

FEDERAL FINANCIAL RELATIONS

In 2007-08, the States and Territories (the States) will receive GST revenue of \$42.2 billion and other payments from the Australian Government of \$30.9 billion, totalling \$73.1 billion, as shown in Table 22. This is a 7.4 per cent increase in total payments, compared with the \$68.1 billion the States received in 2006-07.¹

Table 22: GST and Australian Government payments to the States, 2007-08

| \$million | NSW | VIC | QLD | WA | SA | TAS | ACT | NT | Total |
|---|--------|--------|--------|-------|-------|-------|-------|-------|--------|
| (1) GST revenue to the States | 11,928 | 9,245 | 8,517 | 3,963 | 3,904 | 1,655 | 843 | 2,174 | 42,230 |
| (2) General revenue assistance | 26 | 10 | - | 4 | 3 | - | - | - | 43 |
| (3) Specific purpose payments | 9,899 | 6,981 | 6,078 | 3,740 | 2,398 | 773 | 476 | 496 | 30,851 |
| Payments to the States(a) | 7,274 | 4,948 | 4,469 | 2,878 | 1,761 | 555 | 321 | 402 | 22,619 |
| Payments through the States | 1,894 | 1,494 | 1,136 | 573 | 476 | 134 | 117 | 54 | 5,879 |
| Grants for local governments | 558 | 415 | 345 | 205 | 122 | 58 | 37 | 25 | 1,766 |
| Payments direct to local govt | 173 | 123 | 129 | 84 | 39 | 26 | .. | 14 | 588 |
| (4) Australian Government payments to the States and local govt (2) + (3) | 9,925 | 6,991 | 6,078 | 3,744 | 2,401 | 773 | 476 | 496 | 30,894 |
| (5) GST and total payments (1) + (4) | 21,853 | 16,236 | 14,596 | 7,707 | 6,306 | 2,428 | 1,318 | 2,670 | 73,124 |

(a) The total estimate for specific purpose payments to the States includes \$10 million that has not yet been allocated between the States.

GST revenue

In accordance with the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*, the Australian Government administers the GST on behalf of the States and all GST revenue is paid to the States. This provides the States with a robust, secure and growing source of revenue to spend according to their own budget priorities.

Variations in GST revenue since the 2007-08 Budget

Table 23 is a reconciliation of the GST revenue estimates between the 2007-08 Budget and the *Mid-Year Economic and Fiscal Outlook 2007-08* (MYEFO). The reconciliation accounts for policy decisions and parameter and other variations.

¹ Payments made to the state government sector include payments made to the local government sector unless otherwise specified.

Table 23: Reconciliation of GST revenue estimates

| \$million | Estimates | | Projections | |
|---|---------------|---------------|---------------|---------------|
| | 2007-08 | 2008-09 | 2009-10 | 2010-11 |
| 2007-08 Budget | 43,090 | 45,500 | 47,810 | 50,300 |
| Changes between 2007-08 Budget and MYEFO | | | | |
| Effect of policy decisions | -2 | -3 | -3 | -3 |
| Effect of parameter and other variations | 442 | 1,153 | 1,183 | 1,323 |
| Total variations | 440 | 1,150 | 1,180 | 1,320 |
| 2007-08 MYEFO | 43,530 | 46,650 | 48,990 | 51,620 |

GST revenue in 2007-08 is expected to be \$43.5 billion – \$440 million higher than forecast at the 2007-08 Budget, reflecting continued strength in consumption. Household consumption is expected to grow strongly in 2007-08, driven by strong growth in real after-tax incomes and supported by continued growth in household net wealth.

Policy decisions will have a small negative impact on GST revenue in 2007-08 and the forward years. The estimated revenue effect of each GST policy decision since the 2007-08 Budget is shown in Table 24.

