

CHAPTER 2

WHAT STATES DO

INTRODUCTION

- 1 State governments provide services to their populations, funded by revenues they raise and by transfers of goods and services tax (GST) revenue, specific purpose payments (SPPs) and other payments from the Australian Government. In delivering services, States use physical and financial assets. Chapter 5 provides an analysis of what States have been doing in these areas.
- 2 This chapter provides an overview of ‘what States do’ in terms of the services they provide and the revenues they raise. It draws on the information contained in the adjusted budget the Commission uses to calculate the relativities used to share the GST and health care grants (the GST and HCG pool) among the States¹. The adjusted budget is set out in Attachment A.
- 3 The adjusted budget is a representation of State budgets used by the Commission to derive the average per capita revenues and expenses. It covers all operating transactions of the general government sector in State public accounts, except those excluded by terms of reference or the Commission’s SPP guidelines. Other adjustments are made to improve comparability between States over time. The budget is dissected into revenue, expense and user charges categories. The data used to construct it are derived from the Australian Bureau of Statistics Government Finance Statistics (GFS), State budgets and other sources. There may be differences in how States classify apparently similar transactions in GFS and some caution is required in making comparisons between States.

STATE EXPENSES AND REVENUE

- 4 Table 2-1 shows States net² expenses and revenues from their own sources, on an annual average per capita basis, for 2002-03 to 2006-07. It compares each State’s annual average per capita expense and revenue with the Australian average expense and revenue. It also compares:

¹ Commonwealth Grants Commission, *Report on State Revenue Sharing, 2008 Update*, Canberra, 2008.

² User charges have been subtracted from gross expenses.

- each State's annual average per capita expense with what each State would have needed to spend to provide the average level of services to its population; and
- each State's annual average per capita revenue with what each State could have raised from its revenue bases, if it taxed them at Australian average tax rates.

Table 2-1 State net expenses and revenues, average for 2002-03 to 2006-07

	NSW	Vic	Qld	WA	SA	Tas	ACT (a)	NT	Aust
Expense (\$pc)	5 071	4 771	4 647	5 702	5 472	5 756	6 321	13 001	5 124
Relative to Australian average expense	0.990	0.931	0.907	1.113	1.068	1.122	1.235	2.543	1.000
Level of service provision (b)	1.004	1.013	0.904	1.032	1.076	1.041	1.247	1.018	1.000
Own-source revenue (\$pc)	2 512	2 159	2 189	3 271	2 061	1 665	2 130	2 006	2 371
Relative to Australian average revenue	1.062	0.913	0.922	1.370	0.868	0.703	0.895	0.845	1.000
Tax effort (c)	1.012	1.005	0.891	1.080	1.099	1.039	1.057	0.969	1.000

(a) ACT expenses include municipal expenses.

(b) Ratio of what a State actually spends to what it would need to spend to deliver the Australian average level of services.

(c) Ratio of what a State raises in taxes to what it could raise if it applied Australian average tax rates to its revenue bases.

