



Australian Government

Commonwealth Grants Commission

REPORT ON
STATE REVENUE SHARING RELATIVITIES
2004 REVIEW

CANBERRA

Report

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This Report and the accompanying volume of Supporting Information are supplemented by the following working papers, copies of which are being made available to major parties to the inquiry. Others are being deposited in the National Library of Australia and State and Territory reference libraries. The names below may change when published.

Volume 1	Assessment Methods and the Equalisation Budget	ISBN 174134 904-4
Volume 2	Assessment Results	ISBN 174134 905-2
Volume 3	Revenue Assessment Issues	ISBN 174134 906-0
Volume 4	Expense Assessment Issues — Education, Health and Welfare	ISBN 174134 907-9
Volume 5	Expense Assessment Issues — Economic Activities	ISBN 174134 908-7
Volume 6	Expense Assessment Issues — Law and Order, Other State Government Services and User Charges	ISBN 174134 909-5
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Australian Government

Commonwealth Grants Commission

Chairman Alan G Morris

Senator the Hon Nick Minchin
Minister for Finance and Administration
Parliament House
CANBERRA ACT 2600

Dear Minister

As members of the Commonwealth Grants Commission appointed under the *Commonwealth Grants Commission Act 1973*, we respond in this report to terms of reference received in a letter dated 5 December 1999 from John Fahey MP, the then Minister for Finance and Administration, and in a letter from you dated 31 October 2003.

Yours sincerely

A G Morris, Chairman

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25 February 2004

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1. We acknowledge the ready co-operation extended to the Commission and its staff, throughout the review, by the Australian, State and Territory governments and their officials across a range of departments and agencies. We are grateful particularly for the efforts of the Australian and State Treasuries in organising submissions to the inquiry, participating in conferences, responding to our many requests for information and in helping us reach the decisions required. The Australian Bureau of Statistics has been most helpful in providing the data needed to complete the necessary calculations. We also acknowledge the help of other research and data gathering agencies.

2. We express special thanks to the staff of the Commission. The review could not have been completed without the exceptional professionalism and dedication of the staff, going beyond the normal call of duty.

TERMS OF REFERENCE

The terms of reference for this inquiry were given to the Commission in two parts. Part 1 was provided by the then Minister for Finance and Administration in December 1999. Part 2 was provided by the Minister for Finance and Administration¹ in November 2003.

The consolidated terms of reference are as follows:

1. Pursuant to sections 16, 16A and 16AA of *the Commonwealth Grants Commission Act 1973*, I hereby refer to the Commission for inquiry into and report upon, by 25 February 2004 at the latest, the question of per capita relativities which the Commission would regard as appropriate to apply after 2003-04 for the distribution of the combined pool of GST revenue grants and health care grants among the States, the Northern Territory and the Australian Capital Territory.
2. The Commission should review whether the allowances for special circumstances granted to the Australian Capital Territory continue to be necessary and, if so, make appropriate assessments.
3. The Commission should commence a work programme for improving methods of assessment and consult with the States and the Commonwealth in deciding the priorities for the work programme.
4. The Commission should continue to prepare its assessments on the basis that Specific Purpose Payments quarantined in previous terms of reference should continue to not affect the per capita relativities. These payments include (but are not necessarily limited to):
 - (a) National Competition Payments;
 - (b) States' contribution the Commonwealth's deficit reduction strategy;
 - (c) payments to the States to reimburse them for revenue lost as a result of the establishment of a national scheme of companies, securities and future regulation;
 - (d) payments which are funded from the Natural Heritage Trust of Australia and the Regional Telecommunications Infrastructure Fund;
 - (e) payments for the Fringe Benefit Tax Transitional Grants for the public and not-for-profit hospitals;
 - (f) payments for Building IT Strengths – Tasmanian 'Intelligent Island';
 - (g) payments for Connecting Tasmanian Schools;
 - (h) payments for the Extension of the First Home Owners Scheme;

¹ The full text of the Ministers' letters is at the front of the volume of Supporting Information that accompanies this report.

Terms of reference

- (i) payments for the Roads to Recovery program; and
- (j) Commonwealth payments made to the Sinking Fund on State Debt.

5. In preparing its assessments the Commission should have regard for the need to observe policy neutrality in relation to a reduction in the level of a Specific Purpose Payment resulting from non-compliance by a State or Territory with the conditions of the payment. Any such reductions should not directly influence the Commission's assessments of the per capita relativities. Given the complexity and variety of Specific Purpose Payment agreements, additional guidance in relation to any actual reductions for non-compliance will be provided to the Commission if and when the need arises.

6. The Commission should prepare its assessments on a basis consistent with the Commonwealth's intention that the following components of the Australian Health Care Agreements between the Commonwealth and a State should not directly influence the per capita relativities:

- (a) payments in relation to mental health;
- (b) payments in relation to the National Health Development Fund;
- (c) payments in relation to the Pathways Home Initiative;
- (d) all payments under an adjustment module, including those related to the Critical and Urgent Treatment (CUT) Waiting List Initiative; and
- (e) compliance payment arrangements (in this case including the maximum available compliance payments in the assessments).

7. Further to part 6(e), the Commission should prepare its assessments on the basis that the pool of funds to be distributed in accordance with the per capita relativities includes the maximum available compliance payments under the Australian Health Care Agreements – notwithstanding that these have been designated as deductible amounts pursuant to s.6 of the *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999* – in order to reflect the Commonwealth's intention that the per capita relativities should be equivalent to those that would have been assessed had the compliance payments been retained as part of the pool of GST and unquarantined Health Care Grants.

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EXECUTIVE SUMMARY

1. The Commonwealth Grants Commission advises the Australian Government on the distribution of the revenue from the goods and services tax (GST) and health care grants (HCGs) among the States and Territories¹. The Commission applies a specific principle of fiscal equalisation, which says that:

State governments should receive funding from the pool of goods and services tax revenue and health care grants such that, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the capacity to provide services at the same standard.

2. Application of this principle is intended to give all States the financial capacity to provide the same level of services while maintaining their flexibility to vary the service levels and standards to best meet the needs of their citizens. Our implementation of the equalisation principle reflects three pillars of equalisation:

- (i) The financial capacities of States, not their performance or outcomes, are equalised.
- (ii) States are equalised to standards that reflect what they all do on average.
- (iii) A State's own policies or choices should not directly influence its grant.

3. Equalisation results in the distribution among the States of the pool of GST revenue and HCGs being uneven, in per capita terms. This is because States have different per capita capacities to raise revenue and different per capita expense requirements. These differences are illustrated in Figures 1 and 2.

4. The different assessments of needs, expressed as per capita relativities for each State, are used to distribute the pool of GST revenue and HCGs. This report provides per capita relativities we regard as appropriate for application in 2004–05.

¹ In the remainder of this report the words 'State' and 'States' include the Australian Capital Territory and the Northern Territory unless the context indicates otherwise.

Figure 1 STATES' RELATIVE REVENUE RAISING CAPACITIES, AVERAGE 1998-99 TO 2002-03

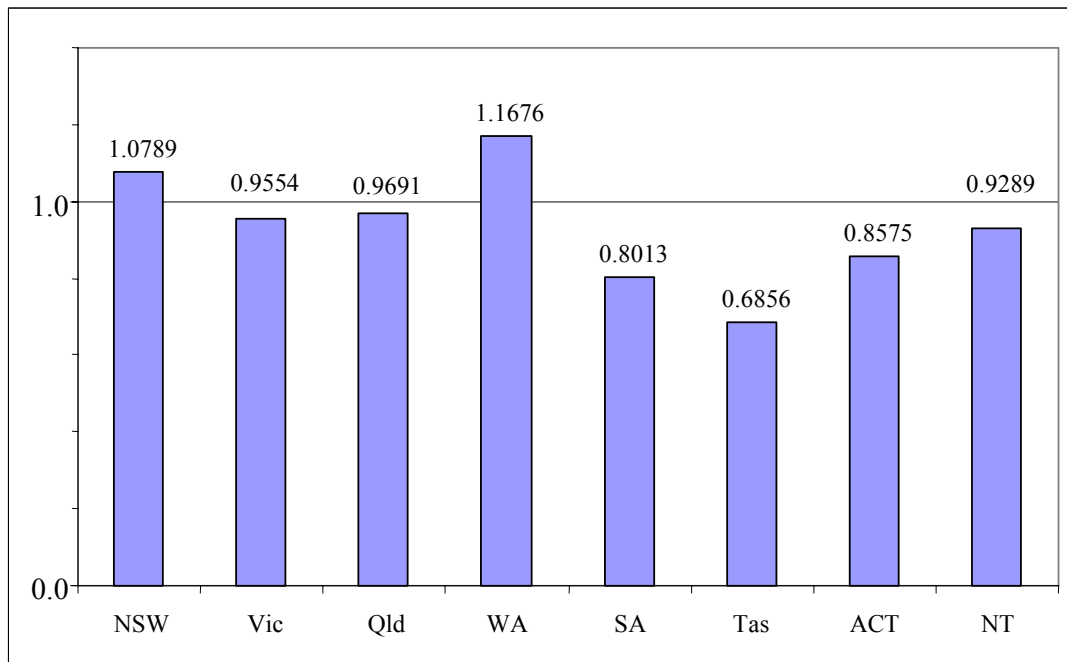
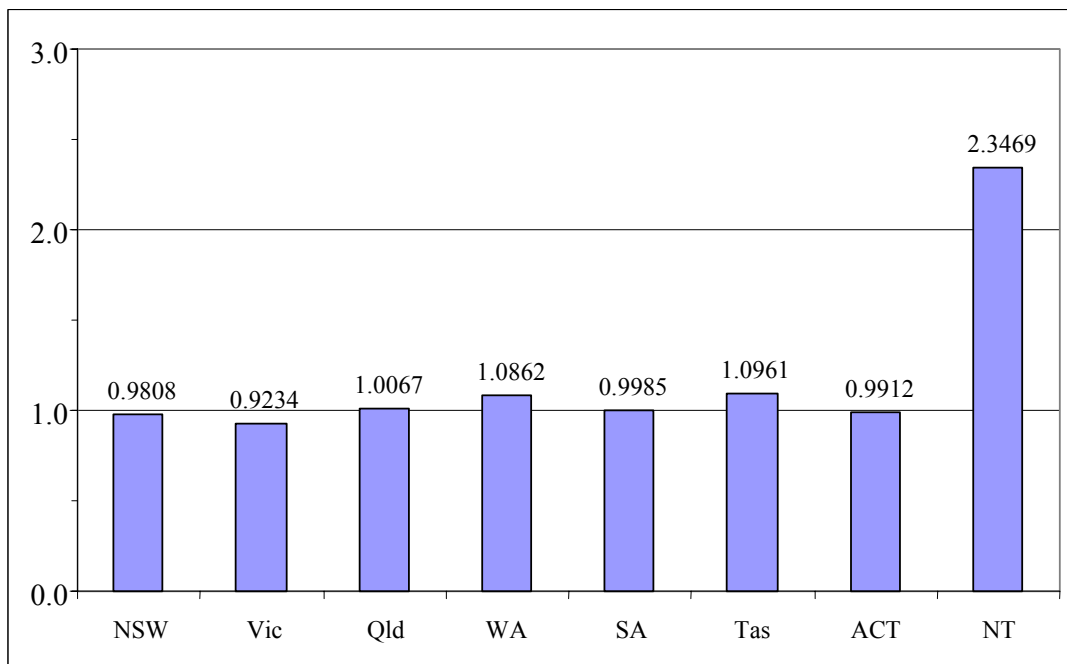


Figure 2 STATES' RELATIVE COSTS OF PROVIDING SERVICES, AVERAGE 1998-99 TO 2002-03



THE MAIN FINDINGS

5. The terms of reference require us to develop per capita relativities that are appropriate to apply to the distribution of GST revenue and HCGs in 2004–05. These indicate the share of the GST and HCG pool required to give each State the financial capacity to provide the Australian average standard of State services — assuming that it operates at an average level of efficiency and makes an average effort to raise revenue from its own sources. The relativities are based on the latest available data for the five years 1998–99 to 2002–03.

Relativities

6. Table 1 shows the relativities we regard as appropriate for use in 2004–05, based on the methods of assessing State needs we adopt in this review.

Table 1 PER CAPITA RELATIVITIES FOR DISTRIBUTING THE GST AND HCG POOL IN 2004–05

New South Wales	0.86750
Victoria	0.86534
Queensland	1.05504
Western Australia	1.03054
South Australia	1.20407
Tasmania	1.55939
Australian Capital Territory	1.12930
Northern Territory	4.26538
Australia	1.00000

7. These relativities imply that providing the States with equal financial capacities to provide services means that for each \$86.75 and \$86.53 per capita in GST revenue and HCGs New South Wales and Victoria receive respectively, the others would receive more, ranging from \$103.05 per capita for Western Australia to \$426.54 per capita for the Northern Territory.

8. Table 2 shows an estimate of each State’s potential GST revenue and HCGs for 2004–05. It is based on applying the relativities we assess in this report to the currently projected State populations at 30 December 2004 and the information available to us on the pool of GST revenue and HCGs expected to be available for distribution in 2004–05. That illustrative estimate is compared with each State’s GST revenue and HCGs for 2003–04, as shown in the Australian Government’s Budget Paper No. 3, *Federal Financial Relations, 2003–04*.

9. Table 2 excludes the extra budget balancing assistance some States received in 2003–04 under the transitional provisions of the *A New Tax System (Commonwealth–*

State Financial Arrangements) Act 1999. Those provisions are designed to ensure that States receive at least as much untied funding as they would have received had the tax reforms introduced in July 2000 not taken place. Some States may receive budget balancing assistance in 2004–05 if their share of the GST revenue and HCGs available for distribution in that year is less than their guaranteed minimum amount plus their HCG.

Table 2 COMPARISON OF DISTRIBUTION OF GST REVENUE AND HCGs, 2004–05 AND 2003–04

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Illustrative 2004–05 GST revenue and HCGs ^(a)	12 128.0	8 920.3	8 460.4	4 232.6	3 806.2	1 525.4	760.1	1 761.2	41 594.1
2003–04 GST revenue and HCGs ^(b)	11 656.7	8 385.9	7 574.9	3 705.6	3 607.9	1 475.1	727.9	1 691.3	38 825.2
Illustrative change in funds	471.4	534.4	885.5	527.0	198.3	50.3	32.1	69.9	2 768.9
	%	%	%	%	%	%	%	%	%
Grant shares 2004–05 ^(c)	29.16	21.45	20.34	10.18	9.15	3.67	1.83	4.23	100
Grant shares 2003–04 ^(c)	30.02	21.60	19.51	9.54	9.29	3.80	1.87	4.36	100
Population share ^(d)	33.57	24.76	19.26	9.86	7.59	2.35	1.62	0.99	100

(a) Obtained by applying the 2004 Review relativities to projected populations at December 2004 and the estimated 2004–05 pool of GST revenue and HCGs shown in the *2003 Australian Government MYEFO Version of the State by State Tax Reform Impact Tables (Version 37)*.

(b) From Australian Government Budget Paper No. 3, *Federal Financial Relations, 2003–04*.

(c) The estimated funding for each State as a percentage of the total pool of GST revenue and HCGs being distributed.

(d) Based on projected State populations at December 2004.

10. The illustrative estimates of State GST revenue and HCGs for 2004–05 will change with later estimates of the GST revenue collections, the HCGs to be paid, and State populations.

11. Implementing the relativities we assess would lead to a redistribution of 7.7 per cent of the forecast GST revenue and HCG pool for 2004–05 relative to an equal per capita distribution. This redistribution is broadly comparable with the level of redistribution in the past.

WHY RELATIVITIES ARE NOT EQUAL TO ONE

12. All the relativities are different from one, meaning that each State's share of the pool for 2004–05 differs from its share of the Australian population. This reflects differences between the States in:

- (i) their relative capacity to raise revenue from State taxes and charges;
- (ii) their relative costs of providing the standard range and level of services; and
- (iii) their relative revenue from specific purpose payments by the Australian Government.

13. The revenue raising capacity of New South Wales is above average mainly because of the general strength of its economy, especially the relatively high land values. Western Australia has above average revenue raising capacity mainly because of the strength of the mining industry. In contrast, revenue raising capacity is below average in Queensland, South Australia, Tasmania, the ACT and the Northern Territory. In the case of the ACT and the Northern Territory, this is because they have large government sectors that do not add to their net capacity to raise revenue.

14. Relative costs of services are well below average in Victoria. Victoria is a compact State with circumstances that are relatively conducive to service delivery: distances are not great, its physical environment is relatively favourable, and it has below average proportions of its population in high-cost groups. Those groups include students attending government schools, people who have low incomes, and people who are Indigenous or live in remote areas.

15. At the other extreme, the Northern Territory has very high relative costs of services: it is a large State with a small population spread throughout. It is remote from the main centres of activity in south-east Australia and has relatively high proportions of its population in high-cost groups.

16. The Northern Territory, Tasmania and South Australia receive above average per capita amounts of specific purpose payments from the Australian Government, which partly meet some of their above average costs of providing services.

17. In aggregate, above average revenue raising capacity is the main reason why New South Wales has a relativity below one; that is, its share of the GST revenue and HCGs is below its population share. Below average revenue raising capacity is the main reason for Queensland, South Australia, Tasmania and the ACT having relativities above one. The relativities of Victoria and the Northern Territory are determined predominantly by their relative costs of providing services. In Western Australia's case, above average costs of providing services are largely offset by a high revenue raising capacity.

WHY RELATIVITIES HAVE CHANGED SINCE THE 2003 UPDATE

18. The relativities we assess in this review differ from those assessed in the 2003 Update and used to distribute the pool of GST revenue and HCGs in 2003–04 because we:

- (i) reviewed the methods we use to measure the States' relative revenue raising capacities and costs of providing services; and
- (ii) made the relativities as up to date as possible by including data for the most recently completed financial year (2002–03) and the most recent data on demographic trends (from the 2001 Census) and the use and cost of State services.

Methods of assessment

19. In general, our approach to assessment of the relativities is similar to that used for the last five years. We made changes to methods to strengthen their conceptual soundness, to make them as policy neutral and as firmly based on objective and quantifiable evidence as possible. The new methods also reflect the current circumstances of the States and their current policies on revenue collection and service delivery.

20. To enhance the conceptual rigour, transparency and consistency of our decision making, we developed and applied a set of guidelines. Those guidelines, which are set out in Chapter 2, require us to explain how we came to decisions by making explicit the conceptual case we accepted, the data available, whether we used judgment, and what informed our judgment.

21. The general method used to assess States' revenue raising capacities has changed very little; the same applies to the method of integrating the States' receipts of specific purpose payments (SPPs) into the measurement of their needs for GST revenue and HCGs. We have, however, changed the way we apply the method to mining royalties to better reflect the way the States impose them and we amended the range of SPPs included in the assessments to reflect only those that have a direct effect on State budgets.

22. The general approach to expense assessments is also largely unchanged, although we have made many changes in the way it is applied in particular instances, to better measure the disabilities that cause differences between States in the relative cost of providing services. For example, we have made the depreciation and debt charges assessments much more rigorous, with greater reliance on evidence and conceptual clarity. These new assessments reflect our view that the differences between States' needs in these areas are not as large as previously assessed. Other large changes in the assessment method were made for urban transit, to better reflect the current role of State governments in providing subsidies to service providers and the capital-intensive nature of the services in the large cities. Chapter 5 and the working papers that accompany this report provide information about other changes in method.

Other changes

23. The change in relativities since 2003–04 is also partly caused by the inclusion of data from the 2001 Census on State population characteristics and the latest data on State revenue bases, service use, and the extra costs of providing services to some groups of people.

Outcome of changes

24. In comparison with the 2003 Update, the relativities of Queensland and Western Australia have increased. For Queensland, this is mostly because of its growing share of people who place larger demands on service provision, as well as our reconsideration of its needs relating to borrowing and the use of capital. For Western Australia, it is largely because of a reduction in our assessment of its capacity to raise revenue, along with our assessment of increased needs relating to roads, borrowing and capital. The needs of both States, particularly Western Australia, are further increased because they receive a smaller share of specific purpose payments than they did previously.

25. The relativities of the other States have decreased mainly because of declines in their assessed relative costs of providing services. For New South Wales, this is mainly due to smaller disabilities associated with borrowings and the use of capital assets. For the other States, changes in the composition of their population, which reduced the relative cost of services, were a large influence. Reductions in our assessment of diseconomies of small scale and generally declining relative wages rates also affected the less populous States. Further, the financial capacities of New South Wales and the Northern Territory were strengthened by higher assessed revenue raising capacities. Victoria, Tasmania and the ACT received relatively larger shares of specific purpose payments, which reduced their relativities.

**THE SPECIAL CIRCUMSTANCES OF THE
AUSTRALIAN CAPITAL TERRITORY**

26. The terms of reference require us to review the need for allowances for any special circumstances of the ACT and to make appropriate assessments if necessary. We conclude that the ACT continues to need some special allowances because of:

- (i) its status as the national capital and the impact of this on the operating requirements of the ACT Government; and
- (ii) special fiscal needs in the areas of police services, corporate affairs compensation, and roads.

27. The allowances resulting from the ACT's status as the national capital are included in the assessments of disabilities and they influence the per capita relativities.

28. Chapter 6 discusses the ACT's special fiscal needs and requirements for transitional funding. In summary, we recommend that the ACT receive funding of \$14.2 million in 2004–05, in addition to its share of the pool of GST revenue and HCGs.

THE FUTURE

29. This report concludes with a brief outline of a number of broad matters of concept and principle relating to equalisation and its application that were raised during the review. We did not pursue them because we consider they are beyond the requirements of the terms of reference for this review. We do, however, consider them to be important and worthy of further consideration. We think there would be benefit in a review of equalisation principles, but whether such a review is initiated is a matter for governments.

CHAPTER 1

INTRODUCTION

1. This report provides advice on the outcome of the Commission's review of the per capita relativities used to distribute the goods and services tax (GST) revenue and the health care grants (HCGs) among the States. It contains the per capita relativities the Commission considers appropriate for distributing the pool of GST revenue and HCGs in 2004–05.

2. Since 1988 procedures have been in place for reviewing the methods used to calculate relativities every five years¹. Reviews were completed in 1988, 1993 and 1999. Between reviews, the relativities were updated annually by applying data for the most recent five years to the methods from the last review. This 2004 Review is part of that cyclical process, which is aimed at ensuring that the relativities reflect changes over time in the circumstances of the States, developments in public administration, and trends in service delivery.

The Commission's terms of reference

3. On 5 December 1999 we received Part 1 of the terms of reference, setting out the broad task for this review and requiring the Commission to:

- (i) report by 25 February 2004 on the per capita relativities that the Commission would regard as appropriate to apply after 2003–04;
- (ii) review whether the allowances for special circumstances granted to the ACT continue to be necessary and, if so, make appropriate assessments; and
- (iii) commence a work program for improving the methods of assessment and consult with the State and the Australian Government treasuries in deciding the priorities for the program.

4. We received Part 2 of the terms of reference on 3 November 2003. It set out the treatment to be accorded elements of the Australian Health Care Agreements signed by the Australian and State governments in August 2003. It also said that the relativities should not be affected by certain other specific purpose payments (SPPs).

¹ The Commission had previously reported on reviews of per capita relativities in 1981, 1982 and 1985.

Chapter 1

5. We interpreted the terms of reference as requiring us to review the methods of assessment used in applying the equalisation principle and to report on the relativities that would be appropriate for use in 2004–05. Consistent with our interpretation and the procedures used in the 1999 Review, the relativities we have calculated are based on an average of calculations for each of the last five financial years (1998–99 to 2002–03).

6. Chapter 7 discusses some broader matters relating to interpretation of the terms of reference and the equalisation principle.

Procedures for the conduct of the review

7. The Commission and the States agreed on a work program for the review in May 2000. Under that program and subsequent revisions the review procedures included:

- (i) four conferences between the Commission and the Heads of Treasury, dealing with priority issues of principle and practice, major issues in assessment methods, and draft assessments;
- (ii) two sets of visits by the Commission to each State for workplace discussions, in metropolitan and country areas, with State treasury officials and senior officials responsible for service delivery;
- (iii) the circulation of several sets of Commission discussion papers on priority issues of principle and practice, other issues of principle, proposed methods of assessment, and draft assessment outcomes;
- (iv) several series of submissions by the States on matters of principle and assessment and responses to the proposed assessment methods and the draft assessments;
- (v) general conferences and information sessions, involving Commission staff and State officials, on proposed assessment methods and draft assessments and specific conferences on major assessments (including urban transit, mining revenue and information technology); and
- (vi) establishment of a working party of Commission staff and State officials to examine the important issues associated with assessments for depreciation and debt charges.

8. Attachment A provides details of activities during the review.

9. In the course of the review the Commission also sought advice from external experts on some technical matters, including the influences on interstate differences in debt charges and depreciation expenses, the risk ratings of regions for natural hazards, the influences on road maintenance costs, the interpretation of legislative provisions for stamp duty, superannuation expenses, and State use of privately financed projects. The experts' reports were circulated to the States.

10. The Commission gave considerable attention to quality assurance in its processes. We engaged external consultants to consider whether there was a need for a review of processes and if so what aspects of the processes should be reviewed. The consultants reported that in general there was a high level of satisfaction with Commission processes but that some stakeholders considered there was room for improvement, especially in relation to the transparency of processes and internal procedures for calculations, record keeping and succession planning. The Commission responded by reviewing and rebuilding its systems for performing, checking and storing the results of the calculations required to produce the State relativities. The revised processes, which were examined by external consultants, have provided a more reliable process and allowed the detail of all Commission calculations to be provided to the States².

Structure of the report

11. This report provides the Commission's response to the terms of reference:

- (i) Chapter 2 describes the equalisation principle we have applied and provides an overview of the Commission's processes.
- (ii) Chapter 3 presents the assessed relativities.
- (iii) Chapter 4 analyses the relativities.
- (iv) Chapter 5 outlines the main issues that arose during the review.
- (v) Chapter 6 reports on the special circumstances of the Australian Capital Territory.
- (vi) Chapter 7 outlines some fundamental matters related to the equalisation principle and its application.

12. The report is accompanied by a volume of supporting information and by working papers that explain the Commission's methods and analysis and provide details of the issues covered during the review and our decisions on them. The reports of consultants are included in the working papers. Details of the Commission's calculations are also being provided to the States.

13. This report, the supporting information volume and the working papers are all available on the Commission's website <www.cgc.gov.au>.

² Work on improving the Commission's internal data collection, data storage, and calculation systems is continuing, with the aim of creating a modern and fully integrated process for producing reliable and quality-assured outputs. External consultants are providing guidance on the design features and critical aspects of the system.

CHAPTER 2

EQUALISATION IN AUSTRALIA

1. The Commission's work aims to achieve fiscal equalisation between the States. Fiscal equalisation is a concept adopted in almost all the world's major federations and in many unitary countries. It is often seen as an aspect of nationhood whereby better endowed States or regions contribute to the capacity of those States or regions whose resource bases are not as abundant or whose needs are greater for reasons beyond their own control.

2. The Australian Constitution provides for the Australian Government to make grants to assist particular States. The Commonwealth Grants Commission was created in 1933 as part of the formalisation of these arrangements. Since then, and particularly since the late 1970s, Australia has developed a comprehensive fiscal equalisation system for distributing untied assistance from the Australian Government among the States.

The fiscal equalisation principle

3. The most recent definition of the principle of fiscal equalisation is that prepared by the Commission in its 1999 Review Report. We have updated this definition, as follows:

State governments should receive funding from the pool of goods and services tax revenue and health care grants such that, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the capacity to provide services at the same standard.

4. We have applied this definition in this review.

5. The definition makes it clear that it is the fiscal capacity of the States that is being equalised. Fiscal equalisation is not directed towards equalisation of the circumstances of individuals, households or communities.

6. It is an essential feature of intergovernmental transfers in Australia that the funds distributed among the States under equalisation arrangements are untied grants in the hands of the States. They may be spent by the States according to their own priorities. This untied nature of the funds has important implications for the interpretation and implementation of equalisation.

7. For this current review, implementation of the equalisation principle, as defined in 1999, rests on what we call the ‘three pillars’:

- (i) *Capacity equalisation.* Equalisation is about equalising the fiscal capacity of State governments. It is not about equalising the States’ performance or the outcomes they achieve. Capacity equalisation means that there is no requirement for States to follow any particular policies on either side of their budgets — a feature that follows from the untied nature of the funds.
- (ii) *Internal standards—what States do.* Under equalisation, the relativities calculated should enable each State, if it so chooses, to provide a standard level of State services. The standards the Commission applies are an average of those actually applied by the States, so they reflect what States do. The Commission does not make judgments about what level of service might be appropriate or about appropriate benchmarks. It is guided solely by what States do, on average.
- (iii) *Policy neutrality.* A State’s own policies or choices about the services it provides or the revenues it raises should not directly influence the level of grants it receives. We base our calculations on the standard policies in delivering services or raising revenue, so they are not directly affected by (or are neutral to) the specific policies of each State.

8. The funds distributed under equalisation arrangements are important for State budgets. In 2003–04 they amounted to \$38.825 billion¹. In the five years covered by this review, the funds distributed under equalisation arrangements were equivalent to 34 per cent of the gross operating expenses of the States in total. The actual percentage varied from State to State².

Current arrangements for payments to the States

9. The current arrangements for payments to the States reflect the provisions of the *A New Tax System (Commonwealth–State Financial Arrangements) Act 1999* and the associated Intergovernmental Agreement on the Reform of Commonwealth–State Financial Relations (IGA)³, signed by the Australian Government and the States in June 1999. Among other things, these provide for:

- (i) all revenue from the GST, after deducting the costs of collection, to be paid to the States to be spent according to their budget priorities;

¹ Australian Government Budget Paper No. 3, *Federal Financial Relations 2003–04*, Table 9, p. 10.

² It varied from 30 per cent in Western Australia to 62 per cent in the Northern Territory.

³ The IGA is reproduced in Budget Paper No. 3 for 1999–2000 and the Commission’s 2000 Update Report (Supporting Information volume).

- (ii) distribution of the GST revenue and HCG pool among the States to be based on horizontal equalisation principles and using per capita relativities based on the Commission's recommendations; and
- (iii) each State to receive a guaranteed minimum amount (GMA) in the transitional years, so that its budget is no worse off than it would have been had the tax reforms not been implemented⁴.

10. The Commission's advice on per capita relativities is considered by the Ministerial Council for Commonwealth–State Relations. Following that consideration, the Australian Government Treasurer determines how the revenues are to be shared. The Commission has no role in determining the amount to be shared.

11. Attachment B outlines the procedures established by the Act for applying the relativities to the pool of funds to be shared. Under those procedures the GST and HCG revenue each State receives in a year is a population-weighted share of the total amount available. The weights applied to State populations are the per capita relativities. This process is one of revenue sharing. Changes in the per capita relativity, and thus the share of the pool, for any State have implications for the relativities and shares of the other States.

THE COMMISSION'S APPROACH

12. At its simplest, equalisation can be thought of as aiming to give the States equal capacity to provide services to their populations, at the national average standard. It also includes an expectation that each State makes the average effort to raise revenue from its own taxes and charges and conducts its business with the same level of operating efficiency as the other States.

13. Equalisation, therefore, involves identifying and measuring the differences between the States in:

- (i) what it costs to provide services of the average standard to their populations — the relative costs of services; and
- (ii) the revenue they could raise from taxes and charges if they made the average effort — the relative revenue raising capacity.

14. The Commission approaches equalisation through an assessment process that:

- (i) is based on national average standards;

⁴ This is achieved by the Commonwealth providing additional assistance (called budget balancing assistance) over and above the GST revenue and the HCG. The guaranteed minimum amount is equal to the amount the State would have received if the 1999–2000 Financial Assistance Grant arrangements had continued, plus the estimated revenue forgone from taxes abolished, plus the extra expenses incurred under the IGA, plus its HCG.