Table 24: GST revenue policy decisions since 2007-08 Budget

| \$million | 2007-08 | 2008-09 | 2009-10 | 2010-11 |
|---|-------------|-------------|-------------|-------------|
| Provision of GST free status to non-alcohol based wipes | - | .. | .. | .. |
| Determination of business vehicle use fraction for decreasing adjustment of GST for compulsory third party scheme | -1.5 | -1.6 | -1.6 | -1.7 |
| Verification measures to support new arrangements concerning liquids, aerosols and gels and the sealed bag scheme - GST component | - | -1.0 | -1.0 | -1.0 |
| Total GST revenue policy decisions | -1.5 | -2.6 | -2.6 | -2.7 |

GST revenue to the States

Under the *Intergovernmental Agreement*, all GST revenue collected by the Australian Taxation Office is provided to the States. The Commissioner of Taxation estimates the level of GST receipts in June, prior to the end of each financial year, which forms the basis of GST revenue paid to the States for that financial year. A balancing adjustment is usually made in the following financial year to ensure that the States receive the full amount of GST receipts for a financial year. The calculation of GST revenue provided to the States is shown in Table 25.

Table 25: GST revenue to the States

| \$million | Outcome | Estimates | | Projections | |
|--|---------|-----------|---------|-------------|---------|
| | 2006-07 | 2007-08 | 2008-09 | 2009-10 | 2010-11 |
| GST revenue | 41,006 | 43,530 | 46,650 | 48,990 | 51,620 |
| less change in GST receivables | 1,446 | 1,280 | 1,380 | 1,320 | 1,490 |
| GST receipts | 39,560 | 42,250 | 45,270 | 47,670 | 50,130 |
| plus variation from the estimate of receipts in the Commissioner's determination(a) | 20 | | | | |
| plus prior year balancing adjustment | -28 | -20 | | | |
| GST revenue to the States | 39,552 | 42,230 | 45,270 | 47,670 | 50,130 |

(a) The Commissioner's estimate of receipts for 2006-07 was \$20 million higher than the final outcome.

In 2007-08, the States will receive GST revenue totalling an estimated \$42.2 billion – \$380 million higher than estimated at the 2007-08 Budget. The upward revision reflects an increase of \$400 million in the estimate of GST receipts for 2007-08, offset by the recovery of a \$20 million overpayment in respect of 2006-07.

GST revenue to the States has grown strongly since its introduction, as shown in Table 26. The average annual increase since 2001-02² has been 8.0 per cent.

Table 26: GST revenue to the States, 2000-01 to 2007-08

| \$million | NSW | VIC | QLD | WA | SA | TAS | ACT | NT | Total |
|------------|--------|-------|-------|-------|-------|-------|-----|-------|--------|
| 2000-01 | 7,258 | 5,099 | 4,658 | 2,375 | 2,279 | 988 | 473 | 1,226 | 24,355 |
| 2001-02 | 8,132 | 5,593 | 5,019 | 2,518 | 2,477 | 1,060 | 544 | 1,290 | 26,632 |
| 2002-03 | 9,080 | 6,365 | 5,888 | 2,910 | 2,859 | 1,247 | 616 | 1,515 | 30,479 |
| 2003-04 | 9,667 | 6,961 | 6,553 | 3,158 | 3,146 | 1,394 | 658 | 1,681 | 33,219 |
| 2004-05 | 9,884 | 7,346 | 7,329 | 3,624 | 3,293 | 1,435 | 680 | 1,730 | 35,323 |
| 2005-06 | 10,362 | 7,833 | 7,689 | 3,804 | 3,442 | 1,496 | 723 | 1,834 | 37,182 |
| 2006-07 | 10,938 | 8,588 | 8,092 | 3,968 | 3,605 | 1,568 | 778 | 2,015 | 39,552 |
| 2007-08(a) | 11,928 | 9,245 | 8,517 | 3,963 | 3,904 | 1,655 | 843 | 2,174 | 42,230 |

