

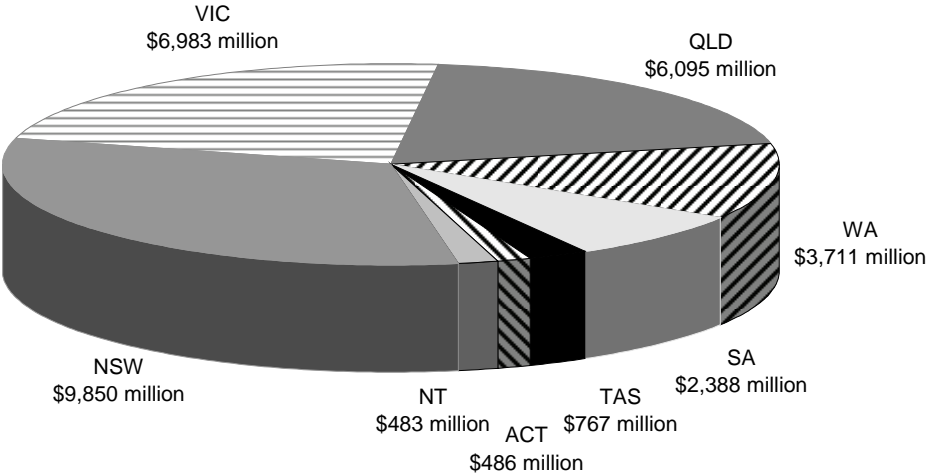
AUSTRALIAN GOVERNMENT PAYMENTS TO THE STATES

Australian Government payments to the States consist of general revenue assistance and specific purpose payments.

Prior to the reform of federal financial relations, implemented from 1 July 2000, general revenue assistance comprised the largest component of Australian Government payments to the States. Those payments consisted mostly of financial assistance grants, which have now been replaced by the provision of GST revenue to the States. General revenue assistance also includes a range of other payments, most of which have largely been phased out. For 2007-08 and the forward years, the Australian Government has estimated that it will not provide any general revenue assistance to the States.

The Australian Government will continue to provide specific purpose payments to state and local governments. In 2007-08, these payments will total \$30.8 billion, an increase of \$2.5 billion (9.0 per cent) from 2006-07. The state shares of these payments are shown in Chart 4.

Chart 4: State shares of Australian Government payments, 2007-08



GENERAL REVENUE ASSISTANCE TO THE STATES

General revenue assistance is a broad category of payments that are provided to the States to spend according to their own budget priorities. They include budget balancing assistance (BBA), compensation payments in respect of GST policy decisions and National Competition Policy payments.

Budget balancing assistance

In the Intergovernmental Agreement, the Australian Government guaranteed that the budgetary position of each State would be no worse than it would have been had its reforms not been implemented. The guaranteed minimum amount (GMA) is an estimate of the revenue that each State would have received under the previous system of financial assistance grants and if their own inefficient state taxes had not been abolished as part of the reforms. Detailed calculations of the GMA for 2006-07 and 2007-08 are provided in Appendix B.

The Australian Government will pay BBA to the States during the transitional period (which will expire on 30 June 2009) if a State's share of GST revenue in a financial year is less than its GMA for that year.

In 2007-08 and the forward years, all States will receive more GST revenue than their GMA. Consequently, no State will require BBA. Indeed, the States will receive a total revenue gain from tax reform of \$3.2 billion more than their GMA in the Budget year. These revenue gains are estimated to increase to \$4.6 billion by 2010-11, as shown in Table 10.

Table 10: State revenue gains from tax reform^(a)