- (ii) has comprehensive coverage of the services provided by States and the revenues they raise;
- (iii) seeks to have comprehensive coverage of material influences that affect the costs of services provided and the revenue raised; and
- (iv) seeks to ensure that each State's relativity is determined only by differences in expenses and revenues that arise for reasons beyond its control. Differences in expenses and revenues that arise because the policies of a State differ from the average policy should not affect the calculations.

Standards

15. Consistent with the three equalisation pillars, we base our assessments on standard levels of expense for each service States provide and on standard levels of revenue for each tax and charge they impose. We base the standards on national average per capita expenses and revenues, not the actual expenses and revenues of each individual State.

The scope of the assessments

16. In this review we include in our assessments all the services State governments provide and all the taxes and charges they impose, so long as they have a direct impact on State operating statements. We exclude activities that do not directly affect State operating statements. In particular, we exclude outlays for the purchase of buildings and capital equipment, the proceeds of borrowings, the business activities of State trading and financial enterprises, and payments the Australian Government makes to local government or non-government service providers that pass through the States. However, any direct effects of those activities on the operating statements are included; for example, we include depreciation expenses, interest expenses, subsidies States provide to enterprises, and taxes and other contributions that trading enterprises make to State budgets.

Disabilities

17. States do not have the same financial capacity to provide the standard level of services. Differences in their physical and economic circumstances and the characteristics of their population lead to differences in their relative costs of providing services and their relative revenue raising capacities. We call those differences in State circumstances — which are beyond the control of an individual State government — 'disabilities'. When we assess disabilities we recognise that the costs of providing services and the ability to raise revenue from State taxes and charges vary from State to State.

18. Distributing the GST and HCG revenue among the States on the basis of the equalisation principle aims to ensure that each State's share allows for the effects of disabilities on its costs of providing services and its ability to raise revenue: we call those 'needs'. Equalisation relies heavily on identifying and measuring disabilities and calculating the needs implied by them.

19. Just as the standards applied under the equalisation principle are based on national average per capita expenses and receipts, so are disabilities measured relative to the Australian average position. A State has a positive (or negative) disability if the proportion of its population in a particular group that uses State services is above (or below) the proportion of the Australian population in that group. For example, we would assess States with an above average proportion of their population enrolled in government schools to have a positive expense disability in terms of expenses on government schools. States also have positive (or negative) disabilities if they have an above (or below) average proportion of their population in groups that cost more to service (such as Indigenous people, people with low English fluency and people who live in remote areas). Interstate differences in the prices of inputs used in providing State services (such as labour, office accommodation and borrowings) can also lead to disabilities, providing the differences are not the result of policies adopted by individual States.

20. Figures 2-1 and 2-2 show the relative revenue raising capacity and relative costs of providing services that we assess for each State from 1998–99 to 2002–03. New South Wales has an above average revenue raising capacity and below average costs of providing services. In contrast, the Northern Territory has a below average revenue raising capacity and its costs of providing services are well above average. The differences mean that, without differential levels of assistance, the States' capacities to provide services would vary greatly. Equalisation provides those differential levels of assistance.

Specific purpose payments and quarantining

21. As well as passing the GST revenue to the States and making health care grants, the Australian Government makes a wide range of specific purpose payments (SPPs) to the States to contribute towards the costs of achieving national objectives. Like previous Commissions, we consider that the equalisation principle requires us to look at all State services, including those funded by SPPs. We take into account all operating revenue available to a State, including its SPPs, before calculating its relative need for revenue from the GST and HCG pool.

22. In general, we have included expenses financed from SPPs in the expense standards used in our assessments. We have also treated the revenue from those SPPs as funds available to meet part of the costs of providing the standard level of services. To the extent that States receive above (or below) average per capita revenue from SPPs, their requirement for revenue from the GST and HCG pool is decreased (or increased). The States broadly support this approach.

23. Guidelines for decisions on whether an SPP should be included in or excluded from our assessments are in the volume of supporting information that accompanies this report.

24. As was the case with past reviews and updates of relativities, the terms of reference for this review require the Commission to ensure that the calculations are not affected by the interstate distribution of certain SPPs. Those payments are listed in the terms of reference. Among them are national competition payments, payments from the Natural

Heritage Trust of Australia and the Regional Telecommunications Infrastructure Fund, and payments under the Roads to Recovery program.

Figure 2-1 ASSESSED REVENUE RAISING CAPACITIES, AVERAGE
1998-99 TO 2002-03

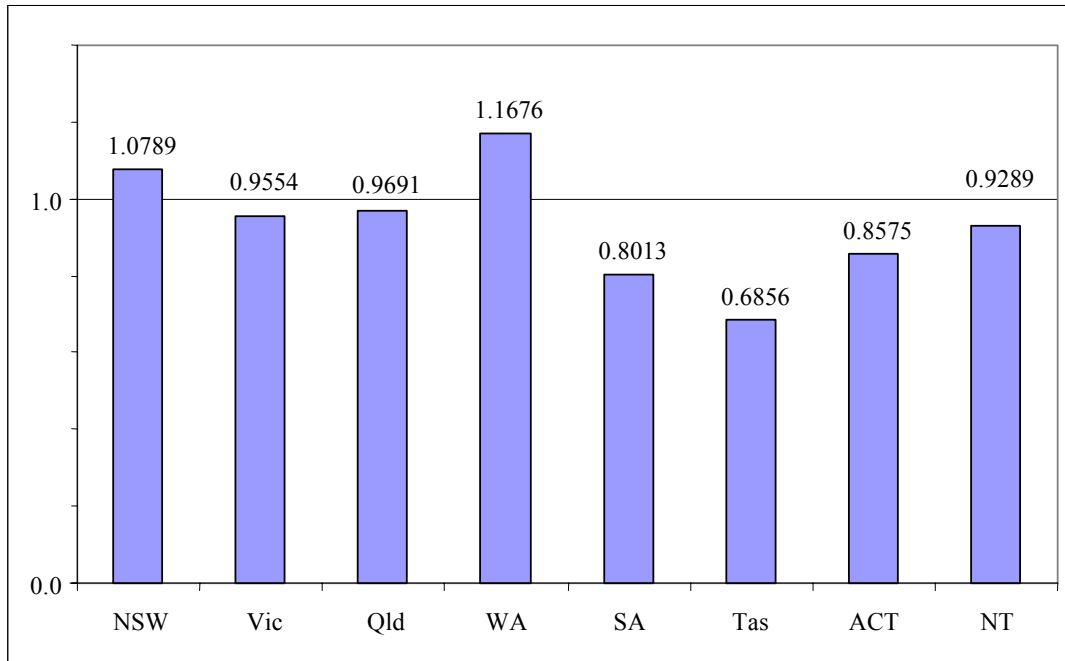
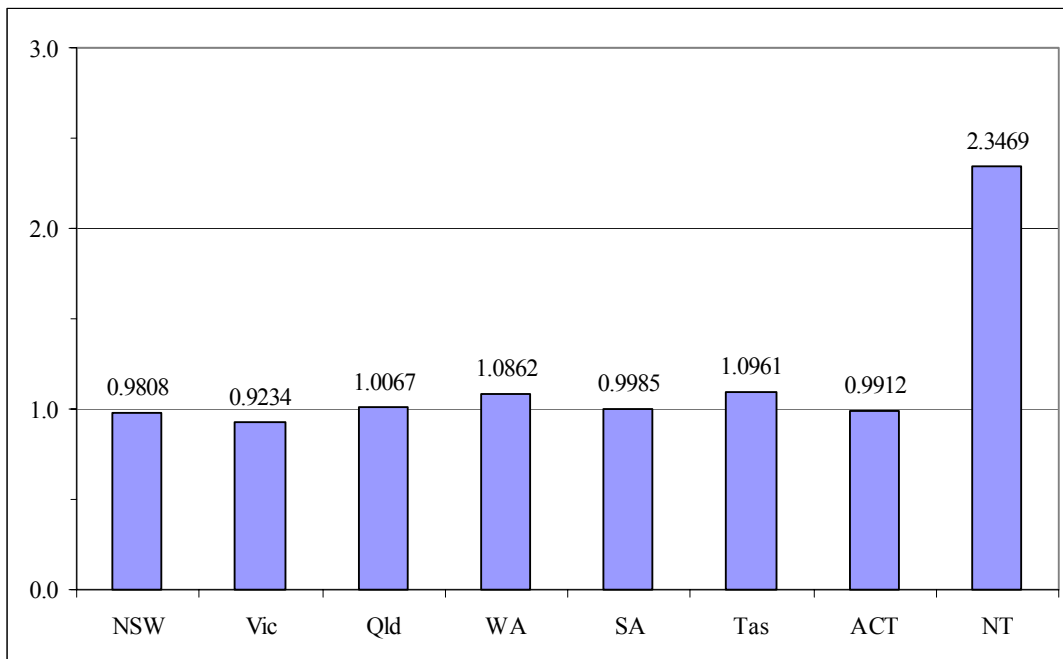


Figure 2-2 ASSESSED COSTS OF PROVIDING SERVICES, AVERAGE
1998-99 TO 2002-03



The assessment guidelines

25. Implementing equalisation requires a large number of decisions about what transactions to include in the assessments, what disabilities should be assessed, and how disabilities or revenue bases should be measured. For the relativities recommended by the Commission to be credible and acceptable, those decisions must be transparent, consistent and supported by a strong conceptual case and good evidence.

26. For this review we developed, exposed to the States for comment, and applied a set of assessment guidelines to increase the transparency and consistency of our decisions. The assessment guidelines require us to explain how we came to a decision by making explicit the conceptual case we accept, the data available to measure the impact on State costs or revenue raising capacity, and whether we use judgment. They also require us to consider the importance, or materiality, of an assessment.

27. The assessment guidelines are as follows.

The Commission will make an assessment when:

- (i) a conceptual basis for the existence of the disability is established — for example, it has been established that States experience different use and cost imposts when they apply the standard policy; and
- (ii) either:
 - (a) there is empirical evidence that differences exist between States in the levels of use and/or unit costs in providing services or in their capacities to raise revenues; or
 - (b) there is incomplete evidence that the identified influence is causing a difference between States, but the ‘in-principle’ case is strong, and it judges that sufficient evidence exists and that including the assessment improves the equalisation outcome; and
- (iii) the assessment is material; and
- (iv) the margin of error associated with the assessment is acceptably small.

If the application of the guidelines leads to a decision that an assessment should be made, we will undertake a reality check of the results.

28. In addition to these guidelines, we sought to develop assessment methods that were:

- (i) as simple as possible, while not materially reducing equalisation; and
- (ii) amenable to updating, so that, to the extent possible, the calculations for each year reflect data on expenses, revenues, service use and revenue bases for that year. This ensures that equalisation reflects the recent circumstances of the States and will continue to do so in subsequent annual updates.

29. We applied the guidelines when evaluating arguments raised by the States during the review and when reconsidering disabilities or revenue base measures adopted under the 1999 Review methods.

30. ***Use of judgment.*** Use of the guidelines does not mean we ceased to use judgment or declined to make assessments when data were incomplete. Most States agree that in the real world — where State activities and the influences on their budgets are wide-ranging and the information required to assess disabilities is often incomplete — using judgment is an essential part of the process. We often conclude that there is a strong conceptual case for assessing a disability (or adopting a particular approach to measuring a revenue base) and that doing so materially improves the equalisation outcome, but that complete data are not available. In those cases we make an assessment using judgment (informed by the qualitative and quantitative information provided by States, other data gathering bodies and workplace visits), provided we are sufficiently confident about the basis of that judgment.

31. ***No partial adjustments.*** We take the view that, as far as possible, disabilities and adjustments within the assessments should be comprehensive. During the review States sometimes argued that we should make allowances or adjustments to allow for parts of broad ranging or pervasive influences, such as the effects of State policies on revenue bases. Others argued we should make special allowances for the effects on expenses of sub-sets of broader influences, such as giving special treatment to renal dialysis and HIV/AIDS treatment in the hospital inpatients calculations. We did not do so because we are not convinced that partial or selective adjustments for parts of broad-ranging effects are policy neutral and improve the equalisation outcome.

32. ***Use of independent data.*** The Commission's assessments call for data on State finances, the characteristics of State populations, the use of services, and revenue bases. The data need to be comparable across States and independent of State policies. Our general approach is, wherever possible, to use data produced by independent expert bodies, such as the Australian Bureau of Statistics (ABS), or from other national collections. As a general principle, we consider it appropriate to make adjustments to published statistics only if there is unambiguous evidence that this will improve the accuracy of the data and enhance equalisation. We adjust ABS data only if the ABS accepts the need for adjustment. If comprehensive data are not available from independent sources, we use information collected from the States or other sources. In those cases we specify the data required in a consistent fashion. As far as possible, we subject the information provided to scrutiny to maximise comparability and to satisfy ourselves that it is representative of the situation across the States.

33. ***Use of modelling.*** To improve the policy neutrality of the assessments, we carried out econometric modelling of some issues to provide a basis for judgments. As far as possible, the modelling was done and refined in the light of comments provided by the States. Among the cases where modelling was done are the measurement of influences on enrolments in post-compulsory education, urban transit, and the assessment of allowances for interstate differences in wage levels. Because the work on interstate differences in wage levels was expected to have an important effect on the relativities, we had it refereed by an external expert.

34. In some cases, such as modelling the influences on post-compulsory education enrolments, the modelling directly measured the influences that we include in our assessments; in others, such as wages input costs, it helped us evaluate the conceptual case and provided empirical evidence, but judgment was still needed to set the size of the allowances we assessed.

35. *Use of external experts.* We sought expert external advice on a number of technical matters, including the impact of historical unfunded liabilities on State superannuation expenses; the value of minerals produced in each State; how best to measure the influences of road use, climate and heavy vehicles on road operating expenses; the comparability of land values; the relative risk ratings of the States for natural hazards; and State use of privately financed projects.

36. These actions supplemented our routine inquiry procedures, which include extensive and iterative consultation with the States through written submissions, Commission conferences, workplace discussions, staff working parties and staff conferences. Consultation generally followed the circulation of discussion papers outlining the development of our thinking and our proposed approaches to all aspects of the assessments. We also provided the States with preliminary indications of each assessment outcome and of the aggregate relativities. The volume of supporting information that accompanies this report contains a list of the publications issued by the Commission during the review.

37. All these actions were designed to provide an open and inclusive process that offered the States many opportunities for input into the analysis, to help us improve the objectivity and consistency of our decisions and assessments.

THE COMMISSION'S MODEL FOR IMPLEMENTING EQUALISATION

38. The starting point for calculation of relativities is the **financial standards**, which are derived from the Australian total general government sector expenses on each service (or revenue from each tax and charge) per head of the Australian resident population.

39. The figures for expenses and revenue are derived from State accounting records using data provided by State treasuries through the Government Finance Statistics (GFS) collection prepared by the ABS. Data on State tax revenues and some supplementary detail on expenses are collected directly from the States. All State financial transactions are classified on a functional or head-of-tax basis and the total for each expense and revenue category is converted to an Australian per capita amount, which is the financial standard for the category. The expenses and revenues of each State are weighted by its population.

40. The **equalisation budget** is the collection of all the expense and revenue categories for which the Commission makes assessments. For this review it includes only financial transactions that have a direct impact on the operating statements of the States.

41. The next step in the process is to calculate:

- (i) for each service, the per capita expense each State would incur if it were to provide the Australian average level of service; and
- (ii) for each source of revenue, the per capita revenue each State would raise if it applied the Australian average revenue raising effort to its revenue base.

42. To the extent possible, the assessments are policy neutral: a State's own policies do not influence its grant, although they do affect the average standards. The assessments are based on the assumption that all States apply standard policies and practices that are an average of what all States do.

43. **Expense assessment** methods adjust the standard expenses to allow for the effects of disabilities. Disabilities are influences beyond the control of individual States that require a State to spend more (or allow it to spend less) per capita than other States to provide the average standard of service. Disabilities can be broadly classified into two types — use disabilities and cost disabilities — according to whether they affect the rate of use or the cost of each unit of service.

44. **Use disabilities** reflect differences between States in the use of services as a result of things such as population characteristics and the availability of private services. The first step in assessing use disabilities is to consider the type of service and the policies of the States to see what part of the population (or the broader economy) the service is provided for. In many cases services are provided to the whole population, but in some they are for a part of the population; for example, school services are provided to the student age group and aged care services to older people. Some services are provided to business units such as the manufacturing or mining industries.

45. The second step is to examine data on the use of services to see whether across Australia some groups in the population use the services more or less than others. For example, hospital services are used relatively more intensively by some age groups and by Indigenous people; some welfare and law and order services are used more intensively by Indigenous people; some services are used more by people in remote areas; and for other services people in urban areas are the more intensive users. States are assessed to have a positive disability if their population groups that use a service are larger than the average⁵. Conversely, they have a negative disability if the size of the group is smaller than average.

46. **Cost disabilities** are influences that affect the cost per unit of service provided to particular (identifiable) groups of people or places. For example, higher costs might be incurred when providing some services in large cities or in remote and dispersed areas. Cultural and communication factors can increase the costs of providing some services to people from cultural and linguistically diverse backgrounds, and more resources can be devoted to providing school services to students from low-income families. In these cases,

⁵ Commission measurements are all in relative terms. The size of each population group is measured as the proportion of the State population in the group. States have a positive disability if the proportion of their population in the group exceeds the national proportion. It can also be said that a State has a positive disability if its share of a particular group in the population, such as people aged over 65 years, is greater than its share of the Australian population.

States with relatively larger populations in the groups that cost more are assessed to have positive disabilities.

47. Some cost disabilities arise because the prices of inputs used in providing State services vary between States for reasons that are beyond the control of individual States; for example, wage rates differ across the States, as do office accommodation costs and power costs. Further, some States have higher cost structures because of diseconomies of small scale.

48. **Revenue assessment** methods take account of the influences beyond a State's control that would result in it raising more (or less) revenue per capita than other States if it applied Australian average rates of tax to its tax bases — that is, if it made the average effort to raise revenue.

49. Tax bases are generally measured using the value of transactions in each State that would be taxed under the average tax policy. For example, the tax base for payroll tax is the estimated annual value of payrolls above a threshold level paid by private sector businesses and most public trading enterprises, and the tax base for stamp duty on conveyances reflects the value of property sold. In a few cases other economic indicators are used as proxies for the tax base — such as gross household disposable income in the gambling tax assessment.

50. There are some cases where we consider that:

- (i) all differences in costs or revenues are due to differences in State policies, implying that no State has a disability;
- (ii) there are disabilities but they cannot be adequately measured; or
- (iii) there are disabilities but we do not measure them because they would not have a material effect on equalisation.

In these cases we assess the revenue capacity or cost of service provision to be the same in all States and we apply an equal per capita (EPC) assessment.

Bringing the assessments together

51. A State's aggregate per capita requirement for a share of the GST revenue and HCG pool in each year for which assessments are made is calculated as an equal per capita share of the pool, adjusted⁶ for:

- (i) the effect of assessed unavoidable influences on the use and costs of providing services — expense needs;
- (ii) the effect of assessed unavoidable influences on revenue raising capacities — revenue needs; and

⁶ Each of these adjustments can have a negative or positive value.

- (iii) its above or below average per capita revenue from specific purpose payments from the Australian Government that are available to fund its expense requirements⁷ — SPP needs.

52. The final phase of the process is to average the assessments for the five most recently completed years to **calculate per capita relativities** to apply in the grant year. Each State's relativity for a grant year is the average of its per capita requirements for a share of the pool in each of the five most recently completed financial years.

53. The relativities the Commission assesses are thus measures of the relative per capita need of each State for assistance that, together with the revenue from its taxes and charges, would give it the financial capacity to provide the national average standard of government services.

54. The relativities are expressed as ratios of an Australian average of one. A relativity below one indicates that a State requires less than an equal per capita share of the GST revenue and HCG pool; a relativity above one indicates that a State requires more than an equal per capita share. Expressing relativities in this way makes it clear that no State can have its relativity increased without one or more of the other States having theirs reduced.

⁷ The treatment of SPPs is described in the volume of supporting information.

CHAPTER 3

THE RELATIVITIES FOR 2004–05

1. This chapter presents the GST relativities we assess for use in 2004–05. It also provides an illustration of the effect of those relativities on the revenue from the GST and HCG pool received by each State.

THE ASSESSED RELATIVITIES

GST relativities

2. The GST relativities reflect the fiscal circumstances of the States under the new tax system. They reflect:

- (i) the States' capacity to raise revenue from the range of taxes and charges they currently impose¹; and
- (ii) the costs of providing the current range of services².

3. Table 3-1 shows the GST relativities that we regard as appropriate for use in distributing the pool of GST revenue and HCGs among the States in 2004-05. Attachment C provides details of the calculation of the relativities.

¹ As part of the arrangements for the new tax system, the States agreed to the abolition of financial institutions duty, stamp duty on quoted marketable securities, bed taxes, the wholesale sales tax, and payments from the Australian Government to replace revenue from previous State taxes on alcohol, tobacco and petroleum.

² As part of the arrangements for the new tax system, the States accepted responsibility for the First Home Owners Scheme, the administration costs of the GST, and subsidies on petroleum and most low-alcohol products.

Table 3-1 PER CAPITA GST RELATIVITIES: 2004 REVIEW

	2004 Review
New South Wales	0.86750
Victoria	0.86534
Queensland	1.05504
Western Australia	1.03054
South Australia	1.20407
Tasmania	1.55939
Australian Capital Territory	1.12930
Northern Territory	4.26538

APPLYING THE RELATIVITIES

4. The relativities we assess in this review are for use, together with State population estimates, in determining State shares of the GST and HCG pool for 2004–05.

5. Table 3-2 provides details of the latest Australian government estimates of the revenue each State is expected to receive from the GST and HCG pool in 2003–04 and our illustrative estimates of the amounts they might receive in 2004–05 based on:

- (i) the relativities we assess in this review;
- (ii) the latest available Australian government estimates of the GST revenue and HCG pool for 2004–05; and
- (iii) the latest ABS projections of States' populations at December 2004.

Table 3-2 DISTRIBUTION OF 2003–04 GST REVENUE AND HCGs AND ILLUSTRATIVE 2004–05 GST REVENUE AND HCGs

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Estimated 2003–04 GST revenue and HCGs ^(a)	11 656.7	8 385.9	7 574.9	3 705.6	3 607.9	1 475.1	727.9	1 691.3	38 825.2
Illustrative 2004–05 GST revenue and HCGs ^(b)	12 128.0	8 920.3	8 460.4	4 232.6	3 806.2	1 525.4	760.1	1 761.2	41 594.1
Increase	471.4	534.4	885.5	527.0	198.3	50.3	32.1	69.9	2 768.9

(a) From Australian Government Budget Paper No.3, *Federal Financial Relations 2003-04*. The amounts exclude the budget balancing assistance received by New South Wales, Victoria and South Australia under the transitional provisions of the IGA.

(b) Excludes any budget balancing assistance that may be paid.

6. Our estimates for 2004–05 are illustrative only. The amount each State actually receives will vary from that shown in Table 3-2 in accordance with:

- (i) decisions taken at the 2004 meeting of the Ministerial Council for Commonwealth–State Financial Relations, including decisions on whether the relativities in this report should be applied; and
- (ii) revised estimates of GST collections, HCGs and projected State populations as at December 2004.

7. The increase in revenue for each State is the combined effect of changes between:

- (i) its per capita relativity assessed by the Commission in the 2003 Update and its 2004 Review relativity;
- (ii) its estimated population as at December 2003 and December 2004; and
- (iii) the total GST and HCG pool for 2003–04 and the estimated pool for 2004–05.

8. To help show the impact of the Commission’s work, Table 3-3 dissects the total change for each State into that arising from each of the above sources.

Table 3-3 COMPONENTS OF CHANGE IN DISTRIBUTION OF GST REVENUE AND HCGs BETWEEN 2003–04 AND 2004–05

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Change due to new relativities ^(a)	- 317.0	- 51.2	262.7	230.9	- 26.3	- 37.9	- 13.4	- 47.7	0.0
Change due to new application year population ^(b)	- 18.9	- 8.2	59.6	14.3	- 28.7	- 13.3	- 5.0	0.4	0.0
Change due to new pool ^(c)	807.4	593.8	563.2	281.8	253.4	101.5	50.6	117.2	2 768.9
Total change	471.4	534.4	885.5	527.0	198.3	50.3	32.1	69.9	2 768.9

(a) Effects on the distribution of the 2003–04 notional GST and HCG pool of applying the 2004 Review GST relativities instead of those assessed in the 2003 Update.

(b) Effects on the distribution of the 2003–04 notional GST and HCG pool of using estimated State populations as at December 2004 instead of populations as at December 2003.

(c) The effects of applying the 2004 Review relativities to the increase in the GST revenue and HCG pool between 2003-04 and 2004-05.

Budget balancing assistance

9. Under the transitional provisions of the IGA, some or all States received budget balancing assistance grants in the years 2000–01 to 2003–04. The budget balancing assistance was the amount required to ensure that they received the larger of:

- (i) their share of the GST and HCG pool, calculated using their GST relativity; and
- (ii) their guaranteed minimum amount (GMA) plus their HCG. A State's GMA is what it would have received if the 1999–2000 financial assistance grant arrangements had continued, plus the estimated revenue forgone from taxes abolished and the extra expenses incurred under the terms of the IGA.

10. It is likely that in 2004–05 some States will continue to receive payments under the transitional provisions. Accordingly, although the terms of reference for the 2004 Review do not formally seek the financial assistance grant relativities that are required to estimate State GMAs, the relativities are presented in Attachment D.

CHAPTER 4

ANALYSIS OF THE RELATIVITIES

1. This chapter analyses the 2004 Review relativities in their historical context and compares them with some indicators relevant to States' revenue raising capacities and costs of providing services. It also identifies the main influences on the relativities for each State.

RELATIVITIES OVER TIME

2. The equalisation process in Australia is a dynamic one. Comparison of an equalisation distribution with an equal per capita distribution provides one perspective on the relativities and the changes over time. Table 4-1 shows the amount and the proportion of the pool redistributed since 1981–82, when comprehensive relativities were first assessed. Figure 4-1 shows the fluctuations in the proportion redistributed.

3. The proportion redistributed by equalisation reflects Commission assessments of the aggregate differences between the States in their relative financial capacities. The amount redistributed in any year (and the change between years) is affected by the relativities assessed by the Commission, the amount available for distribution, and each State's population. Even if there were no changes in the relative disabilities (and thus in the proportion of the pool required to equalise State financial capacities), the amounts redistributed in any year would change to reflect changes in the total amount available for redistribution and State shares of the Australian population.

4. Figure 4-1 shows that the proportion of the pool redistributed by equalisation has generally fallen — with changes often coinciding with reviews of methods — but there are no clear trends between reviews.

5. The cycle of periodic reviews and annual updates is designed to keep the relativities as up to date as possible. Table 4-2 shows the 2004 Review relativities compared with the relativities assessed in the 1999 Review and subsequent updates.

Table 4-1 AMOUNT AND PROPORTION OF THE POOL REDISTRIBUTED BY EQUALISATION, 1981–82 TO 2004–05

Review or update results applied	Total pool distributed	Amount redistributed	Proportion redistributed
	\$m	\$m	%
1981 Review applied in 1981–82	8 202.9	932.4	11.4
1982 Review applied in 1982–83	9 217.9	1 023.5	11.1
1985 Review applied in 1985–86	11 826.3	1 205.7	10.2
1988 Review applied in 1988–89	16 019.9	1 265.0	7.9
1993 Review applied in 1993–94	17 315.7	1 632.0	9.4
1999 Review applied in 1999–2000	23 064.6	1 692.1	7.3
2000 Update applied in 2000–01	30 506.3	1 961.0	6.4
2001 Update applied in 2001–02	33 209.7	1 988.5	6.0
2002 Update applied in 2002–03	37 555.7	2 472.4	6.6
2003 Update applied in 2003–04	38 825.2	2 747.5	7.1
2004 Review applied in 2004–05	41 594.1	3 213.7	7.7

Source: Details of the pool are from Australian Government Budget Paper No. 3, *Federal Financial Relations*, and *Final Budget Outcome* documents for various years.

Figure 4-1 PROPORTION OF POOL REDISTRIBUTED, 1981–82 TO 2004–05

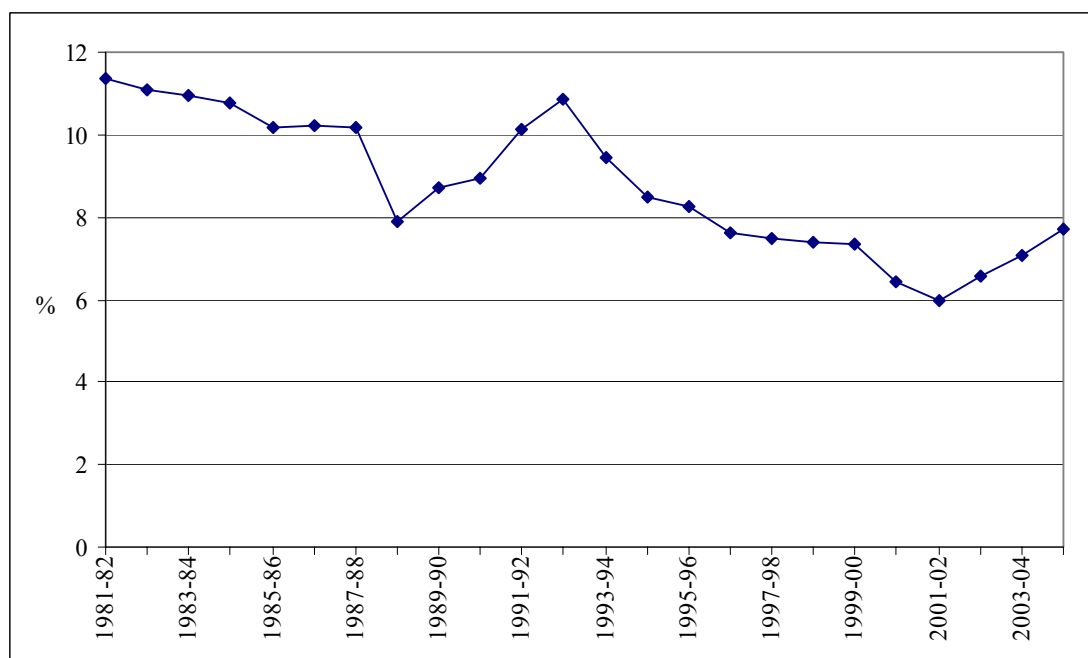


Table 4-2 PER CAPITA RELATIVITIES: 1999 REVIEW TO 2004 REVIEW^(a)

	1999 Review ^(b)	2000 Update	2001 Update ^(c)	2002 Update	2003 Update	2004 Review
New South Wales	0.89948	0.90913	0.92032	0.90631	0.89117	0.86750
Victoria	0.86184	0.87049	0.87539	0.86824	0.87010	0.86534
Queensland	1.00687	1.01830	1.00269	1.01174	1.01902	1.05504
Western Australia	0.94793	0.98365	0.97516	0.97592	0.96946	1.03054
South Australia	1.20680	1.18258	1.17941	1.19447	1.21215	1.20407
Tasmania	1.60905	1.51091	1.50095	1.55419	1.59948	1.55939
Australian Capital Territory	1.10270	1.11289	1.14633	1.15216	1.14979	1.12930
Northern Territory	4.84429	4.16385	4.02166	4.24484	4.38638	4.26538

- (a) The relativities for each of the updates are those adopted at the annual meeting of the Ministerial Council for Commonwealth–State Financial Relations and may differ from those shown in the relevant Commission reports because of revisions in data.
- (b) The 1999 Review relativities were assessed under the previous Commonwealth–State financial arrangements for use in distributing the financial assistance grants. They reflect the range of State taxes and services that existed before the new tax system came into operation. They are not fully comparable with the GST relativities shown for subsequent years.
- (c) The general narrowing of interstate differences in the 2001 Update was mainly because abolition of the financial institutions duty and stamp duty on share transfers led to a narrowing of differences in assessed revenue raising capacity.

