

COMMONWEALTH-STATE FINANCIAL RELATIONS

The States will receive revenue and payments totalling an estimated \$57.0 billion in 2003-04 (Table 1) and \$60.2 billion in 2004-05 (Table 2).

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 (CGC). The CGC's recommendations are based on the principles of Horizontal Fiscal Equalisation.

From 2004-05 onwards, all States will fully benefit from tax reform, with GST revenues for each State and Territory in excess of what they would have received from Australian Government Financial Assistance Grants and their own inefficient taxes abolished under tax reform.

Since tax reform commenced on 1 July 2000, the Australian Government has been paying Budget Balancing Assistance to the States to cover any difference between GST revenue and a State's Guaranteed Minimum Amount. This has ensured that no State is worse off after the changes made to Commonwealth-State financial relations as part of the Australian Government's *New Tax System*. From 2004-05 onwards, Budget Balancing Assistance will no longer be required as each State and Territory will receive an amount in excess of its entitlement had the old system continued.

The Australian Government also 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 Australian Government payments to the state/local sector in 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(a)	9,690.5	6,973.6	6,574.9	3,159.8	3,154.3	1,399.0	660.7	1,684.2	33,297.0
(2) Budget Balancing Assistance	46.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	46.0
(3) National Competition Policy Payments	203.5	178.7	87.9	33.6	40.7	17.2	11.0	5.9	578.5
(4) Total Specific Purpose Payments (4.1)+(4.2)+(4.3)	7,731.6	5,401.5	4,327.7	2,540.5	1,803.5	569.0	400.6	342.4	23,116.9
(4.1) Specific Purpose Payments to the States	5,658.0	3,810.0	3,145.2	1,882.3	1,327.0	417.2	274.6	273.3	16,787.6
(4.2) Specific Purpose Payments through the States	1,961.0	1,510.1	1,112.6	610.1	450.7	138.3	121.0	63.4	5,967.3
(4.3) Specific Purpose Payments direct to local government	112.6	81.5	69.8	48.1	25.8	13.4	5.0	5.7	361.9
(5) Total Commonwealth payments to the state/local sector (2)+(3)+(4)	7,981.2	5,580.2	4,415.5	2,574.1	1,844.2	586.1	411.6	348.4	23,741.4
(6) GST revenue and total Commonwealth payments (1)+(5)	17,671.7	12,553.8	10,990.5	5,733.8	4,998.6	1,985.1	1,072.3	2,032.5	57,038.4

(a) The GST estimate has been adjusted by \$57 million to account for the final 2002-03 outcome, reflecting cash collections in 2002-03 exceeding the Commissioner's determination. (Further details are provided on p17.)

Table 2: GST revenue provision and total Australian Government payments to the state/local sector in 2004-05 (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	9,648.3	7,151.4	7,168.5	3,528.9	3,212.7	1,407.8	663.8	1,678.7	34,460.0
(2) Budget Balancing Assistance	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(3) Compensation for GST Deferral	95.9	70.6	67.6	33.5	30.2	12.3	6.0	13.9	330.0
(4) National Competition Policy Payments	259.8	191.8	151.4	76.6	59.2	18.8	12.4	7.7	777.7
(5) Total Specific Purpose Payments (5.1)+(5.2)+(5.3)(a)	7,684.1	5,473.7	4,325.0	2,640.1	1,845.9	560.5	404.7	335.1	24,592.4
(5.1) Specific Purpose Payments to the States(a)	5,509.0	3,792.5	3,071.5	1,956.6	1,333.4	399.0	272.5	267.0	17,924.8
(5.2) Specific Purpose Payments through the States	2,086.3	1,609.7	1,192.3	642.8	490.8	149.6	128.0	63.2	6,362.9
(5.3) Specific Purpose Payments direct to local government	88.8	71.5	61.2	40.7	21.7	11.8	4.2	4.9	304.7
(6) Total Commonwealth payments to the state/local sector (2)+(3)+(4)+(5)	8,039.8	5,736.1	4,543.9	2,750.2	1,935.3	591.7	423.1	356.6	25,700.1
(7) GST revenue and total Commonwealth payments (1)+(6)(a)	17,688.1	12,887.5	11,712.4	6,279.1	5,148.0	1,999.4	1,086.9	2,035.3	60,160.1

(a) Individual state and territory AusLink allocations are not yet available and accordingly are not included in individual state and territory estimated amounts for 2004-05. These allocations will be announced as part of the *AusLink White Paper* in June 2004. The aggregate AusLink amount of \$1,323.4 million for 2004-05 is included in the aggregate state and territory total.

GST REVENUE PROVISION TO THE STATES

All GST revenue collected is received by the States. Consequently, they have a secure, growing and broad-based revenue source. States can spend the GST revenue according to their own budgetary priorities. The States' GST revenue has grown significantly since its introduction in 2000-01 (Table 3).

