



Australian Government

Commonwealth Grants Commission

Chairman Alan G Morris

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MEDIA RELEASE

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REPORT ON STATE REVENUE SHARING RELATIVITIES REVIEW 2004

The Chairman of the Commonwealth Grants Commission, Alan Morris, has presented the Commission's Report on State Revenue Sharing Relativities Review 2004. The Report recommends the State and Territory relativities on which the State and Territory revenue sharing distributions could be based in 2004-05. These apply to the funds, comprising largely the revenue from the Goods and Services Tax (GST) and the Health Care Grants (HCGs) which are expected to be about \$41 594 million in 2004-05.

The report completes a comprehensive review by the Commission that commenced with terms of reference from the then Minister for Finance and Administration in December 1999. The Commission received further terms of reference from Senator Minchin, the Minister for Finance and Administration in November 2003. Members of the Commission who conducted the review with Mr Morris, a former Executive Director of the European Bank for Reconstruction and Development were: Professor Ken Wiltshire, Professor of Public Administration at the University of Queensland Business School; Len Early, a former Deputy Secretary of the Department of Finance and Administration; Hylda Rolfe, former director of public and private sector corporations, and former Mayor of Woollahra; and Professor Ross Williams, former Dean of the Faculty of Economics and Commerce at the University of Melbourne.

Previous reviews of the funding arrangements were conducted in 1993 and 1999. The Commission has proposed a number of changes in the way State and Territory relativities are calculated and shares of GST and HCG revenue determined. However, the recommended relativities would result in an overall level of redistribution broadly the same as recent years. Compared with the relativities applying in 2003-04, the recommended relativities resulting from the review would result in larger grant shares for Queensland and Western Australia, and smaller shares for the other States and Territories.

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The report will be discussed at the meeting of the Ministerial Council of Treasurers on 26 March 2004.

A summary of the main findings of the report, including comments on the outcomes for each State and Territory, is attached.

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COMMONWEALTH GRANTS COMMISSION

REPORT ON STATE REVENUE SHARING RELATIVITIES REVIEW 2004

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.