6. The changes in the update relativities following the 1999 Review reflect changes in State circumstances because, with one exception¹, the relativities were based on the methods adopted in the 1999 Review. The changes in the 2003 Update relativities and the 2004 Review relativities reflect the new methods we have adopted in this review and changes in the circumstances of the States.

7. Figure 4-2 shows the extent to which relativities fluctuate over time. It illustrates how changes in States' circumstances can cause the relativities to move between reviews, even when the methods used to assess them are unchanged.

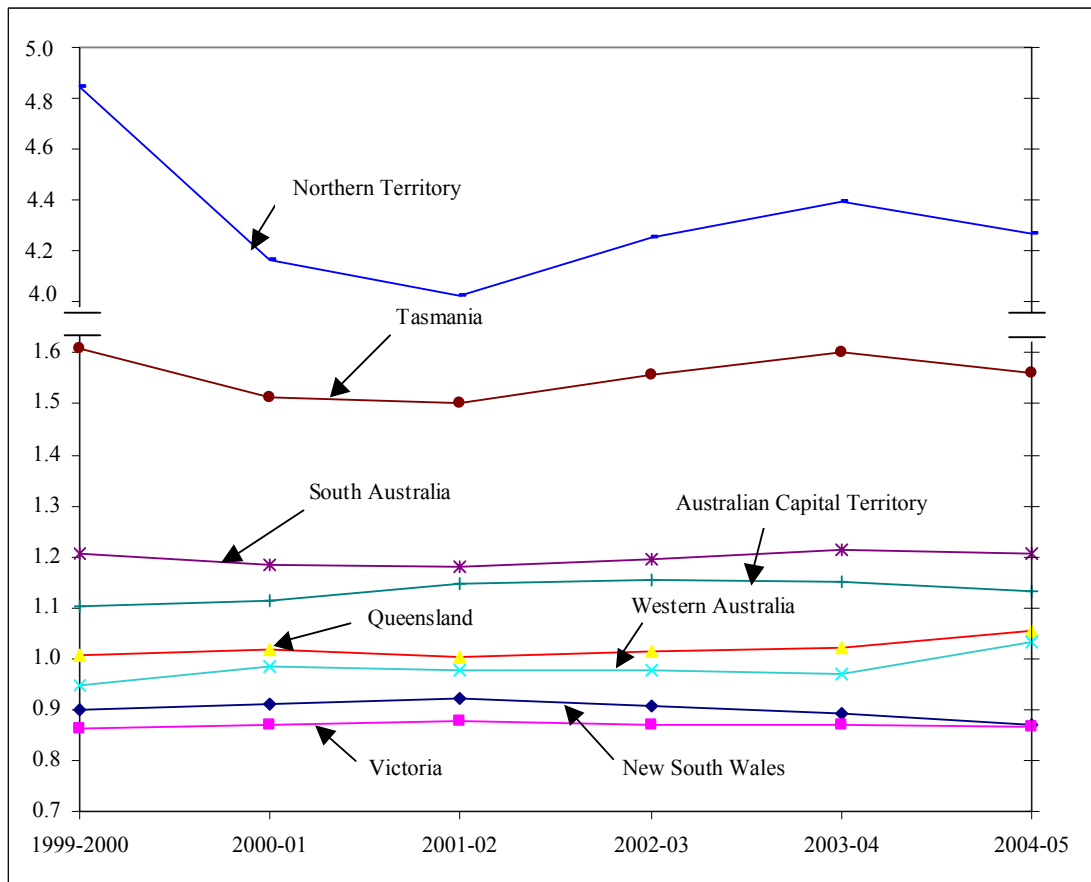
¹ The exception was in the 2001 Update. The data on State revenues and expenses changed from a cash to an accrual basis. In addition, in response to a request in the terms of reference, the Commission reviewed and changed the assessment method for superannuation expenses to ensure that unfunded liabilities were taken into account.

Changes since the 2003 Update

8. The relativities we assess in this review differ from those assessed in the 2003 Update and used to distribute the pool of GST revenue and HCGs in 2003–04 because we:

- (i) reviewed and amended the methods we use to measure the States’ relative revenue raising capacities and costs of providing services; and
- (ii) made the relativities as up to date as possible by including data for the most recently completed financial year (2002–03) and the most recent data on demographic trends (from the 2001 Census) and the use and cost of State services. Details of the changes in important demographic indicators are in the supporting information that accompanies this report.

Figure 4-2 FLUCTUATIONS IN STATE PER CAPITA RELATIVITIES, 1999–2000 TO 2004–05



9. Our general approaches to measuring relative revenue raising capacities and relative costs of providing services are similar to those adopted in the 1999 Review and subsequent updates. We have, however, made numerous changes to the detailed methods for specific assessments. These are aimed at strengthening the assessments' conceptual approach, making them as policy neutral and as firmly based on objective, quantifiable evidence as possible, and having them reflect the current circumstances of the States and their current policies on revenue collection and service delivery.

10. Some of the most important changes are designed to make the depreciation and debt charges assessments much more rigorous, with greater reliance on evidence and conceptual clarity. These new assessments reflect our view that the differences between States' needs in this area are not as great as previously assessed, when interstate differences in construction costs and the influences of climate and urban complexity were overstated. Compared with previous assessments, the new method substantially increases the assessed costs of providing services in Queensland (and to a lesser extent Western Australia) and reduces them in New South Wales and the Northern Territory. Other large changes in the assessment method are in urban transit and mining revenue. Chapter 5 provides information on these and other major changes in method.

11. Compared with the 2003 Update, the relativities of Queensland and Western Australia have increased. For Queensland, this is mostly due to its growing share of people who place larger demands on service provision, as well as our reconsideration of its needs relating to borrowing and the use of capital. For Western Australia, it is largely due to a decline in our assessment of its capacity to raise revenue, along with our assessment of increased needs relating to roads, borrowing and capital. The needs of both States, particularly Western Australia, are further increased because they receive a smaller share of SPPs than they did previously.

12. Compared with the 2003 Update, the relativities of the other States have decreased mainly because of declines in their assessed relative costs of providing services. For New South Wales, this is mainly due to smaller disabilities associated with borrowings and the use of capital assets. For the other States, changes in the composition of their population, which reduced the relative cost of services, were a large influence. Reductions in our assessment of diseconomies of small scale and generally declining relative wages rates also affected the less populous States. The financial capacities of New South Wales and the Northern Territory were also strengthened by higher assessed revenue raising capacities. Victoria, Tasmania and the ACT received relatively larger shares of specific purpose payments, which reduced their relativities. Attachment F provides details of the changes since the 2003 Update.

WHY STATE RELATIVITIES DIFFER

13. If all States had the same capacity to raise revenue and faced the same use of services and costs per unit of service — that is, if they had no disabilities — an equal per capita allocation of the GST revenue and HCG pool would give them all the same financial capacity to provide services. The States differ, however, in their economic, demographic

and physical circumstances and this affects their capacity to raise revenue and the use of services and unit costs they face. Equalising their financial capacities involves making allowances for the effects of those disabilities, and making those allowances results in some States receiving more and others less than an equal per capita share of the GST revenue and HCG pool. States with inherently low revenue raising capacities or high expense needs receive more than an equal per capita share; those with inherently high revenue raising capacities or low expense needs receive less.

14. Table 4-3 shows the distribution of the 2003–04 GST and HCG pool of \$38.825 billion among the States based on the 2004 Review relativities (called the ‘equalisation distribution’) compared with an equal per capita distribution of the same pool.

Table 4-3 EQUALISATION AND EQUAL PER CAPITA DISTRIBUTIONS OF 2003–04 GST REVENUE AND HCG POOL: A COMPARISON

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Equalisation distribution ^(a)	11 339.6	8 334.6	7 837.6	3 936.5	3 581.5	1 437.2	714.5	1 643.6	38 825.2 ^(b)
Equal per capita distribution	13 057.9	9 621.5	7 420.9	3 815.8	2 971.4	920.7	632.0	384.9	38 825.2 ^(b)
Difference	-1 718.3	-1 286.9	416.7	120.7	610.1	516.5	82.5	1 258.7	0.0
	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc
Equalisation distribution	1 683.44	1 679.26	2 047.39	1 999.84	2 336.60	3 026.12	2 191.49	8 277.29	1 938.54
Equal per capita distribution	1 938.54	1 938.54	1 938.54	1 938.54	1 938.54	1 938.54	1 938.54	1 938.54	1 938.54
Difference	- 255.10	- 259.28	108.86	61.30	398.06	1 087.59	252.95	6 338.75	0.0

(a) Based on application of the 2004 Review GST relativities to the notional GST revenue and HCG pool for 2003–04 and ABS estimates of State populations as at December 2003.

(b) From Australian Government Budget Paper No. 3, *Federal Financial Relations 2003–04*, p. 10.

15. Table 4-4 summarises the main causes of the differences in Table 4-3 — the differences between States in their:

- (i) assessed revenue raising capacities, which reflect the above or below average levels of transactions that States tax;
- (ii) costs of services, which reflect the above or below average use of State services or costs of providing each unit of service; and
- (iii) SPP revenues per capita.

Table 4-4 ASSESSED REVENUE RAISING CAPACITIES, COSTS OF PROVIDING SERVICES AND SPP REVENUES, 1998–99 TO 2002–03

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Revenue raising capacities	1.0789	0.9554	0.9691	1.1676	0.8013	0.6856	0.8575	0.9289	1.0000
Costs of providing services	0.9808	0.9234	1.0067	1.0862	0.9985	1.0961	0.9912	2.3469	1.0000
Relative SPP revenue	0.9687	0.9409	0.9828	0.9984	1.0955	1.2345	1.0539	2.4244	1.0000
Relativities ^(a)	0.8675	0.8653	1.0550	1.0305	1.2041	1.5594	1.1293	4.2654	1.0000

(a) The relativities are a weighted combination of the previous ratios. Costs of providing services have the greatest weight because expenses are a larger part of State budgets than own-source revenue and SPP revenue.

16. The needs we assess vary from State to State because they reflect what States do and changes in States' circumstances. States impose taxes on particular types of transactions and provide a range of services that are used by different groups in the population. The assessed needs therefore depend on specific features of each State's economy and its population, and these differ between States.

17. Table 4-4 shows how the main influences on relativities differ between States. The main influence on the relativity for New South Wales is its high revenue raising capacity. In contrast, low revenue raising capacity is the main influence on the relativities of Queensland, South Australia, Tasmania and the ACT. Low relative costs of services are the main reason for Victoria's relativity being less than one. Very high relative costs of services cause the Northern Territory's high relativity. High relative costs of service delivery reinforce the revenue raising effects in Tasmania. In Western Australia the effects of the State's very high relative revenue raising capacity are offset by its relatively high disabilities in providing services.

18. Attachment E provides details of the effect of individual revenues, groups of services and the disabilities we assess on the differences between an equalisation distribution of the pool and an equal per capita distribution.

DO RELATIVITIES REFLECT THE UNDERLYING CIRCUMSTANCES OF THE STATES?

19. This section examines the 2004 relativities in the light of some common indicators of the relative levels of economic activity across the States and the use and cost of State government services.

Revenue raising capacity

20. Per capita gross State product (GSP) provides an approximation of the broad relative revenue raising capacities of the States. The first two lines of Table 4-5 show our assessment of each State's relative capacity to raise revenue and the relationship between each State's per capita GSP and the Australian figure.

21. The ACT and the Northern Territory aside, the rankings of States based on relative per capita GSP and our assessed revenue raising capacities are similar. We assess the two Territories as having low revenue raising capacities despite their high per capita GSP. This is because Australian government activities (which they cannot tax) and the general government activities of the States (which do not add to their net revenue raising capacity) are an above average part of their economies².

22. Per capita GSP provides some insight into the revenue capacities we assess, but it does not fully mirror them because State taxes do not relate directly to GSP. Table 4-5 also shows how each State compares with the Australian average position for some other indicators that reflect the differences between States in activities that are closely related to the main State taxes.

23. The above average per capita values of real estate sales, land values and taxable payrolls in New South Wales and the below average values of those factors in South Australia, Tasmania and the ACT are broadly consistent with our assessments of their relative revenue raising capacities. The very high relative level of activity in the mining industry, including the North West Shelf project, is the main reason for Western Australia's high assessed relative revenue raising capacity. While Queensland has above average per capita levels of mining and real estate sales, its revenue base for the largest State tax (payroll tax) is below average.

Table 4-5 INDICATORS OF STATE REVENUE BASES RELATIVE TO AUSTRALIA^(a): 1998–99 TO 2002–03

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Assessed revenue raising capacity	1.079	0.955	0.969	1.168	0.801	0.686	0.857	0.929	1.000
Relative GSP per capita	1.050	1.030	0.884	1.112	0.842	0.720	1.224	1.193	1.000
Relative per capita payrolls of large businesses	1.087	1.114	0.860	0.983	0.794	0.667	0.749	0.876	1.000
Relative per capita sales of real estate	1.257	0.778	1.079	0.951	0.663	0.533	0.987	0.567	1.000
Relative per capita value of commercial/industrial land	1.214	1.055	0.772	1.052	0.612	0.390	0.709	1.132	1.000
Relative per capita value mining production	0.143	0.021	0.564	1.495	0.186	0.124	0.000	1.492	1.000

(a) The index for each indicator is derived by comparing the average per capita value for each State for 1998–99 to 2002–03 with the comparable average Australian per capita value. Attachment E provides further details.

Source: ABS *Australian National Accounts* (Catalogue No.5220.0) and *State Accounts* and data provided to the Commission by the States.

² Australian government and State government activity accounted for 51 per cent of final demand in the ACT, 38 per cent in the Northern Territory, and 22 per cent in Australia as a whole between 1998–99 and 2002–03.

24. The assessed relative revenue raising capacities of the States correspond reasonably well with the patterns shown by a broad measure of the States' economic circumstances. Consideration of the taxes States impose and the data on the interstate distribution of the activities that are the subject of the major State taxes, further supports the pattern of assessed relative revenue raising capacities.

Relative costs of providing services

25. In a similar fashion, the broad pattern of our assessed relative costs of providing services is supported by consideration of indicators that reflect aspects of the use and unit cost of State services. Those indicators are shown in Table 4-6.

Table 4-6 STATE RELATIVITIES FOR SELECTED INDICATORS RELEVANT TO THE USE AND COST PER UNIT OF STATE SERVICES^(a)

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Assessed relative costs of providing services	0.98	0.92	1.01	1.09	1.00	1.10	0.99	2.35	1.00
State share of Australian population — 2001 Census (%)	33.84	24.74	18.79	9.80	7.76	2.42	1.64	1.01	100.00
Relative proportion of population aged 65 years or over ^(b)	1.04	1.04	0.93	0.88	1.17	1.10	0.67	0.30	1.00
Relative proportion of population who are Indigenous ^(b)	0.87	0.25	1.47	1.47	0.72	1.56	0.52	12.18	1.00
Relative proportion of population resident in centres of 50 000 or more ^(b)	0.98	1.05	0.96	1.03	1.03	0.73	1.42	0.62	1.00
Relative proportion of population resident in remote areas ^(b)	0.55	0.05	1.56	2.70	1.08	0.23	0.00	15.56	1.00
Relative proportion of population enrolled at government schools (ave 1998–99 to 2002–03)	0.98	0.94	1.06	1.07	0.97	1.11	1.01	1.28	1.00
Relative proportion of population with low income ^(b)	0.97	0.95	1.07	1.00	1.11	1.25	0.64	0.96	1.00
Relative average weekly earnings ^(c)	1.06	1.00	0.93	0.95	0.92	0.91	0.86	0.94	1.00
Relative length of arterial roads per capita	0.90	0.80	0.90	1.86	1.09	0.96	0.51	3.01	1.00

(a) Each indicator is derived by comparing the proportion of each State's population in the relevant group with the proportion of the Australian population in that group. Further details are in Attachment E.

(b) Based on data from the *2001 Census of Population and Housing*.

(c) Based on private sector average weekly earnings for 2000. This is, however, not a good indicator of relative costs to the States because it is affected by interstate differences in workforce characteristics.

26. The indicators shown in Table 4-6 do not cover all the influences on the relative costs of providing State services, but they are relevant to the use of the more important services or the costs of many services. Our assessments of the interstate differences in relative costs of providing services are heavily influenced by diseconomies of small scale in providing administrative services (which reflect relative population sizes), the proportion of people in population groups that use State services heavily (such as students enrolled in government schools, people aged 65 or over, Indigenous people, people with low incomes and people who live in remote areas) and the per capita length of State arterial roads.

27. Those influences generally produce below average service use and unit costs in New South Wales and Victoria and above average use and unit costs in Western Australia and the Northern Territory. The main difference between New South Wales and Victoria is the above average wage levels in New South Wales. The overall relative costs of providing services in Queensland, South Australia, Tasmania and the ACT reflect a more complex interplay of these influences.

28. The general picture of relative costs of providing services we assess is broadly consistent with the combined effects of the underlying influences captured by the indicators in Table 4-6.

29. In general, the broad pattern of the relativities — with New South Wales and Victoria being assessed to have above average financial capacities, Western Australia having a financial capacity close to the average and the other States having below average capacities — is consistent with broad economic and demographic indicators and past experience.

MAIN INFLUENCES ON THE PER CAPITA RELATIVITY FOR EACH STATE

30. This section outlines the main influences on the relativity for each State.

New South Wales

31. We assess New South Wales to have an above average relative financial capacity to provide services. Its above average revenue raising capacity is reinforced by below average relative costs of providing services.

32. Our assessment that New South Wales has above average revenue raising capacity reflects its relatively high levels of economic activities that are subject to State taxes. In particular, it has:

- (i) well above average per capita values of real estate sales and above average values of land (especially commercial and industrial land), implying that above average revenues can be collected from stamp duties on conveyances, land taxes and insurance taxes;

- (ii) above average per capita payrolls, which generate above average payroll tax revenue;
- (iii) above average volumes of financial transactions, which are linked to its revenue from financial transactions taxes, some stamp duty and insurance taxes; and
- (iv) above average household disposable income, which is linked to above average revenues from gambling taxes.

33. Those effects are partly offset by below average capacity to raise mining revenue (reflecting the relatively small contribution of the New South Wales mining industry to the national picture) and motor taxes (reflecting below average vehicle registrations).

34. We assess the per capita costs of providing services in New South Wales to be below average. The influences that drive its per capita costs of providing services below the national average are greater than those that drive them above the average.

- (i) The below average cost of providing services reflects the ability to achieve economies of scale. It also reflects below average proportions of the population in groups who use services more extensively or who cost more to service — people who are Indigenous, people in remote areas, students enrolled in government schools, people who have a low income, and so on.
- (ii) The main influence that increases the relative cost of providing services in New South Wales is an above average (and increasing) level of wages. Other influences are the complex urban environment of Sydney and the service use or unit cost implications arising from the above average proportions of the population aged 65 or over or with low English fluency.

Victoria

35. We assess Victoria to have an above average aggregate financial capacity to provide services. Its relative costs of providing services are below average. That effect is partly offset by a below average assessed capacity to raise revenue.

36. Our assessment that Victoria's revenue raising capacity is below average reflects:

- (i) the very low value of mining production; and
- (ii) the below average per capita value of sales of real estate.

37. Those influences are partly offset by the above average per capita value of taxable payrolls and the above average level of financial transactions and motor vehicle registrations.

38. We assess Victoria's relative costs of providing nearly all services as being below average. This is because Victoria has:

- (i) compared with the other States, the lowest proportion of Indigenous people in its population, which reduces the relative use and the average unit cost of many services;
- (ii) a below average proportion of its population with a low income, which reduces the relative use of many services, including public health and housing services. It also reduces the costs of some services, such as government schools, where States devote extra resources to people from low-income backgrounds;
- (iii) an ability to achieve economies of scale in service delivery; and
- (iv) a relatively compact area to service, with a low per capita road length and a low proportion of people living in remote areas.

39. Victoria's proportion of the population enrolled in government schools is lower than that of all other States. Government schools account for 15.9 per cent of average State expenses, so this has a big effect on Victoria's aggregate relative costs of providing services.

40. Generally low relative costs of service provision are partly offset by above average costs stemming from the greater complexities of providing some services in Melbourne, the effects of the above average proportion of the population aged 65 or over on the use of some services, and the extra unit costs of some services arising from the above average proportion of the population having low English fluency.

Queensland

41. We assess Queensland to have a below average relative financial capacity to provide services. Its aggregate relative capacity to raise revenue is below average and its aggregate relative costs of providing services are above average.

42. The per capita value of production by the mining industry and the value of real estate sales are above average and so produce an above average capacity to raise revenue from those bases. But that is more than offset by:

- (i) a below average value of payrolls paid by large businesses, which results in below average per capita revenue from payroll tax;
- (ii) a below average household disposable income, which generates below average income-related taxes (such as gambling taxes);
- (iii) relatively low per capita values of commercial and industrial land, which lead to below average revenue from land tax; and

- (iv) relatively low levels of activity in financial markets, which lead to below average revenues from financial transactions taxes and insurance taxes.

43. We assess that, in total, per capita costs of providing services in Queensland are above average. This is primarily because the Queensland population contains above average proportions of people who use State services more extensively or who cost more than average to service. Among these groups are people who are enrolled in government schools, people who are Indigenous, people who have low incomes, holders of pension or health care concession cards, and people who live in remote areas. Queensland's service cost disabilities from those sources are partly offset by its ability to access some economies of scale in policy making and central administration and its relatively low wage levels and prices of other inputs (such as office accommodation and electricity).

Western Australia

44. We assess Western Australia to have an aggregate financial capacity to provide services that is below average. Above average costs of providing services are partly offset by a high relative capacity to raise revenue.

45. Western Australia has a higher capacity to raise revenue than the other States. It has a very large capacity to raise revenue from royalties on mining activity, including its payment from the Australian Government in lieu of royalties from the North West Shelf. It also has above average capacity to raise revenue from:

- (i) land taxation, reflecting above average per capita values of commercial and industrial land; and
- (ii) taxes on motor vehicles, reflecting an above average per capita number of vehicle registrations and above average sales of vehicles.

46. We assess Western Australia's aggregate costs of providing services to be above average because of:

- (i) the structure and nature of the Western Australian economy, including the effect of the large mining and primary industry sectors on the need for regulation and research;
- (ii) the dispersed population, which results in higher costs of communication, freight, and allowances for staff working in remote areas;
- (iii) diseconomies of scale in service provision;
- (iv) the above average Indigenous proportion of the population, the above average proportion of the population enrolled in government schools, and the above average proportion of the population living in cities of 50 000 or more;

- (v) the well above average per capita length of State arterial roads; and
- (vi) the relative scarcity of water.

47. Western Australia does, however, have below average wage levels, and this partly offsets some of its service cost disabilities.

South Australia

48. We assess South Australia's financial capacity to provide services to be below average. Its relative capacity to raise revenue is below average: its GSP per capita is the second lowest of all the States, and the activity in areas subject to State taxes is below average. That effect is partly offset by the below average costs of providing services and by above average per capita revenue from SPPs paid by the Australian Government.

49. We assess South Australia's revenue raising capacity to be below average for all the major State taxes, including:

- (i) taxes on sales of real estate and land holdings, mainly due to the relatively low land values;
- (ii) payroll tax, because the per capita value of payrolls paid by large businesses is below average, partly reflecting below average wage rates;
- (iii) financial transactions and insurance taxes, reflecting below average levels of activity in financial markets; and
- (iv) gambling tax, reflecting below average household disposable income.

50. Our assessment that South Australia has below average costs of providing services is the net effect of individual assessments. There are above average costs of providing services, reflecting:

- (i) diseconomies of scale in service provision;
- (ii) above average proportions of some population groups that use some services extensively or who cost more to service, including the population aged 65 or over, people who live in remote areas, and people who have low incomes;
- (iii) the structure and nature of the economy, including an above average number of establishments in primary industries; and
- (iv) the relative scarcity and poor quality of water.

51. Those effects are, however, more than offset by below average costs of services, reflecting:

- (i) the below average proportion of the population that is Indigenous;
- (ii) the low (and declining) proportion of young people in the population, especially the below average enrolments in government schools;
- (iii) the low proportion of the population with low English fluency;
- (iv) the comparatively small size of the major metropolitan area; and
- (v) below average (and declining) wage rates and costs of office accommodation.

Tasmania

52. We assess Tasmania's financial capacity to provide services to be below average. It has a substantially below average revenue raising capacity and above average costs of providing services. Those assessments are partly offset by Tasmania's above average per capita revenue from SPPs paid by the Australian Government.

53. Tasmania has a below average capacity to raise revenue. Its share of virtually all activities subject to State taxes is well below average. This is particularly the case for taxes on sales of real estate, land holdings and the payrolls of large businesses. Its mining production is also below average and declining. At an aggregate level, this is reflected in the fact that Tasmania's GSP per capita is the lowest of all States — at 72 per cent of the Australian average.

54. Our assessment that Tasmania has above average costs of providing services reflects:

- (i) diseconomies of small scale in service provision;
- (ii) above average proportions of the population in groups who use services more or who cost more to service, including students enrolled in government schools, Indigenous people, people with low incomes, and people who hold pension or health care concession cards; and
- (iii) isolation from the main sources of supply of goods and services used in providing services, which increases the relative costs of those goods.

55. Aspects of the structure of Tasmania's economy — including the above average per capita number of establishments in primary industry and the below average private sector provision of health services and support for sporting and cultural activities — also increase the relative costs of some services.

Australian Capital Territory

56. We assess the ACT to have an aggregate financial capacity to provide services that is below average. Its capacity to raise revenue is below average, and that effect is only partly offset by below average costs of providing services.

57. The ACT has a high GSP per capita, but it has below average levels of activity in most areas that are subject to State taxes. It has:

- (i) a below average value of wages and salaries paid by employers who are subject to payroll tax (the largest employer in the ACT, the Australian Government, is not subject to State taxes);
- (ii) a below average value of sales of real estate, although this was mainly evident in the early years of the assessment period;
- (iii) below average values of commercial and industrial land and insurance business;
- (iv) below average levels of motor vehicle registrations and sales, particularly for heavy vehicles; and
- (v) no mining industry and thus no capacity to collect mining royalties.

58. Those revenue raising disabilities are partly offset by an above average capacity to raise revenue from taxes related to income (primarily gambling taxes) and off-market sales of securities.

59. We assess the ACT's costs of providing services to be below average because:

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

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

Northern Territory

61. We assess the Northern Territory's aggregate financial capacity to provide services to be below average. It has very high costs of providing services. It also has a slightly below average revenue raising capacity. These assessments are partly offset by above average per capita revenue from SPPs paid by the Australian Government.

62. The Northern Territory's below average capacity to raise revenue reflects below average per capita sales of real estate, commercial and industrial land values, and payrolls paid by businesses subject to payroll tax. Those revenue raising disadvantages are partly offset by a high capacity to raise mining royalties — the second highest of all States.

63. We assess the Northern Territory to have above average per capita costs of providing virtually all services. The most significant causes of above average costs are:

- (i) large diseconomies of scale in policy formulation and central administration and the need to provide a high proportion of services in small and dispersed communities;
- (ii) the very high proportion of Indigenous people in the population, which increases the use and unit cost of many services;
- (iii) enrolments in government schools that are well above the national average;
- (iv) the dispersion of the small population over large remote areas, resulting in above average per capita length of arterial roads and higher communication, travel and staffing costs in providing most services;
- (v) above average wage levels, although these have been moving towards the average in recent years;
- (vi) few private sector service providers relative to the demand, especially in health services and support for sport and cultural activities; and
- (vii) a harsh physical environment, which increases some costs.

64. Among the few areas where circumstances in the Northern Territory lead to below average costs of providing services are the very low proportion of the population aged 65 or over and the small size of Darwin.

CHAPTER 5

MAJOR ASSESSMENT ISSUES

1. This chapter presents a summary of the Commission's approach to the more important issues raised in this review. It illustrates the impact of the changes in those areas by reference to implied changes to State grants based on the 2003–04 goods and services tax (GST) and health care grants (HCGs) pool of \$38.825 billion. It concludes with some remarks on the annual updating process.

2. During the course of the review, matters raised in discussion papers, submissions, workplace discussions and conferences meant that we had to re-assess virtually every aspect of our methods. The details of all of this work are in the working papers accompanying this report.

3. Not all the arguments put by the States led to changes in methods. In many areas, though, we introduced substantial assessment method changes to improve equalisation outcomes. As a consequence, State relativities and the implied grant distributions have changed.

SIMPLIFICATION

Overview

4. Simplification of the Commission's methods was on the agenda during the 1999 Review, but States also sought greater transparency and greater accuracy in the assessments. The scope for simplifying the assessments was therefore limited. The 1999 Review Report proposed that, as a matter of priority, the Commission investigate whether it could substantially simplify the methods used to reduce the cost of fiscal equalisation while having little effect on equalisation outcomes.

State views

5. All the States gave in-principle support to simpler assessments, especially if they would help to improve the understanding of the assessments and engender greater confidence in the results. However, most States rejected across-the-board approaches to simplification.

Consideration of the issues

6. Complexity in the assessments results from pursuing the objective of accuracy and comprehensiveness. But complexity that does not improve the outcomes or increase confidence in them is not desirable.

7. In this context, we proposed changes that would:

- (i) reduce the number of categories, disability factors and adjustments in the expense assessments; and
- (ii) use broader measures of revenue bases and reduce the number of adjustments made for some revenue categories.

8. We proposed that separate assessments or adjustments within an assessment should be made only if they had a material effect on grant shares. We also said that the way they were done should be decided on the basis of our confidence in the available data. For example, we considered reducing the number of assessments to those for which we could obtain reliable Government Finance Statistics (GFS) data.

Results

9. Although the States supported simplification in principle, there was no agreement on how that simplification could be achieved. Most States were concerned about possible implications for their grant shares. Instead, the States accepted a challenge to improve their GFS data to better support the current level of detail in the assessments. Subsequent submissions from the States usually argued for even more complex and detailed recognition of State needs.

10. As a result, we did not make many changes to assessment methods for reasons of simplification.

WAGES INPUT COSTS

Overview

11. Wages and salaries are the major costs incurred by States in providing services and differ significantly between States. In the 2003 Update our assessment of wages input costs disabilities redistributed almost \$550 million among the States. Assessment of the extent to which wages differentials are beyond the control of States and thus represent disabilities has been controversial.

1999 Review

12. In the 1993 and 1999 Reviews the Commission concluded there were underlying differences in the wage levels across the States and assessed a disability to allow for them.

13. In the 1999 Review the disability was measured by reference to interstate differences in average weekly earnings in the non-State sector because the Commission considered those differences were not influenced by State policies. To allow for variability and uncertainty in the data, the Commission averaged the assessments over 10 years and halved the interstate differences on the basis of judgment.

State views

14. The States had divergent views about the extent to which there are underlying differences in State wages costs and, if so, the extent to which such differences result from disabilities that are beyond States' control. One view was that States are increasingly competing for staff from the same labour pool and that any wage differentials are rapidly disappearing. Another view was that there are material differences in wages between States and that these differences are not narrowing, even for occupations where States are the dominant employers. States that held this view argued that States compete for labour in their regional labour markets.

Process

15. Given the importance of the assessment and the differences in views between States, we decided that wages input costs should be a major area of research.

16. We undertook extensive econometric analysis of the causes of wage differentials between States and had this work refereed by an independent expert. We gave the States several opportunities to examine the analysis and its results. Some States engaged their own consultants.