Table 3: GST revenue provision to the States (cash), 2000-01 to 2004-05 (estimated)

	2000-01	2001-02	2002-03	2003-04	2004-05	Increase from 2000-01 to 2004-05	Increase	Average annual increase
	\$m	\$m	\$m	\$m	\$m	\$m	%	%
NSW	7,257.6	8,132.0	9,080.2	9,690.5	9,648.3	2,390.7	32.9	7.5
VIC	5,099.3	5,593.1	6,365.1	6,973.6	7,151.4	2,052.1	40.2	8.9
QLD	4,658.2	5,018.6	5,887.6	6,574.9	7,168.5	2,510.3	53.9	11.4
WA	2,374.6	2,518.1	2,910.2	3,159.8	3,528.9	1,154.3	48.6	10.5
SA	2,278.9	2,476.6	2,859.1	3,154.3	3,212.7	933.8	41.0	9.1
TAS	988.1	1,059.8	1,246.7	1,399.0	1,407.8	419.6	42.5	9.4
ACT	472.6	543.9	615.7	660.7	663.8	191.2	40.5	9.0
NT	1,225.6	1,289.8	1,514.5	1,684.2	1,678.7	453.1	37.0	8.4
Total	24,354.9	26,632.0	30,479.1	33,297.0	34,460.0	10,105.1	41.5	9.1

GST revenue

Estimates of GST revenue in accrual terms for the years 2003-04 to 2006-07 are shown in Table 4. These estimates have been revised since the 2003-04 Budget and the *Mid-Year Economic and Fiscal Outlook 2003-04* (MYEFO) to account for policy decisions and parameter variations.

Table 4: Reconciliation of GST revenue (accrual), 2003-04 to 2006-07 (estimated)

	2003-04	2004-05	2005-06	2006-07
	\$m	\$m	\$m	\$m
GST revenue at 2003-04 Budget	32,050	33,815	35,680	37,690
<i>Changes from 2003-04 Budget to MYEFO</i>				
Effect of policy decisions	-26	-20	-20	-20
Effect of parameter and other variations	1,026	835	940	1,040
Total variations	1,000	815	920	1,020
GST revenue at 2003-04 MYEFO	33,050	34,630	36,600	38,710
<i>Changes from MYEFO to 2004-05 Budget</i>				
Effect of policy decisions	0	-332	-18	-19
Effect of parameter and other variations	1,125	892	788	839
Total variations	1,125	560	770	820
GST Revenue at 2004-05 Budget	34,175	35,190	37,370	39,530

Estimated GST revenue in 2003-04 has been revised upwards by \$1.1 billion in accrual terms, reflecting upward revisions in the consumption and dwellings forecasts.

The GST revenue estimate for 2004-05 has been revised up since MYEFO by \$560 million, reflecting the flow-on effect of the stronger expected outlook for GST revenue in 2003-04. Some unwinding of this strength is expected in the forward years. Estimates of GST receipts in cash terms are shown in Table 5.

Table 5: GST receipts (cash), 2004-05 to 2007-08 (estimated)

	2004-05	2005-06	2006-07	2007-08
	\$m	\$m	\$m	\$m
GST receipts	34,460.0	36,610.0	38,720.0	40,850.0

GST revenue measures

Policy decisions affecting GST revenue estimates include: the decision to allow taxpayers (mainly small businesses) that are voluntarily registered for GST to pay and lodge annually; changes to Australia's duty-free concessions; changing the treatment of barter trade exchange schemes; and changing the treatment of first aid and life saving courses. The revenue effect of these GST measures is estimated for 2004-05 to 2007-08 (Table 6). Detailed information on each measure is in Appendix A.

The measure to allow annual payment and lodgement of GST is an important means of improving the operation of *The New Tax System* through reducing compliance costs for up to 740,000 small businesses and up to 30,000 non-profit organisations. Given the reduction in GST revenue in 2004-05 associated with this measure (because GST remitted by the eligible taxpayers will be deferred until 2005-06), the Australian Government will offer to fully compensate the States should each of them agree to the policy. This compensation will mean that the full financial impact of the measure will be taken by the Australian Government and none of the impact will affect the States.

Table 6: GST revenue measures since the 2003-04 Budget (estimated)

	2004-05	2005-06	2006-07	2007-08
	\$m	\$m	\$m	\$m
Barter trade exchange schemes	-2.0	-2.0	-2.0	-2.0
Changes to Australia's duty free concessions	-17.0	-17.0	-17.0	-17.0
Compulsory third party insurance transactions	*	*	*	*
Extension of the GST-free car concessions for injured veterans
GST-free ibuprofen	-	-	-	-
Income tax consolidation - interaction with the GST	-	-	-	-
Long-term non-reviewable contracts	-	*	*	*
Payments out of the National Guarantee Fund	-	-	-	-
Small business - annual payment and lodgement	-330.0	-16.4	-17.2	-18.2
Small business - annual private apportionment	*	*	*	*
Treatment of first aid and life saving courses	-3.0	-3.0	-3.0	-3.0
Total impact of GST revenue measures	-352.0	-38.4	-39.2	-40.2

GST revenue provision

The Australian Government will distribute 2004-05 GST revenue among the States in accordance with the recommendations of the Commonwealth Grants Commission (CGC).

