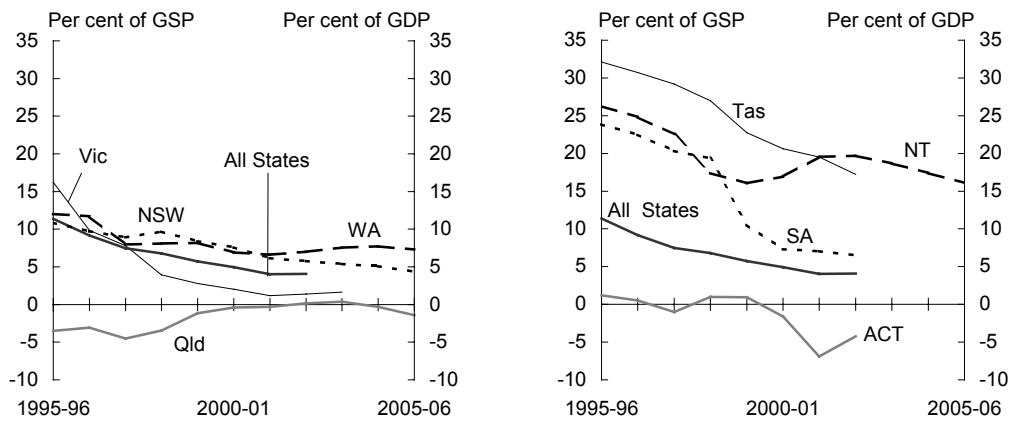
Chart 6: Individual State net debt by sector (as at end of financial year)
General government



Public non-financial corporations



Non-financial public sector



Sources: ABS Cat. No. 5512.0, state 2002-03 mid-year reports, Victoria, Western Australia and the Australian Capital Territory 2003-04 Budgets and Treasury estimates.

LOAN COUNCIL ARRANGEMENTS

The Australian Loan Council is a Commonwealth-State Ministerial Council that coordinates public sector borrowing. The Loan Council comprises the Commonwealth Treasurer as Chairman, and the State and Territory Treasurers.

Present Loan Council arrangements operate on a voluntary basis and emphasise transparency of public sector financing rather than adherence to strict borrowing limits. These arrangements are designed to enhance financial market scrutiny of public sector borrowing and facilitate informed judgments about each government's financial performance.

The Loan Council traditionally meets annually in March to consider jurisdictions' Loan Council Allocation nominations for the forthcoming year. As part of the agreed arrangements, the Loan Council considers these nominations, having regard to each jurisdiction's fiscal position and the macroeconomic implications of the aggregate figure. The Loan Council Allocation is a headline measure of a government's call on financial markets.

Outcome of March 2003 Loan Council meeting

The Loan Council met on 28 March 2003 to consider Loan Council Allocation nominations for 2003-04. In aggregate, they represent a surplus of \$3,876 million (Table 17). The Loan Council approved each State's nominated Allocation.

The Loan Council agreed four proposals to further increase the transparency of the Uniform Presentation Framework. These proposals focus on disaggregating particular items within the Uniform Presentation Framework Operating Statement and adopting guidance on the publication of 'underlying' budget results in the Uniform Presentation Framework. These changes are to be included in Commonwealth, State and Territory Uniform Presentation Framework tables from 2002-03 Outcomes (Actuals) reports. The Commonwealth Government's Loan Council Allocation Budget update for 2003-04 is included in Statement 9, Budget Paper No.1.

Table 17: Loan Council Allocation nominations for 2003-04(a)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	C/with	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Nominated 2003-04 LCAs										
General government sector cash deficit(+)/surplus(-)	-1,325	348	-59	158	-81	-101	1	25	-4,899	-5,933
PNFC sector cash deficit(+)/surplus(-)	1,121	399	413	502	-40	-49	-12	8	-2,351	-10
Non-financial public sector cash deficit(+)/surplus(-)(b)	-204	670	354	660	-121	-150	-10	33	-7,250	-6,018
<i>minus</i> Net cash flows from investments										
in financial assets for policy purposes(c)	40	-16	7	5	-2	0	16	-11	-909	-870
<i>plus</i> Memorandum items(d)	1,053	204	-157	-252	-214	22	-6	0	626	1,276
Loan Council Allocation	809	890	190	403	-337	-128	-32	44	-5,715	-3,876
2003-04 tolerance limit	951	575	526	307	191	76	47	54	4,664	

(a) Loan Council Allocation (LCA) nominations for 2003-04 reflect current best estimates of non-financial public sector deficits/surpluses. Nominations have been provided on the basis of policies announced up to and included in jurisdictions' mid-year reports. Nominations are based on preliminary estimates of general government finances provided by jurisdictions for purposes of their mid-year reports, and projected bottom lines for each jurisdiction's public non-financial corporations sector, where actual estimates are unavailable.

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

(c) This comprises net lending by governments with the aim of achieving government policy, as well as net equity sales and net lending to other sectors or jurisdictions. Such transactions involve the transfer or exchange of a financial asset and are not included within the cash deficit/surplus. However, the cash flow from investments in financial assets for policy purposes has implications for governments' call on financial markets.

(d) Memorandum items are used to adjust the non-financial public sector deficit/surplus to include in LCAs certain transactions — such as operating leases — that have many of the characteristics of public sector borrowings but do not constitute formal borrowings. They are also used, where appropriate, to deduct from the non-financial public sector deficit/surplus certain transactions that 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.

Note: Governments' contingent exposures under infrastructure projects with private sector involvement are identified in the Loan Council report, rather than included as components of LCAs. These exposures, which are measured as the governments' contractual liabilities in the event of termination of projects, 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 total public sector deficit, and hence the LCA.