Consideration of the issues

17. The theory of labour market economics strongly supports the view that wages are influenced by features of the locations where work is performed (such as the cost of living and relative inherent attractions of the location), as well as by the productive characteristics of employees. We conclude that the influence of those 'location effects' on wages is beyond the control of individual State governments and presents a strong conceptual case for the continued assessment of a wage cost disability.

18. Our econometric analysis reinforces that view. It establishes to our satisfaction that there are ongoing regional wage differentials that are significantly different between States. It shows that underlying wage levels are noticeably above average in New South Wales and below average in Queensland, South Australia and Tasmania.

19. Our independent consultant confirmed that the theory on which our analysis is based and the technical specifications of the quantitative model used in it are sound. The States, however, had a range of views. New South Wales, the ACT and the Northern Territory generally supported the analysis. The others argued against it for various reasons, mostly reflecting concerns about the data and the extent to which the results were consistent with real-world outcomes.

20. We therefore subjected the model and its results to considerable scrutiny and reality testing. In particular, we compared the results of our modelling with other data on average weekly earnings, wage rates paid to selected occupations, and measures of the cost of living (especially the cost of housing) for each State. That checking confirmed that the results of our modelling are generally consistent with the real world.

21. We conclude that our econometric analysis gives us adequate empirical evidence of ongoing wage differentials between States. It also provides some basis to quantify those wage differentials — and thus to estimate disabilities. However, our analysis produces noticeably different results for 1997 and 2001 and does not provide a fully adequate basis to estimate disabilities for the smaller States.

22. For that reason, we consider that the model results should be adjusted on the basis of judgment. Specifically, we discounted the model results to allow for uncertainties that arose because there are differences between the results for 1997 and 2001. We do recognise, however, that wages in New South Wales increased relative to other States between 1997 and 2001. We also made specific adjustments to the results for Tasmania and the ACT. We considered that the low mobility of labour in the Tasmanian private sector meant that the analysis might understate the wage levels required to attract the staff needed to provide State services. For the ACT, we thought the analysis understated the effect of the Australian Government on wage levels paid by the ACT.

Results

23. As shown in Table 5-1, the change in the method of assessing wages input cost disabilities has a large impact on the distribution of the 2003–04 GST revenue and HCG pool.

Table 5-1 CONTRIBUTION TO THE EQUALISATION DISTRIBUTION^(a),
2003 UPDATE AND 2004 REVIEW: WAGES COSTS DISABILITY

Contribution	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
2003 Update ^(b)	447.5	-38.4	-350.1	58.6	-123.8	-37.8	16.0	28.0	550.2
2004 Review	631.4	-13.0	-403.1	-104.5	-140.9	-55.7	26.5	59.3	717.2
Change since 2003 Update	183.9	25.4	-53.0	-163.2	-17.1	-17.8	10.5	31.3	251.1

(a) The distributions are calculated by applying the 2003 Update and 2004 Review relativities to State populations as at 30 December 2003 and the 2003–04 GST revenue and HCG pool of \$38.825 billion.

(b) The figures for the 2003 Update include the effects of differences in all input costs, which are wages, office accommodation, electricity and construction costs. Interstate differences in wage levels are the dominant component of these figures.

SOCIO-DEMOGRAPHIC COMPOSITION

Overview

24. Socio-demographic composition factors measure the impact on State costs of differences in the characteristics of the States' populations. They are assessed in most expense categories and redistribute large amounts between the States. Because there is a large measure of agreement on the way these disabilities should be assessed, we made few changes to the method used in this review. The main questions were whether the Commission's use of judgment was consistent and whether the effects of cultural and linguistic diversity were adequately recognised.

1999 Review

25. The Commission assessed socio-demographic composition disabilities in the 1999 Review by applying Australian average use and unit cost weights to the number of people in each State in different groups characterised by age, sex, income, location, non-English speaking background, and Indigenous status. Where possible, use and cost weights were calculated from national data sets. Judgment was used when data were limited, particularly when deciding cost weights for Indigenous people living in remote locations and for people having low English fluency.

State views

26. All States accepted that the socio-demographic composition of their populations has an impact on the costs of providing services because of differences in service use by different population groups and unit costs. They agreed that such disabilities should continue to be assessed.

27. Most States supported the Commission's use of judgment in these assessments, saying that equalisation could not be achieved without it. Some, however, said that judgment was not being used consistently.

28. Some States were also critical of the lack of transparency in the methods the Commission had used in the past for assessing socio-demographic composition disability factors. Victoria, Queensland and Western Australia asked the Commission to explain fully its methods and the judgments behind calculations, weights, data, and adjustments in this review.

Consideration of the issues

29. All the States accept the strong conceptual case for the assessment of socio-demographic composition factors in this review.

30. There is also broad agreement that the socio-demographic influences that should be taken into account in our assessments are:

- (i) the age and sex composition of State populations;
- (ii) socio-economic status, usually measured by income;
- (iii) location/region of residence;
- (iv) the proportion of the population that is Indigenous; and
- (v) the cultural and linguistic diversity of the population.

31. In virtually all cases we have good data to estimate the impact of the first three disabilities and we use such data in our assessments. We also have good data on the use that Indigenous people make of many services and have used that information.

32. Data on the unit costs of providing services to Indigenous people are not as readily available. However, we are convinced by our observations at workplace discussions, the findings of the Commission's 2001 Indigenous Funding Inquiry, and the research findings of others that there is a strong conceptual case that States incur additional costs in providing most services to Indigenous people, especially those living a traditional lifestyle. These costs are associated with factors such as the time taken to negotiate service delivery arrangements, the duplication of facilities to provide separate services for men and for women, and the special training that is required to improve the wellbeing of Indigenous people. The same sources provided information suggesting that the extra costs are material and can be estimated with an acceptable level of confidence.

33. We consider there is overwhelming evidence that Indigenous status causes differences between the States in the unit cost of service provision and that this cost is material. We therefore assess a differential cost of service provision on the basis of this status in many categories. Subject to our guidelines, we do this by using judgment — especially for remote areas, where data are more limited.

34. In the case of culturally and linguistically diverse (CALD) people, States provided evidence to demonstrate that the size and diversity of CALD populations differ across States. What we do not have is evidence on how costs are affected — how cultural differences and the diversity of population groups affect service delivery. Apart from the higher costs arising from low English fluency, the States did not provide, and we could not discover, robust empirical evidence that CALD people use many services more or less frequently than other groups in the population or that the extra costs incurred in providing complex services to them are material. Thus we are not able to introduce a widespread allowance for the cost of cultural and linguistic diversity in our assessments. What we do include measures of service use where data are available, usually defining CALD people as those born in a non-English speaking country. We also estimate allowances by judgment in instances where there is a strong conceptual case and we are satisfied that the available data, often from only one State or from case studies, are robust and representative of all States under average policies. In most cases we do not have sufficient data on which to base such a judgment.

35. We do not think this is a satisfactory outcome. There is a strong conceptual case that cultural and linguistic diversity affects service delivery costs. What we lack is evidence to support an assessment. We encourage the States to consider how the evidence to support a more comprehensive assessment can be provided during the course of the next review.

Results

36. There are no major method changes from the approach adopted in previous reviews to assess socio-demographic composition. We recognise in this review some additional costs due to cultural and linguistic diversity. Table 5-2 shows the effects of the assessment of socio-demographic composition disabilities on the distribution of the pool.

Table 5-2 CONTRIBUTION TO THE EQUALISATION DISTRIBUTION^(a),
2003 UPDATE AND 2004 REVIEW: SOCIO-DEMOGRAPHIC
COMPOSITION

Contribution	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
2003 Update	-305.7	-735.4	379.8	131.7	0.0	105.9	-104.5	528.3	1145.6
2004 Review	-642.7	-1180.4	634.2	367.9	89.9	175.3	-199.5	755.3	2022.5
Change since 2003 Update	-337.0	-445.0	254.4	236.3	89.9	69.4	-95.0	227.1	876.9

(a) The distributions are calculated by applying the 2003 Update and 2004 Review relativities to State populations as at 30 December 2003 and the 2003–04 GST revenue and HCG pool of \$38.825 billion.

37. The change is mainly due to changes in service use patterns and costs per unit of service and the significant changes in the socio-demographic composition of State populations that have taken place between censuses. For example, large changes have occurred in school enrolment patterns across the States and there have been large increases in Indigenous use in the law and order categories. Low-income groups' use of health and welfare services has also increased. Data on changes in use and costs weight are in the working papers accompanying this report.

38. Each State's share of the total Australian population has changed since the 1996 Census. Queensland and Western Australia now have much larger shares, while those of the other States have fallen. In addition, relative to the Australian average:

- (i) the proportion of State populations that has low income has increased noticeably in Queensland, Western Australia, Tasmania and the Northern Territory and decreased in the other States;
- (ii) the proportion of State populations that lives in remote areas has increased markedly in New South Wales, South Australia and the

Northern Territory, partly because of a change in the basis of classifying regions¹;

- (iii) the proportion of State populations that is not fluent in English has increased in New South Wales, Queensland and Tasmania and decreased in other States; and
- (iv) the proportion of State populations that is Indigenous has increased in New South Wales, Tasmania and the ACT and declined in the Northern Territory.

Data to illustrate how State population characteristics have changed between censuses are included in the volume of supporting information.

Minority view

39. While agreeing with the vast majority of the assessment for socio-demographic factors, Professor Wiltshire believes that the weighting for cultural and linguistic diversity should have been slightly higher. He acknowledges that this would have to be principally by judgment since States provided very little supporting data and there are no robust national data sets that measure this component. However, workplace discussions and other anecdotal evidence confirm that CALD does increase costs of service provision and this cannot be accurately measured by measures of English fluency alone. The complexity associated with CALD encapsulates more than just proficiency in English; true cultural factors also have to be recognised.

ADMINISTRATIVE SCALE

Overview

40. Administrative scale factors recognise the fixed costs that all States incur in providing basic administrative structures for service delivery. These costs are greater in per capita terms for less populous States. Scale factors therefore result in higher relativities for the less populous States and lower relativities for New South Wales, Victoria and Queensland.

1999 Review

41. In the 1999 Review the Commission assessed administrative scale disabilities for minimum fixed costs and scale-affected variable costs. Minimum fixed costs were defined as the costs of the minimum amount of corporate services and basic head

¹ Previously regions were classified using the Rural, Remote and Metropolitan Area classification. They are now classified using the State Accessibility/Remoteness Index of Australia (SARIA).

office structures required to provide policy and planning for Statewide functions, regardless of the size of the task. Scale-affected variable costs were expenses incurred for corporate services and policy and planning additional to minimum fixed costs, but still subject to some diseconomies of small scale.

Process

42. We reviewed the assessment with considerable assistance from State treasuries. We issued a discussion paper that proposed continuing the fixed cost assessment but removing the assessment for scale-affected variable costs: we were not convinced there was a conceptual case for continuing to assess scale needs for them. We proposed that needs relating to scale-affected variable costs should be assessed using factors that reflected service delivery needs.

43. The States responded to that and subsequent papers by means of submissions and in workplace discussions. They also provided data on scale-affected costs and changes in head office functions that had occurred since the last review.

State views

44. All the States accepted the conceptual case for economies of scale in administrative costs. The more populous States, however, argued for a reduction in the allowances assessed and supported the removal of the variable scale assessment. The less populous States said that scale disabilities were underestimated and should be increased.

Consideration of the issues

45. The concept of fixed costs is well supported by economic theory. We consider fixed costs to be the minimum amount each State must spend to provide the basic head office structures required for policy, planning and the administration of State services, regardless of population size or characteristics or the size of the task. The existence of fixed costs means that the less populous States incur greater per capita expenses in providing the minimum administrative structure. The minimum fixed cost assessment is designed to give each State the same absolute financial capacity to operate the minimum-sized head office.

46. Some data on fixed costs are available for most expense categories or groups of categories but comprehensive estimates call for the use of judgment. We consider the estimates we have made to be robust and to have an acceptable level of confidence. Data are available to measure the population-based disability.

47. We are not convinced there is a conceptual case for continuing to assess what were previously called scale-affected variable costs. We consider that some of these costs — which we estimate on the basis of judgment to be 10 per cent — are in effect fixed costs. The rest we are treating as service delivery costs, to be assessed using the relevant service delivery factors, such as the size and composition of the user groups and differences in unit costs.

Results

48. Table 5-3 shows the effects of the assessment of administrative scale disabilities on the distribution of the 2003–04 GST revenue and HCG pool. It shows a substantial reduction in the amount redistributed, which is consistent with the removal from this assessment of a large proportion of scale-affected variable costs².

Table 5-3 CONTRIBUTION TO THE EQUALISATION DISTRIBUTION^(a),
2003 UPDATE AND 2004 REVIEW: ADMINISTRATIVE SCALE

Contribution	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
2003 Update	-374.6	-218.9	-108.4	60.9	84.0	159.5	175.1	222.4	701.9
2004 Review	-322.7	-180.3	-88.5	42.1	68.2	141.3	157.5	182.3	591.5
Change since 2003 Update	51.9	38.6	19.9	-18.8	-15.8	-18.2	-17.6	-40.1	110.5

(a) The distributions are calculated by applying the 2003 Update and 2004 Review relativities to State populations as at 30 December 2003 and the 2003–04 GST revenue and HCG pool of \$38.825 billion.

DEPRECIATION**Overview**

49. The Commission began assessing relative needs for depreciation expenses in the 1999 Review because it concluded that, in the absence of an assessment of these needs, its approach to equalisation was not sufficiently comprehensive. The assessment estimates the operating expenses for the capital stock each State would use to provide the average level of service.

1999 Review

50. In the 1999 Review the Commission considered needs relating to several groups of assets — buildings, plant and equipment, housing, other construction, and urban transit infrastructure. The assessment involved a large exercise of judgment.

State views

51. The States accepted the conceptual underpinnings of the 1999 Review assessment but were critical of some aspects of its implementation. In particular, they argued that any assessment of needs relating to climate and population size should be based

² Those scale-affected variable costs are now assessed on the basis of service delivery factors.

solidly on evidence. They also questioned the way the non-capital needs were used in the assessment and said the measure of differences in construction costs was policy influenced.

Process

52. Because of the concerns about this assessment (and that of debt charges), we convened a working party of Commission staff and State treasury officers. It provided advice about how we could assess needs more appropriately. We devoted considerable time and attention to this topic at Commission conferences. We engaged expert consultants to help us evaluate alternative approaches for assessing capital needs and develop more effective assessments of needs arising from climate and natural hazards.

Consideration of issues

53. We consulted closely with the States and agreed that the assessment would benefit from a more rigorous approach.

54. We simplified the assessment by narrowing its scope. Because depreciation relating to housing, roads and urban transit is an integral part of State expenses for those services, we now assess their depreciation needs in those categories. We also removed the isolation allowance (which was intended to capture the effects of remoteness from the main centres of activity in south-east Australia) because there is insufficient evidence to support it.

55. In this review we measure interstate differences in the capital cost of buildings and equipment required to provide services by selectively using our assessments for non-capital related expenses, which have already undergone rigorous analysis. For example, we use our measures of differences in wage levels and intrastate freight costs to provide more policy neutral and reliable measures of regional differences in construction costs than the construction costs index previously used. We also target assessments to ensure that they are appropriate for capital stock. For example, we measure the need for school buildings using the number of school children, rather than also including allowances for the higher costs associated with some groups of students, as was done previously. When using non-capital assessments, we weight them to apply to the relevant proportion of depreciation expenses.

56. Unless there is specific evidence of the effects of large urban centres on depreciation costs we do not assess different needs. (Apart from a few services, such as police, there is limited evidence that the large urban centres affect the per capita quantity and cost of buildings [excluding land] and equipment required to provide services.) We measure the effects on depreciation expenses of the need to provide services to small or scattered populations using the non-capital assessments for those influences. By explicitly using assessments established for particular areas of service delivery, we aim to ensure that our findings are applied consistently.

57. On the basis of our observations in northern Australia, we consider that differences in climatic conditions affect the useful life of assets, especially buildings. This

view is generally supported, but States argued that that any assessment should be based on strong evidence. We commissioned independent research to measure the impact. Although we have no reason to question the factual findings of the research, we are unable to transform them into an assessment of the impact of climatic conditions on depreciation costs in a credible way. Rather than apply an assessment in which we lack confidence, we are not assessing needs on that basis. We do, however, assess allowances for the effects of natural hazards on depreciation expenses. Information commissioned by the insurance industry on each State's vulnerability to natural hazards, together with information provided during workplace discussions, allows us to measure the effects with a sufficient level of confidence.

Results

58. As shown in Table 5-4, the changes in the scope and assessment method for depreciation expenses have a large impact on the distribution of the 2003–04 GST revenue and HCG pool.

Table 5-4 CONTRIBUTION TO THE EQUALISATION DISTRIBUTION^(a),
2003 UPDATE AND 2004 REVIEW: DEPRECIATION

Contribution	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
2003 Update	213.9	-10.6	-126.9	-45.4	-23.5	-22.7	-13.9	29.1	243.0
2004 Review	-18.9	-29.5	14.1	8.3	-3.2	9.1	0.6	19.5	51.6
Change since 2003 Update	-232.8	-18.9	141.0	53.6	20.3	31.8	14.5	-9.6	261.3

(a) The distributions are calculated by applying the 2003 Update and 2004 Review relativities to State populations as at 30 December 2003 and the 2003–04 GST revenue and HCG pool of \$38.825 billion.

59. In the 1999 Review the Commission considered that New South Wales and the Northern Territory would incur above average depreciation costs to provide the average level of services. The measure it used of the different construction costs was a major driver of those needs. In the case of New South Wales, the strong emphasis on the costs associated with large cities and the inclusion of urban transit depreciation needs in this category further increased its assessed needs. In the case of the Northern Territory, the assessments relating to climate and isolation further increased its needs. The assessment determined that Queensland could spend less than average on depreciation while providing the average level of services. We were, however, concerned that the 1999 Review methods understated Queensland's needs.

60. The 2004 Review approach results in much less money being redistributed. This accords with our understanding that the per capita depreciation expenses of each of the States are similar. We also note that the removal of needs for urban transit depreciation expenses results in smaller needs for New South Wales and Victoria in this category and larger needs in the Urban Transit category. Our new approach assesses greater depreciation needs than before for Queensland, largely because we measure needs relating to

construction costs more reliably and now give greater emphasis to the costs facing small or scattered non-urban populations.

61. We are concerned by the large difference between the Northern Territory's actual depreciation expenses and the amount we assess would be required to provide standard services under standard policies. We consider that some of this may be due to policy choice, but we also consider that the Northern Territory's circumstances are unique. It is likely that there are determinants of depreciation expenses that are beyond the Territory's control that we do not recognise — the effects of its harsh climate being the most obvious. As noted, we made a concerted effort to take climate into account but we could not develop an assessment in which we had sufficient confidence.

DEBT CHARGES

Overview

62. The Commission has had a debt charges assessment for many years, but it has been much criticised. Unlike the Depreciation category, where there is broad conceptual agreement, the very foundations of the debt charges assessment were under scrutiny in the 2004 Review: even the most fundamental question of what was being measured was a matter of contention. As a result, improvement of the debt charges assessment was a high priority for this review.

63. The assessment is complicated because present debt charges relate to past accumulations of debt. It is difficult to discern a standard policy on the way States have financed debt charges in the past 40 or so years because State policies on indebtedness have changed, as have accounting and budgeting approaches. Commission methods on the treatment of various components of State budgets have also changed over time, and data quality and availability are variable because of the need to cover so many past years.

1999 Review

64. In the 1999 Review the debt charges assessment was based on a private sector model that assumed the States borrowed to finance deficits and capital expenditure on capital stock and financial assets. Thus the assessment calculated borrowings as the accumulated capital expenditures less accumulated resources from depreciation, surpluses, capital-related revenues and capital grants.

Process

65. The Commission devoted considerable effort to reviewing the debt charges assessment. That included convening a working party of Commission staff and State treasury officers. With the advice of a consultant, the working party identified six options — among them redevelopment of the 1999 Review approach — that were considered at a

conference with the States in October 2002. The debt charges assessment was discussed further at subsequent Commission conferences.

State views

66. The States accepted that there are differences in the per capita amount they need to borrow. Although some States preferred other approaches, the consensus of the October 2002 Conference was that the Commission should adopt a modified version of the 1999 Review approach. Given that decision, the major issues raised were:

- (i) whether it was appropriate to attribute larger borrowing needs to States that had high population growth when price levels were higher (disputed by New South Wales, Victoria, South Australia and Tasmania);
- (ii) whether it was appropriate to attribute larger borrowing needs to States that received a lower per capita level of capital grants (disputed by South Australia, Tasmania and the Northern Territory); and
- (iii) whether smaller States paid higher interest rates for reasons outside their control and whether any such impact could be measured reliably (disputed by New South Wales, Victoria and Queensland).

67. Most States agreed that the relativities should not be affected by the growing differences between the States in their policies relating to the use of borrowings to purchase financial assets. They supported offsetting interest earned from financial assets against debt charge expenses as the simplest way of excluding the effects of those policy differences from the assessments.

Consideration of the issues

68. Our approach for the 2004 Review is based on a refinement of the 1999 Review approach. We start from the position that, unless it is demonstrated that there are disabilities, we assume that the States have the same per capita borrowing needs. Our analysis, however, indicates that States have different borrowing needs due to:

- (i) current differences in the demand for and cost of non-replacement assets;
- (ii) the higher capital expenses on buildings that would have been incurred by States with recent population growth because of the higher prices they faced in more recent years;
- (iii) the funding of accumulated budget outcomes, recognising that States with a declining population share shoulder a greater per capita burden of accumulated deficits; and

- (iv) differences in the per capita level of capital specific purpose payments that offset borrowing needs.

69. We agree that we should assess only needs for borrowings for non-financial assets. As suggested by most States, we do this by subtracting interest earnings from interest payments. This is one of the reasons why the assessment redistributes less money than before.

70. There is a strong conceptual case that the small scale of less populous States results in their paying higher interest rates. Data on secondary bond market rates support this, as does expert advice. Our examination of the evidence suggests that the differentials are material and can be estimated with acceptable confidence. We are therefore retaining and updating the assessment.

Results

71. As shown in Table 5-5, our changes in the assessment method for debt charges expenses have a large impact on the distribution of the 2003–04 GST revenue and HCG pool.

Table 5-5 CONTRIBUTION TO THE EQUALISATION DISTRIBUTION^(a),
2003 UPDATE AND 2004 REVIEW: DEBT CHARGES

Contribution	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
2003 Update	298.6	-63.0	-225.1	-31.6	-16.8	-18.6	-22.9	79.4	378.0
2004 Review	14.0	-4.7	1.0	18.5	-2.4	-6.5	-6.8	-13.1	33.5
Change since 2003 Update	-284.6	58.3	226.1	50.1	14.3	12.1	16.2	-92.5	377.1

(a) The distributions are calculated by applying the 2003 Update and 2004 Review relativities to State populations as at 30 December 2003 and the 2003–04 GST revenue and HCG pool of \$38.825 billion.

72. We were concerned that the 1999 Review method redistributed such a large amount of money and were not convinced that Queensland, in particular, had the low level of needs that was assessed. Our improvements to the model result in a much smaller redistributive impact, which has a large grant impact on New South Wales and the Northern Territory. In the case of New South Wales, this is because of the generally earlier timing and relatively lower price level at which it purchased much of its stock. For the Northern Territory, it is mostly because of the large amount of capital grants provided to it by the Australian Government. Queensland's assessed needs have risen significantly, largely because our new approach recognises the impact of recent population growth on the cost of its assets.

73. As with depreciation expenses, we are concerned at the very large difference between the amount the Northern Territory spends on debt charges and the amount we assess it would spend under standard policies. Policy choice may play a role in the

discrepancy, but we also suspect that the Northern Territory's unique circumstances give it borrowing needs that we have been unable to capture.

URBAN TRANSIT

Overview

74. Since the 1999 Review, the States in general have changed from directly providing urban transit services to subsidising them. This required us to reconsider the assessment. In any event, the States did not have confidence in the previous assessment and we can no longer collect the detailed data required to support it.

1999 Review

75. In the 1999 Review the urban transit assessment related to the operations of providers. This was because many State governments were directly involved in the provision of urban transit services, and influences on the gross expenses and revenues of the services were the relevant determinants of State needs.

State views

76. The States generally supported the view, expressed by the Commission in an early discussion paper, that the assessment should reflect the nature of the current involvement of State governments in providing subsidies for urban transit services. The States also said the assessment method should be simplified and its reliance on extensive, detailed data collections and judgment reduced.

Consideration of the issues

77. Consistent with our decision to base the assessments on transactions that have a direct impact on State budgets, we consider there is a strong conceptual case for focusing the assessment on the net impact of urban transit on State operating statements. This is because under current policies the States are generally not directly involved in the provision of urban transit services: their approach is to provide subsidies of various sorts to operators of transport enterprises. Focusing this assessment on the subsidies paid by the States is consistent with the approach to the assessment of needs relating to other public trading enterprises that the Commission adopted in the 1999 Review.

78. The expenses in this category, and our assessment, recognise that States make three broad groups of subsidies towards the costs of urban transit enterprises — subsidies for concessions granted to certain groups of passengers such as pensioners and students; subsidies for operating costs, excluding capital-related costs; and subsidies towards the capital costs of the services.

79. The assessment for concessions reflects the relative numbers of eligible concession holders. These are measured by the relevant population of students, unemployed people and pensioners that live in the urban centres of each State as a proportion of the State's total population.

80. The estimates of the pricing subsidies that States would pay under standard policies are based on an average of what States do in subsidising bus and rail operators in centres of various population sizes³. We also allow for the effect of the differences between States in wage levels, using our wages input costs factors. In the case of the ACT, we make an extra allowance for the effects of its status as the national capital on urban form and the capacity of the bus service to collect fare revenue.

81. Differences in expenses for capital subsidies are estimated by deriving a notional level of assets that would be used in each State, based on observations of the assets used by transit services across Australia. Specifically, we conclude that centres of 50 000 or more people require urban transit services based predominantly on buses, but centres of 1 million have a rail service and centres of 2 million or more have, in addition, underground rail services. We also make allowances for underlying differences between States in the construction costs of track and station assets.

Results

82. Overall, the urban transit assessments reflect the effects of urbanisation. They show that the States with the largest urban centres (Sydney and Melbourne) have the greatest needs, stemming largely from the high capital costs of their intensive rail services. Per capita needs in the less populous States, excluding the ACT, are generally low, reflecting the small size of the populations served and the reliance on bus services. The city-State nature of the ACT, with virtually all its population living in an urban area, means that its assessed needs are about average, even though it has a fairly small scale bus service.

83. The results of the urban transit assessments are similar to those we obtained for the 2003 Update once allowance is made for the change in the scope of the category to include allowances for depreciation expenses. This change in scope accounts for most of the change in the redistribution resulting from this assessment, although the growth of urban populations in some States, as reflected in data from the 2001 Census, has had an effect.

84. Table 5-6 shows the impact of the 2003 Update and 2004 Review assessments on the distribution of the 2003-04 GST revenue and HCG pool.

³ We examined the average relationship across the States between the population of urban centres and the per capita operating deficits of the transport providers. Separate relationships were measured for rail and bus services because their cost structures were materially different.

Table 5-6 CONTRIBUTION TO THE EQUALISATION DISTRIBUTION^(a),
2003 UPDATE AND 2004 REVIEW: URBAN TRANSIT

Contribution	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
2003 Update	-49.2	11.0	15.9	8.8	36.8	-19.2	8.7	-13.0	81.3
2004 Review	119.4	51.2	-46.6	-25.3	-34.3	-41.5	-4.4	-18.5	170.6
Change since 2003 Update	168.6	40.2	-62.5	-34.1	-71.1	-22.4	-13.2	-5.5	208.8

(a) The distributions are calculated by applying the 2003 Update and 2004 Review relativities to State populations as at 30 December 2003 and the 2003–04 GST revenue and HCG pool of \$38.825 billion.

SUPERANNUATION

Overview

85. Following the States' change from cash to accrual accounting, the Commission adopted, in the 2001 Update, an accrual-based assessment of superannuation. It included transitional arrangements intended to ensure that, over time, the needs associated with State unfunded superannuation liabilities would be taken into account. This change was made in response to a requirement in the terms of reference.

86. The main question in this 2004 Review was whether we were adequately recognising States' needs relating to unfunded liabilities.

2001 Update

87. In the 2001 Update the Commission assessed States' relative need for unfunded superannuation liabilities using an average of the superannuation disabilities it had assessed for each of 20 years preceding the introduction of accrual accounting.

State views

88. New South Wales proposed that the Commission use the disabilities it applies to the accruing expense for assessing the unfunded liability because this would be simpler and consistent with the original cash assessment and would not double-count superseded disabilities from earlier years.

89. The ACT submitted that its historical factor needed adjustment to recognise that the Commission's past cash-based assessment gave it the capacity to fund only a proportion of the standard cash superannuation payments. This meant that it was accruing above standard unfunded liabilities in the period between 1987–88 and 1997–98.

90. Other States said the accumulation period needed to be extended to reflect the longer period in which liabilities had been incurred: Victoria and South Australia

suggested 50 years and Western Australia suggested longer than 40 years. The Northern Territory disagreed, arguing that the accumulation period for determining the unfunded superannuation liability should be restricted to the period since the introduction of comprehensive equalisation.

91. States also argued that the disabilities recognised for earlier years should be given a higher weight because in those years superannuation schemes were more likely to be unfunded and were more generous. They also argued that the historical superannuation disabilities needed to be weighted to reflect accumulated interest over time.

Consideration of the issues

92. The question of how the assessment of disabilities relating to outstanding superannuation liabilities should be undertaken is a technical one. On reflection, we concluded that an accumulation period of 20 years could understate the outstanding unfunded liabilities of States, depending on the rate at which early liabilities had been extinguished by benefit payments. Having received advice from the Australian Government Actuary⁴, we accept that States have outstanding unfunded liabilities that have accumulated over 50 rather than 20 years and that the liabilities have grown and been extinguished at different rates over the period. This is reflected in the revised assessment.

93. To rectify the other anomaly with respect to the ACT and the Northern Territory, we include adjustments in the assessment to recognise that the Commission's cash-based assessments before the 2001 Update did not fully recognise the Territories' accruing unfunded liabilities.

Results

94. Table 5-7 shows the impact of the 2003 Update and 2004 Review assessments on the distribution of the 2003–04 GST revenue and HCG pool.

95. The differences in assessed costs of providing superannuation are caused by the relative per capita size and cost of State public sectors today and in the past. The smaller States have the largest per capita needs, but the needs are lower for the ACT and the Northern Territory because of the relatively short period over which they have been accruing liabilities.

⁴ The advice of the Australian Government Actuary is reproduced in the working papers that accompany this report, as are the comments of a referee. Comments on the advice were also received from consultant actuaries for the ACT and the Northern Territory.

Table 5-7 CONTRIBUTION TO THE EQUALISATION DISTRIBUTION^(a),
2003 UPDATE AND 2004 REVIEW: SUPERANNUATION

Contribution	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
2003 Update	-61.6	-160.3	-4.8	88.8	32.0	47.1	-42.8	101.6	269.5
2004 Review	-45.4	-134.4	1.5	71.8	25.9	36.7	-36.0	79.8	215.8
Change since 2003 Update	16.2	25.9	6.2	-17.0	-6.1	-10.4	6.9	-21.8	55.2

(a) The distributions are calculated by applying the 2003 Update and 2004 Review relativities to State populations as at 30 December 2003 and the 2003–04 GST revenue and HCG pool of \$38.825 billion.

INPATIENT SERVICES

Overview

96. The cost of providing inpatient services to State populations accounts for a high proportion of State net expenses — an average of 15 per cent over the years 1998–99 to 2002–03. The assessment has a large impact on State relativities. There is broad acceptance of the notion that various socio-demographic composition characteristics affect the use and cost of inpatient services. Extensive data are available to measure these impacts, but in this review we have had difficulty using the data satisfactorily.