The CGC recommends relativities to calculate each State's share of GST by applying the principles of Horizontal Fiscal Equalisation. Broadly, the CGC 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 CGC takes into account differences in States' capacities to raise revenues and differences in the costs States incur in providing an average standard of government services. The CGC's recommended relativities reflect these differences. GST relativities are shown for 2003-04 and 2004-05 (Table 7).

The CGC also recommends Financial Assistance Grants (FAGs) forgone relativities (Table 7), which are used for the calculation of each State's Guaranteed Minimum Amount (Tables 11 and 12).

Table 7: GST relativities and Financial Assistance Grants forgone relativities, 2003-04 and 2004-05

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT
GST relativities								
2003-04	0.89117	0.87010	1.01902	0.96946	1.21215	1.59948	1.14979	4.38638
2004-05	0.86750	0.86534	1.05504	1.03054	1.20407	1.55939	1.12930	4.26538
FAGs relativities								
2003-04	0.84317	0.84030	1.04870	0.92093	1.30919	1.79057	1.19727	5.34163
2004-05	0.80363	0.83480	1.10104	1.00781	1.30402	1.74908	1.16529	5.22707

Source: CGC Report on State Revenue Sharing Relativities 2004 Review.

The GST relativities are applied to state populations to determine a weighted population for each State. The Australian 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 2003-04 and 2004-05 (Tables 8 and 9).

Table 8: Distribution of GST revenue in 2003-04 (estimated)

	(1) Projected population as at 31 December 2003	(2) Per capita relativities	(3) Weighted population (1)×(2)	(4) Share of weighted population (%)	(5) GST revenue/HCGs pool according to (4) (\$m)	(6) Unquarantined HCGs (\$m)	(7) Distribution of GST revenue (\$m)
NSW	6,718,063	0.89117	5,986,936	30.0	12,108.1	2,417.5	9,690.5
VIC	4,947,771	0.87010	4,305,056	21.5	8,706.6	1,733.0	6,973.6
QLD	3,841,027	1.01902	3,914,083	19.6	7,915.9	1,340.9	6,574.9
WA	1,966,423	0.96946	1,906,368	9.5	3,855.5	695.7	3,159.8
SA	1,531,880	1.21215	1,856,868	9.3	3,755.4	601.0	3,154.3
TAS	480,149	1.59948	767,989	3.8	1,553.2	154.2	1,399.0
ACT	323,329	1.14979	371,760	1.9	751.9	91.2	660.7
NT	198,613	4.38638	871,192	4.4	1,761.9	77.7	1,684.2
Total	20,007,255	na	19,980,253	100.0	40,408.3	7,111.3	33,297.0

(a) Total weighted population differs from the total population in column (1) as the CGC calculates the per capita relativities using population numbers for 1997-98 to 2001-02, then rounds these figures.

Note: HCGs means Health Care Grants.

Table 9: Distribution of GST revenue in 2004-05 (estimated)

Projected population as at 31 December 2004	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) (\$m)
(1)	(2)	(3)	(4)	(5)	(6)	(7)
NSW	6,776,851	5,878,918	29.1	12,183.2	2,534.9	9,648.3
VIC	5,003,201	4,329,470	21.4	8,972.2	1,820.8	7,151.4
QLD	3,927,404	4,143,568	20.5	8,586.9	1,418.4	7,168.5
WA	1,996,095	2,057,056	10.2	4,262.9	734.0	3,528.9
SA	1,539,177	1,853,277	9.2	3,840.6	628.0	3,212.7
TAS	485,402	756,931	3.7	1,568.6	160.9	1,407.8
ACT	324,575	366,543	1.8	759.6	95.8	663.8
NT	199,107	849,267	4.2	1,760.0	81.3	1,678.7
Total	20,251,812	20,235,030	100.0	41,934.1	7,474.1	34,460.0

(a) Total weighted population differs from the total population in column (1) as the CGC calculates the per capita relativities using population numbers for 1998-99 to 2002-03, then rounds these figures.

Note: HCGs means Health Care Grants.

The Effect of Horizontal Fiscal Equalisation

One way to view the effect of the Commonwealth Grants Commission's (CGC) application of Horizontal Fiscal Equalisation is to compare each State's distribution of the GST revenue/Health Care Grants pool using the CGC's relativities with the distribution on an equal per capita basis. In 2004-05, approximately \$3.2 billion (7.7 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 2004-05

	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	12,183.2	14,032.4	-1,849.2	6.8	-272.9
VIC	8,972.2	10,359.8	-1,387.6	5.0	-277.3
QLD	8,586.9	8,132.2	454.7	3.9	115.8
WA	4,262.9	4,133.2	129.8	2.0	65.0
SA	3,840.6	3,187.1	653.6	1.5	424.6
TAS	1,568.6	1,005.1	563.5	0.5	1,161.0
ACT	759.6	672.1	87.5	0.3	269.7
NT	1,760.0	412.3	1,347.7	0.2	6,768.7
Total	41,934.1	41,934.1	0.0	20.3	na

Note: HCG means Health Care Grants.

