

OVERVIEW OF FEDERAL FINANCIAL RELATIONS

THE AUSTRALIAN GOVERNMENT'S REFORMS

The Australian Government implemented *The New Tax System* from 1 July 2000. An important component of the new system was the substantial reforms which were also made to Australia's system of federal financial arrangements.

In 1999, Commonwealth and State agreement was reached on the reform of federal financial relations. That agreement was formalised in the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* of June 1999. The Australian Government gave effect to the agreement by enacting the *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999*.

There are three objectives underpinning the Intergovernmental Agreement:

- the achievement of a new national tax system, including the elimination of inefficient indirect taxes;
- the provision to the States of a more robust tax base that will grow over time; and
- an improvement in the financial position of all States.

The Australian Government has implemented all of its Intergovernmental Agreement commitments. It abolished the inefficient Commonwealth tax listed in the agreement (wholesale sales tax) and implemented the goods and services tax. It also ensured, through legislative provision, that the States receive every dollar of GST revenue. As was anticipated at the time, GST revenues have proved to be a robust source of state revenue that has been growing over time. Furthermore, every State now receives more revenue under the current federal financial arrangements than it would have if the previous arrangements had continued.

REFORM OF STATE TAXES

In the Intergovernmental Agreement, the States agreed to abolish a range of inefficient indirect taxes that were impeding economic activity. The States themselves nominated the taxes to be abolished.

By 1 July 2005, the States had abolished several taxes that were listed in the Intergovernmental Agreement. This first tranche of abolished state taxes included accommodation tax, financial institutions duty, quoted marketable securities duty and debits tax.

The agreement also provided for further state taxes to be abolished once GST revenues proved to be sufficient. In 2006, the Australian Government reached agreement with all States on a schedule for the abolition of a second tranche of taxes, including all but one of the remaining state taxes listed in the Intergovernmental Agreement. This second tranche of inefficient state taxes being abolished includes stamp duties on mortgages, leases, and credit and rental arrangements. Notwithstanding that all States are already receiving substantial revenue gains from the Australian Government's reforms, some of these state taxes will not be abolished until as late as 2012-13.

Furthermore, the States are still required to abolish the one remaining tax before all of their commitments will have been met. So far, no State has specified when it will abolish stamp duty on conveyances of real non-residential property. The Australian Government will continue to pursue this matter.

PAYMENTS TO THE STATES AND TERRITORIES

In 2007-08, the States will receive GST revenue of \$41.9 billion and other payments from the Australian Government of \$30.8 billion, totalling \$72.6 billion, as shown in Table 1. This is a 7.1 per cent increase in total payments, compared with the \$67.8 billion that the States will receive in 2006-07.¹

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

Table 1: GST revenue and Australian Government payments to the States

\$million	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
2006-07									
(1) GST revenue to the States	11,034	8,573	8,049	3,978	3,591	1,573	768	1,985	39,552
(2) General revenue assistance	-	-	-	-	-	-	-	-	-
(3) Specific purpose payments	9,076	6,540	5,477	3,412	2,199	679	444	417	28,244
Payments to the States	6,633	4,641	4,001	2,623	1,605	495	297	331	20,627
Payments through the States	1,797	1,418	1,073	541	451	115	110	51	5,555
Grants for local governments	539	396	326	195	117	55	35	24	1,687
Payments direct to local govt	108	86	76	52	26	14	1	11	374
(4) Australian Government payments to the States and local govt (2) + (3)	9,076	6,540	5,477	3,412	2,199	679	444	417	28,244
(5) GST and total payments (1) + (4)	20,110	15,113	13,526	7,390	5,790	2,253	1,212	2,402	67,796
2007-08									
(1) GST revenue to the States	11,926	9,147	8,384	3,945	3,855	1,646	823	2,124	41,850
(2) General revenue assistance	-	-	-	-	-	-	-	-	-
(3) Specific purpose payments	9,850	6,983	6,095	3,711	2,388	767	486	483	30,774
Payments to the States	7,168	4,906	4,454	2,831	1,737	545	328	388	22,367
Payments through the States	1,962	1,547	1,186	597	493	138	122	56	6,100
Grants for local governments	559	410	338	202	121	57	37	25	1,749
Payments direct to local govt	160	120	117	81	38	27	..	14	557
(4) Australian Government payments to the States and local govt (2) + (3)	9,850	6,983	6,095	3,711	2,388	767	486	483	30,774
(5) GST and total payments (1) + (4)	21,776	16,130	14,479	7,657	6,243	2,413	1,309	2,606	72,624