| \$million | NSW | VIC | QLD | WA | SA | TAS | ACT | NT | Total |
|------------------------------------|--------------|--------------|------------|------------|------------|------------|------------|------------|--------------|
| 2006-07 | | | | | | | | | |
| (1) GMA | 10,873 | 8,123 | 7,368 | 3,651 | 3,388 | 1,464 | 707 | 1,867 | 37,440 |
| (2) GST revenue | 11,034 | 8,573 | 8,049 | 3,978 | 3,591 | 1,573 | 768 | 1,985 | 39,552 |
| (3) BBA (1) - (2) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| (4) States' revenue gain (2) - (1) | 162 | 450 | 681 | 327 | 203 | 109 | 61 | 119 | 2,112 |
| 2007-08 | | | | | | | | | |
| (1) GMA | 11,295 | 8,422 | 7,554 | 3,516 | 3,585 | 1,529 | 740 | 2,000 | 38,642 |
| (2) GST revenue | 11,926 | 9,147 | 8,384 | 3,945 | 3,855 | 1,646 | 823 | 2,124 | 41,850 |
| (3) BBA (1) - (2) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| (4) States' revenue gain (2) - (1) | 631 | 725 | 830 | 429 | 269 | 117 | 82 | 124 | 3,208 |
| 2008-09 | | | | | | | | | |
| (1) GMA | 11,941 | 8,832 | 7,662 | 3,368 | 3,750 | 1,579 | 765 | 2,122 | 40,019 |
| (2) GST revenue | 12,911 | 9,849 | 8,629 | 3,898 | 4,092 | 1,710 | 862 | 2,249 | 44,200 |
| (3) BBA (1) - (2) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| (4) States' revenue gain (2) - (1) | 970 | 1,017 | 966 | 530 | 342 | 131 | 97 | 127 | 4,181 |
| 2009-10 | | | | | | | | | |
| (1) GMA | 12,866 | 9,271 | 7,880 | 3,290 | 3,942 | 1,628 | 804 | 2,250 | 41,931 |
| (2) GST revenue | 13,969 | 10,393 | 8,847 | 3,850 | 4,324 | 1,768 | 906 | 2,392 | 46,450 |
| (3) States' revenue gain (2) - (1) | 1,103 | 1,122 | 967 | 560 | 382 | 140 | 102 | 142 | 4,519 |
| 2010-11 | | | | | | | | | |
| (1) GMA | 13,893 | 9,831 | 8,297 | 3,220 | 4,163 | 1,687 | 840 | 2,365 | 44,296 |
| (2) GST revenue | 15,009 | 11,020 | 9,190 | 3,738 | 4,564 | 1,839 | 952 | 2,538 | 48,850 |
| (3) States' revenue gain (2) - (1) | 1,117 | 1,189 | 893 | 517 | 402 | 152 | 112 | 173 | 4,554 |

(a) No BBA is payable when GST revenue exceeds the GMA. As part of the agreement with the States to abolish most of the state taxes listed for review under the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*, the Australian Government has extended the transitional period (in which BBA may be paid) from 30 June 2006 to 30 June 2009.

Compensation payments for GST policy decisions

The Australian Government, with the agreement of state governments, legislated that from 2004-05, small businesses and non-profit organisations which voluntarily registered for the GST could pay and report GST on an annual rather than monthly or quarterly basis. To obtain the agreement of the States, the Australian Government agreed to compensate the States for the deferral of GST revenue.

At MYEFO, it was anticipated that the States would be provided compensation payments of \$17 million in 2006-07 and \$18 million in 2007-08, increasing over the forward years.

Final tax return data for 2004-05 now indicates that the impact of the policy decision on GST revenue was lower than forecast. Consequently, there has been an overpayment of compensation to the States. The overpayment is currently estimated to be about \$320 million. The Australian Government has agreed with the States to suspend future compensation payments to prevent further overpayment. Once final tax return data for 2005-06, 2006-07 and 2007-08 is available, the States will acquit accounts based on a net present value calculation of the total compensation required. If the amount already

paid to the States is less than the net present value, the shortfall will be paid to the States. More likely, there will be a remaining overpayment to be recovered.

Further information is contained in the expense measure *Suspending GST compensation* in Budget Paper No. 2 in the Treasury portfolio.

National Competition Policy payments

Between 1997-98 and 2005-06, the Australian Government provided National Competition Policy payments to the States for implementing National Competition Policy and related reforms. Each State's payments were conditional on that State achieving satisfactory progress with the implementation of the reforms, including a commitment to review legislation that restricts competition, applying competitive neutrality principles to government business activities and introducing specific reforms in the electricity, gas, water and road transport sectors.

The Australian Government suspended \$43.2 million in 2005-06 National Competition Policy payments, following recommendations provided by the National Water Commission. This included water reform suspensions for outstanding obligations relating to interstate trading in the southern Murray-Darling Basin, and for lack of progress and outstanding reforms with respect to water planning.

The Commission has indicated that it will make recommendations about the 2005-06 suspensions following assessments in 2007.

SPECIFIC PURPOSE PAYMENTS

Specific purpose payments constitute a significant amount of Australian Government expenditure. In 2007-08, they are estimated to total \$30.8 billion, an increase of \$2.5 billion (9.0 per cent) over 2006-07. For the Budget year, total specific purpose payments will represent 13.1 per cent of total Australian Government expenditure.