HFE means Horizontal Fiscal Equalisation.

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

The CGC finalised its five-yearly review into its methodology in February 2004, under terms of reference developed in consultation with all the States and Territories. The changes the CGC made to its methodology have been incorporated in its recommended relativities for 2004-05.

Review of Horizontal Fiscal Equalisation Methodology

At the March 2004 meeting of the Ministerial Council for Commonwealth-State Financial Relations, the majority of States and Territories, with the support of the Australian Government, agreed to a work programme to examine aspects of the Commonwealth Grants Commission's (CGC) methodology for the allocation of the GST to the States.

There was also majority agreement that the Australian Government and State and Territory Heads of Treasuries will undertake the work programme, and will draw on the expertise of the CGC. The work programme will include a consideration of whether the present approach is appropriate and necessary, the size and trend of the redistributions, simplification, and data issues. The work programme will not examine the underlying principles of horizontal fiscal equalisation.

Arrangements are underway to establish a steering committee to oversee the review and report to Heads of Treasuries. A secretariat will support the steering committee. The Australian Government Treasury will lead the organisational arrangements for conducting the review, with representation from the States and the CGC. Additional funding of \$1.3 million has been included in the budget for the secretariat (see Budget Paper No. 2, *Budget Measures 2004-05* for a description of the measure).

DELIVERING MORE FUNDING TO THE STATES

In 2004-05, all States will receive a windfall over the Guaranteed Minimum Amount (GMA). Including the compensation for the annual payment of GST (a measure which requires unanimous agreement from the States), the States will receive a total gain from tax reform of over \$1.6 billion more than the GMA (Table 13). The GMA is an estimate of funding each State would have had available to it had tax reform not been implemented. Components of the GMA comprise estimates of Australian Government Financial Assistance Grants forgone, state taxes abolished by tax reform and other items. Narrow and inefficient state taxes that have been abolished include Financial Institutions Duty, stamp duty on quoted marketable securities, and accommodation taxes (bed taxes).

As the GST is a secure, growing and broad based revenue source, the States' gain from tax reform is estimated to continue growing to over \$2.9 billion by 2007-08 (Table 13). This means that the Australian Government's tax reform will deliver to the States an extra \$1.6 billion in 2004-05, growing to over \$2.9 billion in 2007-08, to spend according to their own budgetary priorities. States can use this additional funding for essential community services such as hospitals, schools, public transport, roads and police, and to lower their tax burdens.

Under the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*, the Australian Government guaranteed that in the transitional years after the introduction of *The New Tax System* in July 2000, each State's budgetary position would be no worse off than had the reforms to Commonwealth-State financial relations not been implemented. To meet this guarantee, the Australian Government has paid Budget Balancing Assistance (BBA) to any State whose GMA exceeds its GST revenue entitlement.

On the basis of the Budget estimates, in 2003-04 only New South Wales requires BBA to ensure that it is no worse off. All other States are estimated to benefit from a total gain from tax reform of over \$1.1 billion in 2003-04. As all States are expected to receive GST revenue in excess of their GMA from 2004-05, the Australian Government will no longer be required to provide BBA.

Tables 11 and 12 show the estimated GMA components, GST revenue entitlement and the BBA calculation for each State in 2003-04 and 2004-05. Table 13 shows the estimated GMA, GST revenue entitlement, BBA and gains from tax reform for each State from 2003-04 to 2007-08.

Table 11: Guaranteed Minimum Amount components, GST revenue provision and Budget Balancing Assistance in 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	5,410.5	4,012.6	4,225.7	1,806.9	2,170.5	1,033.9	443.8	1,388.4	20,492.3
Revenue Replacement Payments	2,544.0	1,702.4	1,543.4	1,064.1	661.8	224.7	113.1	143.6	7,997.0
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	583.2	393.3	236.7	62.7	98.5	25.9	24.3	17.4	1,442.0
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	237.9	195.8	168.8	93.9	57.0	19.5	11.3	7.8	792.0
GST Administration Costs	191.7	141.2	109.6	56.1	43.7	13.7	9.2	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	141.2	58.8	137.4	177.7	37.7	2.3	0.0	4.0	559.1
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	25.3	17.5	4.9	8.0	4.7	1.7	1.0	1.2	64.4
minus Growth Dividend									
Remaining State Taxes	99.1	64.0	33.5	20.0	16.1	4.1	3.1	2.2	242.0
Plus Adjustments									
2002-03 GMA Adjustment	-4.4	6.5	-6.1	-2.5	-0.6	2.1	0.3	0.7	-4.0
Total Guaranteed Minimum Amount (1)	9,736.5	6,834.6	6,041.2	2,997.8	3,047.9	1,324.4	620.3	1,569.0	32,171.8
GST Revenue Provision (2)	9,690.5	6,973.6	6,574.9	3,159.8	3,154.3	1,399.0	660.7	1,684.2	33,297.0
Budget Balancing Assistance (1)-(2)	46.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	46.0