1999 Review

97. The Commission assessed higher needs for those States that had an above average number of people who were likely to use inpatient services (as indicated by age, sex, Indigenous status, income and place of residence). The Commission also assessed needs for those States that had an above average number of people who cost more to treat when they use these services (Indigenous people and people with low English fluency). Further, it took account of differences in hospital costs in different regions and made relatively small adjustments for the high incidence of HIV/AIDS in New South Wales and renal dialysis in the Northern Territory.

State views

98. The States accepted the general approach. Suggestions for how to improve it included a higher estimate of the costs of treating people from culturally and linguistically diverse backgrounds (Victoria) and using non-English speaking background to predict hospital use (Queensland). Western Australia said we should recognise above average Indigenous use rates in some States, while New South Wales and the Northern Territory argued that special adjustments should be retained for HIV/AIDS and renal dialysis respectively.

Consideration of the issues

99. In this review we make several changes to the assessment while maintaining the fundamental approach applied in the 1999 Review. These changes include using the most recent data to increase our allowances for the extra costs of treating some Indigenous and CALD people and recognising that country of birth has an effect on hospital use. We continue to apply national average hospital use rates for each population group to the people in those groups in each State because this approach is more policy neutral and provides a better equalisation outcome than adjusting use rates for particular States. We no longer apply special allowances for HIV/AIDS and renal dialysis because we think our analysis of the use of hospitals by people in the various population groups adequately reflects interstate differences.

100. We were unable to obtain reliable inpatient data for all years disaggregated in a way that allowed us to recognise the use of services by CALD people and their effect on costs per service and to consistently apply the State Accessibility/Remoteness Index of Australia (SARIA) regional classification. We therefore based the assessment on inpatient data for two years. The factors assessed for 1998–99 to 2000–01 use 1999–2000 inpatient data. Those data allow us to identify the use of services by CALD people, but the data retain the Remote, Rural and Metropolitan Area regional classification used in the last review. The factors for 2001–02 and 2002–03 use 2001–02 inpatient data that identify the use of services by CALD people and are classified by SARIA. In future updates we will progressively replace the factors calculated using 1999–2000 data with assessments using the latest data and the SARIA regional classification.

101. We are concerned that the increased level of disaggregation in the data increases the likelihood of volatility in the measured use rates for inpatient services and that they may not reflect real changes in State circumstances. We see some scope for improving the way we use inpatient data in the assessment, and we propose to work with the States during 2004 to achieve this.

Results

102. Table 5-8 shows the impact of the 2003 Update and 2004 Review assessments on the distribution of the 2003–04 GST revenue and HCG pool.

Table 5-8 CONTRIBUTION TO THE EQUALISATION DISTRIBUTION^(a),
2003 UPDATE AND 2004 REVIEW: INPATIENT SERVICES

Redistribution	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
2003 Update	-7.4	-132.5	-55.7	37.5	66.7	29.5	-47.8	109.7	243.4
2004 Review	-45.0	-136.6	-14.6	5.2	114.9	26.4	-58.5	108.3	254.7
Change since 2003 Update	-37.6	-4.1	41.1	-32.3	48.2	-3.1	-10.7	-1.4	89.3

(a) The distributions are calculated by applying the 2003 Update and 2004 Review relativities to State populations as at 30 December 2003 and the 2003–04 GST revenue and HCG pool of \$38.825 billion.

MINING REVENUE

Overview

103. The mining revenue assessment has the largest single effect on the relativities of all categories, and its effects are volatile over time. The assessment method adopted in the 1999 Review was becoming unsustainable because changes in the basis on which data on mining activities are collected meant that much of the data required to implement the method were no longer available. For this review we proposed adopting a simplified approach based on value of production or value added for major groups of minerals.

1999 Review

104. In the 1999 Review and subsequent updates the mining revenue assessments for onshore production were made by measuring the revenue base using adjusted value added⁵ as a proxy for the profitability of the mining industry in each State.

State views

105. New South Wales and South Australia said data difficulties are not sufficient reason to change the method. Western Australia said that economic rent⁶ is the most appropriate measure of the revenue base because it defines what States could ultimately tax. New South Wales, South Australia, Tasmania and the Northern Territory supported an approach based on profitability to recognise differences between States in the costs of production. Other States supported value of production because they considered that it better reflects the way States impose royalties.

Consideration of the issues

106. In concept, the revenue base for mining royalties is economic rent because it reflects the underlying capacity of the industry to pay. However, our examination of how States impose royalties indicates that, while some States said that they took account of the capacity of the industry to pay when setting the royalty rates, they do not actually impose royalties on economic rent. Some States, including the Northern Territory and Tasmania, have profit-based royalties, but most royalties are based on the value or volume of production.

⁵ The measure of the revenue base was value added from onshore activity less wages and related on-costs, average capital expenditure and average on-lease exploration costs. Revenues from royalty sharing arrangements between the Australian Government and Western Australia (for offshore oil and gas) and the Northern Territory (for uranium) were treated as SPPs and assessed using the differences in actual revenues per capita.

⁶ Economic rent is equal to profit less a return to equity capital.

107. We conclude that we should generally use value of production as the measure of the revenue base because that best reflects what States do. The conceptual case is reinforced by discussions with the Australian Bureau of Statistics, which indicate that, given current data collection processes, an output-based assessment is more likely to be supported by robust and accurate data and would require less estimation than an economic rent or profit-based assessment.

108. We also consider that the assessments should recognise the policies of the States to tax some minerals more heavily than others. We now make separate assessments for onshore oil and gas, coal, other minerals where royalties are value based (mainly metallic minerals) and minerals where royalties are volume based.

109. There is, however, convincing evidence that application of the value of production approach would overstate the capacity of New South Wales and Tasmania to raise royalty revenue. Some of the larger mines producing metallic minerals in New South Wales and Tasmania are nearing the end of their lives or are in financial difficulties, or both. The overall profitability of the coal industry in New South Wales is well below average. The actual effective royalty rates imposed in those cases are below average. We therefore discount the measured revenue base of New South Wales and Tasmania for metallic minerals and that for coal in New South Wales on the basis of judgment.

Processes

110. Commission staff held a workshop with State officers to consider matters relating to the collection of data on the value of production. We also engaged the Australian Bureau of Agricultural and Resource Economics (ABARE) to review the data provided by the States and to advise on whether the comparability across the States could be improved. ABARE recommended that we use the value of the metal content of mine output, valued at the metal free-on-board export unit value. Its recommendation had the general support of the States and we implemented it.

Results

111. Table 5-9 shows the impact of the 2003 Update and 2004 Review assessments on the distribution of the 2003–04 GST revenue and HCG pool.

Table 5-9 CONTRIBUTION TO THE EQUALISATION DISTRIBUTION^(a),
2003 UPDATE AND 2004 REVIEW: MINING REVENUE

Contribution	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
2003 Update	511.1	533.0	-257.3	-909.2	68.9	44.6	37.8	-29.0	1195.5
2004 Review	423.5	545.0	-297.6	-794.9	81.1	43.4	37.6	-38.1	1130.6
Change since 2003 Update	-87.6	11.9	-40.3	114.2	12.2	-1.2	-0.1	-9.2	138.4

(a) The distributions are calculated by applying the 2003 Update and 2004 Review relativities to State populations as at 30 December 2003 and the 2003–04 GST revenue and HCG pool of \$38.825 billion.

112. A large part of the change in the effect of the mining revenue assessment is due to the change in the method of measuring the revenue raising capacity. Although the circumstances of the States vary, the new method better reflects what most States do in imposing mining royalties and is better supported by data.

TREATMENT OF ASSISTANCE FOR ECONOMIC DEVELOPMENT

Overview

113. During this review Western Australia argued that the 1999 Review approach to the costs and benefits of economic development assistance was inconsistent with equalisation principles. We continue to apply those methods because we are not convinced on conceptual and practical grounds that equalisation would be improved by alternative approaches.

1999 Review

114. In the 1999 Review the Commission considered that interstate differences in expenses on economic development were the result of differences in State policies. It assessed them on an equal per capita basis, implying zero needs.

State views

115. Western Australia argued that all its revenue from economic activities in the State, especially large natural resource projects, is included in the Commission's revenue assessments and much of it is in effect equalised away to the other States. However, it said the State expenses required to help establish the projects that produce those revenues are not adequately recognised in the expense assessments. It argued that this asymmetry in treatment substantially penalises Western Australia and creates a disincentive for States to invest in projects that increase their economic activity.

116. Western Australia suggested that the assessment of revenue capacity should exclude economic activity attributable to State government policy and/or that expense assessments should recognise the disabilities States face in encouraging development, especially in the case of projects that could demonstrate a strong national economic benefit.

117. The Northern Territory supported Western Australia. New South Wales, Victoria, Queensland, South Australia and the ACT acknowledged that all States provide assistance for economic development, but said they often do so for different reasons and that the assistance takes many forms, ranging from broad long-term policies to direct and highly specific assistance. They argued that the practical difficulties of adjusting revenue bases for the effects of economic development policies and of assessing expense needs are too great for the Commission to proceed down that path.

Consideration of the issues

118. All States are involved in economic development-type activities and incur expenses in assisting economic development. They do so through indirect assistance (putting in place the policies and social and economic infrastructure that make a State attractive for investment) and direct assistance (industry programs, revenue concessions, specific infrastructure and other project specific assistance). We are unable to identify common policies beyond the broad policy of providing assistance.

119. We are also unable to identify the underlying influences that create the differences between States in the level of economic development assistance. It is not clear that using education, general services, and so on, to achieve economic development aims leads to disabilities beyond those we already assess for those expenses. For the direct forms of assistance, we considered indicators such as gross State product, the size of the State budget, the State's demography and geography, and the lack of infrastructure, but we could not establish adequate links between them and economic development expenses. We also examined a number of options for adjusting revenue assessments to remove the effects of economic development policies but could not clearly establish the links between the expenses and the revenues.

120. We conclude that differences in State policies are the main influence on interstate differences in the level of assistance provided. Even if, in practice, it had been possible to develop assessments for particular types of direct assistance or for particular types of projects, we consider that making selective or partial assessments for those cases and not for others would not improve the overall equalisation outcome.

121. We do not accept that expense and revenue assessments must be symmetrical. Our general approach is to make separate assessments for expenses and for revenues, so that we can best consider which disabilities affect relative costs of services and revenue raising capacity. If some disabilities are identified, a decision can then be made on how best to measure them.

122. We continue to assess expenses related to economic development on an equal per capita basis and have not attempted to adjust revenue bases for the effects of economic development expenses.

Minority view

123. Professor Wiltshire disagrees with the whole approach to this assessment. He believes that there is already much identifiable expenditure associated with economic development, which is a common State government policy, and this could have been augmented by survey. It is possible to establish revenue streams associated with much of this outlay and as far as possible these should be treated symmetrically. Although it may not be possible to capture the comprehensive expenditure on this factor, Professor Wiltshire believes that partial equalisation is better than no equalisation. As a minimum, identifiable revenue from economic development outlay should be netted off before revenue equalisation is considered and, as an absolute minimum, this could be done for only those sectors where the States could demonstrate the linkages. There are clear disabilities for

certain States in this area, including costs of providing infrastructure, accessing large capital, and risk. Since the Commission already has some disability measures in related areas these could be used in this sector also — for example, cost of capital, scale, minimum outlays involved, and related access to capital etc. The data on State expenditure in this sector are contained within the GFS and so the onus is on States to give the Commission at least broad expenditure amounts, even if individual project expenditure cannot be provided.

TECHNOLOGY

Overview

124. The growing use of information and communications technology in the delivery of services affects the costs and use of State resources. The States agree that the use of technology is increasing but most consider that it is not uniformly available or effective across all regions and that it affects many types of costs. Our assessment methods capture most of those effects and have been varied to allow for some specific changes in relative costs arising from the use of technology.

1999 Review

125. In the 1999 Review the Commission concluded that the growing use of technology was aimed as much at enhancing service provision as it was at reducing the costs of previously provided services. The Commission decided that no special adjustments were required but said that this was an area where the methods of public sector service provision should be monitored.

State views

126. Victoria said that increased use of technology has reduced the range and level of costs affected by dispersion. On the basis of a consultant's report, it argued that the 1999 Review method of measuring the effects of population dispersion overstated the assessed disability for telephone and travel costs. It said that those disabilities and the estimates of the costs affected by them should be discounted.

127. Queensland, Western Australia, Tasmania and the Northern Territory argued that new technologies have not reduced dispersion-affected costs. Rather, they argued, they have improved service standards and at least partly bridged the gap in access to services between regional and metropolitan areas.

Process

128. We examined extensively the role of technology in service provision during State workplace discussions across Australia. We observed what it could and could not do.

129. We carried out research to understand what seemed like conflicting evidence on the technical capacity of technology to assist in the delivery of services in different parts of Australia, its relative cost, and how it is used. In particular, we examined the availability of technology in the various regions across Australia, what factors affect the extent of its use in providing State services, how technology affects State costs, and whether costs differ across regions in the States. The results of that work were shown to the States.

130. Commission officers held a conference with State officers to discuss the issues, including a Commission proposal for a survey of the use of technology in providing selected services — primarily education and health — and the costs associated with it across regions in the States. A full collection of regional data was not feasible, but States provided some data on technology use and costs on a whole of State basis and for a number of sample locations.

Consideration of the issues

131. There is a strong conceptual case that the growing use of technology affects the nature of services the States provide and their cost. In theory, the growing use of technology could change the mix of staff and other inputs that States use to provide services, which could reduce the cost of each service provided. On the other hand, it could increase the demand for services and their quality, resulting in an increase in total expenses.

132. From our research, we conclude that the use of technology in delivering State services has increased since the 1999 Review. However, the use made of technology differs from service to service. Our analysis also shows that the availability of telecommunications infrastructure is market oriented, with more and better services, and thus greater use, in the more populated areas. In many rural and outer regional areas infrastructure availability is patchy and there are often gaps in availability within short distances of major regional centres. The total costs of using technology include systems development and equipment and staff support costs, as well as the costs of accessing and using communication infrastructure. Most of those costs vary noticeably across regions.

133. Our method for calculating dispersion disabilities is designed to allow for such regional differences in costs. We conclude that most effects of technology on State budgets are reflected in our assessment. This is because we update the data on the level of expenses affected by dispersion and the prices of inputs (especially technology-based ones) used in providing State services. We did, however, make some adjustments to the method to better capture specific effects of technology on costs.

PRIVATELY FINANCED PROJECTS

Overview

134. A privately financed project (PFP) is one in which the private sector provides infrastructure and associated services that could otherwise have been purchased and

provided by government. The assets or services can be funded through payments by government or through user charges. It is integral to most privately financed projects that the operator designs, builds, finances and operates a property to provide the contracted service.

135. So far, most PFPs involve economic infrastructure (such as transport and communication facilities and the production and transmission of electricity, gas and water) that is usually provided by State public trading enterprises, the internal operations of which are not within the scope of the equalisation budget. However, PFPs are increasingly being used to finance a broader spectrum of services and social infrastructure (such as schools, hospitals, courts and prisons).

1999 Review

136. Needs relating to PFPs were not assessed in the 1999 Review.

Process

137. We asked States whether:

- (i) there was a need to reclassify PFP expenses;
- (ii) privately financed and funded roads should be included in a State's road length;
- (iii) they had different capacities to undertake PFPs and, if so, whether needs should be assessed for this; and
- (iv) having the processes in place to implement PFPs imposed greater per capita expenses on smaller States.

State views

138. The States agreed that, in principle, PFP expenses should be treated in their accounts and thus in the GFS data in a way that enables us to apply any appropriate disabilities to them. Most States (but not New South Wales) agreed that the roads assessment should exclude privately financed and funded roads in determining each State's road length. New South Wales and Victoria strongly opposed a specific assessment of needs relating to the ability to use PFPs. Queensland considered any such assessment to be premature. The other States supported an assessment.

Consideration of the issues

139. Where governments pay for a stream of services, there is a draft Australian accounting standard that is intended to ensure that expenses are classified appropriately. It

should assist the Commission to correctly classify the expenses. Where user charges apply, the services will be outside the scope of equalisation.

140. This leaves the questions of whether:

- (i) States face different expenses for fixed costs associated with developing and maintaining the capacity to produce guidelines and policies and the capacity to develop and manage contracts; and
- (ii) for reasons beyond their own control, the less populous States have relatively lower access to viable PFPs.

141. The available evidence supports the view that States incur extra fixed costs in developing and maintaining the capacity to use PFPs and suggests that the impact is material. We include these costs in the fixed costs recognised in our administrative scale assessment.

142. On the second question, the Commission sees a conceptual case that the less populous States are unlikely to have the same opportunities as larger States to take advantage of the opportunities provided by PFPs. But we could not find enough reliable data to develop a credible assessment. For example, it is generally considered to be too soon to know the level of any potential savings in Australia for the provision of social infrastructure, but it currently appears to be small. Victoria noted that it is possible that some projects will not generate savings. Similarly, the take-up rate for such projects is not clear, although as a proportion of capital spending by all State governments it was low during the years relevant to the assessments for this review. The problem of finding solid data, together with doubts about materiality, convinced us that it would be premature to make an assessment in the 2004 Review.

Results

143. The decision to reflect PFP-readiness in fixed costs increases the assessed needs of the five smaller States.

Minority view

144. Professor Wiltshire agrees with the disability for scale that the Commission has made in this assessment. However, he believes that there should also be a disability assessed for the smaller States in accessing capital for these projects because of the smaller size of their projects, their lesser capacity to carry the associated risk, and the demonstrated lack of interest of the private sector in a State with a small critical mass of such projects and a small or vulnerable economy. He believes that the readily available data from the private sector, combined with the views expressed to the Commission by most of the smaller States, reveal that the Commission is too conservative in its forecast of the magnitude of use by the States of PFPs over the next five years, and hence has been too low in its forecast of the impact on State budgets of those States more able to avail themselves of opportunities to use PFP provision.

OTHER ISSUES

Scope of the equalisation budget

145. States do not have major concerns about the scope of the equalisation budget, although some argue for different treatments of some transactions and for changes in the specific purpose payments included in the assessments.

146. Consistent with the equalisation pillar of ‘what States do’, we consider that the equalisation budget should include only those revenues and expenses that have a direct impact on State general government sector operating statements. There are three consequences of this:

- (i) The operating transactions of public trading enterprises (PTEs), except those providing housing services, are excluded. Under current policies only the subsidies provided to PTEs or the revenue contributions collected from them are recorded in State operating statements.
- (ii) Capital grants received from the Australian Government are included, subject to our general guidelines for the treatment accorded individual SPPs, because they are recorded as revenues in State operating statements.
- (iii) Commonwealth own-purpose outlays on State-type services are excluded if they are not paid to State general government agencies or if they are simply passed through agency budgets to other providers.

Compiling the equalisation budget and Government Finance Statistics

147. Following the adoption of accrual accounting by most States, the ABS GFS system moved to an accrual basis commencing with the 1998–99 data. This and related developments created instability in the data and some problems for the Commission’s analysis. The ABS and the States generally considered that the purpose classification of expenses was acceptable at the broad function level, but there were concerns about the accuracy and the interstate comparability of the detailed classification. To overcome those concerns, the Commission previously made systematic adjustments to the data for 1998–99 and subsequent years.

148. We still have concerns about the accuracy and interstate comparability of the GFS data on State expenses for 1998–99 to 2001–02, despite the improvements made during the review. However, we have no basis for making further adjustments. Given that our financial standards are an average of the expenses of all States, we conclude that the revised data should be used in this review.

149. Further improvements in the overall quality of financial data used in the review were made possible by a decision of the States to start publishing data on their

expenses classified using the detailed GFS purpose classification in their annual financial reporting documents for 2002–03⁷.

Counting State populations

150. Despite the concerns of several States, we propose to continue to use ABS population data in our assessments. These data include ABS census data, intercensal estimates of resident populations, and experimental estimates of the Indigenous population, as appropriate. We consider these constitute the best available measures of the relevant populations.

151. The ABS confirmed that it makes a significant effort to ensure that its remote Indigenous population count is as good as possible and that the Indigenous experimental estimates are the best available estimates of Indigenous resident populations. The Commission will continue to use them. We will also work with the ABS and other experts to see whether the data can be further improved.

152. The assessments do not specifically recognise any impact that transient populations and population mobility have on the costs of service provision. Transient groups such as tourists, visitors, itinerant and fly-in, fly-out workers, and mobile Indigenous populations may materially affect service costs, but there is insufficient evidence to support specific conceptual cases or to enable us to estimate those effects with any confidence. We therefore do not assess disabilities related to the impact of population mobility for this review. We note, however, that the ABS is investigating the possibility of compiling service populations on a national basis: we will monitor that work, with the possibility that adjustments could be introduced in an update.

Salinity

153. The impact of salinity on the costs of providing services is of increasing importance to State budgets. States report that salinity is affecting the amounts and types of assistance they need to provide to agricultural and water producers, the maintenance costs of roads, buildings and other assets, and the costs of managing national parks.

154. We considered whether the assessments adequately recognise these impacts. We concluded that most identifiable salinity expenses were included in the Primary Industry and Water, Sanitation and Protection of the Environment categories and that the impact of salinity was largely reflected in the disabilities assessed in those categories.

155. The major change we have made is to include expenses incurred by the Australian Government and the States on the National Action Plan for Salinity and Water Quality in the Primary Industry category. We assess needs arising from those expenses using the results of an evaluation undertaken by the Australian Government Department of Agriculture, Fisheries and Forestry.

⁷ In previous updates, data for the last of the five years used in the assessments were not available and were estimated by the Commission.

156. We also include a small allowance for differences in the effects of salinity on roads maintenance and depreciation in the Roads category.

Cross-subsidies

157. Western Australia argued that its cross-subsidies for electricity and gas should be included in the equalisation budget. We agree with Western Australia that differences in accounting treatments should not by themselves affect the assessments. However, the conceptual case for including the cross-subsidies in the equalisation budget was not established. The cross-subsidies do not have a direct impact on the State's general government operating statement, and their economic effects are not the same as those of direct subsidies for community service obligations because they directly affect consumers, not taxpayers. We have not included any cross-subsidies for electricity and gas in our assessment. Our approach gives each State the financial capacity to provide the Australian average level of explicit subsidies given the disabilities it would face in doing so.

158. ***Minority view.*** Professor Wiltshire disagrees with this assessment and believes the approach unfairly penalises Western Australia. In his view the standard State policy is to provide a subsidy to electricity and gas consumers; it happens that Western Australia chooses to do this by way of internal cross-subsidisation in these sectors rather than by community service obligations from the budget sector. (This is also completely in line with National Competition Policy guidelines and so, from this perspective, it can also be regarded as standard State policy.) In Western Australia the cross-subsidies do relieve the budget sector of this outlay and so there is an effect on the standard budget, albeit a slightly more indirect one. The Commission, by obtaining further details from the other States, could have adjusted the Western Australian fiscal situation to align it with the practice of the other States. Also, this assessment method has now created a future grant-design effect that Western Australia can take up, something which is contrary to the Commission's principles.

National parks and wildlife services

159. We recognise that all categories of terrestrial and marine park have an impact on the costs of providing national park services; we have altered the assessment accordingly.

160. We accept that the costs of park services are affected by the characteristics of the physical environment of States and their parks and the different impact human activities have on them. Costs are particularly affected by visitors to parks, the impact of population and other human activities adjacent to the parks, diseconomies of small scale, and the role played by Indigenous people in park management and other capacities. The 1999 Review method did not capture these effects well.

161. We do not think the revised assessment is ideal, but it does deal with the data deficiencies in a manner consistent with our guidelines. For example, we assess marine parks on an equal per capita basis because we have little confidence in doing otherwise. We use cost data for the different International Union for Conservation of Nature categories of

park as the basis of estimates of the effects of conservation values on park costs because alternative data sources are too out of date and/or not related directly to cost impacts.

Roads

162. After consulting with the States and the Australian Road Research Board, we changed the measure of road use to annual vehicle-kilometres travelled, rather than average annual daily traffic. The annual vehicle-kilometres travelled measure is widely considered to be more up to date, more representative of the use of the whole arterial road network in each State, and more comparable across States. We also implemented the advice of our consultant, that virtually all the effects on maintenance costs of road use stem from heavy vehicles: our consultant said that light vehicles have a negligible impact on road maintenance costs.

Housing

163. We revised the assessment method for housing expenses and user charges to give greater emphasis to influences on the demand for, and the cost of, public housing. We also included depreciation expenses in this category, rather than in the Depreciation category. The net effect of these changes (including a consistent assessment of user charges) is an increase in the relativity of the Northern Territory and to a lesser extent Victoria and Western Australia.

Non-government schools

164. Following our decision to treat payments by the Australian Government for non-government schools by exclusion, the only expenses relating to non-government schools remaining in the equalisation budget are the subsidies States fund from their own sources. Our investigations indicate that States generally decide the level of subsidy they provide to non-government schools by reference to the number of enrolments in the non-government sector and the cost influences that affect the per student costs of government education⁸. We changed the method of assessing the cost impact of non-government schools on State budgets to focus on those factors. This assessment change, coupled with the changed treatment of the Commonwealth SPPs, leads to increases in relativities for New South Wales, South Australia, Tasmania and the Northern Territory.

Post-compulsory enrolments

165. We responded to State criticism of the statistical model used in the 1999 Review to measure the effects of non-policy influences on post-compulsory enrolments by designing a new model. It specifically allows for a wider range of non-policy

⁸ The common policy of most States is to calculate the quantum of funds available for subsidies to non-government schools using a fixed proportion (ranging between 20 and 26.5 per cent) of total costs per student in the government sector.

variables, including family income, employment status, school sector, Indigenous status, ethnicity, location (remoteness) and parental expectations. It also measures the impact on post-compulsory enrolments of policy variables, including the level of provision of vocational education and training in schools and the level of provision of secondary colleges.

166. We conclude that, compared with the model used in the 1999 Review and other models proposed by some States, the regression model of participation rates developed in this review offers a better method for estimating post-compulsory enrolments in schools on a policy-neutral basis. This assessment change increases the relativities for New South Wales, Victoria, South Australia and the ACT, the States with above average participation in the post-compulsory years of schooling.

ANNUAL UPDATES

Updating

167. Achieving equalisation over time implies that State shares of the funds available for distribution should be adjusted to reflect changes in their relative fiscal circumstances. We consider that updating the relativities annually is a comparatively straightforward means of doing so and assume that it will continue.

168. In this review we sought to develop assessment methods that are amenable to updating, so that ongoing equalisation reflects the recent circumstances of the States and can continue to be achieved in subsequent annual updates. We also aimed to make clear how the assessments should be updated. Our general principles are as follows:

- (i) where new and better data are available, they should be used;
- (ii) where new factual information is available, calculations and judgments should be updated.; and
- (iii) where updating would require some data to be estimated, a decision on whether the updating is to be done should be made by the Commission on a case-by-case basis, depending on the materiality of the expected changes and the extent and reliability of the estimation involved.

169. Those principles mean that:

- (i) where updated data to measure a revenue base or a disability factor are available annually, they would be used;
- (ii) where different use or cost data are available annually and the change in average patterns is likely to be material, the Commission would use different factors for each of the five assessment years based on the

relevant use and cost data for each year and census data on populations; and

- (iii) where data are available and the change is material, component weights in each assessment category would be reviewed (and updated if appropriate) on an annual basis.

170. The working papers accompanying this report outline how we envisage updating being achieved for each part of an assessment.

Unresolved issues

171. With the completion of this review, some matters remain unresolved and we think they could be addressed in updates rather than wait for the next review. They include the following.

172. ***Socio-demographic composition.*** There are two unresolved issues associated with the assessment of socio-demographic composition disabilities. At our conference with the States on 10 December 2003, we said we would continue to use the 1999 Review method of classifying people as being in either low or other income households. However, we recognise that there is merit in using the new ABS measure of household-equivalised income to adjust for the impact of differences in family size. We consider that this should be investigated further, with a view to its possible adoption in an early update.

173. We also recognise a conceptual case for an adjustment to the income threshold for differences between States in the cost of living. However, the existing data sources do not allow us to make such an adjustment with confidence. We note that the ABS is developing a comprehensive Spatial Consumer Price Index. We will monitor the work on that measure to see if it provides a basis for an adjustment in the future.

174. ***Land revenue.*** At the 10 December 2003 conference with the States, we said that there was a clear conceptual case for including an adjustment for non-principal residential land in the assessment. We have included estimates of the value of non-principal residential properties in the assessment for this review. We will work on improving the quality and comparability of the data to improve the accuracy of the assessments in the 2005 Update.

175. ***Inpatient services.*** The Commission's decision to make the inpatient services assessment more comprehensive by considering country of birth has resulted in a high level of disaggregation. The increase in the number of variables used in the calculation has doubled the number of different socio-demographic composition groups recognised in the assessment. This means that more cells in the calculation have very small numbers and that our use rates could be volatile. The very late receipt of inpatient data for 2001–02 meant that this problem did not become clear until late in the review. We see value in working with the States to make the assessment more stable before the next update.

176. ***Service populations.*** As noted, we propose to work with the ABS to develop measures of service populations. We will also need the assistance of the States to develop

measures of the impact that different types of service populations — tourists, mobile Indigenous people, itinerant workers, and so on — have on State costs of service provision.

177. ***National parks and wildlife services.*** Further work will be required to improve the national parks and wildlife services assessment to better reflect the effects on park costs of the physical environment and human activity. Assistance from the States and Environment Australia will be needed to develop a database to support this.

178. ***Other possible issues.*** It is also possible that other issues might arise that could warrant changes in methods being introduced in the updates preceding the next review. If any such cases do arise, we think the Commission should bring them to the attention of governments. If governments agree, the update terms of reference could enable the Commission to deal with them.

CHAPTER 6

THE SPECIAL CIRCUMSTANCES OF THE AUSTRALIAN CAPITAL TERRITORY

1. In the 1999 Review and subsequent updates the Commission assessed allowances for the special circumstances of the ACT through:

- (i) national capital disability factors, to take account of the effects of Canberra's status as the national capital;
- (ii) an allowance to compensate the ACT for the ongoing higher costs of police services (assessed as a transitional allowance in the 1999 Review and as special fiscal needs from the 2001 Update); and
- (iii) a special fiscal needs allowance to take account of differences between the Australian Government's financial arrangements with the ACT and the financial arrangements it has with the other States in respect of corporate affairs.

2. National capital disability factors were included in the calculation of relativities. The other two allowances were paid as special provisions outside the pool of GST revenue and HCGs.

3. Part 1 of the 2004 Review's terms of reference requires the Commission to 'review whether the allowances for special circumstances granted to the Australian Capital Territory continue to be necessary and, if so, make appropriate assessments'. This chapter outlines our response to that request.

The ACT's views

4. The ACT argued for a continuation of national capital allowances. It said that the financial impact on the ACT resulting from its role as the national capital and seat of government is significant and pervasive.

5. The ACT asked the Commission to adjudicate all the claims the ACT made in respect of national capital influences on its costs of providing services. In particular, it asked the Commission to evaluate the ACT's estimates of the financial effects of each claim and to make a recommendation on whether those claims should be funded through the distribution of the GST and HCG pool or by the Australian Government through separate

payments. The ACT also asked the Commission to arbitrate on disputes between the ACT and the Australian Government about the extent of special fiscal needs. It argued that this broad approach was consistent with the terms of reference and would assist in its negotiations with the Australian Government.

6. In its submissions and workplace discussions the ACT provided evidence of the financial impact of national capital influences. Table 6-1 summarises its claims.