The Australian Government provides specific purpose payments to pursue important national policy objectives in areas that may be administered by the States. Typically the States need to fulfil specified conditions in order to receive these payments, which cover most functional areas of state and local government activity, including education, health, social security, housing and transport.

Detailed tables of specific purpose payments for 2006-07 and 2007-08, including state shares of each payment, are provided in Appendix D.

The broad categories of specific purpose payment, as shown in Chart 5 and Table 11, are:

- payments made to the States to help fund state government functions;

- payments made through the States, where the state governments distribute the payment to other organisations, such as private schools;
 - this includes financial assistance grants to be distributed to local governments; and
- payments made by the Australian Government direct to local governments.

Chart 5: Specific purpose payments, 2007-08

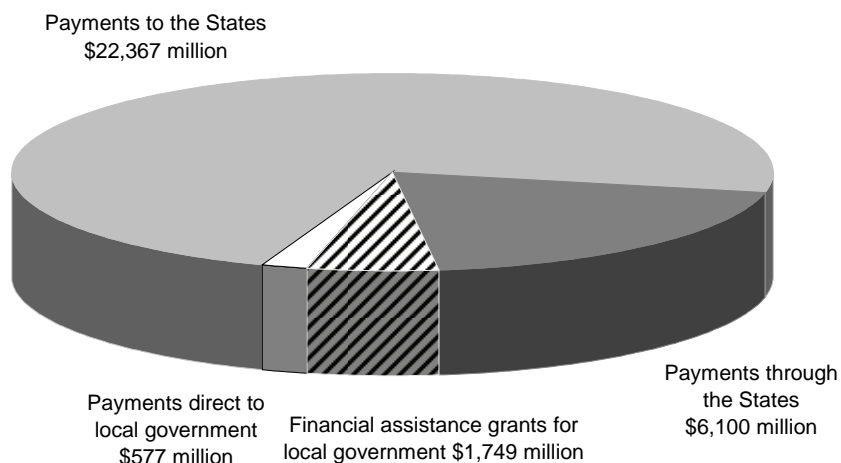


Table 11: Specific purpose payments

| \$million | Actual | | Estimates | |
|-------------------------------------|----------|----------|-----------|----------|
| | 2005-06 | 2006-07 | 2006-07 | 2007-08 |
| Payments to the States | 19,612.5 | 20,627.0 | | 22,367.4 |
| Payments through the States | 5,296.9 | 5,555.3 | | 6,100.2 |
| Financial assistance grants | | | | |
| through States to local government | 1,618.6 | 1,687.5 | | 1,749.4 |
| Payments direct to local government | 376.1 | 374.3 | | 556.6 |
| Total payments | 26,904.1 | 28,244.1 | | 30,773.6 |

Specific purpose payments have grown strongly since 1999-00, as shown in Table 12, with an average annual growth of 7.0 per cent.

Table 12: Growth in specific purpose payments since 1999-00

| \$million | NSW | VIC | QLD | WA | SA | TAS | ACT | NT | Total |
|------------|-------|-------|-------|-------|-------|-----|-----|-----|--------|
| 1999-00 | 5,813 | 4,148 | 3,213 | 2,082 | 1,500 | 549 | 321 | 290 | 17,916 |
| 2000-01 | 6,256 | 4,401 | 3,544 | 2,313 | 1,533 | 526 | 327 | 309 | 19,207 |
| 2001-02 | 6,806 | 5,024 | 3,999 | 2,517 | 1,687 | 554 | 366 | 505 | 21,458 |
| 2002-03 | 7,067 | 5,155 | 3,988 | 2,539 | 1,721 | 550 | 395 | 366 | 21,781 |
| 2003-04 | 7,618 | 5,355 | 4,287 | 2,551 | 1,801 | 563 | 405 | 361 | 22,940 |
| 2004-05 | 8,154 | 5,742 | 4,614 | 2,898 | 1,955 | 637 | 415 | 379 | 24,795 |
| 2005-06 | 8,727 | 6,262 | 5,055 | 3,249 | 2,079 | 680 | 426 | 426 | 26,904 |
| 2006-07(a) | 9,076 | 6,540 | 5,477 | 3,412 | 2,199 | 679 | 444 | 417 | 28,244 |
| 2007-08(a) | 9,850 | 6,983 | 6,095 | 3,711 | 2,388 | 767 | 486 | 483 | 30,774 |