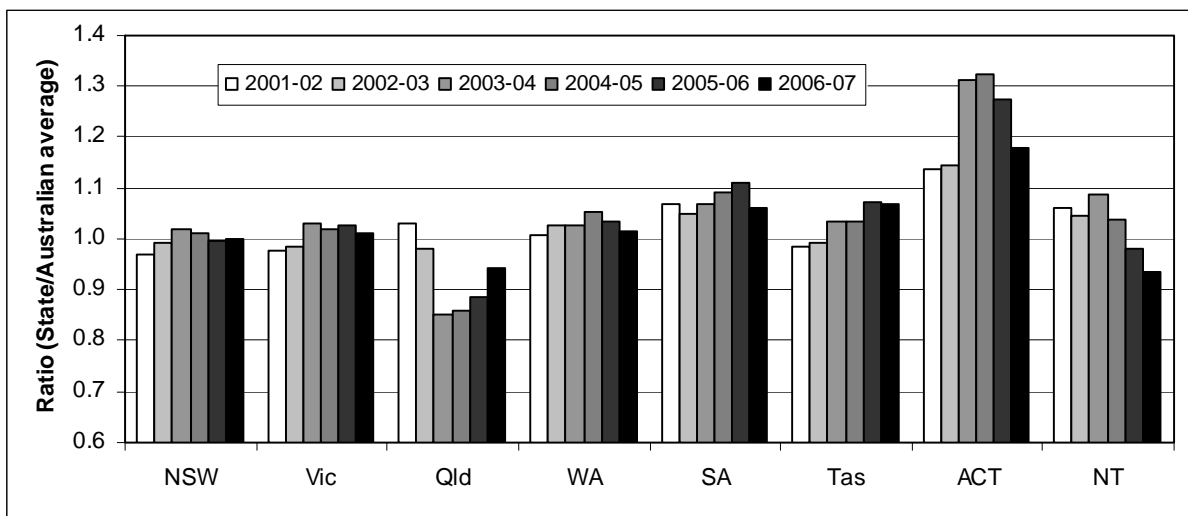
Source: CGC adjusted budget and Attachment E.

- 5 The table shows that the Northern Territory had the highest per capita expenses, more than twice that of all the other States. Expenses for New South Wales, Victoria and Queensland were below the Australian average, while those of other States were above.
- 6 Western Australia raised the highest amount of revenue per capita, followed by New South Wales. They were the only States that raised more than the Australian average.
- 7 Western Australia was the only State that raised more revenue per capita and spent more per capita than average. Victoria and Queensland, on the other hand, raised and spent less per capita than the average.
- 8 New South Wales raised more revenue than the average but, on the expense side, spent less than the average. South Australia, Tasmania, the ACT and the Northern Territory raised less revenue per capita than the average and spent more than the average.
- 9 Of perhaps more interest is how a State's actual expenses and revenues compare with what it would have needed to spend to provide the average level of services and what it could have raised by applying Australian average tax rates. All States except Queensland spent more than the average. The ACT recorded the highest level of service provision at 25 per cent above the average³. Although Queensland spent less than the average, this does not necessarily mean that the actual service levels were lower in the State. Above average efficiencies in service delivery could cause lower spending — conversely, higher spending than the amount needed to provide average levels of service may mean either higher standards of service or less efficient delivery (or both).

³ The ACT's expenses include municipal transactions and therefore its level of service provision ratios are not directly comparable with those of other States.

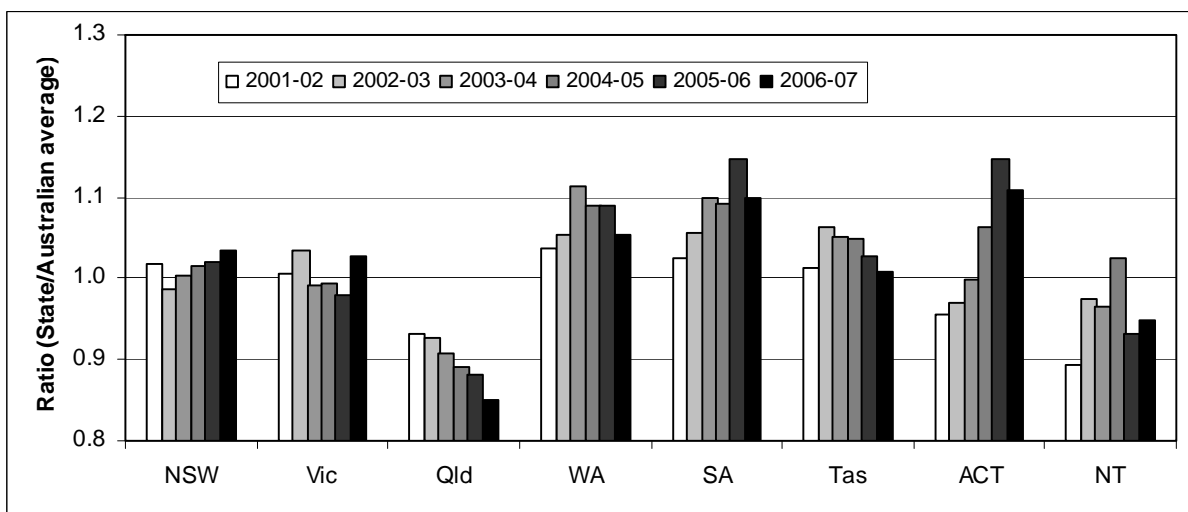
- 10 The revenue comparison suggests that South Australia made the highest effective tax effort, raising some 10 per cent more per capita than what would have been raised at average tax rates, followed by Western Australia (8 per cent more), ACT (6 per cent more), and the Tasmania (4 per cent more). New South Wales' and Victoria's tax efforts are at Australian average levels — their actual revenues were very close to what would have been raised at average tax rates. Queensland and the Northern Territory were the only States with tax efforts below the average.
- 11 Figure 2-1 and Figure 2-2 show the annual movements in level of service ratios and revenue effort ratios respectively.
- 12 The rest of the chapter examines the composition of State budgets.