GST revenue provided to the States will increase by \$2.3 billion (5.8 per cent) in 2007-08 and Australian Government payments to state and local governments will increase by a further \$2.5 billion (9.0 per cent). Australian Government payments to the States include payments provided for local governments of \$2.3 billion in 2007-08.

All GST revenue is provided to the States to spend according to their own budget priorities. As agreed by all States in the Intergovernmental Agreement, GST revenues are distributed among the States in accordance with the principle of horizontal fiscal equalisation, and having regard to the recommendations of the Commonwealth Grants Commission.

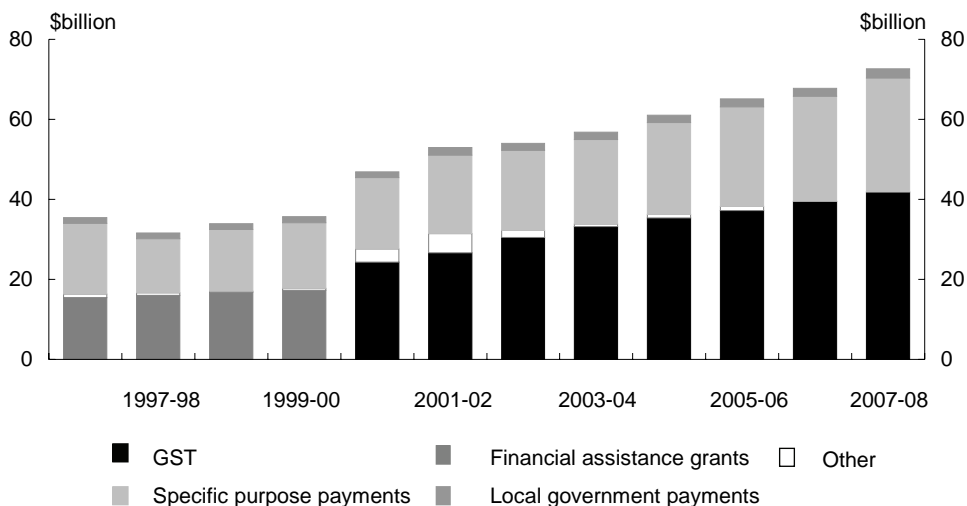
Specific purpose payments are a financial contribution to important areas of state responsibility which the Australian Government makes in pursuit of its policy objectives. Typically, the States need to fulfil specified conditions in order to receive these payments, which cover most functional areas of state and local government activity, including education, health, social security, housing and transport.

At the request of the States, the Australian Government provided a commitment in the Intergovernmental Agreement that it would maintain specific purpose payments in aggregate. The commitment was consistent with the objective of the States being

financially better off under the new arrangements. The Australian Government continues to meet this commitment.

Total payments to the States have grown steadily since the introduction of *The New Tax System* in 2000-01 (Chart 1). The average annual increase in total payments over this seven year period has been 6.5 per cent, compared with 6.3 per cent for the previous seven years.

Chart 1: Total payments to the States since 1996-97



MINISTERIAL COUNCILS

The Ministerial Council for Commonwealth-State Financial Relations was established in accordance with the Intergovernmental Agreement to oversee the operation of the agreement. The Ministerial Council generally meets annually to review the administration of the GST by the Australian Taxation Office, consider amendments to the GST, and consider the on-going reform of federal financial relations.

The Australian Loan Council generally meets annually to coordinate public sector borrowing. The council has regard to each jurisdiction’s fiscal position as well as the macroeconomic implications of the aggregate borrowing requirement. Current arrangements operate on a voluntary basis and emphasise transparency of public sector financing rather than adherence to strict borrowing limits.