Table 12: Guaranteed Minimum Amount components, GST revenue provision and Budget Balancing Assistance in 2004-05 (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	5,184.2	4,099.1	4,710.6	2,117.3	2,216.9	1,042.5	440.3	1,393.8	21,204.7
Revenue Replacement Payments	2,614.0	1,749.1	1,584.9	1,090.6	679.7	230.7	116.3	147.4	8,212.6
Financial Institutions Duty	737.0	410.2	na	155.8	103.7	24.8	20.5	18.2	1,470.2
Marketable Securities Duty	483.0	250.7	28.0	31.1	16.5	0.8	25.4	1.1	836.6
Marketable Securities Duty Needs	-29.1	12.4	13.8	3.9	2.4	2.8	-7.5	1.1	0.0
Accommodation Taxes	88.0	na	na	na	na	na	na	9.5	97.5
plus Reduced Revenues									
Gambling Taxes	608.2	415.3	250.7	63.7	102.5	26.2	24.9	18.2	1,509.7
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	232.8	191.6	165.2	91.9	55.8	19.1	11.1	7.6	775.2
GST Administration Costs	194.9	143.9	112.9	57.4	44.3	14.0	9.3	5.7	582.3
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	142.7	59.6	140.8	180.7	37.9	2.3	0.0	4.0	568.0
Savings from Tax Reform	191.2	131.5	108.4	64.6	47.1	15.9	10.7	15.7	585.0
Low Alcohol Beer Subsidies	25.9	17.9	5.0	8.2	4.8	1.8	1.0	1.3	65.8
minus Growth Dividend									
Remaining State Taxes	122.9	79.3	41.5	24.7	19.9	5.1	3.9	2.7	300.0
Total Guaranteed Minimum Amount (1)	9,630.5	6,984.1	6,570.5	3,333.4	3,112.0	1,335.8	624.7	1,578.9	33,169.9
GST Revenue Provision (2)	9,648.3	7,151.4	7,168.5	3,528.9	3,212.7	1,407.8	663.8	1,678.7	34,460.0
Budget Balancing Assistance (1)-(2)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Table 13: Estimates of Budget Balancing Assistance and State and Territory gains from tax reform^(a)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
2003-04 (\$m)									
(1) Guaranteed Minimum Amount	9,736.5	6,834.6	6,041.2	2,997.8	3,047.9	1,324.4	620.3	1,569.0	32,171.8
(2) GST Revenue	9,690.5	6,973.6	6,574.9	3,159.8	3,154.3	1,399.0	660.7	1,684.2	33,297.0
(3) Budget Balancing Assistance (1) - (2)(b)	46.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	46.0
(4) State and Territory gains from tax reform (2) - (1)(b)	0.0	139.0	533.7	162.0	106.4	74.6	40.4	115.1	1,171.2
2004-05 (\$m)									
(1) Guaranteed Minimum Amount	9,630.5	6,984.1	6,570.5	3,333.4	3,112.0	1,335.8	624.7	1,578.9	33,169.9
(2) GST Revenue	9,648.3	7,151.4	7,168.5	3,528.9	3,212.7	1,407.8	663.8	1,678.7	34,460.0
(3) Budget Balancing Assistance (1) - (2)(b)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(4) Compensation for GST Deferral	95.9	70.6	67.6	33.5	30.2	12.3	6.0	13.9	330.0
(5) State and Territory gains from tax reform (2)+(4)-(1)	113.7	237.9	665.6	229.1	130.9	84.3	45.1	113.6	1,620.1
2005-06 (\$m)(c)									
(1) Guaranteed Minimum Amount(d)	10,228.1	7,522.6	7,159.4	3,487.3	3,260.6	1,412.3	655.5	1,649.8	35,375.6
(2) GST Revenue	10,317.4	7,691.1	7,629.9	3,660.1	3,371.6	1,486.8	696.5	1,756.5	36,610.0
(3) Budget Balancing Assistance (1) - (2)(b)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(4) State and Territory gains from tax reform (2)-(1)	89.2	168.5	470.5	172.9	111.0	74.5	41.0	106.7	1,234.4
2006-07 (\$m)(e)									
(1) Guaranteed Minimum Amount	10,601.9	7,940.5	7,449.6	3,541.4	3,390.7	1,463.6	674.9	1,723.8	36,786.4
(2) GST Revenue	10,921.8	8,268.9	8,067.7	3,763.4	3,556.4	1,560.3	726.8	1,834.7	38,720.0
(3) State and Territory gains from tax reform (2)-(1)	319.9	328.4	618.2	242.0	165.7	96.7	51.8	110.9	1,933.6
2007-08 (\$m)									
(1) Guaranteed Minimum Amount	10,825.9	8,278.0	7,720.4	3,628.9	3,497.9	1,503.9	692.3	1,796.5	37,943.7
(2) GST Revenue	11,446.6	8,839.6	8,540.7	3,988.7	3,734.0	1,623.1	763.4	1,914.1	40,850.0
(3) State and Territory gains from tax reform (2)-(1)	620.7	561.6	820.3	359.8	236.1	119.1	71.1	117.6	2,906.3

(a) Projections will be affected by variations in Guaranteed Minimum Amount components, GST revenue growth and recommendations by the Commonwealth Grants Commission on the distribution of GST to each of the States and Territories in future years.