¹ In this document 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

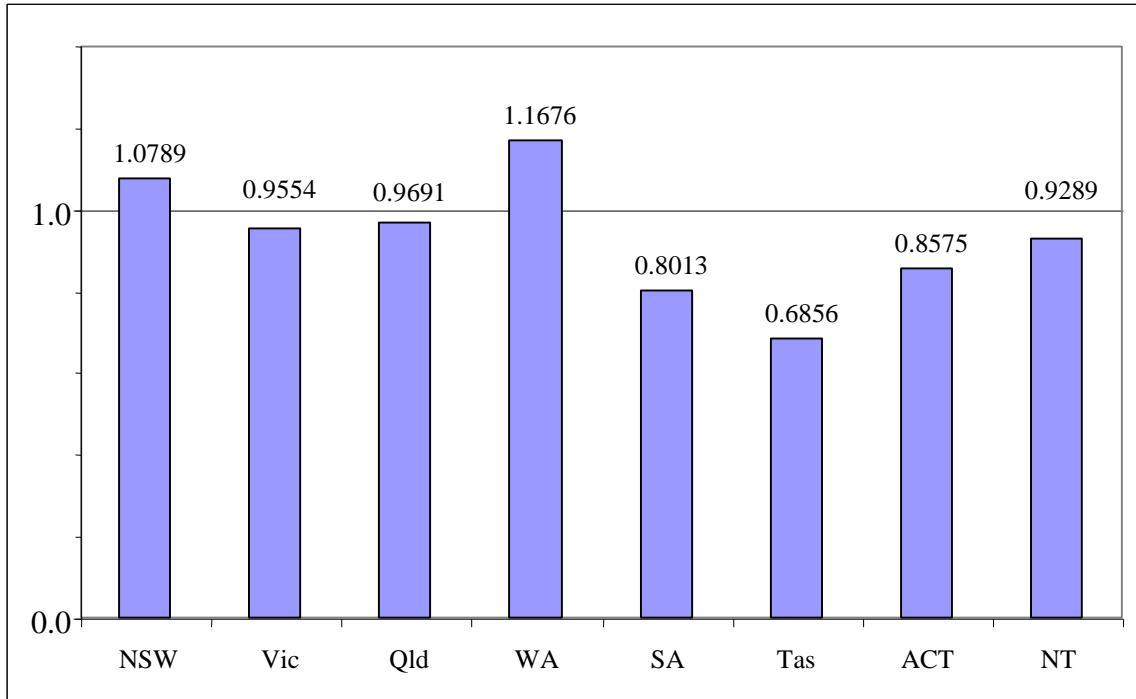
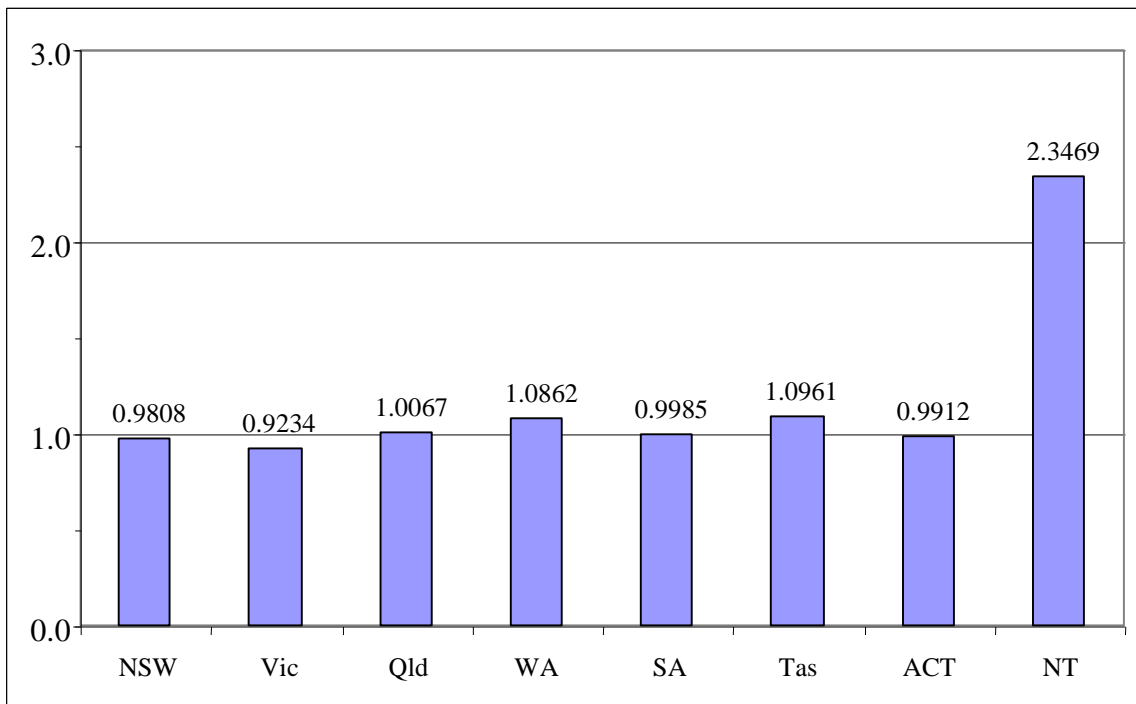


Figure 2 STATES' RELATIVE COSTS OF PROVIDING SERVICES, AVERAGE 1998-99 TO 2002-03



THE MAIN FINDINGS

4. Table 1 shows the relativities we regard as appropriate for use in 2004–05.

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

5. 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.

6. 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*.

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.

7. 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.

8. 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.

9. 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.

10. 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.

11. 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.

12. 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.

13. 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.

14. 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.

MAIN INFLUENCES ON THE PER CAPITA RELATIVITY FOR EACH STATE

New South Wales

15. 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.

16. 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.

17. 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).

18. 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

19. 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.

20. 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.

21. 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.

22. 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.

23. 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.

24. 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

25. 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.

26. 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.

27. 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

28. 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.

29. 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.

30. 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.

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

South Australia

32. 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.

33. 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.

34. 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.

35. 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

36. 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.

37. 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.

38. 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.

39. 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

40. 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.

41. 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.

42. 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.

43. 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.

44. 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

45. 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.

46. 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.

47. 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.

48. 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.