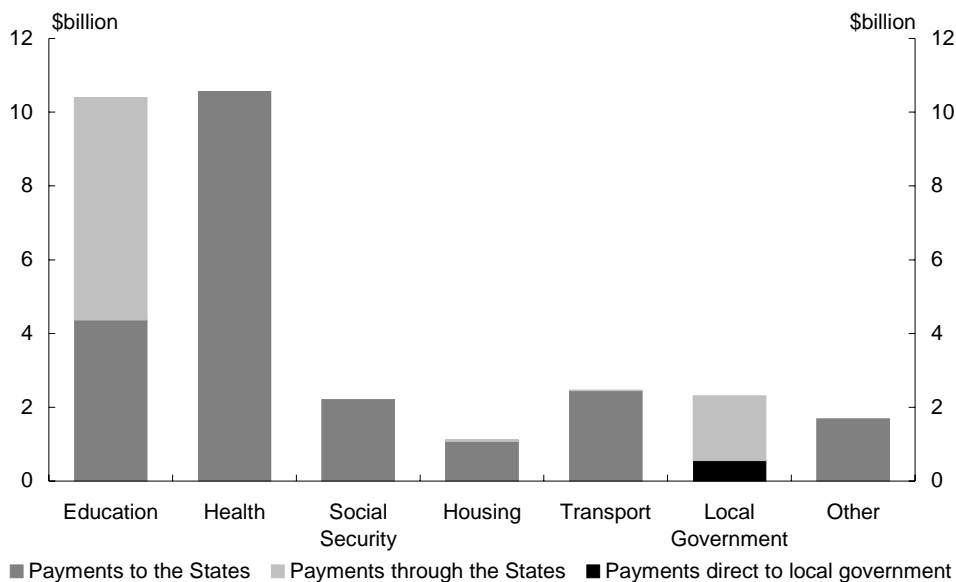
(a) Estimates.

The Australian Government’s commitment to maintain specific purpose payments in aggregate is being met. In nominal terms, total specific purpose payments have increased by 71.8 per cent since 1999-2000.

Major categories of specific purpose payments

In 2007-08, specific purpose payments for health, education and transport are estimated to account for 76.2 per cent of all specific purpose payments. These categories encompass payments for public hospitals, schools, vocational education and training, and the development, construction and maintenance of the National Land Transport Network under AusLink (Chart 6). Payments to local governments account for a further 7.5 per cent of all specific purpose payments.

Chart 6: Composition of specific purpose payments, 2007-08



‘Tied’ and ‘untied’ specific purpose payments

Agreements to provide specific purpose payments are often put in place to achieve national objectives in areas of state and local government responsibility. However, in making these payments, the Australian Government does not seek to take over responsibility for those functions.

Most specific purpose payments are ‘tied’, meaning that they are subject to conditions designed to ensure that the national objectives are achieved. Such objectives may include:

- general policy conditions – for example, the provision of free public hospital access for Medicare patients in return for funding under the Australian Health Care Agreements; and
- requirements that payments be expended for a specific purpose only – for example, grants provided for the eradication of red imported fire ant infestations detected in Australia.

Many of the ‘tied’ payments are made subject to the States maintaining real growth in their own financial contributions to a specified programme area or matching the Australian Government’s funding contributions. The States are also required to report agreed financial and performance information relating to each ‘tied’ payment in order to evaluate whether the national objectives are being achieved.

Some specific purpose payments are not subject to conditions relating to expenditure – or are ‘untied’. These typically relate to revenue sharing arrangements or compensation – either for the referral of powers, the transfer of responsibilities or for other Australian Government action that affects the States.

PAYMENTS TO LOCAL GOVERNMENTS

The Australian Government provides financial assistance to local governments to enhance their capacity to provide services to local communities. This funding is provided in the form of financial assistance grants (which are specific purpose payments paid through the States) and specific purpose payments direct to local governments.

In aggregate, Australian Government payments to local government will be \$2.3 billion in 2007-08, as shown in Table 13.

Table 13: Australian Government payments to local government (accrual basis)

| \$million | 00-01 | 01-02 | 02-03 | 03-04 | 04-05 | 05-06 | 06-07 | 07-08 |
|---------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Financial assistance grants | 1,328 | 1,394 | 1,455 | 1,508 | 1,548 | 1,619 | 1,687 | 1,749 |
| Payments direct to local govt | 109 | 503 | 279 | 368 | 311 | 376 | 374 | 557 |
| Australian Government payments | 1,437 | 1,897 | 1,734 | 1,876 | 1,859 | 1,995 | 2,062 | 2,306 |

There is some variation in payments between financial years. This is a consequence of the specific purpose payments direct to local government being programme based and provided in response to identified needs. In contrast, financial assistance grants are indexed annually so that they are maintained in real per capita terms.