Figure 2-1 Level of service ratio, 2001-02 to 2006-07



Note: ACT expenses may include municipal transactions so ratios may not be comparable with other States.
Source: Attachment E.

Figure 2-2 Revenue effort ratio, 2001-02 to 2006-07

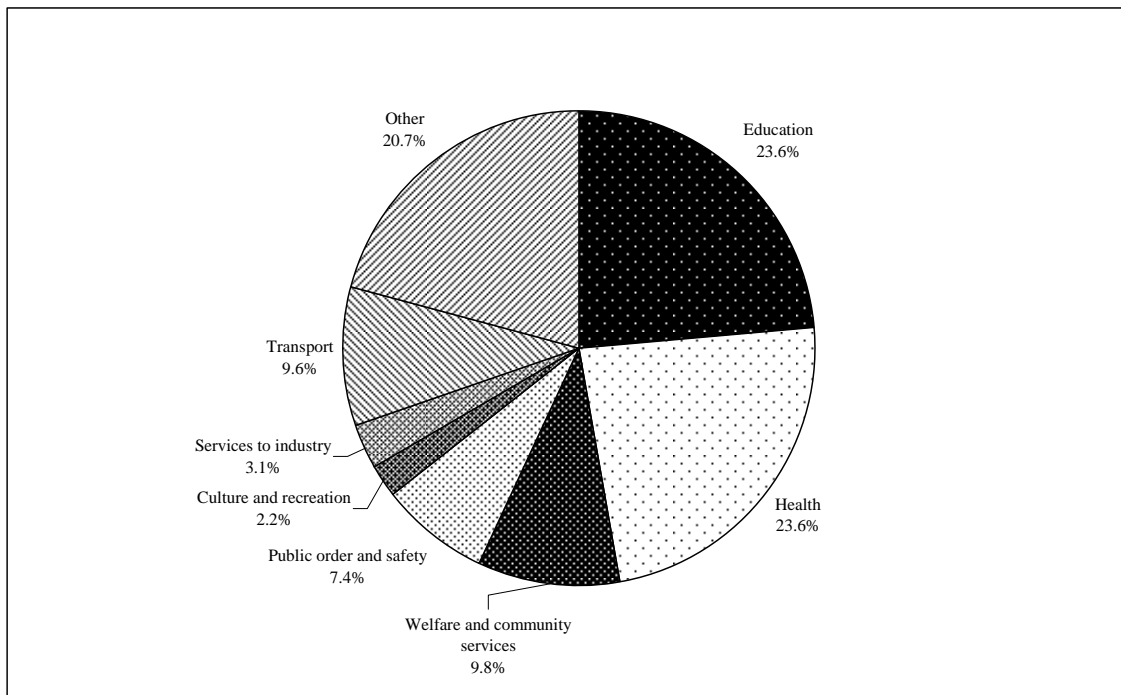


Source: Attachment E.