Table 6-1 NATIONAL CAPITAL ALLOWANCES SOUGHT BY THE ACT:
2004 REVIEW

Category	Claim	2004 Review allowance sought \$m
Education	For the additional cost of educating 507 students from diplomatic families, covering all education costs, including special tuition for people with low English fluency	4.000
Housing	For the backlog of housing maintenance, no sinking fund, and a mismatch between dwellings and needs resulting from decisions made for the national capital before self-government	13.000
General public services	For the higher costs of the leasehold system mandated by the Australian Government, extra costs associated with strategic regional planning arising from the ACT's status as the national capital, and extra net costs arising from forgone opportunities for land development	33.387
Culture and recreation	For above-standard costs incurred in maintaining Commonwealth Designated Land Areas in the ACT and above standard provision of open space and sports grounds	5.800
Urban transit	For the effect on bus patronage of Australian government policies on pay parking	2.100
Public safety and emergency services	For the extent of the bush-urban interface and open space in and around the city, the increased costs arising from the threat of terrorism, and its limited capacity to recruit volunteer fire fighters resulting from the planning of Canberra as the national capital with abnormal land use patterns	3.300
National parks and wildlife services	For the additional costs incurred in producing and implementing a management plan for the Canberra Nature Park arising from extra consultation time and the need for works approvals	0.500
Roads	For the above standard width of arterial roads in the ACT and the shorter life span of roads because of previous Australian government policies for the national capital	6.400
Tourism	For the cost impact of Australian government regulations and obligations imposed on the Canberra Tourism and Events Corporation in relation to the staging of events within the Parliamentary Triangle	5.700
Primary industry	For the impact of the National Capital Plan on the net operating deficit of forestry operations	0.572
Total allowances		74.759

7. In addition, the ACT asked the Commission to continue assessing special fiscal needs allowances for corporate affairs compensation and the higher costs associated with using the Australian Federal Police to provide policing in the ACT.

The Commission's approach

8. We developed guidelines to clarify the possibilities for treating each claim and to help us reach objective and consistent decisions. In formulating the guidelines, we had regard to our core business of applying equalisation principles.

9. The guidelines are as follows:

National capital allowances to be funded from the GST revenue and HCG pool using equalisation principles should be assessed for additional costs incurred by the ACT that stem directly from influences that are unavoidable consequences of Canberra's status as the national capital and the seat of government. In examining the individual merit of each proposed national capital allowance, we asked:

- (i) Does the cost relate to a State-type activity and is it the consequence of an unavoidable impact of the National Capital Plan or an Australian government policy because the ACT is the national capital or seat of government? If yes to both, and the consequence of the national capital and seat of government influence is that:
 - the amount of the service provided and the cost per unit of service is not within the control of the ACT Government, a national capital allowance should be assessed based on the extra costs incurred by the ACT;
 - the amount of the service provided is within the control of the ACT Government, but the cost per unit of service is not within its control, a national capital allowance should be assessed based on the extra costs per unit of service incurred by the ACT;
 - the amount of the service provided is not within the control of the ACT Government but the cost per unit of service is within its control, a national capital allowance should be assessed based on the standard level of costs per unit of service.
- (ii) Does the cost relate to a municipal activity? An assessment should not be made for municipal activities. The ACT's municipal costs are met through a separate specific purpose payment.

Special fiscal needs allowances to be funded outside the scope of equalisation relativities and the pool should be assessed:

- (i) for Australian government cost legacies inherited by the ACT after self-government; and
- (ii) to create arrangements between the Australian and ACT Governments analogous to those between the Australian Government and other States.

Allowances for special fiscal needs may not continue to be necessary and should be reviewed at regular intervals to determine whether they are.

Where Australian government policy influences have an effect on any State and it is standard policy for bilateral arrangements to be made, no assessment should be made. The arrangements would be out of scope.

However, if Australian government policy influences have an effect on any State, and it is not standard policy for bilateral arrangements to be made, where a case can be made for a disability factor, an assessment should be made and costs met from within the pool of GST revenue and HCGs for all States so affected¹.

10. Using the guidelines, if we find that a matter meets the criteria for a national capital and seat of government influence or a special fiscal need, we proceed to estimate the amounts involved. If, however, a matter does not meet the criteria, our view is that there is no basis for the Commission to consider it further. We also conclude that we should not quantify amounts or arbitrate disputes between the Australian and ACT Governments on these wider matters unless we are explicitly asked to do so by terms of reference.

11. We conclude that allowances for national capital and seat of government influences should continue to be assessed within the relativities and funded from the GST revenue and HCG pool.

12. We further conclude that some of the special circumstances of the ACT should continue to be recognised outside the equalisation framework. They should not be funded from the GST pool because they are cost legacies inherited by the ACT as a result of decisions by the Australian Government. They are not disabilities in the context of equalisation and are not a responsibility shared with the other States. Our guidelines establish the basis for considering what are known as special fiscal needs in a way that is consistent with broader Commonwealth-State financial arrangements. In developing the guidelines, we were informed by, but did not restrict ourselves to, existing practices on national capital or special needs that were recognised in the past.

National capital allowances

13. For the 2004 Review we assess specific national capital allowances mainly as disability factors. In some cases allowances are built into other factors in expense assessments and into revenue bases for revenue assessments. For example, the socio-demographic composition factors in the Education categories include allowances for the costs of educating students from diplomatic families. A number of revenue bases also encapsulate the effects of the ACT's status as the national capital. In particular, the ACT's revenue bases for payroll tax, land tax, insurance taxation and stamp duty on conveyances exclude transactions by the Australian Government, which constitutionally does not pay State taxes.

14. We assess specific national capital allowances to recognise that the ACT Government incurs above standard costs in the following areas:

¹ Examples of these cases are Australian Government Land Rights and Native Title legislation and superannuation costs.

- (i) the General Public Services category, where we consider that the operation of the National Capital Plan increases ACT government planning and development costs by \$1.5 million a year and siting and building requirements of the Plan increase capital costs by \$1 million a year. We also consider that the leasehold land tenure system results in annual land management costs that are \$2.5 million above the standard level;
- (ii) the Public Safety and Emergency Services category, where we consider that the National Capital Plan has resulted in an above average amount of open space in and around the city and a more extensive city–bush interface, which increase annual costs by \$0.5 million. We also consider that the atypical land use patterns in the ACT resulting from its national capital status result in additional costs of employing bushfire fighters of \$1 million a year. The national capital status also leads to additional public safety costs of \$0.4 million a year because of the increased threat of terrorism;
- (iii) the Culture and Recreation category, where we consider that the requirements of the National Capital Plan mean that the costs incurred by the ACT in managing and maintaining designated land and in maintaining above average areas of urban open space in the Territory exceed the standard by \$4.87 million a year;
- (iv) the National Parks and Wildlife Services category, where we consider that the extra consultation and works approvals stemming from the requirements of the National Capital Authority increase the annual costs of producing and implementing a management plan for the Canberra Nature Park by \$0.1 million; and
- (v) the Urban Transit category, where we consider that the effect of the Nation Capital Plan on the urban form of the ACT and Australian government policies on providing free parking in many national areas (which reduce bus patronage) increase the subsidies the ACT must pay by \$1.5 million a year.

15. We also recommend that these allowances be updated annually using the Consumer Price Index.

16. We do not assess national capital allowances for a number of the ACT's claims. This is because we conclude that the higher costs are not unavoidable costs arising from the ACT's status as the national capital. For example, we do not accept the claims relating to the impact of the National Capital Plan on forestry operations and the Canberra Tourism and Events Corporation because the case was not made that the costs are an unavoidable outcome of the ACT's status as the national capital. We consider the net impact of forestry and tourism operations are economic development–type expenses, which should have no impact on the equalisation result.

17. The working papers accompanying this report provide details of the ACT's claims and the reasons for the Commission's decisions.

Special fiscal needs

18. In the 2004 Review we assess special fiscal needs allowances in the Police and Roads categories and for the Corporate Affairs arrangements.

19. The allowance for police recognises that the ACT has no practical alternative but to use the Australian Federal Police (AFP) to provide policing services. As a consequence, the ACT must pay salary levels established by the Australian Government, which are currently higher than Australian average police salary levels. We expect that this allowance will continue while AFP salary levels remain above those of other police forces². We consider this amount should be updated annually using data on police salaries contained in the Productivity Commission's *Report on Government Services*.

20. The allowance for roads recognises that at the time of self-government the ACT inherited roads that were wider than Australian standards. We expect this allowance will continue to be required for a further 15 years. After that, sufficient time should have elapsed to allow the ACT to rebuild or restructure the wider roads it inherited. Until then, this allowance should be updated using the Consumer Price Index.

21. The ACT was excluded from the arrangements agreed between the Australian Government and the other States for payments to replace revenue forgone following the establishment of the national scheme of companies regulation. Unless the ACT is included in these ongoing arrangements, the need for a corporate affairs allowance will persist. Consistent with the approach used to derive the corporate affairs compensation SPP amounts paid to the States, this allowance should be updated annually using the Consumer Price Index.

Summary

22. Table 6-2 summarises the assessed national capital allowances and special fiscal needs for the 2004 Review³ and compares them with those assessed in the 2003 Update.

² The allowance is calculated as the additional amount paid to an Australian average number of police officers and unsworn staff because of above standard salaries and superannuation on-costs.

³ Special fiscal needs allowance to be paid in 2004–05, compared with those assessed in 2003–04.

Table 6-2 NATIONAL CAPITAL ALLOWANCES AND SPECIAL FISCAL NEEDS

Category	Allowance assessed in 2003 Update using 1999 Review methods \$m	2004 Review allowance \$m
<i>National capital allowances</i>		
Education	4.000	(a)
General public services	3.400	5.000
Administration of justice	0.200	(b)
Public safety and emergency services	0.615	1.900
Culture and recreation	1.385	4.870
National parks and wildlife services	0.000	0.100
Urban transit	1.500	1.500
Total national capital allowances	11.100	13.370
<i>Special fiscal needs</i>		
Roads	0.000	2.600
Police	10.900	7.400
Corporate affairs	4.100	4.200
Total special fiscal needs	15.000	14.200

(a) Allowance included in the normal assessment of student numbers and ESL costs.

(b) Discontinued because the ACT introduced new criminal compensation legislation.

CHAPTER 7

ISSUES IN EQUALISATION

1. During the course of the review a number of issues of concept and principle were raised by several States. Some of them go to the objectives underlying equalisation; many go beyond what the Commission believes its terms of reference call for; many are properly matters for consideration by governments. It is clear that the stakeholders in the financial arrangements underpinning the Australian federation differ in their views about the ongoing appropriateness of the current approach.

2. We think this is a matter of concern. While some differences of view are not new, and are to be expected, the nature of the issues raised and the vigour with which they have been put forward suggest a strengthening view among some States that the principles that have underpinned the implementation of fiscal equalisation for many years need to be revisited. Some views imply a weakening in the commitment to equalisation.

3. We think the integrity and acceptance of equalisation demand a high degree of consensus about the broad principles and objectives that are to apply, particularly on the part of State governments. We acknowledge that, in an environment of rapid change in the role of the public sector and in the delivery of public goods and services, it would be reasonable and appropriate for the objectives, principles and practices of equalisation to be re-examined from time to time. This has been done in the past.

4. This chapter is not a part of our formal response to the terms of reference. The issues raised here do not impact in any way on the relativities we have assessed. The chapter is intended to record some of the more substantive issues raised during the 2004 Review that we considered were outside our terms of reference and that we therefore did not pursue. We include this chapter because we think many of the issues do warrant further consideration, and our report provides an appropriate vehicle to record some of the matters that might be addressed if governments subsequently agree on the need for a fundamental examination of the principles and objectives of equalisation.

Terms of reference

5. Early in the review process it became apparent that there was no clear consensus among the States about the meaning of the terms of reference we had been given and therefore what it was open to the Commission to do in the review. The differences of view essentially turned on the scope of the review — whether it was to be limited to a consideration of the issues of method that the Commission applies (however broad these

might be) or whether it should extend to a consideration of the purposes and objectives underlying fiscal equalisation and the concepts and principles of equalisation. In essence, the differences reflected divergent views as to whether the review was about the implementation of a historically agreed concept of equalisation or whether the concept itself was within the mandate of the review.

Matters raised by the States

6. Differences of view remain among the States about the principles underlying equalisation and its implementation.

7. New South Wales and Victoria argued that the existing approach to equalisation distorts efficiency, drives mediocrity rather than efficiency, and is not consistent with the wider public policy framework. Victoria, for example, argued that the current approach stifles the evolution of competitive and dynamic State governments and does not adequately take account of changes in public administration using the best available measurement techniques. It argued that, in its approach to the assessment of needs and disabilities, the Commission should use standards that reflect best practice in service delivery or revenue collection.

8. Victoria said that those States that receive above average per capita grants should be accountable to the broader Australian community for the use of the funds. This could extend to some explanation of why the extra funds received have not led to reductions in disabilities over time. Describing the redistribution of funds to the smaller States as subsidies, it said there was an obligation on the recipient States to make effective and efficient use of them. Victoria described horizontal fiscal equalisation as a 'safety net', rather than a process requiring the equalisation of everything all the time. Consistent with the concept of a safety net, it argued there must be mutual obligation to minimise the disadvantage that is being addressed.

9. Victoria also argued that there should be evidence of disabilities reducing over time as recipient States apply their larger per capita grant shares to overcoming the disabilities they face.

10. The two larger States forcefully expressed the view that the level of redistribution under the existing approach to equalisation was becoming unsustainable.

11. The issue of equity was also raised, with Victoria arguing that equalisation should be based on outcomes rather than inputs.

12. Several States questioned whether the Commission attributed too much of the differences between States in the costs of providing services or revenue raised to effects of disabilities, with a consequent understatement in the effects of policy differences.

13. Some States, particularly Western Australia, argued that the scope of equalisation should be extended to better reflect the role States play in developing their economies and enhancing their revenue bases. New South Wales, in contrast, proposed limiting the scope of equalisation, on the expense side of the budget, to the provision of

what it called ‘merit goods’. New South Wales also encouraged the Commission to move to a global assessment of revenue capacities, rather than the current tax base approach. Western Australia supported this view, as has Victoria in the past.

14. Several States argued that Commission decisions are based too heavily on ‘what States do’, resulting in a high level of detail. These States suggested that other decision criteria — such as materiality and the reliability of measurements — should be given more emphasis.

15. New South Wales and Victoria expressed ongoing support for and commitment to horizontal fiscal equalisation, but not necessarily as it is currently defined by the Commission. New South Wales and Victoria said they do not accept that the Intergovernmental Agreement on the Reform of Commonwealth–State Financial Relations (IGA) proscribes further consideration of the principle of equalisation and that it is open to the Commission to reconsider the principle. New South Wales said there are other ways of interpreting how fiscal equalisation is applied and they do not want to be locked into the existing words forever.

16. These views were strongly contested by Queensland, South Australia, Tasmania and the two Territories. They expressed their support for the current approach to fiscal equalisation, arguing that it reflects the broad political consensus about the objectives of equalisation, which constitute an integral part of the fabric of the federation.

17. We accepted that some aspects of these issues fell within the mandate given to us by our terms of reference. In this review we considered the arguments put to us in relation to the scope of equalisation, the issue of policy versus disability, and the level of detail in our assessments. These matters are addressed elsewhere in the report and in the accompanying working papers.

18. We did not take up all of the issues raised by the States. In responding to the various matters of principle raised by some States, we took the view that we should have particular regard to the language of the terms of reference, the context in which they were prepared, and the history of previous reviews. We thought that the language of our terms of reference called for the same type of review as had been undertaken by the Commission in 1993 and 1999. We noted that Schedule 2 to the IGA provides that GST revenue is to be distributed among the States on the basis of horizontal fiscal equalisation principles. These principles are not defined in the IGA, but we interpreted this to mean that our approach should be based on the equalisation principle in place at the time the IGA came into effect — that is, the 1999 Review principle. It is worth noting that States have very different views about the relevance of the IGA to our terms of reference. Some strongly support the conclusion we reached; others do not.

19. The IGA also specifies that the GST revenues are to be freely available to the States — that is, they are untied — and can be spent by the States in accordance with their own budget priorities. We think this has implications for some of the issues that were raised by States.

20. Against these considerations, it seemed to us that the terms of reference called for a review of the methods of assessment used in applying the (existing) principle of

fiscal equalisation. In conveying this view to the States, we indicated our intention to take a broad view of what constituted ‘methods’. Our work for this review has included consideration of the equalisation model, the scope of our assessments, the range of revenue and expenditure disabilities to be assessed and how they would be assessed, and the treatment of specific purpose payments.

21. In the past, when the Commission was asked to review issues of principle, separate and specific terms of reference were provided and this work was done separately from a review of relativities. We indicated to the States that if governments wished us to undertake a wider review, we would need further terms of reference that made this clear.

22. We were also guided by a fundamental question: how should the scope of equalisation and the objectives and purposes to which it is directed be determined? We are firmly of the view that these issues are matters for governments. While we accept that the Commission could play a useful role in evaluating the many arguments and their implications, decisions about the financial architecture of the federation are decisions for governments. We did not accept that our terms of reference gave us a mandate to consider and make recommendations about these matters.

23. These views about the terms of reference and the scope of the current review were conveyed to heads of treasuries at a Priority Issues Conference in September 2001. That conference did not reconcile the differences of view among the States. It is clear that some States continue to see a fundamental reconsideration of the principles of equalisation as necessary and important and they are frustrated that there is no current opportunity for this to be done. It is equally clear that this present review is not understood by other States to be a vehicle for delivering a fundamental reappraisal of the objectives of equalisation.

24. Most of these issues are not new. Although the way they are presented and the particular emphasis specific issues are given differ, they reflect long-standing views about equalisation in Australia. They have been addressed at other times, including in the following publications:

- (i) the Commission’s 1990 *Report on Issues in Fiscal Equalisation*;
- (ii) the March 1994 *Report of the Heads of Treasuries Working Party on Horizontal Fiscal Equalisation*;
- (iii) the 2001 *Review of Commonwealth–State Funding*, commissioned by New South Wales, Victoria and Western Australia; and
- (iv) *Financing the Federation*, a 2001 study by the South Australian Centre for Economic Studies.

25. Among the issues the Commission thinks could usefully be explored in an appropriate forum are:

- (i) the objectives of equalisation;
- (ii) the application of equalisation;

- (iii) complexity and transparency; and
- (iv) data issues.

The objectives of equalisation

26. ***What is equalisation being asked to deliver?*** A common criticism of the existing approach to equalisation is that it is not doing what might naturally be assumed. This criticism, in part, reflects a view about equity. The 2001 Review of Commonwealth–State Funding commissioned by New South Wales, Victoria and Western Australia argued that the concept of equity among States has no meaning, that instead equity must relate to outcomes for individuals and households. It concluded that the current methods do not improve vertical equity and do nothing to address the disparities in access to services between regions within States. Others have expressed different views, and the Commission itself has argued in the past that without the present equalisation arrangements the fiscal system would be even further away from the equal treatment of equals.

27. As noted in Chapter 2, the current objectives of fiscal equalisation are directed towards the equalisation of State fiscal capacities. They do not have as their objective a fiscal transfer system directed towards interpersonal equity or community or regional equity. Within the limits of their current fiscal capacities, States do not themselves follow policies of interpersonal or community equalisation; for example, by and large, it is accepted in the policies of states that residents of rural and remote communities cannot be assured the same level of access to services as that received by residents of metropolitan areas.

28. ***Is equalisation being asked to do too much?*** We think there are grounds for considering whether equalisation is being asked to do too much. Equalisation is an important element of intergovernmental financial arrangements in Australia. But it is not the only channel by which funds flow from the Australian Government to the States, and it is not the only vehicle by which national objectives and priorities, appropriate to the wider canvas of the federation, can be progressed. Many objectives in Commonwealth–State relations might be better addressed by bilateral, rather than multilateral, arrangements.

29. Large differences are evident within Australia in the standard of public services, between regions and between services. We have observed the state of facilities in Indigenous communities, particularly in the tropical north and the central deserts, and the circumstances facing teachers and welfare workers in poorer metropolitan areas in some of our major cities. It is difficult to tell whether what is being observed reflects differences in standards of living associated with lack of community support, as opposed to differences in government service provision. Equalisation, in relating to budget capacities, not standards of living, may have little to do with differences such as these.

30. Some have argued that the needs of States experiencing secular decline in relative economic performance are not adequately addressed under existing equalisation arrangements. It is not obvious that equalisation would be the most appropriate means to address such secular decline. Other forms of Commonwealth–State cooperation may be needed.

31. ***Should other national objectives be affected by equalisation?*** One specific issue that arises from the way equalisation is currently implemented is the treatment of specific purpose payments (SPPs). These are payments from the Australian Government to the States for various purposes relating to specific programs and objectives. Under the current equalisation approach, most are effectively taken into the Commission's equalisation assessment processes and so have a direct impact on the distribution of untied GST funds.

32. We are conscious that this approach to the treatment of SPPs can be perceived to override other national objectives. This issue is not new; it was 'noted' by the Heads of Treasuries Working Party and has been raised by the Commission on a number of occasions. We advise the States in detail about the way we propose to treat these payments, and they generally support the approach we take.

The application of equalisation

33. From time to time States have expressed concerns about the extent to which relativities and grant shares change over time. These concerns relate to the changes that flow from one review to the next, and to the sometimes quite sizeable changes that flow through in annual updates. The changes are sometimes said to demonstrate that the current approach is unreliable, and particularly that the data on which they are based are not reflecting accurately or realistically the actual changes on the ground in the relative circumstances of the States.

34. At a more practical level, States have expressed concerns that unanticipated changes in their grant shares create severe problems of budget management, particularly in relation to commitments that are embedded in their forward estimates. From this perspective, stability and predictability in results are assigned some importance by the States.

35. A question that then arises is whether the outcomes of reviews and updates should be applied as they result, or whether, particularly when changes in grants are large, they should be moderated in some way.

36. We accept that States face practical budget management difficulties if confronted with large changes against the assumptions they have made about revenue. We are less convinced that variations in relativities and grant shares from year to year and review to review are evidence that the equalisation process is flawed. They might equally be seen as evidence that equalisation is working; that is, it is reflecting the changing circumstances of the States. It is also the case that basing the relativities on the average of five years of data provides some moderation of short-term fluctuations. On the other hand, we acknowledge the possibility that, because of data problems, our process may be picking up changes that are not reflecting actual changes in States' circumstances. The greater the level of disaggregation and complexity in the assessments, the greater this risk might be.

37. There are several ways in which changes in relativities could be moderated further. The simplest would be for new relativities recommended by the Commission to be phased in over a period. This approach could be relevant when the relativities are generally

accepted as appropriate, but practical issues such as budget management suggest the need for some transitional approach.

Complexity and transparency

38. The approach to equalisation in Australia is frequently criticised for its complexity and lack of transparency. In all federations equalisation processes — which are generally less comprehensive than those in Australia — are complex.

39. The Commission's methods are complex because the assessments require consideration of complex and often sophisticated arguments about the extent to which States face disabilities across the entire spectrum of their activities. This involves close examination of the States' demographic, physical and economic circumstances and how they affect the demand for and costs of service provision. Such an approach requires the analysis, interpretation, application and manipulation of large amounts of data and other evidence, the application of econometric modelling, and the use of judgment.

40. This complexity does inhibit the Commission's transparency even though its processes are open and inclusive. Its consultations with States are open to observers from all other States. All submissions received are copied to all States. The Commission provides a great deal of material to enable interested parties to ascertain how it has reached its conclusions.

41. Efforts to simplify the approach were proposed by the Commission and were made a priority at the start of the work program for the 2004 Review. While at one level States generally indicate support for greater simplicity in approach, in practice they did not support simplification over the course of the review. Our proposal that the Commission might take a more across-the-board approach in setting aside detailed consideration of the small assessments was not supported by the States.

42. That response is not surprising. The present process encourages States to focus on identifying areas where disabilities might be thought to exist and developing supporting arguments. While the more important among them are generally well supported by data or other evidence, others are not. Similarly, while some assessments have a large impact on the relativities, others do not; but arguments in the latter category are pursued by the States with no less vigour. The consequence of this process is that the scope of our work has broadened — precisely the opposite to the direction that our stakeholders and we are advocating.

43. It is not obvious that increasing detail is producing a better equalisation outcome. Our processes are stretching the available data to the limit. We have noted that the application of new or alternative data can generate changes in the assessed State relativities in particular categories that are difficult to reconcile with the extent to which the States' underlying circumstances can have changed. This necessarily gives rise to unhelpful comparisons and arguments about consistency and robustness. We have come to the very strong view that simplification of methods should be a priority going forward, irrespective of any decision governments might make about a wider reconsideration of principles and objectives.

Data issues

44. The Commission's existing assessment process depends heavily on the availability of data, and the resulting relativities and grant shares are largely driven by data. We require robust, reliable, comparable and up-to-date data at a high level of disaggregation. We think it essential to have confidence in the quality of the data we are using. If we cannot have a high level of confidence in the data, we are strongly of the view that methods should be changed, rather than relying on data that might be inadequate for the purpose.

45. Against this background, we have serious concerns. We remain uncertain that some of the data we are using are as robust and reliable as we believe is necessary. We may be pushing the data too far in some of the ways we use them. Particularly towards the end of this review, we observed large changes in relativities for some States flowing from the application of new data sets. The extent of the changes could not readily be explained by changes in the underlying circumstances of the States. If the data we are using are not consistently reflecting the circumstances of the States, the quality of our results is compromised.

46. Of particular concern is the comparability and reliability of data on State revenues and expenses in the ABS Government Finance Statistics collection, which is central to what we do. The ABS has indicated that coding of expenses according to their purpose was not done consistently by States. Based on discussions with the ABS, we understand that, at the major group (or two-digit) level, the quality of General Purpose Classification data is 'very good'; at the sub-group (or four-digit) level that we rely on extensively, it is 'very patchy, unreliable and inconsistent across jurisdictions'. There are questions about how much improvement can be made over what time frame at the four-digit level and whether improvements can be maintained over time. The States themselves have differing levels of confidence in some of the data.

47. It is the need for finely classified or more highly disaggregated data that gives rise to most of these data concerns.

A way forward?

48. Fiscal equalisation remains central to intergovernmental financial arrangements in Australia. We understand the concerns that are being expressed to be less about the need for equalisation arrangements and more about whether the current approach continues to be justified.

49. All Members of the present Commission acknowledge that important issues of concept and principle have been raised. The approach to equalisation and the Commission's role have evolved over time and we do not think the current arrangements should be seen as inviolable. We take the view that ongoing support for equalisation can best be strengthened through a process that allows issues of concern to be addressed.

50. In our conferences with Heads of Treasury, and at other times (including in public forums), we have made it clear that we are supportive of a far-reaching review of

equalisation, including its underlying purposes and objectives. In the context of the changing circumstances of the States, and changes in thinking about the way services are provided, we think this is something that should be done from time to time.

51. We did not undertake such a task in this review because we did not consider we had a mandate to do so, and we would not have had the support of a majority of the States in interpreting our terms of reference this way. In any event, there is a more fundamental consideration. The financial architecture of the federation is a matter for governments. And it is a matter for governments to initiate a review of this architecture, if they judge it desirable. We can do no more than express our strong view that we think there would be value in doing so.

52. Given that equalisation is about distributing a given pool of funds across the States, it would be difficult for a normal Commission review process to separate issues of principle from grant share outcomes. For this reason we think that any review of the underlying principles or objectives of equalisation — whether conducted by the Commission or not — would be best conducted outside the cycle of the Commission's regular review processes. This would help to give the right focus to the right issues. The terms of reference for such a review would need to be developed in full consultation with all States to ensure an inclusive process that encouraged a comprehensive presentation of views.

53. We think there would be benefit in a review of equalisation principles, but whether such a review is initiated is a matter for governments. Whatever might be decided, we think there would be value in the Commission and the States agreeing to a somewhat different work program that could inform the debate, ahead of the Commission's next normal review, which, if past practice is followed, will be required in 2009.

54. We recommend to the next Commission and to the States a work program that enables the widest possible consideration of the issues of concern to the States. On the basis of the issues raised with us during the course of this review, the first two years of the work program could be directed towards consideration of such matters as:

- (i) the scope of equalisation — is the present approach, which is based on a comprehensive assessment of virtually all receipts and expenses in the operating statements of States, appropriate and necessary?
- (ii) the size and trend of the redistributions;
- (iii) simplification — the Commission's current approach is based on high levels of disaggregation and large numbers of adjustments. Is this necessary and does it deliver a better equalisation outcome than possible alternatives? and
- (iv) data issues — a consultative examination of the robustness and comparability of key data sets and likely data availability in the future.

55. It would be a matter for the Commission and the States to identify and agree more specifically on the scope and priorities for such a work program. This work might lead

to the development of a series of discussion papers and a conference between the Commission and Heads of Treasury at which the scope of the subsequent review could be determined. We would expect these discussion papers to develop issues of principle rather than to focus on the implications for State relativities.

ATTACHMENT A

PROCEDURAL ARRANGEMENTS

1. The Commission received Part 1 of the terms of reference for this review in December 1999. In anticipation of its receipt, the Commission commenced planning for the work of the review earlier in 1999. It received Part 2 of the terms of reference in November 2003.

2. The activities associated with the review in which the parties to the inquiry discussed issues with the Commission are set out below.

2000

23 June	Staff depreciation and debt charges working party meeting
28 August	Staff urban transit conference
27 November	Staff urban transit conference

2001

30 April	Staff depreciation and debt charges working party meeting
28-31 August	Workplace discussions in the Northern Territory
14 September	Staff urban transit conference
21 September	Staff depreciation and debt charges working party meeting
28 September	Priority issues conference
15-19 October	Workplace discussions in Queensland
19-23 November	Workplace discussions in New South Wales
7 December	Staff depreciation and debt charges working party meeting

2002

24-27 June	Workplace discussions in South Australia
15-19 July	Workplace discussions in Victoria
29 July – 2 August	Workplace discussions in Western Australia
12-16 August	Workplace discussions in Tasmania
6 September	Valuers-General conference (held as part of the 2003 Update but was also relevant to the 2004 Review)
23 October	2004 Review general conference
13-15 November	Workplace discussions in the Australian Capital Territory
20-21 November	Staff general conference
5 December	Staff information and communications technology conference (with some States participating by tele-conference)

2003

12 March	Bilateral discussions in Victoria
13 March	Bilateral discussions in Tasmania
20 March	Bilateral discussions in Western Australia
1 April	Bilateral discussions in New South Wales
2 April	Bilateral discussions in South Australia
8 April	Bilateral discussions in the Northern Territory
10 April	Bilateral discussions in Queensland
August	Draft assessment papers (preliminary calculations) distributed to the States and the Australian Government Treasury
20 August	Staff draft assessments information day
5 September	Draft assessments conference
10-12 September	Staff draft assessments conference
1 October	Staff mining data workshop
23 October	Bilateral discussions in the Australian Capital Territory
11 December	Final conference

ATTACHMENT B

HOW THE COMMISSION'S RELATIVITIES ARE USED AND THE CALCULATION OF GUARANTEED MINIMUM AMOUNTS

How the Commission's relativities are used

1. The per capita relativities the Commission calculates are used in sharing the GST revenue and HCG (or notional FAG and HCG) pool among the States. The process is:

- (i) weighted populations are calculated by applying the per capita relativities to ABS estimates of State populations as at 30 December;
- (ii) each State's share of the weighted population is calculated by dividing its weighted population by the Australian weighted population; and
- (iii) each State receives a share of the GST revenue and HCG (or notional FAG and HCG) pool equal to its share of the weighted population.

Calculation of the guaranteed minimum amounts

2. Starting with the GST and HCG pool, each State's guaranteed minimum amount (GMA) is the sum of:

- (i) its GST revenue provision — determined by applying the Commission's GST relativities to the combined pool of GST revenue and HCGs, less the actual distribution of HCGs; and
- (ii) its budget balancing assistance — the amount that meets the gap between the State's share of the GST revenue pool and its GMA.