(b) Where the difference between the Guaranteed Minimum Amount and GST Revenue (and vice versa) is less than zero, the reported amount is zero.

(c) In 2005-06 and beyond there may be small flow-on effects from compensation for the GST deferral which will be subject to negotiation with the States.

(d) As agreed at the 26 March 2004 meeting of the Ministerial Council for Commonwealth-State Financial Relations, bank account debits tax is to be abolished by 1 July 2005. The revenue forgone by the States and Territories is included in their Guaranteed Minimum Amount from 2005-06 to ensure the States are no worse off. Accordingly, State and Territory gains from tax reform decrease in 2005-06 compared to 2004-05. However, the estimates of Guaranteed Minimum Amounts do not contain reductions in the following state taxes: non-residential conveyances; non-quotable marketable securities; leases; mortgages, bonds, debentures and other loan securities; credit arrangements, instalment purchase arrangements and rental arrangements; cheques, bills of exchange and promissory notes, which are the subject of review by the Ministerial Council in 2005.

(e) The transition period in which the Australian Government guarantees that no State will be worse off due to tax reform expires on 30 June 2006.

Adjustments in 2003-04

GST revenue provision in 2003-04 has been adjusted to account for the final 2002-03 outcome (Table 1). In 2002-03 the final GST cash collections outcome was \$57 million higher than the amount determined by the Commissioner of Taxation in June 2003 and provided to the States in 2002-03 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 2003-04 will take account of this variation. The BBA entitlement for New South Wales for 2003-04 has also been calculated to account for this variation (Table 11).

Adjustments in 2004-05

Consistent with the terms of the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*, the Australian Government has advanced BBA to the States in four quarterly instalments in 2003-04. These advances were based on the estimated BBA entitlements of the States at the time of each advance. The upward revision to GST revenue estimates and the downward revision to GMA in the Budget have resulted in lower than previously estimated BBA entitlements of the States. Based on current estimates, the advances to the States in the year to date exceed the States' entitlements to BBA in 2003-04 by \$397 million (Table 14).

Consistent with the provisions of the Act, the Australian Government will deduct the amount of excess BBA paid in 2003-04 from payments to be made to the States under the Act in 2004-05. The final amount to be deducted from State payments in 2004-05 will be known when the final determination of each State's BBA entitlement is made under the Act in June 2004.

Table 14: Overpayment of Budget Balancing Assistance in 2003-04 (estimated)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Payments to date	316.7	104.2	0.0	0.0	22.0	0.0	0.0	0.0	443.0
BBA entitlement	46.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	46.0
BBA overpayment	270.7	104.2	0.0	0.0	22.0	0.0	0.0	0.0	397.0

Residual Adjustments

The Australian Government has introduced a mechanism to ensure that all States receive their appropriate payments under the Act as they come off BBA. It came into effect when the *A New Tax System (Commonwealth-State Financial Arrangements) Amendment Act 2004* received Royal Assent on 23 March 2004.

Residual adjustments will give effect to any underestimate or overestimate of payments in a previous financial year that, prior to the amendments, could not be paid or reclaimed using existing mechanisms under the Act.

Queensland and the Northern Territory no longer required BBA in 2002-03. The residual adjustment amounts for 2002-03 will reflect an underestimate of payments in 2001-02. As the legislative requirements were not in place last year, these adjustments will be paid in 2003-04.

Current estimates show that Victoria, Western Australia, South Australia, Tasmania and the Australian Capital Territory will no longer require BBA in 2003-04. Based on the current estimates, the residual adjustment amounts for 2003-04 will reflect an overestimate of payments in 2002-03.

As final payments for 2003-04 will not be known until the June 2004 determinations, it will not be known until after that time whether a residual adjustment for 2004-05 will be needed.

Table 15 shows estimates of the residual adjustment amounts that will be paid in 2003-04.

Table 15: Residual adjustment amounts for 2002-03 and 2003-04 (estimated)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
2002-03	0.0	0.0	38.8	0.0	0.0	0.0	0.0	11.0	49.8
2003-04	0.0	-5.7	0.0	-8.0	-5.9	-0.1	-0.7	0.0	-20.4
Total adjustment in 2003-04	0.0	-5.7	38.8	-8.0	-5.9	-0.1	-0.7	11.0	29.4

DELIVERING FURTHER TAX REFORM

Under the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*, all the States and Territories committed to abolish the bank account debits tax, subject to review by the Ministerial Council for Commonwealth-State Financial Relations. At the March 2004 Ministerial Council meeting, the Australian Government and State governments agreed to abolish bank account debits tax by 1 July 2005.