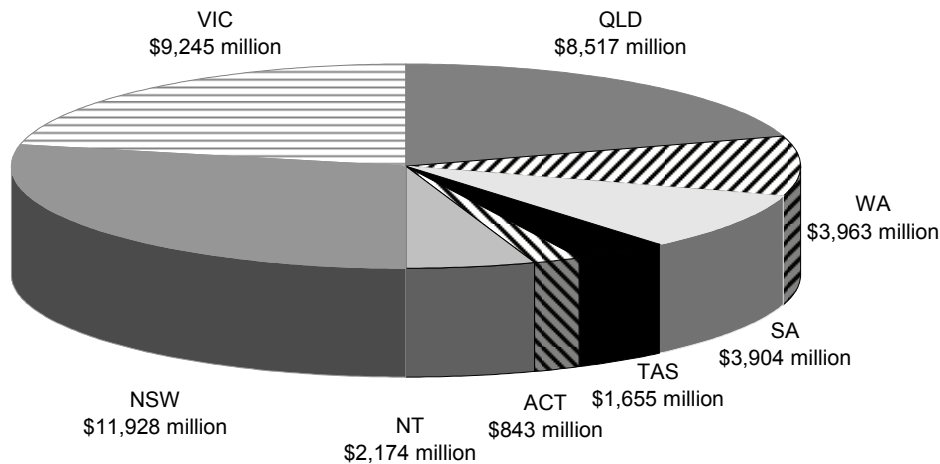
(a) Estimates.

Distribution of GST revenue among the States

As agreed by all States in the *Intergovernmental Agreement*, GST revenue is distributed among the States in accordance with the principle of horizontal fiscal equalisation and having regard to the recommendations of the Commonwealth Grants Commission.

The state shares of GST revenue for 2007-08 (totalling \$42.2 billion) are shown in Chart 5.

² As only 11 monthly activity statements, 3 quarterly activity statements, and no annual activity statements were payable in 2000-01, the calculated annual increase uses 2001-02 as the base year.

Chart 5: State shares of GST revenue, 2007-08

General revenue assistance

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, compensation payments in respect of GST policy decisions and National Competition Policy payments. In 2007-08, only previously suspended National Competition Policy payments will be made.

Budget balancing assistance

In the *Intergovernmental Agreement*, the Australian Government guaranteed that the budgetary position of each individual State would be no worse than it would have been had the reforms in the agreement not been implemented. As part of the agreement with the States to abolish the majority of the state taxes listed for review under the *Intergovernmental Agreement*, the Australian Government has extended the transitional period to 30 June 2009.

The guaranteed minimum amount 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. During the transitional period, where any State's guaranteed minimum amount is higher than its GST revenue in that same year, the Australian Government provides that State with budget balancing assistance, to compensate for that difference. Where GST revenue exceeds the guaranteed minimum amount, no budget balancing assistance is payable.

For 2007-08, it is estimated that all States will receive more GST revenue than their guaranteed minimum amount and consequently no State will require budget balancing assistance. Indeed, the States will receive a total revenue gain from the Australian Government's reforms of around \$3.4 billion more than their guaranteed

minimum amount. These revenue gains are estimated to increase to around \$4.6 billion by 2010-11, as shown in Table 27.

Table 27: Revenue gains to the States as a result of reform^(a)

| \$million | NSW | VIC | QLD | WA | SA | TAS | ACT | NT | Total |
|------------------------------------|--------------|--------------|--------------|------------|------------|------------|------------|------------|--------------|
| 2007-08 | | | | | | | | | |
| (1) GMA | 11,282 | 8,449 | 7,628 | 3,508 | 3,610 | 1,531 | 752 | 2,036 | 38,796 |
| (2) GST revenue | 11,928 | 9,245 | 8,517 | 3,963 | 3,904 | 1,655 | 843 | 2,174 | 42,230 |
| (3) BBA (1) - (2) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| (4) States' revenue gain (2) - (1) | 646 | 796 | 890 | 455 | 294 | 124 | 91 | 139 | 3,434 |
| 2008-09 | | | | | | | | | |
| (1) GMA | 11,942 | 8,906 | 7,752 | 3,371 | 3,790 | 1,589 | 780 | 2,168 | 40,297 |
| (2) GST revenue | 13,125 | 10,122 | 8,904 | 3,971 | 4,199 | 1,740 | 896 | 2,313 | 45,270 |
| (3) BBA (1) - (2) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| (4) States' revenue gain (2) - (1) | 1,183 | 1,216 | 1,153 | 600 | 409 | 151 | 116 | 145 | 4,973 |
| 2009-10 | | | | | | | | | |
| (1) GMA(b) | 13,268 | 9,591 | 8,330 | 3,480 | 4,074 | 1,659 | 824 | 2,302 | 43,528 |
| (2) GST revenue | 14,213 | 10,708 | 9,157 | 3,925 | 4,446 | 1,807 | 949 | 2,464 | 47,670 |
| (3) States' revenue gain (2) - (1) | 945 | 1,117 | 827 | 445 | 372 | 148 | 125 | 162 | 4,142 |
| 2010-11 | | | | | | | | | |
| (1) GMA(c) | 14,179 | 10,079 | 8,640 | 3,346 | 4,272 | 1,721 | 864 | 2,422 | 45,523 |
| (2) GST revenue | 15,250 | 11,354 | 9,521 | 3,809 | 4,693 | 1,885 | 1,001 | 2,618 | 50,130 |
| (3) States' revenue gain (2) - (1) | 1,071 | 1,274 | 881 | 462 | 421 | 164 | 138 | 195 | 4,607 |