3. By starting with the notional financial assistance grant (FAG) and HCG pool, each State's GMA is the sum of:

- (i) its notional FAG distribution — determined by applying the Commission's FAG relativities to a combined pool of FAGs that would have been available for distribution if the tax reforms had not taken place, and HCGs, less the actual distribution of Health Care Grants; and

- (ii) the estimated impact on its budget of changes agreed in the IGA — to compensate the State for the net effect of its loss of revenue and the increase in expenditure responsibilities.

4. These relationships are shown in the following equation.

$$\left[\begin{array}{l} \text{GST} \\ \text{Revenue} \\ \text{Provision} \end{array} + \begin{array}{l} \text{Budget} \\ \text{Balancing} \\ \text{Assistance} \end{array} \right] = \text{GMA} = \left[\begin{array}{l} \text{FAG} \\ \text{Distribution} \end{array} + \begin{array}{l} \text{Estimated State} \\ \text{Budget Impacts} \end{array} \right]$$

5. Table B-1 also shows the estimated budget balancing assistance for each State from page 14 of the Australian Government Budget Paper No 3, *Federal Financial Relations 2003-04*.

Table B-1 APPLYING THE COMMISSION'S RELATIVITIES, 2003-04

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Projected populations ^(a)	6 736.0	4 963.3	3 828.1	1 968.4	1 532.8	474.9	326.0	198.6	20 028.1
Per capita relativities ^(b)	0.89117	0.87010	1.01902	0.96946	1.21215	1.59948	1.14979	4.38638	na
Weighted populations ^(c)	6 002.9	4 318.5	3 900.9	1 908.3	1 858.0	759.6	374.9	871.0	19 994.1
Share of weighted population ^(d) (%)	30.0	21.6	19.5	9.5	9.3	3.8	1.9	4.4	100.0
Distribution of GST/HCG pool ^(e) \$m	11 656.6	8 385.9	7 574.9	3 705.6	3 607.9	1 475.1	727.9	1 691.3	38 825.2
Plus: Budget balancing assistance \$m	563.3	209.2	0.0	0.0	47.6	0.0	0.0	0.0	820.1
Total GMA plus HCG	12 219.9	8 595.1	7 574.9	3 705.6	3 655.5	1 475.1	727.9	1 691.3	39 645.3

- (a) Projected populations in thousands as at 31 December 2003, prepared by ABS.
 (b) The per capita relativities for 2003-04 as adopted by the Ministerial Council for Commonwealth-State Financial Relations.
 (c) The product of the first and second rows.
 (d) State weighted population in thousands as a percentage of total Australian weighted population. Although shown to one decimal place, unrounded percentages are used in the ensuing calculation.
 (e) The application of each State's unrounded share of weighted populations to the GST revenue and HCG pool of \$38.825 billion.

6. In 2003-04, Queensland, Western Australia, Tasmania, the ACT and the Northern Territory did not receive budget balancing assistance. That is, their shares of the 2003-04 GST revenue and HCG pool exceed their GMA plus HCG (the amounts they would have received if the Commonwealth-State financial arrangements in place in 1999-2000 had continued).

7. Table B-2 provides a calculation of the illustrative budget balancing assistance States would receive given our illustrative estimates of their share of the 2004-05 GST and HCG pool and their GMA for 2004-05. The illustrative estimate of each State's GMA is based on:

- (i) the assessed FAG relativities shown in Attachment D;

- (ii) the latest available estimates of the notional financial assistance grants and HCGs that would have been paid if the 1999-2000 Commonwealth-State financial arrangements had continued; and
- (iii) the effects on State budgets of the taxes they abolished and the extra service responsibilities they accepted under the IGA.

Table B-2 ILLUSTRATIVE CALCULATION OF BUDGET BALANCING ASSISTANCE FOR 2004-05

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Illustrative GMA	12 240.5	8 866.7	7 975.7	4 088.0	3 743.0	1 476.4	727.5	1 672.3	40 790.1
Illustrative share of 2004-05 GST and HCG pool	12 128.0	8 920.3	8 460.4	4 232.6	3 806.2	1 525.4	760.1	1 761.2	41 594.1
Illustrative budget balancing assistance ^(a)	112.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	112.5

(a) The amount required to bring a State's illustrative GST revenue and HCG pool up to its illustrative GMA. A State would not receive budget balancing assistance if its GST revenue and HCG pool exceeded its GMA.

8. Table B-3 shows the projected populations as at December 2003 and December 2004 that have been used in this report.

Table B-3 ESTIMATED RESIDENT POPULATIONS, DECEMBER 2003 AND 2004

	31 December 2003		31 December 2004	
	'000	%	'000	%
New South Wales	6 736	33.63	6 798	33.57
Victoria	4 963	24.78	5 012	24.76
Queensland	3 828	19.11	3 899	19.26
Western Australia	1 968	9.83	1 997	9.86
South Australia	1 533	7.65	1 537	7.59
Tasmania	475	2.37	476	2.35
Australian Capital Territory	326	1.63	327	1.62
Northern Territory	199	0.99	201	0.99
Australia	20 028	100.00	20 246	100.00

Sources: Australian Government Budget Paper No. 3, *Federal Financial Relations 2003-04*, Table 9. Data related to the *Mid-Year Economic and Fiscal Outlook 2003-04*, December 2003, provided to the Commission by the Australian Government Treasury.

ATTACHMENT C

CALCULATION OF RELATIVITIES — GST RELATIVITIES

1. This attachment shows the calculation of the per capita GST relativities required by the terms of reference.

2. The tables show the calculation of standardised deficits per capita and relativities for each year of the assessment period, 1998-99 to 2002-03, by two methods.

(i) Tables C-1, C-3, C-5, C-7 and C-9 show the calculation using standardised expenses, standardised revenues, the equalisation budget results and SPPs treated by inclusion.

(ii) Tables C-2, C-4, C-6, C-8 and C-10 provide an alternative presentation, using the Australian average per capita level of untied assistance and HCGs paid during each year (called 'the pool' in the tables) and per capita needs associated with expense, revenue and SPPs.

3. Table C-11 shows the five-year average per capita relativities, rounded to five decimal places.

Table C-1 PER CAPITA GST RELATIVITIES, 1998-99

	Standard	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Standardised expenses	3999.18	3893.13	3692.34	4047.10	4359.44	4039.59	4421.91	3946.18	9411.03
<i>plus:</i> Equalisation budget result	-335.87	-335.87	-335.87	-335.87	-335.87	-335.87	-335.87	-335.87	-335.87
	3663.31	3557.26	3356.47	3711.23	4023.57	3703.72	4086.05	3610.31	9075.16
<i>less:</i> Standardised revenue	1777.97	1894.75	1708.54	1761.65	2010.78	1457.11	1314.21	1520.69	1705.44
Total financial assistance requirement	1885.34	1662.52	1647.92	1949.58	2012.79	2246.61	2771.83	2089.62	7369.72
<i>less:</i> SPPs treated by inclusion	316.25	316.22	274.54	314.67	319.07	357.10	412.59	313.47	783.34
Standardised deficits	1569.10	1346.30	1373.39	1634.92	1693.72	1889.51	2359.24	1776.15	6586.38
Per capita relativity		0.85801	0.87527	1.04195	1.07942	1.20420	1.50357	1.13196	4.19756

Table C-2 PER CAPITA GST RELATIVITIES, ALTERNATIVE PRESENTATION, 1998-99

	Pool	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Expense needs		-106.05	-306.84	47.92	360.26	40.41	422.73	-53.00	5411.85
<i>plus:</i> Revenue needs		-116.78	69.42	16.31	-232.81	320.85	463.75	257.28	72.52
<i>plus:</i> SPP needs		0.03	41.71	1.58	-2.82	-40.86	-96.34	2.77	-467.09
Total needs		-222.80	-195.71	65.82	124.62	320.41	790.15	207.05	5017.28
Standardised deficits ^(a)	1569.10	1346.30	1373.39	1634.92	1693.72	1889.51	2359.24	1776.15	6586.38
Per capita relativity		0.85801	0.87527	1.04195	1.07942	1.20420	1.50357	1.13196	4.19756

(a) Standardised deficits equals the pool plus total needs

Table C-3 PER CAPITA GST RELATIVITIES, 1999-2000

	Standard	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Standardised expenses	4056.38	3964.43	3724.45	4093.78	4464.65	4036.15	4477.93	4081.16	9667.23
<i>plus:</i> Equalisation budget result	-336.72	-336.72	-336.72	-336.72	-336.72	-336.72	-336.72	-336.72	-336.72
	3719.66	3627.70	3387.73	3757.05	4127.93	3699.43	4141.20	3744.44	9330.51
<i>less:</i> Standardised revenue	1801.31	1942.13	1749.63	1716.80	2074.23	1469.91	1236.23	1542.71	1651.23
Total financial assistance requirement	1918.35	1685.58	1638.10	2040.26	2053.70	2229.52	2904.97	2201.73	7679.28
<i>less:</i> SPPs treated by inclusion	322.78	315.79	287.44	329.84	316.42	343.47	416.80	374.02	874.65
Standardised deficits	1595.57	1369.79	1350.66	1710.42	1737.27	1886.04	2488.17	1827.71	6804.63
Per capita relativity		0.85850	0.84651	1.07198	1.08881	1.18205	1.55942	1.14549	4.26470

Table C-4 PER CAPITA GST RELATIVITIES, ALTERNATIVE PRESENTATION, 1999-2000

	Pool	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Expense needs		-91.96	-331.93	37.39	408.26	-20.24	421.54	24.78	5610.84
<i>plus:</i> Revenue needs		-140.81	51.68	84.52	-272.92	331.40	565.08	258.60	150.08
<i>plus:</i> SPP needs		6.99	35.34	-7.06	6.36	-20.69	-94.02	-51.24	-551.87
Total needs		-225.78	-244.91	114.85	141.70	290.47	892.60	232.14	5209.06
Standardised deficits ^(a)	1595.57	1369.79	1350.66	1710.42	1737.27	1886.04	2488.17	1827.71	6804.63
Per capita relativity		0.85850	0.84651	1.07198	1.08881	1.18205	1.55942	1.14549	4.26470

(a) Standardised deficits equals the pool plus total needs

Table C-5 PER CAPITA GST RELATIVITIES, 2000-01

	Standard	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Standardised expenses	4294.49	4228.22	3937.30	4328.47	4659.20	4285.65	4755.88	4216.33	10135.34
<i>plus:</i> Equalisation budget result	-460.24	-460.24	-460.24	-460.24	-460.24	-460.24	-460.24	-460.24	-460.24
	3834.25	3767.98	3477.06	3868.23	4198.96	3825.41	4295.64	3756.09	9675.10
<i>less:</i> Standardised revenue	1847.00	1972.63	1774.55	1773.88	2223.97	1491.73	1236.36	1580.82	1768.26
Total financial assistance requirement	1987.25	1795.35	1702.50	2094.35	1974.98	2333.69	3059.29	2175.27	7906.84
<i>less:</i> SPPs treated by inclusion	335.54	330.74	291.10	358.55	327.65	358.95	440.25	339.97	791.47
Standardised deficits	1651.71	1464.61	1411.41	1735.80	1647.33	1974.73	2619.03	1835.29	7115.37
Per capita relativity		0.88672	0.85451	1.05091	0.99735	1.19557	1.58565	1.11115	4.30788

Table C-6 PER CAPITA GST RELATIVITIES, ALTERNATIVE PRESENTATION, 2000-01

	Pool	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Expense needs		-66.27	-357.19	33.98	364.71	-8.83	461.40	-78.16	5840.85
<i>plus:</i> Revenue needs		-125.63	72.44	73.12	-376.98	355.27	610.64	266.17	78.74
<i>plus:</i> SPP needs		4.80	44.44	-23.01	7.89	-23.41	-104.71	-4.43	-455.93
Total needs		-187.10	-240.30	84.09	-4.38	323.02	967.32	183.58	5463.66
Standardised deficits ^(a)	1651.71	1464.61	1411.41	1735.80	1647.33	1974.73	2619.03	1835.29	7115.37
Per capita relativity		0.88672	0.85451	1.05091	0.99735	1.19557	1.58565	1.11115	4.30788

(a) Standardised deficits equals the pool plus total needs

Table C-7 PER CAPITA GST RELATIVITIES, 2001-02

	Standard	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Standardised expenses	4545.86	4481.48	4184.96	4601.00	4880.72	4514.84	4934.83	4487.84	10643.06
<i>plus:</i> Equalisation budget result	-489.58	-489.58	-489.58	-489.58	-489.58	-489.58	-489.58	-489.58	-489.58
	4056.28	3991.90	3695.38	4111.42	4391.14	4025.26	4445.25	3998.26	10153.48
<i>less:</i> Standardised revenue	1974.65	2159.86	1887.99	1885.24	2304.93	1538.30	1310.62	1663.46	1799.31
Total financial assistance requirement	2081.62	1832.03	1807.39	2226.18	2086.22	2486.96	3134.63	2334.79	8354.17
<i>less:</i> SPPs treated by inclusion	364.58	350.82	345.83	378.52	356.29	375.99	413.76	371.49	886.50
Standardised deficits	1717.05	1481.21	1461.56	1847.65	1729.93	2110.97	2720.87	1963.30	7467.67
Per capita relativity		0.86265	0.85121	1.07606	1.00750	1.22942	1.58462	1.14342	4.34913

Table C-8 PER CAPITA GST RELATIVITIES, ALTERNATIVE PRESENTATION, 2001-02

	Pool	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Expense needs		-64.38	-360.90	55.14	334.87	-31.02	388.98	-58.02	6097.20
<i>plus:</i> Revenue needs		-185.21	86.66	89.41	-330.27	436.35	664.03	311.19	175.34
<i>plus:</i> SPP needs		13.75	18.75	-13.95	8.29	-11.41	-49.19	-6.92	-521.92
Total needs		-235.84	-255.48	130.60	12.88	393.92	1003.82	246.25	5750.62
Standardised deficits ^(a)	1717.05	1481.21	1461.56	1847.65	1729.93	2110.97	2720.87	1963.30	7467.67
Per capita relativity		0.86265	0.85121	1.07606	1.00750	1.22942	1.58462	1.14342	4.34913

(a) Standardised deficits equals the pool plus total needs

Table C-9 PER CAPITA GST RELATIVITIES, 2002-03

	Standard	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Standardised expenses	4876.00	4810.90	4501.51	4922.79	5223.52	4838.93	5304.44	4805.22	11390.73
<i>plus:</i> Equalisation budget result	-446.18	-446.18	-446.18	-446.18	-446.18	-446.18	-446.18	-446.18	-446.18
	4429.82	4364.72	4055.33	4476.61	4777.34	4392.76	4858.26	4359.05	10944.56
<i>less:</i> Standardised revenue	2142.19	2332.38	1987.65	2113.03	2537.21	1679.55	1434.11	1879.57	1928.37
Total financial assistance requirement	2287.64	2032.35	2067.68	2363.58	2240.13	2713.21	3424.16	2479.48	9016.19
<i>less:</i> SPPs treated by inclusion	375.62	365.82	348.37	385.93	367.09	401.32	434.32	348.59	971.18
Standardised deficits	1912.02	1666.52	1719.31	1977.65	1873.04	2311.89	2989.83	2130.89	8045.01
Per capita relativity		0.87161	0.89921	1.03433	0.97961	1.20914	1.56371	1.11447	4.20761

Table C-10 PER CAPITA GST RELATIVITIES, ALTERNATIVE PRESENTATION, 2002-03

	Pool	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Expense needs		-65.10	-374.49	46.79	347.52	-37.07	428.44	-70.78	6514.73
<i>plus:</i> Revenue needs		-190.19	154.53	29.15	-395.02	462.64	708.08	262.62	213.82
<i>plus:</i> SPP needs		9.80	27.25	-10.31	8.53	-25.70	-58.70	27.03	-595.56
Total needs		-245.49	-192.71	65.63	-38.98	399.87	1077.82	218.87	6133.00
Standardised deficits ^(a)	1912.02	1666.52	1719.31	1977.65	1873.04	2311.89	2989.83	2130.89	8045.01
Per capita relativity		0.87161	0.89921	1.03433	0.97961	1.20914	1.56371	1.11447	4.20761

(a) Standardised deficits equals the pool plus total needs

Table C-11 ASSESSED GST RELATIVITIES 1998-99 to 2002-03

	Australia	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Per capita relativities									
1998-99	1.00000	0.85801	0.87527	1.04195	1.07942	1.20420	1.50357	1.13196	4.19756
1999-2000	1.00000	0.85850	0.84651	1.07198	1.08881	1.18205	1.55942	1.14549	4.26470
2000-01	1.00000	0.88672	0.85451	1.05091	0.99735	1.19557	1.58565	1.11115	4.30788
2001-02	1.00000	0.86265	0.85121	1.07606	1.00750	1.22942	1.58462	1.14342	4.34913
2002-03	1.00000	0.87161	0.89921	1.03433	0.97961	1.20914	1.56371	1.11447	4.20761
Assessed relativity ^(a)		0.86750	0.86534	1.05504	1.03054	1.20407	1.55939	1.12930	4.26538

(a) Average of per capita relativity factors for 1998-99 to 2002-03

ATTACHMENT D

CALCULATION OF RELATIVITIES — FAG RELATIVITIES

1. This attachment shows the calculation of the per capita FAG relativities.
2. The tables show the calculation of standardised deficits per capita and relativities for each year of the assessment period, 1998-99 to 2002-03, by two methods.
 - (i) Tables D-1, D-3, D-5, D-7 and D-9 show the calculation using standardised expenses, standardised revenues, the equalisation budget results and SPPs treated by inclusion.
 - (ii) Tables D-2, D-4, D-6, D-8 and D-10 provide an alternative presentation, using the Australian average per capita level of untied assistance paid during each year (called the pool in the tables) and per capita needs associated with expenses, revenues and SPPs.
3. Table D-11 shows the five-year average per capita relativities, rounded to five decimal places.

Table D-1 PER CAPITA FAG RELATIVITIES, 1998-99

	Standard	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Standardised expenses	3905.14	3806.44	3591.85	3954.53	4245.57	3951.98	4343.04	3847.40	9312.87
<i>plus:</i> Equalisation budget result	-158.04	-158.04	-158.04	-158.04	-158.04	-158.04	-158.04	-158.04	-158.04
	3747.10	3648.40	3433.81	3796.49	4087.53	3793.94	4185.01	3689.36	9154.83
<i>less:</i> Standardised revenue	2238.77	2389.65	2148.19	2188.54	2499.28	1872.15	1766.81	1972.89	2287.36
Total financial assistance requirement	1508.32	1258.75	1285.62	1607.95	1588.25	1921.79	2418.19	1716.46	6867.47
<i>less:</i> SPPs treated by inclusion	316.25	316.22	274.54	314.67	319.07	357.10	412.59	313.47	783.34
Standardised deficits	1192.08	942.53	1011.08	1293.29	1269.18	1564.69	2005.60	1402.99	6084.13
Per capita relativity		0.79066	0.84817	1.08490	1.06468	1.31257	1.68244	1.17693	5.10381

Table D-2 PER CAPITA FAG RELATIVITIES, ALTERNATIVE PRESENTATION, 1998-99

	pool	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Expense needs		-98.69	-313.29	49.39	340.43	46.84	437.91	-57.74	5407.73
<i>plus:</i> Revenue needs		-150.88	90.59	50.24	-260.50	366.62	471.96	265.88	-48.59
<i>plus:</i> SPP needs		0.03	41.71	1.58	-2.82	-40.86	-96.34	2.77	-467.09
Total needs		-249.55	-180.99	101.21	77.11	372.61	813.53	210.91	4892.05
Standardised deficits(a)	1192.08	942.53	1011.08	1293.29	1269.18	1564.69	2005.60	1402.99	6084.13
Per capita relativity		0.79066	0.84817	1.08490	1.06468	1.31257	1.68244	1.17693	5.10381

(a) Standardised deficits equals the pool plus total needs

Table D-3 PER CAPITA FAG RELATIVITIES, 1999-2000

	Standard	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Standardised expenses	3959.30	3874.88	3620.61	3999.16	4350.17	3943.45	4397.77	3961.60	9567.05
<i>plus:</i> Equalisation budget result	-143.96	-143.96	-143.96	-143.96	-143.96	-143.96	-143.96	-143.96	-143.96
	3815.34	3730.91	3476.65	3855.20	4206.21	3799.49	4253.80	3817.63	9423.09
<i>less :</i> Standardised revenue	2281.11	2457.29	2217.41	2151.74	2576.23	1905.88	1702.63	2009.21	2244.05
Total financial assistance requirement	1534.22	1273.62	1259.23	1703.46	1629.98	1893.61	2551.17	1808.43	7179.04
<i>less :</i> SPPs treated by inclusion	322.78	315.79	287.44	329.84	316.42	343.47	416.80	374.02	874.65
Standardised deficits	1211.44	957.83	971.79	1373.62	1313.56	1550.14	2134.37	1434.41	6304.39
Per capita relativity		0.79065	0.80218	1.13387	1.08430	1.27958	1.76184	1.18405	5.20403

Table D-4 PER CAPITA FAG RELATIVITIES, ALTERNATIVE PRESENTATION, 1999-2000

	pool	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Expense needs		-84.42	-338.69	39.86	390.87	-15.85	438.47	2.30	5607.75
<i>plus:</i> Revenue needs		-176.18	63.70	129.37	-295.11	375.24	578.48	271.91	37.07
<i>plus:</i> SPP needs		6.99	35.34	-7.06	6.36	-20.69	-94.02	-51.24	-551.87
Total needs		-253.61	-239.65	162.18	102.12	338.69	922.93	222.96	5092.95
Standardised deficits(a)	1211.44	957.83	971.79	1373.62	1313.56	1550.14	2134.37	1434.41	6304.39
Per capita relativity		0.79065	0.80218	1.13387	1.08430	1.27958	1.76184	1.18405	5.20403

(a) Standardised deficits equals the pool plus total needs

Table D-5 PER CAPITA FAG RELATIVITIES, 2000-01

	Standard	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Standardised expenses	4187.12	4127.56	3833.42	4216.91	4545.18	4162.07	4636.63	4097.43	10032.41
<i>plus:</i> Equalisation budget result	-251.15	-251.15	-251.15	-251.15	-251.15	-251.15	-251.15	-251.15	-251.15
	3935.97	3876.40	3582.27	3965.76	4294.03	3910.91	4385.48	3846.28	9781.26
<i>less :</i> Standardised revenue	2344.75	2503.68	2256.76	2232.73	2747.20	1942.54	1726.58	2049.21	2428.99
Total financial assistance requirement	1591.22	1372.72	1325.51	1733.03	1546.83	1968.37	2658.91	1797.08	7352.27
<i>less :</i> SPPs treated by inclusion	335.54	330.74	291.10	358.55	327.65	358.95	440.25	339.97	791.47
Standardised deficits	1255.68	1041.98	1034.41	1374.47	1219.18	1609.42	2218.66	1457.10	6560.80
Per capita relativity		0.82981	0.82379	1.09460	0.97093	1.28171	1.76690	1.16041	5.22489

Table D-6 PER CAPITA FAG RELATIVITIES, ALTERNATIVE PRESENTATION, 2000-01

	pool	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Expense needs		-59.57	-353.70	29.79	358.06	-25.05	449.51	-89.69	5845.29
<i>plus:</i> Revenue needs		-158.94	87.98	112.01	-402.45	402.20	618.17	295.54	-84.25
<i>plus:</i> SPP needs		4.80	44.44	-23.01	7.89	-23.41	-104.71	-4.43	-455.93
Total needs		-213.70	-221.27	118.79	-36.50	353.74	962.98	201.42	5305.12
Standardised deficits(a)	1255.68	1041.98	1034.41	1374.47	1219.18	1609.42	2218.66	1457.10	6560.80
Per capita relativity		0.82981	0.82379	1.09460	0.97093	1.28171	1.76690	1.16041	5.22489

(a) Standardised deficits equals the pool plus total needs

Table D-7 PER CAPITA FAG RELATIVITIES, 2001-02

	Standard	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Standardised expenses	4418.25	4360.24	4061.88	4461.42	4743.91	4386.30	4801.98	4356.13	10529.67
<i>plus:</i> Equalisation budget result	-241.34	-241.34	-241.34	-241.34	-241.34	-241.34	-241.34	-241.34	-241.34
	4176.91	4118.90	3820.54	4220.08	4502.57	4144.96	4560.64	4114.79	10288.33
<i>less :</i> Standardised revenue	2504.59	2718.12	2392.42	2380.73	2866.59	2033.69	1850.60	2217.17	2540.14
Total financial assistance requirement	1672.32	1400.78	1428.12	1839.35	1635.97	2111.27	2710.04	1897.62	7748.19
<i>less :</i> SPPs treated by inclusion	364.58	350.82	345.83	378.52	356.29	375.99	413.76	371.49	886.50
Standardised deficits	1307.75	1049.95	1082.30	1460.83	1279.69	1735.28	2296.28	1526.12	6861.70
Per capita relativity		0.80287	0.82760	1.11706	0.97854	1.32693	1.75591	1.16699	5.24696

Table D-8 PER CAPITA FAG RELATIVITIES, ALTERNATIVE PRESENTATION, 2001-02

	pool	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Expense needs		-58.01	-356.37	43.17	325.66	-31.95	383.73	-62.12	6111.42
<i>plus:</i> Revenue needs		-213.53	112.17	123.85	-362.00	470.90	653.99	287.42	-35.55
<i>plus:</i> SPP needs		13.75	18.75	-13.95	8.29	-11.41	-49.19	-6.92	-521.92
Total needs		-257.79	-225.45	153.08	-28.06	427.54	988.53	218.38	5553.95
Standardised deficits(a)	1307.75	1049.95	1082.30	1460.83	1279.69	1735.28	2296.28	1526.12	6861.70
Per capita relativity		0.80287	0.82760	1.11706	0.97854	1.32693	1.75591	1.16699	5.24696

(a) Standardised deficits equals the pool plus total needs

Table D-9 PER CAPITA FAG RELATIVITIES, 2002-03

	Standard	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Standardised expenses	4768.16	4713.77	4387.08	4810.05	5107.20	4731.36	5184.77	4696.22	11289.06
<i>plus:</i> Equalisation budget result	-345.62	-345.62	-345.62	-345.62	-345.62	-345.62	-345.62	-345.62	-345.62
	4422.54	4368.15	4041.46	4464.42	4761.58	4385.74	4839.15	4350.59	10943.44
<i>less:</i> Standardised revenue	2688.57	2910.00	2508.27	2618.57	3116.84	2192.32	1989.26	2456.14	2697.49
Total financial assistance requirement	1733.96	1458.15	1533.20	1845.86	1644.74	2193.42	2849.89	1894.46	8245.95
<i>less:</i> SPPs treated by inclusion	375.62	365.82	348.37	385.93	367.09	401.32	434.32	348.59	971.18
Standardised deficits	1358.34	1092.32	1184.82	1459.92	1277.65	1792.10	2415.57	1545.87	7274.77
Per capita relativity		0.80416	0.87226	1.07478	0.94059	1.31933	1.77832	1.13806	5.35563

Table D-10 PER CAPITA FAG RELATIVITIES, ALTERNATIVE PRESENTATION, 2002-03

	pool	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Expense needs		-54.39	-381.08	41.89	339.04	-36.80	416.61	-71.94	6520.90
<i>plus:</i> Revenue needs		-221.43	180.31	70.00	-428.26	496.25	699.31	232.44	-8.91
<i>plus:</i> SPP needs		9.80	27.25	-10.31	8.53	-25.70	-58.70	27.03	-595.56
Total needs		-266.02	-173.52	101.58	-80.69	433.76	1057.23	187.53	5916.43
Standardised deficits(a)	1358.34	1092.32	1184.82	1459.92	1277.65	1792.10	2415.57	1545.87	7274.77
Per capita relativity		0.80416	0.87226	1.07478	0.94059	1.31933	1.77832	1.13806	5.35563

(a) Standardised deficits equals the pool plus total needs

Table D-11 ASSESSED FAG RELATIVITIES 1998-99 to 2002-03

	Australia	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
Per capita relativities									
1998-99	1.00000	0.79066	0.84817	1.08490	1.06468	1.31257	1.68244	1.17693	5.10381
1999-2000	1.00000	0.79065	0.80218	1.13387	1.08430	1.27958	1.76184	1.18405	5.20403
2000-01	1.00000	0.82981	0.82379	1.09460	0.97093	1.28171	1.76690	1.16041	5.22489
2001-02	1.00000	0.80287	0.82760	1.11706	0.97854	1.32693	1.75591	1.16699	5.24696
2002-03	1.00000	0.80416	0.87226	1.07478	0.94059	1.31933	1.77832	1.13806	5.35563
Assessed relativity ^(a)		0.80363	0.83480	1.10104	1.00781	1.30402	1.74908	1.16529	5.22707

(a) Average of per capita relativity factors for 1998-99 to 2002-03

ATTACHMENT E

CONTRIBUTION OF ASSESSMENTS TO THE DIFFERENCES FROM AN EQUAL PER CAPITA DISTRIBUTION

1. Chapter 4 indicates that the equalisation distribution of the pool of GST revenue and HCGs based on the relativities in this report differs from an equal per capita (EPC) distribution. This attachment consisting mainly of tables supports that analysis.

2. The analysis in this attachment is based on alternative distributions of the 2003-04 GST and HCG pool of \$38.825 billion shown in Australian Government *Budget Paper No.3, Federal Financial Relations 2003-04* and the ABS estimates of State populations at December 2003 shown in that publication. The results are illustrative only.

3. Table E-1 shows the aggregate differences between an equalisation distribution based on the relativities assessed in this report and an equal per capita distribution for each State. An equal per capita distribution implies each State's share of the pool of GST revenue and HCGs would be equal to its share of the Australian population. It implies that there are no differences between States that affect their capacities to raise the average level of revenue or their relative costs of providing the average level of services.

Table E-1 COMPARISON OF EQUALISATION AND EQUAL PER CAPITA DISTRIBUTIONS OF THE 2003-04 GST REVENUE AND HCG POOL

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Equalisation distribution ^(a)	11 339.6	8 334.6	7 837.6	3 936.5	3 581.5	1 437.2	714.5	1 643.6	38 825.2 ^(b)
EPC distribution	13 057.9	9 621.5	7 420.9	3 815.8	2 971.4	920.7	632.0	384.9	38 825.2 ^(b)
Difference	-1 718.3	-1 286.9	416.7	120.7	610.1	516.5	82.5	1 258.7	0.0
	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc	\$pc
Equalisation distribution	1 683.44	1 679.26	2 047.39	1 999.84	2 336.60	3 026.12	2 191.49	8 277.29	1 938.54
EPC distribution	1 938.54	1 938.54	1 938.54	1 938.54	1 938.54	1 938.54	1 938.54	1 938.54	1 938.54
Difference	- 255.10	- 259.28	108.86	61.30	398.06	1 087.59	252.95	6 338.75	0.00

(a) Based on the application of the 2004 Review GST relativities to the GST revenue and HCG pool for 2003-04 and ABS estimates of State populations as at December 2003.

(b) Australian Government Budget Paper No.3, *Federal Financial Relations 2003-04*, p10.

4. Table E-2 dissects the total redistribution relative to an EPC distribution for each State as shown in Table E-1 into the contribution of the:

- (i) revenue assessments — reflecting the effects of above or below average capacity to raise revenue;
- (ii) expense assessments — reflecting above or below average relative costs of providing the standard range and level of services; and
- (iii) SPP assessments — reflecting above or below average per capita revenue from SPPs paid by the Australian Government.

5. Table E-2 indicates that:

- (i) New South Wales and Western Australia have above average capacity to raise revenue from their own sources and the other States have below average capacity;
- (ii) New South Wales, Victoria, South Australia and the ACT have below average costs of providing services and the other States have above average costs; and
- (iii) New South Wales, Victoria and Queensland receive below average per capita amounts of SPPs and the other States receive above average per capita amounts.