The abolition of this tax continues the implementation of the reforms contained in the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*, signed by Australian Government and all State and Territory leaders in 1999.

The Australian Government's tax reforms made it possible to abolish this narrow and inefficient tax. The abolition of bank account debits tax is expected to directly save taxpayers around \$1 billion each year.

The *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* also provides that the Ministerial Council will, by 2005, review the need to retain stamp duty on the following:

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

The Ministerial Council committed to this review at its March 2004 meeting and will consider the review at its March 2005 meeting.

First Home Owners Scheme

Eligible home buyers have received over \$4.4 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 Australian Government through Budget Balancing Assistance. The scheme provides all eligible first home buyers with a \$7,000 grant. The States administer the scheme which has provided over 568,000 grants. The Scheme is ongoing and its cost to the States is part of the Guaranteed Minimum Amount (Tables 11 and 12).

In March 2001, the Australian Government made an additional \$7,000 grant available to first home buyers building or purchasing new homes before 31 December 2001. The Australian Government fully funds the additional First Home Owners Scheme with a Specific Purpose Payment through the States to meet the cost of grants. The Australian Government extended the additional First Home Owners Scheme at a rate of \$3,000 for new homes built or purchased between 1 January 2002 and 30 June 2002. To date, the additional First Home Owners Scheme has provided around 69,000 grants to eligible home buyers.

Although the additional First Home Owners Scheme has ended, grants continue to be paid to eligible applicants due to the time needed to complete construction and the one-year period allowed to lodge an application, once construction is complete. Estimates of payments are shown in the Specific Purpose Payments tables (Appendix B).

NATIONAL COMPETITION POLICY PAYMENTS

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

NCPs 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.

Each State's NCPs are subject to that State making satisfactory progress with the implementation of reform commitments. Prior to the scheduled payment of NCPs in each year, the National Competition Council (NCC) assesses whether each State has met the specified conditions and provides recommendations for consideration by the Australian Government.

Out of an estimated maximum level of payments in 2003-04 of \$759 million, the NCC recommended permanent deductions of \$53.9 million and suspensions of \$126.9 million. The NCC has indicated that it will recommend that suspensions be lifted or reduced and the release of suspended monies if and when jurisdictions sufficiently progress reform.

Table 16 shows estimates of NCPs from 2003-04. Each State's amount for 2003-04 reflects that permanent deductions and suspensions recommended by the NCC have been applied. The amounts reported below for 2004-05 and 2005-06 are the current estimates of each State's maximum level of payment (that is, if no permanent deductions or suspensions apply).

Table 16: National Competition Policy Payments

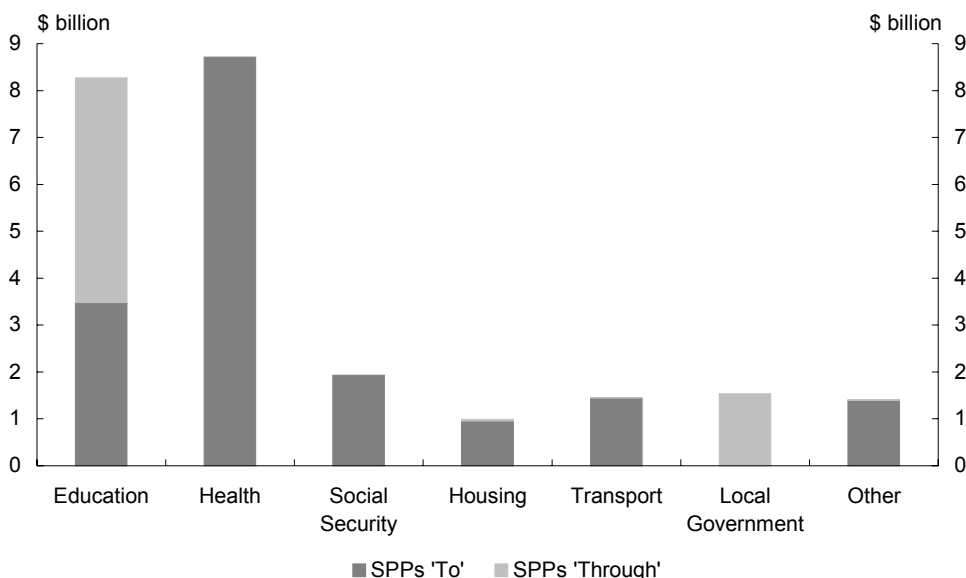
	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
2003-04	203.5	178.7	87.9	33.6	40.7	17.2	11.0	5.9	578.5
2004-05	259.8	191.8	151.4	76.6	59.2	18.8	12.4	7.7	777.7
2005-06	264.5	195.5	155.1	78.4	59.8	18.9	12.6	7.8	792.5

SPECIFIC PURPOSE PAYMENTS

Specific Purpose Payments (SPPs) constitute a significant amount of Australian Government funding to the States. In 2004-05, the Australian Government will provide the States with \$24.3 billion in SPPs. These payments represent almost 13 per cent of total Australian Government expenditure in 2004-05.