(a) Estimates from 2007-08 will be affected by variations in GMA components and GST revenue. Estimates from 2008-09 will also be affected by recommendations by the Commonwealth Grants Commission on the distribution of GST provided to each of the States.

(b) As part of the agreement with the States to abolish the majority of the state taxes listed for review under the *Intergovernmental Agreement*, all States will have abolished stamp duties on credit arrangements, instalment purchase arrangements, rental arrangements, leases and mortgages by 1 July 2009. The revenue foregone is included in the GMA from 2009-10.

(c) As part of the agreement with the States to abolish the majority of the state taxes listed for review under the *Intergovernmental Agreement*, all States will have abolished stamp duties on unlisted marketable securities by 1 July 2010. The revenue foregone is included in the GMA from 2010-11.

Compensation payments for GST policy decisions

The Australian Government provides compensation to the States for the deferral of GST revenue resulting from its 2004 decision to allow small businesses and non-profit organisations which voluntarily registered for the GST, to report and pay GST on an annual, rather than monthly or quarterly, basis.

Due to an overpayment of this compensation to the States in previous years, the Australian Government agreed with the States to suspend future compensation payments until final tax return data for 2005-06, 2006-07 and 2007-08 is available, to ascertain the total compensation required.

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.

On 13 September 2007, the Australian Government lifted the suspensions following a recommendation by the National Water Commission that there has now been satisfactory progress by the States in implementing their water reform commitments.

Consequently, suspended payments of \$43.2 million were paid in 2007-08, as shown in Table 28. These payments are the final payments under the previous National Competition Policy arrangements.

Table 28: National Competition Policy payments

| \$million | NSW | VIC | QLD | WA | SA | TAS | ACT | NT | Total |
|-----------|-----|-----|-----|----|----|-----|-----|----|-------|
| 2007-08 | 26 | 10 | - | 4 | 3 | - | - | - | 43 |

Specific purpose payments

Specific purpose payments constitute a significant amount of Australian Government expenditure. In 2007-08, they are estimated to total \$30.9 billion, an increase of \$2.3 billion (8.1 per cent) over 2006-07. For the 2007-08 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 are 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.

The broad categories of specific purpose payments, as shown in Chart 6 and Table 29, are:

- payments made to the States to help fund state government functions;
- payments made through the States, where state governments distribute the payments 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 6: Specific purpose payments, 2007-08