Financial assistance grants

The Australian Government provides untied financial assistance grants to local governments to spend according to their own priorities. In 2006-07, \$1.69 billion in financial assistance grants will be provided to the local government sector and \$1.75 billion will be provided in 2007-08 (Table 13).

The annual increase in financial assistance grants is based on an escalation factor, which the Treasurer determines with reference to population growth and the consumer price index. For 2007-08, it is estimated that the financial assistance grants will be indexed by 3.8 per cent.

Financial assistance grants are paid to the States as a specific purpose payment, on the condition that all the funds are passed on to local government. The grants contain two components:

- general purpose assistance, which is distributed on the basis of population; and
- untied local road funding, which is distributed on the basis of historical shares.

State grants commissions determine the intra-state distribution of the financial assistance grants between local governments.

State shares of financial assistance grants for 2006-07 and 2007-08 are shown in Table 14. The cash totals vary from the accrual totals shown in Table 13 due to adjustments for any overpayment or underpayment from the previous year. These adjustments arise because the Treasurer determines the escalation factors in June prior to the end of each financial year, and the adjustment in the following financial year ensures that local governments receive their correct entitlement using the final escalation factor.

Table 14: Financial assistance grants to local government (cash basis)

| \$million | NSW | VIC | QLD | WA | SA | TAS | ACT | NT | Total |
|----------------------------|-----|-----|-----|-----|-----|-----|-----|----|-------|
| 2006-07 | | | | | | | | | |
| General purpose assistance | 388 | 288 | 229 | 116 | 88 | 28 | 19 | 12 | 1,168 |
| Untied local road funding | 150 | 107 | 97 | 79 | 28 | 27 | 17 | 12 | 518 |
| Total(a) | 539 | 395 | 326 | 195 | 117 | 55 | 35 | 24 | 1,686 |
| 2007-08 | | | | | | | | | |
| General purpose assistance | 401 | 300 | 240 | 121 | 91 | 29 | 19 | 12 | 1,214 |
| Untied local road funding | 156 | 111 | 101 | 82 | 30 | 29 | 17 | 13 | 539 |
| Total(b) | 557 | 411 | 341 | 204 | 121 | 57 | 37 | 25 | 1,753 |

(a) The 2006-07 estimate takes into account an underpayment of \$1.7 million in 2005-06. The Treasurer will determine the final 2006-07 escalation factor in June 2007. The 2006-07 escalation factor is currently estimated to be 1.0419.

(b) The 2007-08 estimate includes the estimated adjustment for the difference between the 2006-07 escalation factor estimated in June 2006 (used to calculate payments in 2006-07) and the final factor for 2006-07 (to be determined in June 2007). On the basis of the current estimate of the 2006-07 escalation factor, this adjustment will be an increase of \$2.1 million. The 2007-08 escalation factor is currently estimated to be 1.0380. Financial assistance grants in 2007-08 will be paid on the basis of the escalation factor that the Treasurer will estimate in June 2007. The Treasurer will determine the final escalation factor for 2007-08 in June 2008.

Specific purpose payments direct to local governments

The Australian Government provides specific purpose payments direct to local governments to help fund local roads and infrastructure, child care programmes, and disability and other services administered by local governments. These payments will total \$374 million in 2006-07 and increase to \$557 million in 2007-08 (Table 13).

These payments mainly comprise a component of AusLink funding which assists local councils with upgrading and maintenance works on local roads. In 2007-08, the local government sector will receive \$496 million under the AusLink programme.

MIRROR TAX ARRANGEMENTS

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

These arrangements mirror certain state taxes, including payroll taxes, land taxes and stamp duties, with respect to Commonwealth places.

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

Estimates of mirror taxes are provided in Table 15.

Table 15: Mirror taxes accrued on behalf of the States

| \$million | Estimates | | Projections | | |
|-------------------------------------|-----------|---------|-------------|---------|---------|
| | 2006-07 | 2007-08 | 2008-09 | 2009-10 | 2010-11 |
| Mirror taxes | 353.3 | 370.8 | 391.4 | 413.6 | 437.6 |
| Payments to state governments | -353.3 | -370.8 | -391.4 | -413.6 | -437.6 |
| Australian Government budget impact | 0 | 0 | 0 | 0 | 0 |