The Australian Government makes SPPs to the States as a contribution to important areas of state responsibility. In 2004-05, there will be over 90 different payments covering a broad range of policy areas such as education, health, social security, housing and transport (Chart 3).

Chart 3: Composition of Specific Purpose Payments 'to' and 'through' the States in 2004-05 (estimated)



More detailed information, including payments on a state-by-state basis, for 2003-04 and 2004-05 is in Appendix B.

SPPs can be classified into three groups:

- those paid 'to' the States – payments direct to State governments, totalling an estimated \$17.9 billion in 2004-05;
- those paid 'through' the States – payments to State governments to be passed on to local governments (for example, Financial Assistance Grants to local government) and to others (for example, to non-government schools). This category is estimated to total \$6.4 billion in 2004-05; and
- those paid direct to local government to help fund roads, child-care programmes and disability services administered by local governments. These payments are estimated to total \$304.7 million in 2004-05.

SPP agreements often include agreed national objectives. However, in making these payments, the Australian Government does not seek to take over responsibility for state functions.

SPP agreements generally contain conditions to help ensure those objectives are achieved. These conditions 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 below).

Accountability for SPPs

The Australian Government is seeking greater accountability in SPP agreements to improve policy outcomes and deliver better value for money.

All new and renegotiated SPP agreements will include statements of key objectives and the respective responsibilities of the Australian Government and the States, combined with agreed reporting of financial information and detailed performance indicators.

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

Financial Assistance Grants to local government

The Australian 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 can spend both forms of funding according to their own priorities.

The Australian Government is providing a total of \$1.5 billion in Financial Assistance Grants to local government in 2003-04 and an estimated \$1.5 billion in 2004-05 (Table 17). The annual increase in funding is based on an escalation factor, which the Treasurer determines with reference to population growth and CPI.

This financial assistance is paid to the States as a SPP, on condition that all the funds are passed on to local government. In 2004-05, 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 17). State grants commissions determine the intra-state distribution of the grants to local governments.

Table 17: Financial Assistance Grants to local government in 2003-04 and 2004-05 (estimated)^(a)

	NSW \$m	VIC \$m	QLD \$m	WA \$m	SA \$m	TAS \$m	ACT \$m	NT \$m	Total \$m
2003-04									
General Purpose Assistance	353.2	260.0	199.2	103.0	80.9	25.2	17.0	10.4	1,049.0
Untied Local Road Funding	135.0	96.0	87.2	71.2	25.6	24.7	14.9	10.9	465.5
Total Financial Assistance Grants(b)	488.3	355.9	286.4	174.2	106.5	49.9	32.0	21.3	1,514.5
2004-05									
General Purpose Assistance	356.6	262.0	204.4	104.3	81.3	25.5	17.2	10.6	1,061.9
Untied Local Road Funding	136.7	97.1	88.3	72.0	25.9	25.0	15.1	11.0	471.2
Total Financial Assistance Grants(c)	493.3	359.2	292.6	176.4	107.2	50.5	32.3	21.6	1,533.1

- (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 overpayment or underpayment from the previous year.
- (b) The 2003-04 figure takes into account an underpayment of \$6 million in 2002-03. The Treasurer will determine the final 2003-04 escalation factor in June 2004; currently the 2003-04 escalation factor is estimated to be 1.0288.
- (c) The 2004-05 figure includes an estimate of the amount necessary to adjust for the difference between the 2003-04 escalation factor estimated in June 2003 and used to calculate payments in 2003-04 and the final factor for 2003-04 to be determined in June 2004. On the basis of the current estimate of the 2003-04 escalation factor, this adjustment is estimated to be a decrease of \$11.5 million. The 2004-05 escalation factor is currently estimated to be 1.0318. Financial Assistance Grants in 2004-05 will be paid on the basis of the escalation factor that the Treasurer will estimate in June 2004. The Treasurer will determine the final escalation factor for 2004-05 in June 2005.

MIRROR TAX ARRANGEMENTS

The Australian Government introduced mirror tax arrangements in 1998 to ensure the States were 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.

These arrangements mirror certain state taxes including payroll taxes, land taxes, debits tax and stamp duties on activities in or on Commonwealth places.

The States collect these mirror taxes on behalf of the Australian Government and bear the administrative costs of collection. All mirror tax revenues are automatically credited to the Australian Government and automatically appropriated to the States at the same time. Hence, mirror taxes are recorded as both Australian Government revenue and negative revenue, with no net impact on the Budget.

Table 18 shows estimates of accrued mirror taxes from 2003-04 to 2007-08.

Table 18: Accrued mirror taxes on behalf of the States, 2003-04 to 2007-08 (estimated)

	2003-04	2004-05	2005-06	2006-07	2007-08
	\$m	\$m	\$m	\$m	\$m
Mirror taxes	311.8	330.9	347.7	365.3	383.5