Table E-2 DIFFERENCE BETWEEN EQUALISATION AND EQUAL PER CAPITA DISTRIBUTIONS DISSECTED BY CAUSE

Difference in	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total ^(a)
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Revenue raising capacity	-1 159.6	488.6	262.6	- 721.2	668.8	327.5	102.1	31.1	1 880.7
Expense requirements	- 626.5	-1 871.9	132.4	840.8	- 9.4	226.3	- 13.7	1 321.9	2 521.4
SPPs	69.6	97.9	21.2	0.6	- 49.9	- 37.8	- 6.0	- 95.6	189.4
Total difference from EPC	-1 718.3	-1 286.9	416.7	120.7	610.1	516.5	82.5	1 258.7	3 005.2

(a) Total movement from EPC.

6. Table E-3 shows the contribution of each source of revenue to the total redistribution attributable to differences in State relative revenue raising capacity.

Table E-3 CONTRIBUTION OF EACH REVENUE CATEGORY TO THE REDISTRIBUTION

Contribution	Prop'n of rev ^(a)	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total ^(b)
	%	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Mining revenue	5.2	423.5	545.0	-297.6	-794.9	81.1	43.4	37.6	-38.1	1 130.6
Stamp duty on conveyances	16.7	-774.6	334.7	-7.1	66.2	235.5	102.5	8.0	34.9	781.8
Payroll tax	25.5	-323.0	-318.1	296.6	20.7	176.3	87.9	45.8	13.8	641.1
Land revenue	6.1	-364.0	52.5	109.2	5.3	125.8	51.6	13.1	6.6	364.0
Financial transaction taxes	5.1	-88.0	-37.4	64.8	16.3	25.2	17.3	-1.1	3.0	126.6
Stamp duties on shares and marketable securities	0.3	-28.9	12.8	12.5	4.2	2.6	2.6	-6.9	1.1	35.8
Motor taxes ^(c)	11.3	160.9	-71.3	-27.4	-74.5	-4.3	-0.4	11.2	5.8	177.9
Insurance taxation	4.1	-128.1	-9.1	66.3	31.7	11.5	13.4	9.1	5.1	137.2
Gambling taxation	9.5	-37.4	-20.5	45.3	4.0	15.1	9.1	-14.6	-1.0	73.5
Other revenues ^(d)	16.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total	100.0	-1 159.6	488.6	262.6	-721.2	668.8	327.5	102.1	31.1	1 880.7

(a) Revenue from each tax as a percentage of State own-source revenue for years 1998-99 to 2002-03.

(b) Total movement from EPC.

(c) This includes vehicle registration fees and taxes and stamp duty on vehicle registrations and transfers.

(d) Includes contributions from government trading enterprises and other taxes.

7. The contribution of each revenue source to the redistribution relative to an EPC distribution differs between States. For example, stamp duty on conveyances has the largest effect for New South Wales, but mining revenue has the largest effect in Victoria, Western Australia and the Northern Territory.

8. Those redistributions reflect the effects of the Australian average per capita amount of revenue collected from each tax or charge and the interstate differences in capacity to raise them. To provide an insight into the importance of each revenue source in State budgets, the table also shows the average proportion of total standard revenue collected from each tax and charge.

9. Table E-4 provides the average revenue raising capacities assessed by the Commission for the major revenue sources in this review. Mining revenue represents 5.2 per cent of standard own source revenue, but the interstate differences in the capacity to raise it are large. As a result, mining revenue makes the greatest contribution to interstate differences in relative revenue raising capacity. It is responsible for the largest redistribution of all categories.

Table E-4 ASSESSED RELATIVE REVENUE RAISING CAPACITIES: AVERAGE 1998-99 TO 2002-03

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	%	%	%	%	%	%	%	%	%
Mining revenue	46.5	5.0	169.4	448.4	54.1	21.4	0.0	268.7	100.0
Stamp duty on conveyances	131.3	81.6	100.1	91.9	58.7	40.4	92.3	53.2	100.0
Payroll tax	108.7	111.4	86.0	98.3	79.4	66.8	74.9	87.6	100.0
Land revenue	140.3	92.1	78.6	98.0	38.8	19.0	70.0	75.0	100.0
Financial transaction taxes	111.6	106.8	84.8	92.5	85.2	67.3	103.2	86.9	100.0
Stamp duties on shares and marketable securities	159.7	64.6	49.9	71.8	77.3	17.1	423.1	20.8	100.0
Motor taxes	90.4	105.8	102.9	115.3	101.2	100.4	86.2	88.2	100.0
Insurance taxation	121.1	101.8	80.6	82.6	91.4	68.3	69.0	71.2	100.0
Gambling taxation	102.7	102.0	94.3	99.0	95.2	90.8	121.5	102.5	100.0

10. Table E-5 provides details of some underlying indicators of economic activity that drive the relative revenue raising capacities assessed for the major States taxes.

11. Table E-6 shows the contribution of each major group of services to the total difference from an EPC distribution attributable to differences in the relative costs of providing services. It also shows the importance of each function within State budgets, as measured by the proportion of total expenses incurred on the function.

12. The relative importance of each function to the difference from the EPC distribution differs between States. For example, Victoria's below average relative costs of providing education services (reflecting the below average proportion of its population enrolled in government schools) make the largest contribution to its aggregate below average costs of providing services. The community services group, which includes welfare services, housing services and services to Indigenous communities, makes the largest contribution to the Northern Territory's above average costs of providing services. This is because Indigenous people use those services more extensively than non-Indigenous people and the proportion of Indigenous people in the Northern Territory's population is well above the national average.

Table E-5 INDICATORS OF STATE REVENUE BASES: 1998-99 to 2002-03

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Relative revenue raising capacity assessed by Commission	1.079	0.955	0.969	1.168	0.801	0.686	0.857	0.929	1.000
GSP per capita relative to Australia	1.050	1.030	0.884	1.112	0.842	0.720	1.224	1.193	1.000
Per capita GSP	\$pc 36 506	35 810	30 727	38 664	29 286	25 024	42 549	41 472	34 769
Per capita payrolls of large businesses	\$pc 9 744	9 991	7 715	8 811	7 120	5 977	6 720	7 860	8 967
Per capita sales of real estate	\$ 11 737	7 269	10 078	8 883	6 194	4 979	9 221	5 296	9 339
Per capita value of commercial/industrial land	\$ 7 208	6 262	4 583	6 244	3 634	2 317	4 210	6 717	5 936
Per capita value mining production	\$ 841	125	3 316	8 792	1 096	729	0	8 775	5 880

Source: ABS *Australian National Accounts, State Accounts* and data provided to the Commission by the States.

13. Table E-7 provides the relative costs of providing services in each of the functions assessed by Commission for this review.

14. Table E-8 provides an alternative dissection of the contribution of the expense assessments to the difference between an equalisation and an EPC distribution of the pool. It shows the contribution of the influences that cause differences between States in the relative per capita costs of providing services. Differences between States in the characteristics of their population, input costs (mainly wage levels) and the ability to access economies of scale are the main causes of differences in relative costs of providing services.

15. Table E-9 provides details of some underlying indicators of demographic characteristics and other indicators that drive the disabilities assessed by the Commission.

16. Table E-10 shows the effects of above and below average per capita revenues from SPPs. Differences in per capita grants for Indigenous purposes, the roads program and for housing had the largest effects on the difference between an equalisation and an EPC distribution of the 2003-04 GST and HCG pool.

Table E-6 CONTRIBUTION OF SERVICES AND SPPs TO THE REDISTRIBUTION

Contribution	Prop'n of expense ^(a)		NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total ^(b)
	%	\$m									
Education	22.5	-157.4	-477.4	245.9	181.7	-83.3	65.7	12.8	212.0	718.1	
Health	21.5	-100.8	-270.9	27.9	48.2	98.3	40.2	-64.9	222.0	436.6	
Community services	9.0	-168.9	-268.6	43.7	83.5	-20.3	20.5	-8.3	318.5	466.1	
Law, order and public safety	6.9	-17.5	-243.6	3.6	57.8	-76.2	7.3	32.4	236.2	337.2	
Culture and recreation	2.3	-1.5	-77.2	-71.9	33.7	-6.2	19.1	42.3	61.7	156.8	
Concessions, other payments and services to industry	6.7	-200.2	-196.0	33.6	199.3	107.8	29.3	-35.9	62.1	432.0	
Transport ^(c)	7.9	148.9	-89.5	-97.7	121.0	-59.4	-40.8	-16.9	34.5	304.4	
General public services ^(d)	17.4	-124.3	-214.5	-67.8	88.8	35.8	82.4	30.9	168.7	406.7	
Debt charges and depreciation	5.8	-4.8	-34.2	15.1	26.8	-5.7	2.6	-6.2	6.4	50.9	
Total SPPs	na	69.6	97.9	21.2	0.6	-49.9	-37.8	-6.0	-95.6	189.4	
Total expenses and SPPs	100.0	-556.9	-1774.0	153.6	841.4	-59.3	188.5	-19.7	1226.3	2409.8	

(a) Expenses in the group as a percentage of total net State expenses for the years 1998-99 to 2002-03.

(b) Total movement from EPC.

(c) Includes urban transit and roads.

(d) Includes general public services, superannuation and GST administration.

Table E-7 RELATIVE COSTS OF PROVIDING SERVICES: 1998-99 TO 2002-03

Contribution	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust ^(b)
	%	%	%	%	%	%	%	%	%
Education	97.9	91.5	105.7	108.2	95.2	112.3	103.5	194.8	100.0
Health	98.6	94.9	100.6	102.3	105.9	107.9	81.4	204.1	100.0
Community services	94.3	88.1	102.4	109.4	96.9	109.4	94.5	455.0	100.0
Law, order and public safety	99.2	85.7	100.2	108.4	85.5	104.4	128.6	444.5	100.0
Culture and recreation	99.6	86.5	83.7	114.5	96.3	134.3	211.2	366.6	100.0
Concessions, other payments and services to industry	91.0	88.1	102.6	130.5	121.2	118.6	66.8	194.1	100.0
Transport ^(a)	106.5	94.7	92.5	118.0	88.6	74.6	84.8	150.9	100.0
General public services ^(b)	97.8	95.0	97.9	105.1	102.6	119.9	110.9	197.8	100.0
Debt Charges and depreciation	99.7	97.6	101.4	104.7	98.7	102.2	93.9	112.7	100.0
Total expenses	98.1	92.3	100.7	108.6	99.8	109.6	99.1	234.7	100.0

(a) Includes urban transit and roads.

(b) Includes general public services, superannuation and GST administration.

Table E-8 CONTRIBUTION OF EXPENSE DISABILITIES TO REDISTRIBUTION

Contribution	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total ^(a)
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Indigenous socio-demographic composition influences ^(b)	-287.0	-664.8	246.3	188.2	-96.7	15.1	-25.6	624.6	1074.2
Other socio-demographic composition influences ^(c)	-422.5	-527.4	398.7	190.5	188.3	158.8	-133.2	146.8	1083.0
Wage levels	631.4	-13.0	-403.1	-104.5	-140.9	-55.7	26.5	59.3	717.2
Other input costs ^(d)	46.8	-21.6	-80.0	0.1	-23.7	-18.7	10.2	87.0	144.0
Scale of service provision ^(e)	-387.3	-222.6	-91.2	55.9	85.8	160.8	156.4	242.3	701.1
Urban influences ^(f)	159.9	108.9	-71.4	-56.6	-54.9	-48.1	-9.6	-28.3	268.8
Population dispersion ^(g)	-229.9	-292.2	122.4	199.5	-15.8	-36.4	-30.4	282.8	604.7
Economic environment ^(h)	-142.7	-61.2	1.5	144.3	19.0	18.5	-16.4	37.1	220.4
Physical environment ⁽ⁱ⁾	100.9	-358.8	-1.4	183.6	-8.3	9.4	-7.1	81.8	375.7
Expenditure – others ^(j)	-96.1	180.9	10.7	39.9	37.8	22.6	15.5	-211.3	307.4
Total expenditure	-626.5	-1871.9	132.4	840.8	-9.4	226.3	-13.7	1321.9	2521.4
Total effect of SPPs	69.6	97.9	21.2	0.6	-49.9	-37.8	-6.0	-95.6	189.4
Total effect of SPPs and expenses	-556.9	-1774.0	153.6	841.4	-59.3	188.5	-19.7	1226.3	2409.8

(a) Total movement from EPC.

(b) Includes the effects of above average use of services by Indigenous people and higher costs of servicing them, including the effects of land rights and native title legislation, the effects of age, sex, cultural and linguistic diversity, income and the cross-border use of services.

(c) Includes the effects of age, sex, cultural and linguistic diversity, income and the cross-border use of services.

(d) Includes wage costs, costs of office rent and electricity, interest rates and the isolation of some States from major sources of supply in south-east Australia.

(e) Includes diseconomies of small scale in administration and in provision of services from many small centres.

(f) Includes effects of urban complexity, urban traffic management, and urban transit capital and pricing subsidies.

(g) Includes the net effects of population dispersion and of geographic location on hospital costs and patient transport.

(h) Includes effects of structure and nature of State economies, road use, availability of private medical services, and the ACT's status as the national capital.

(i) Includes the effects of climate, natural hazards, conservation task, water availability, other aspects of the physical environment, and road and bridge length.

(j) Includes some miscellaneous small factors and interactions between factors.

Table E-9 SELECTED INDICATORS RELEVANT TO THE USE AND COST PER UNIT OF STATE SERVICES

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Population – State proportion of Australia for 2001-02	% 33.8	24.7	18.8	9.8	7.8	2.4	1.6	1.0	100.0
Proportion of population aged 65 years and over ^(a)	% 13.1	13.1	11.7	11.1	14.7	13.9	8.5	3.8	12.6
Indigenous people as proportion of State resident population ^(a)	% 2.1	0.6	3.5	3.5	1.7	3.7	1.2	28.8	2.4
Residents of centres of 50 000 or more as proportion of population ^(a)	% 69.0	73.9	67.2	72.0	72.3	51.0	99.4	43.6	70.2
Residents of remote areas as proportion of State population ^(a)	% 1.4	0.1	4.0	6.9	2.8	0.6	0.0	39.7	2.6
Government school enrolments per 1000 of population (ave 1998-99 to 2002-03)	116.2	110.9	125.2	127.0	114.7	131.8	119.9	151.1	118.3
Proportion of people with low income ^(a)	% 30.5	30.1	33.8	31.5	35.1	39.4	20.1	30.1	31.5
Average weekly earnings relative to Australia ^(b)	% 106.2	100.1	93.0	95.1	91.7	91.3	86.1	94.0	100.0
Length of State arterial roads per 1000 of population	km 10.82	9.67	10.93	22.49	13.23	11.60	6.11	36.41	12.09

(a) Based on data from the 2001 Census.

(b) Based on private sector average weekly earnings for 2000. It is however not a good indicator of relative costs to States because it is affected by interstate differences in workforce characteristics.

Table E-10 CONTRIBUTION OF SPP REVENUES TO THE REDISTRIBUTION

Contribution	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total ^(a)
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Grants for Indigenous purposes	17.7	34.4	3.8	-6.6	-4.4	0.7	1.4	-47.0	58.0
Housing	27.2	31.6	-7.8	-6.7	-1.9	-3.0	-7.0	-32.3	58.8
Other SPPs	24.7	31.9	25.2	14.0	-43.6	-35.5	-0.4	-16.3	95.7
Total	69.6	97.9	21.2	0.6	-49.9	-37.8	-6.0	-95.6	189.4

(a) Total movement from EPC.

ATTACHMENT F

SOURCES OF CHANGE — 2003 UPDATE TO 2004 REVIEW RELATIVITIES

1. Chapter 5 discusses the major changes made in this review to the methods used to assess the GST relativities. This attachment, consisting mainly of tables, presents the results of an analysis of the changes in the assessments.

2. It shows the contribution made by revenue and expense assessments to the overall change in the distribution of the 2003-04 GST revenue and HCG pool of \$38.825 billion shown in Australian Government *Budget Paper No.3, Federal Financial Relations 2003-04*. The analysis uses the ABS estimates of State populations as at December 2003 shown in that publication. The results are illustrative only and have been derived using one of many possible approaches.

3. Table F-1 shows the total effect on the distribution of the pool of changing from the 2003 Update to the 2004 Review relativities. Because the same pool and population are used in both distributions, the changes in the distribution among the States are due solely to the differences in the relativities. For most States, the bigger changes were in the expense assessments.

Table F-1 CHANGE IN THE DISTRIBUTION RESULTING FROM THE
2003 UPDATE AND 2004 REVIEW GST RELATIVITIES

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
2003 Update ^(a)	11 656.7	8 385.9	7 574.9	3 705.6	3 607.9	1 475.1	727.9	1 691.3	38 825.2
2004 Review ^(b)	11 339.6	8 334.6	7 837.6	3 936.5	3 581.5	1 437.2	714.5	1 643.6	38 825.2
Change	- 317.0	- 51.2	262.7	230.9	- 26.3	- 37.9	- 13.4	- 47.7	0.0

(a) The 2003 Update distribution is sourced from 2003-04 Budget Paper No. 3.

(b) The 2004 Review distribution is calculated using the 2004 Review GST relativities, 2003-04 Budget Paper No.3, GST revenue and HCGs pool, and December 2003 population.

Source: Australian Government Budget Paper No. 3, *Federal Financial Relations 2003-04* and Commission calculations.

4. The changes reflect:
 - (i) the implementation of our decisions on the most appropriate methods of assessing State needs; and
 - (ii) changes in the circumstances of the States, shown by the latest data, including the latest financial, Census and other data that we used.

5. Table F-2 dissects the total change in the distribution into the contribution of changes in the revenue assessments (reflecting the effects of changes in assessed revenue raising capacity), the expense assessments (reflecting changes in assessed relative costs of providing the standard range and level of services), and the SPP assessments (reflecting changes in above or below average per capita revenue from SPPs paid by the Australian Government). It indicates that since the 2003 Update:

- (i) the revenue raising capacities of New South Wales, Queensland and the Northern Territory increased relative to the State average, and the capacities of the other States decreased relatively;
- (ii) the assessed costs of services in Queensland and Western Australia increased relative to the State average, and the costs of services in the other States decreased relatively; and
- (iii) the SPP receipts of New South Wales, Victoria, South Australia, Tasmania and the ACT increased relative to the State average, and the receipts of the other States decreased relatively.

Table F-2 CONTRIBUTION TO THE CHANGE IN DISTRIBUTION, 2003 UPDATE TO 2004 REVIEW^(a)

Contribution of	NSW	Vic	Qld	WA	SA	Tas	ACT	NT Redistrib'n	
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Revenue assessments	-103.5	21.3	-85.2	131.6	41.3	5.9	1.7	-13.1	201.8
Expense assessments	-197.6	-45.1	343.3	49.6	-66.6	-33.1	-3.6	-47.0	393.0
SPPs	-16.7	-28.2	4.6	49.6	-0.6	-10.3	-11.5	13.2	67.4
Total difference	-317.0	-51.2	262.7	230.9	-26.3	-37.9	-13.4	-47.7	493.7

(a) Change in the distribution of the 2003-04 GST revenue and HCG pool of \$38.825 billion caused by applying the GST relativities assessed in the 2004 Review instead of those assessed in the 2003 Update.

6. Table F-3 shows, for the 2003 Update and the 2004 Review, States' revenue raising capacity, costs of service provision and SPP revenue ratios, relative to the Australian standard ratios (of 1.000).

7. Table F-4 shows the contribution of each revenue category to the total change in the distribution. Changes in the mining revenue, stamp duty on conveyances and payroll tax assessments make the largest contributions to the aggregate changes in State relative revenue raising capacities.

Table F-3 REVENUE RAISING CAPACITY, COST OF PROVIDING SERVICES AND RELATIVE SPPs RATIOS, 2003 UPDATE AND 2004 REVIEW

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
Revenue raising capacity									
2003 Update	1.069	0.959	0.961	1.189	0.822	0.705	0.866	0.904	1.000
2004 Review	1.079	0.955	0.969	1.168	0.801	0.686	0.857	0.929	1.000
Cost of providing services									
2003 Update	0.987	0.926	0.988	1.080	1.007	1.108	0.993	2.379	1.000
2004 Review	0.981	0.923	1.007	1.086	0.998	1.096	0.991	2.347	1.000
Relative SPPs									
2003 Update	0.952	0.904	0.982	1.092	1.119	1.215	0.937	3.043	1.000
2004 Review	0.969	0.941	0.983	0.998	1.095	1.234	1.054	2.424	1.000

8. The contribution of each revenue category to the change in aggregate capacity differs between States. For example, changes in mining revenue — which are partly caused by a change in the method of measuring the revenue base — have the greatest effects in New South Wales, Western Australia and the Northern Territory. Stamp duty on conveyances is the largest cause of change in the assessed revenue capacities for South Australia and Tasmania.

9. Table F-5 shows the contribution of each major group of services to the total change in the distribution of the pool attributable to the expense assessments. Changes in debt charges and depreciation, transport and education make the largest contributions to the changes in the aggregate costs of services provided by the States. Changes in assessment methods made during the review have a large effect on these illustrative changes.

10. The relative importance of each function to the aggregate changes since the 2003 Update differs between States.

Table F-4 CONTRIBUTION TO THE CHANGE IN DISTRIBUTION, 2003 UPDATE TO 2004 REVIEW, REVENUE CATEGORIES

Contribution	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total ^(a)
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Payroll taxation	-30.8	-9.2	58.6	-24.4	6.0	3.6	0.0	-3.8	68.2
Land revenue	32.6	-0.3	-34.7	-1.2	1.4	-0.1	1.0	1.3	36.3
Stamp duty on conveyances	-59.0	9.9	-38.0	37.8	38.7	6.7	-3.2	7.0	100.1
Financial transaction taxes	62.0	-11.4	-21.5	-6.3	-13.9	-5.4	-1.1	-2.4	62.0
Stamp duty on shares and marketable securities	-3.8	0.4	-0.7	0.8	-1.4	0.0	4.7	0.1	6.0
Gambling taxation	5.9	5.2	-1.0	-4.2	0.3	-0.3	-0.4	-5.6	11.4
Insurance taxation	-14.3	-4.1	6.5	10.9	-0.4	1.0	0.4	0.1	18.9
Motor taxes	-8.5	18.9	-14.2	3.9	-1.5	1.4	0.5	-0.5	24.8
Mining revenue	-87.6	11.9	-40.3	114.2	12.2	-1.2	-0.1	-9.2	138.4
Other revenues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total	-103.5	21.3	-85.2	131.6	41.3	5.9	1.7	-13.1	201.8

(a) Total movement from EPC.

Table F-5 CONTRIBUTION TO THE CHANGE IN DISTRIBUTION, 2003 UPDATE TO 2004 REVIEW, SERVICES AND SPPS

Contribution	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total ^(a)
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Education	104.9	7.5	-34.8	-76.1	7.7	-8.6	-6.2	5.7	125.7
Health	-31.2	-3.8	64.8	-42.8	47.1	2.4	-11.8	-24.7	114.3
Community services	-69.4	-82.6	43.6	19.1	-19.2	2.1	4.0	102.4	171.2
Law, order and public safety	2.3	-26.4	22.8	-11.6	-26.4	-12.5	6.4	45.4	76.9
Culture and recreation	70.3	25.6	-46.9	-21.9	-20.6	1.4	12.9	-21.0	110.3
Concessions, other payments and services to industry	-36.9	-80.4	16.7	82.5	24.0	3.2	-15.6	6.5	132.9
Transport ^(b)	196.6	28.1	-84.0	38.5	-99.2	-39.5	-20.4	-20.2	263.2
General public services ^(c)	83.1	47.4	-6.1	-41.7	-14.6	-25.5	-3.5	-39.0	130.4
Debt charges and depreciation	-517.4	39.4	367.1	103.7	34.6	43.9	30.7	-102.1	619.5
Total SPPs	-16.7	-28.2	4.6	49.6	-0.6	-10.3	-11.5	13.2	67.4
Total expenses and SPPs	-214.4	-73.3	347.9	99.3	-67.2	-43.4	-15.1	-33.8	447.2

(a) Total movement from EPC.

(b) Includes urban transit and roads.

(c) Includes general public services, superannuation and GST administration.

11. Table F-6 provides an alternative dissection of the contribution of expense assessments to the change in the distribution of the pool. It shows the contribution of the underlying disability factors assessed by the Commission.

Table F-6 CONTRIBUTION TO THE CHANGE IN DISTRIBUTION, 2003 UPDATE TO 2004 REVIEW, DISABILITIES

Contribution	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total ^(a)
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Socio-demographic composition influences ^(b)	-332.4	-458.3	257.4	241.9	92.0	71.0	-93.3	221.7	884.0
Input costs ^(c)	315.0	65.2	-89.0	-201.9	-26.0	-52.9	20.7	-31.0	400.9
Scale of service provision ^(d)	57.3	69.5	-1.0	-37.4	-11.5	-17.7	-4.3	-55.0	126.9
Urban influences ^(e)	-43.6	51.0	72.7	-6.9	-42.4	-21.2	-5.0	-4.5	123.7
Population dispersion ^(f)	-92.4	-79.1	38.0	48.7	20.8	-27.9	-10.2	102.0	209.5
Economic environment ^(g)	22.0	2.8	-38.0	45.0	5.9	-3.4	-18.8	-15.5	75.7
Physical environment ^(h)	165.0	-205.5	16.4	90.3	-71.9	5.1	4.8	-4.2	281.6
Expenditure – others ⁽ⁱ⁾	-288.6	509.3	86.8	-130.1	-33.5	14.0	102.6	-260.4	712.7
Total expenditure	-197.6	-45.1	343.3	49.6	-66.6	-33.1	-3.6	-47.0	393.0
Total effect of SPPs	-16.7	-28.2	4.6	49.6	-0.6	-10.3	-11.5	13.2	67.4
Total effect of SPPs and expenses	-214.4	-73.3	347.9	99.3	-67.2	-43.4	-15.1	-33.8	447.2

(a) Change in redistribution.

(b) Includes the effects of above average use of services by Indigenous people and higher costs of servicing them, and the effects of age, sex, cultural and linguistic diversity, income and the cross-border use of services and the effects of land rights and native title legislation.

(c) Includes the effect of wage differences and costs of office rent and electricity, interest rates and the isolation of some States from major sources of supply in south-east Australia.

(d) Includes diseconomies of small scale in administration and in provision of services from many small centres.

(e) Includes the net effects of urban influences, urban complexity, urban traffic management, capital and pricing subsidies.

(f) Includes the net effects of population dispersion and of geographic location on hospital costs and patient transport.

(g) Includes effects of structure and nature of State economies, road use, availability of private medical services, and the ACT's status as the national capital.

(h) Includes the effects of climate, natural hazards, conservation task, water availability, other aspects of the physical environment, and road and bridge length.

(i) Includes some miscellaneous small factors and interactions between factors.

12. Table F-7 shows the effects of changes in State receipts of SPPs. The SPPs that have the largest effects on the change in the distribution arise from our decisions to exclude from the 2004 Review assessments many Commonwealth own purpose payments for Indigenous purposes and the inclusion of the capital element of payments under the Commonwealth-State Housing Agreement.

Table F-7 CONTRIBUTION TO THE CHANGE IN DISTRIBUTION, 2003 UPDATE TO 2004 REVIEW, SPPS

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total ^(a)
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Grants for Indigenous purposes	-55.4	-54.3	14.8	49.9	4.5	-2.3	-3.4	46.2	115.4
Housing	25.2	29.3	-7.2	-6.2	-1.8	-2.7	-6.6	-30.0	54.6
Other	13.4	-3.2	-3.0	6.0	-3.3	-5.3	-1.5	-3.0	19.4
Total	-16.7	-28.2	4.6	49.6	-0.6	-10.3	-11.5	13.2	67.4

(a) Total movement from EPC.

Main changes for each State since the 2003 Update

13. The tables in this attachment show that the main reasons for New South Wales's declining relativity are an increase in its revenue raising capacity and a large fall in its cost of providing services. Increasing capacity to raise revenue from stamp duty on conveyances, payroll tax and mining revenue, mainly reflects the growth in New South Wales's economy and the change in method for measuring the mining revenue base. The fall in its cost of providing services is largely due to reductions in its assessed needs associated with the use and cost of assets, as measured by our depreciation and debt charges assessments, which in the last review, overstated the effects of construction costs and urban influences on New South Wales's needs. These changes have been partly offset by increases in its urban transit needs (which now include an assessment for its urban transit assets), increases in its share of high cost service populations (the proportion of its population which is remote, Indigenous or not fluent in English), and its increasing wage costs.

14. Victoria's reduced relativity is due to the fall in its assessed cost of service provision. This largely reflects the reduced proportions of its population that cost more to service. For example, between the 1996 and 2001 Censuses, relative to the Australian average, the proportions of Victoria's population that are low income, Indigenous, not fluent in English, or which live in remote areas, have reduced. Victoria has also received a larger share of SPPs, decreasing its relativity.

15. Queensland's relativity has increased. This is largely because its cost of service provision has increased. It has experienced rapid recent population growth and changes in the socio-demographic composition of its population that have increased its needs for assets and thus its relative debt and depreciation costs. Our better measurement of these needs has been the main cause of Queensland's increased relativity. However, Queensland also has an increased proportion of its population which is low income and not fluent in English, although its share of the remote and Indigenous populations has declined.

16. Western Australia's increased relativity is due to a fall in its measured revenue raising capacity in mining (partly due to the change in method), stamp duty on conveyances and insurance tax areas, increased cost of service provision (largely reflecting

its increased need for government assets and a large increase in its road length), and a relatively reduced amount of SPP revenue.

17. The relativities for South Australia and the ACT have reduced, mainly because of reductions in their costs of providing services. Like Victoria, the proportions of the populations in groups that cost more to service have declined for South Australia and the ACT. For example, relative to the Australian average, South Australia now has a smaller proportion of its population which is low income, Indigenous and not fluent in English. The ACT has a smaller proportion of its population that is low income and not fluent in English. They, like the other less populous States, are assessed to require less assistance because of reductions in the diseconomies of small scale in their administrations. Relative wage rates are also lower. Both States have lower needs for urban transit assistance. The ACT has received a higher share of SPPs, reducing its relativity.

18. The relativity for Tasmania has reduced, mainly because of reductions in its costs of providing services. These are largely a result of its lower assessed needs arising from administrative scale diseconomies, urban transit and road maintenance. It also received a higher share of SPPs, reducing its relativity.

19. The Northern Territory's relativity has fallen because its relative cost of providing services has fallen and its assessed revenue raising capacity (especially for mining revenue, gambling taxation and payroll tax) has increased. The fall in its cost of providing services is due to reductions in its assessed needs associated with the use and cost of assets as measured by our depreciation and debt charges assessments, which in the last review, overstated the effects of construction costs and climate. Its above average revenue from capital grants from the Australian Government also reduced its relative need to borrow. A fall in the assessed diseconomies of small scale further reduced its needs. The proportion of its population, relative to the Australian average, which is Indigenous has fallen since the last Census.

ACRONYMS

ABARE	Australian Bureau of Agricultural and Resource Economics
ABS	Australian Bureau of Statistics
CALD	Cultural and linguistic diversity
CGC	Commonwealth Grants Commission
CPI	Consumer price index
CSO	Community service obligations
EPC	Equal per capita
FAG	Financial Assistance Grant
GFS	Government Finance Statistics
GMA	Guaranteed minimum amount
GPC	General Purpose Classification
GSP	Gross State product
GST	Goods and Services Tax
HCG	Health Care Grant
IGA	Intergovernmental Agreement
IUCN	International Union for Conservation of Nature
PFP	Privately financed project
PTE	Public trading enterprise
SARIA	State Accessibility/Remoteness Index of Australia
SPP	Specific purpose payment

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