SERVICES

13 Figure 2-3 illustrates the average importance of different State services across all States for the period 2002-03 to 2006-07. Figure 2-3 shows that education and health services were the largest areas of expenditure, each comprising 24 per cent of total State expenses.

Figure 2-3 State net expenses by type of service — annual average proportion of total expenses for 2002-03 to 2006-07 (all States)



Notes: The proportions have not changed much during the five years.

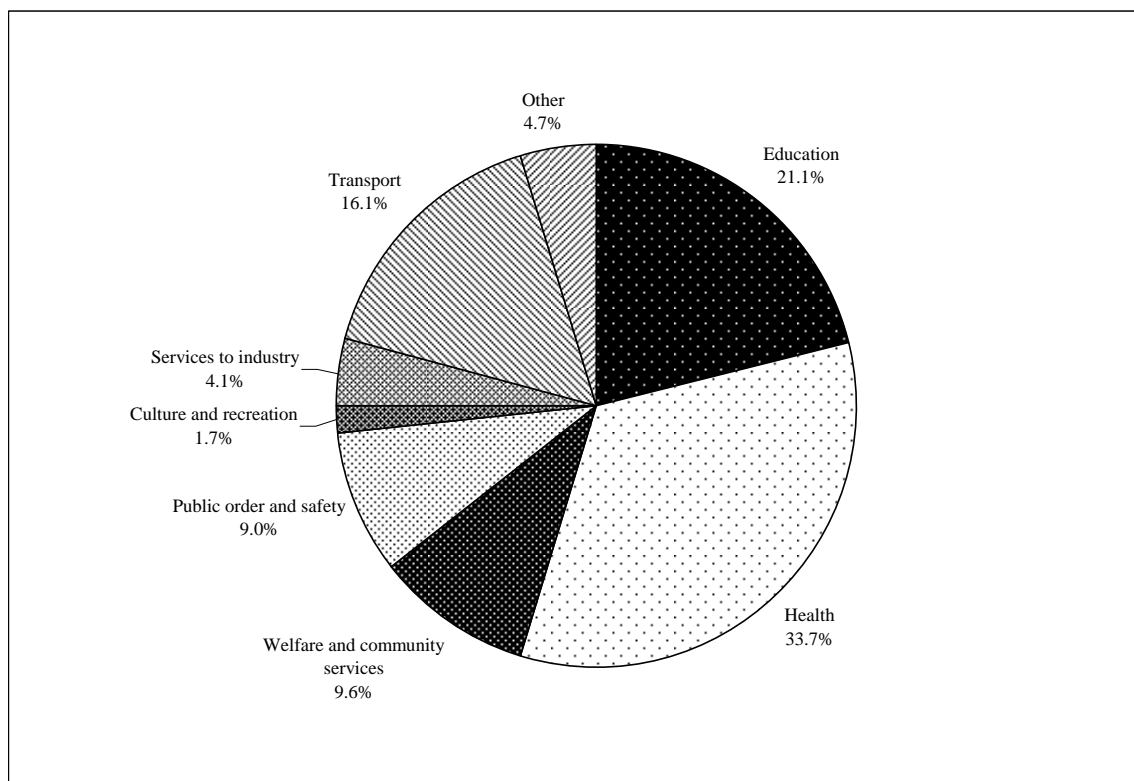
'Welfare and community services' includes social welfare, housing, first home owners scheme and services to Indigenous communities. 'Other' includes concessions and other payments, GST administration costs, general public services, superannuation, debt charges and depreciation.

Source: CGC adjusted budget.