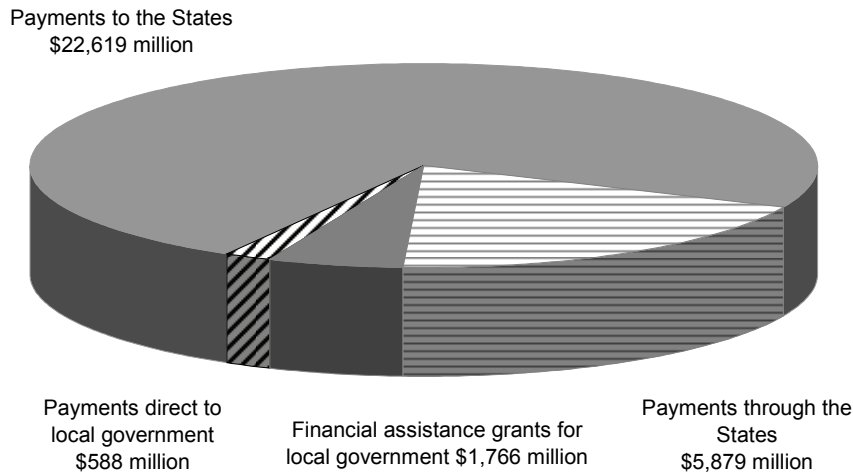


Table 29: Specific purpose payments

| \$million | Outcome | Estimate |
|--|---------------|---------------|
| | 2006-07 | 2007-08 |
| Payments to the States | 20,932 | 22,619 |
| Payments through the States | 5,548 | 5,879 |
| Financial assistance grants through States to local government | 1,689 | 1,766 |
| Payments direct to local government | 381 | 588 |
| Total payments | 28,549 | 30,851 |

Reform of state taxes

In return for receiving all GST revenue, the States agreed to abolish a number of inefficient state taxes that were impeding economic activity. The first tranche of inefficient state taxes were abolished by 1 July 2005. The value of the revenue foregone from the abolition of these inefficient taxes is estimated to be \$4.7 billion in 2007-08 (Table 30), growing to \$5.5 billion by 2010-11.

The remaining state taxes listed in the *Intergovernmental Agreement* were reviewed in 2005. The Australian Government and the States have agreed on a schedule for a second tranche of state tax reform. The value of revenue foregone from the second tranche of tax reform is estimated to be a further \$1.1 billion in 2007-08, growing to \$2.6 billion by 2010-11.

Table 30: State tax revenues foregone as a result of reform, 2007-08^(a)

| \$million | NSW | VIC | QLD | WA | SA | TAS | ACT | NT | Total |
|---|--------------|--------------|------------|------------|------------|-----------|-----------|-----------|--------------|
| <i>Tranche 1</i> | | | | | | | | | |
| Financial institutions duty | 847 | 501 | na | 172 | 154 | 37 | 22 | 23 | 1,757 |
| Debits tax | 361 | 280 | 412 | 129 | 62 | 28 | 20 | 9 | 1,300 |
| Marketable securities duty | 579 | 782 | 31 | 37 | 15 | 4 | 27 | 1 | 1,477 |
| Accommodation taxes | 114 | na | na | na | na | na | na | 11 | 125 |
| Total - Tranche 1 | 1,901 | 1,563 | 443 | 337 | 231 | 69 | 70 | 45 | 4,659 |
| <i>Tranche 2</i> | | | | | | | | | |
| Mortgage duty | 138 | 271 | 70 | 84 | 46 | 17 | na | na | 627 |
| Rental duty | 73 | 73 | 74 | 38 | 5 | 4 | 3 | 5 | 275 |
| Lease duty | 30 | 55 | 32 | 16 | 4 | 1 | 0 | 2 | 139 |
| Non-quotable marketable securities duty | 0 | 31 | 17 | 10 | 0 | 1 | 0 | 1 | 60 |
| Cheque duty | na | na | na | 6 | 3 | na | na | 3 | 13 |
| Non-real business assets duty | 0 | na | 0 | 0 | 0 | 0 | 1 | 0 | 1 |
| Total - Tranche 2 | 241 | 431 | 193 | 154 | 58 | 23 | 5 | 11 | 1,115 |
| Total taxes abolished | 2,142 | 1,993 | 636 | 492 | 289 | 92 | 74 | 55 | 5,774 |

(a) A not applicable (na) indicates that the State did not levy that particular tax at the time of the *Intergovernmental Agreement*. A zero indicates that the State levies that particular tax, but has agreed to abolish it at a later date. Revenue foregone from the abolition of a tax is only included in the calculation of guaranteed minimum amounts once all States have abolished the tax.

Under the *Intergovernmental Agreement*, stamp duty on business conveyances of real property is also to be abolished, by a date to be determined jointly by the Australian Government and the States, on the basis that no State would be worse off in any year compared with their likely financial position if reform had not occurred. This is the last remaining tax listed in the *Intergovernmental Agreement* which all of the States have agreed to abolish, but none have so far set out a timetable for its abolition.