- 14 Other expenses constituted 21 per cent of State expenses. The main components were superannuation⁴ and general public services.
- 15 The next most important services were welfare and community services, transport (both 10 per cent) and public order and safety (7 per cent).
- 16 Between 2001-02 and 2006-07, net expenses grew by 25 per cent on a per capita basis. Figure 2-4 shows the contribution of the main expense categories to that growth. Health expenses made up 24 per cent of expenses but accounted for 34 per cent of growth, indicating above average growth. Education expenses, also contributed 24 per cent to total expenses, accounted for 21 per cent of growth, indicating below average growth.

⁴ Superannuation expenses are a cost of providing all other services and ideally should be allocated to those services. The annual superannuation expenses in the adjusted budget include 10 per cent of superannuation liabilities as at July 1998 and nominal interest on unfunded superannuation which the ABS government finance statistics (GFS) classify as debt charges.

Figure 2-4 State net expenses by type of service — contribution to growth in total expenses for 2001-02 to 2006-07 (all States)



Note: 'Other' includes concessions and other payments, GST administration costs, general public services, superannuation, debt charges and depreciation.

Source: CGC adjusted budget.

17 Over time, health, public order and safety, transport and services to industry have become more important areas in State budgets. The other areas have become less important.

18 Table 2-2 compares the annual average proportions of State expenses attributable to each of those groups of expenses over the years 2001-02 to 2005-06 and 2002-03 to 2006-07.

Table 2-2 Comparison of importance of State net expenses in State budgets — 2001-02 to 2005-06 and 2002-03 to 2006-07

	Annual average proportion of State expenses	
	2001-02 to 2005-06	2002-03 to 2006-07
	%	%
Health	23.0	23.6
Education	23.7	23.6
Welfare and community services	9.8	9.8
Public order and safety	7.3	7.4
Transport	9.2	9.6
Services to industry	3.0	3.1
Culture and recreation	2.3	2.2
Other	21.7	20.7

Source: CGC adjusted budget.

- 19 Table 2-3 shows that the relative importance of different services varies among the States. Education and health are the most important services⁵ for all States. Both services together accounted for at least 40 per cent of State expenses, with the exception of the Northern Territory (34 per cent). Queensland and South Australia were the States with the highest proportion of expenditure on education and health.

Table 2-3 State net expenses by type of service — annual average proportion of total expenses for 2002-03 to 2006-07^(a)

	NSW	Vic	Qld	WA	SA	Tas	ACT (b)	NT
	%	%	%	%	%	%	%	%
Education	23.6	23.6	25.5	23.2	22.8	22.6	21.6	17.4
Health	23.6	24.2	23.9	23.1	25.9	22.0	18.2	16.8
Welfare and community services (c)	10.5	9.9	9.0	8.5	10.2	9.5	9.5	11.9
Public order and safety	7.4	6.8	7.4	8.2	7.4	6.0	10.1	9.4
Culture and recreation	2.0	2.2	1.9	2.2	2.9	3.4	3.0	4.1
Services to industry	2.1	1.9	6.6	3.5	2.5	2.6	0.7	3.4
Transport	12.7	8.0	10.0	8.0	5.5	6.5	5.4	5.9
Other (d)	18.1	23.4	15.7	23.3	22.8	27.4	31.5	31.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

(a) This pattern is representative of the situation in each year.

(b) ACT expenses may include municipal expenses.

(c) Includes social welfare, housing, first home owners scheme and services to Indigenous communities.

(d) Includes concessions and other payments, GST administration costs, general public services, superannuation, debt charges and depreciation.

Source: CGC adjusted budget.

- 20 Welfare and community services were the third most important group of services for most States except New South Wales and Queensland, which spent more on transport and the ACT which spent more on public order and safety.
- 21 The ACT and the Northern Territory spent considerably more of their budgets than the other States on 'other expenses', principally on superannuation, general public services, debt charges and depreciation. The causes are likely to be different for the two States, although each could be more affected by diseconomies of small scale than the other States. The ACT's other expenses may also be higher because the ACT provides municipal services and it incurs higher expenses inherited from the Australian Government that have persisted since self government (such as Commonwealth superannuation scheme costs and those due to national capital influences). The Northern Territory's other expenses are also likely to be higher because of Commonwealth superannuation scheme expenses and land rights costs not faced by other States.
- 22 What each State spends on particular services depends on:

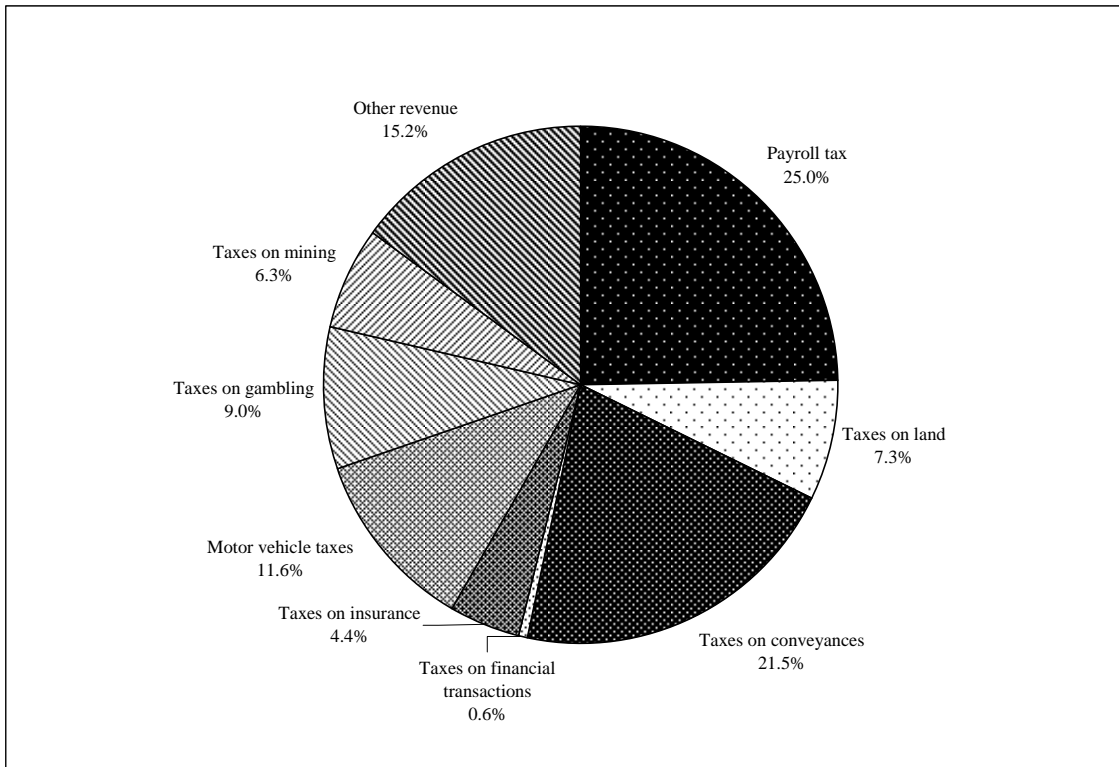
⁵ 'Other' is not considered in this discussion because this group includes mainly general public services and miscellaneous services.

- circumstances outside of its control, such as the needs of their populations; for example, a young population will require higher spending on education and an older population will require higher spending on health;
 - their policies; for example, people in one State may value health services more than other services and demand that their government spend more on them and less on others; and
 - the technical efficiency with which the services are delivered; for example, efficient service provision will result in lower levels of per capita spending than less efficient service provision.
- 23 It is necessary to consider all three influences in explaining a State's level of spending on a particular service. For example, the ACT's below average proportion of expenses on hospital services may be due to a younger, healthier population, ACT residents may value health services less than other services, or the ACT may be delivering services more efficiently.
- 24 It is the circumstances outside State control, or the policy neutral influences, which the Commission attempts to identify in estimating what it considers States need to spend to deliver Australian average levels of service. The major policy neutral drivers of differences in State expenses are discussed in Chapters 3 and 4. Attachment E shows how the Commission's assessed cost of providing services for each State for each service, which takes account of these policy neutral drivers, differs from the Australian average.

REVENUES

- 25 Figure 2-5 shows the important State own-source revenues for 2002-03 to 2006-07. This figure shows that payroll tax was the most important, constituting 25 per cent of total State revenue.
- 26 Taxes on conveyances were the second most important tax (22 per cent), and together with taxes on land, comprised more than a quarter of own-source revenue.

Figure 2-5 State own-source revenue — annual average percentage of total for 2002-03 to 2006-07 (all States)



Notes: There is more variation across the years in proportions of revenue raised by each group of taxes than for services. 'Taxes on financial transactions' have been adjusted to reflect that most States will abolish components of these taxes in 2008-09.

'Other revenue' includes miscellaneous taxes and revenue and contributions by trading enterprises.

Source: CGC adjusted budget.

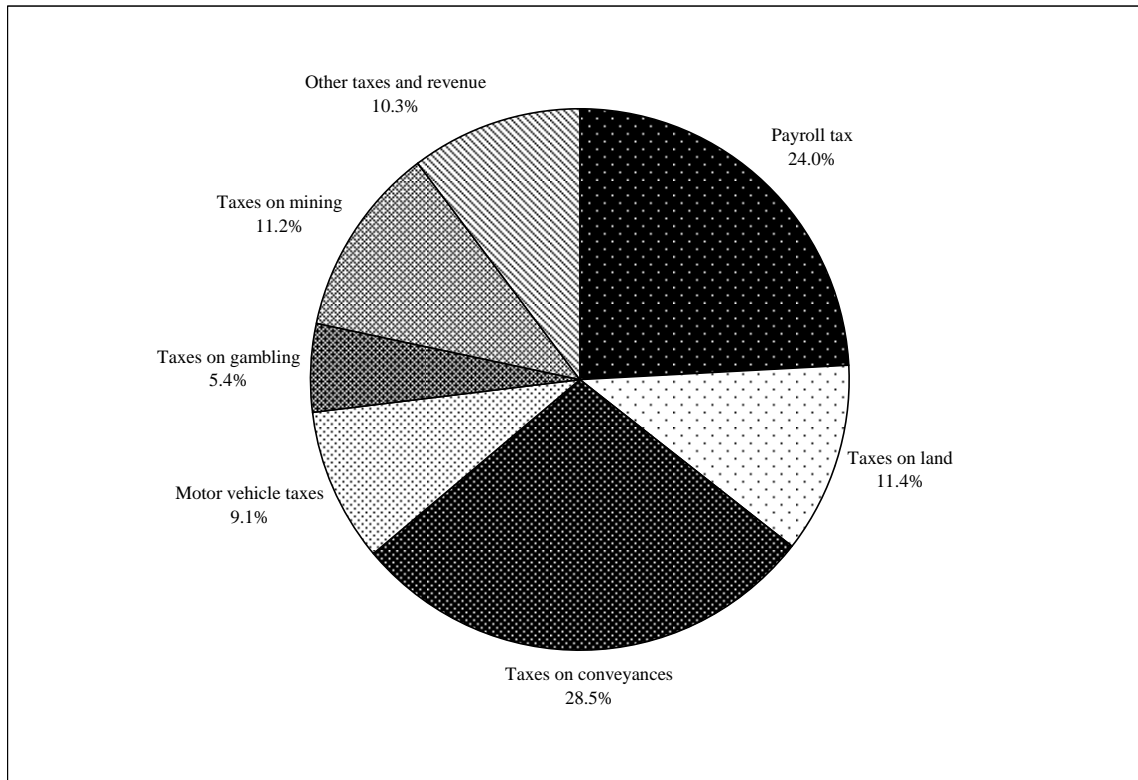
27 Between 2001-02 and 2006-07, State own-source revenue increased by 42 per cent on a per capita basis. Figure 2-6 shows the contribution of the main State revenue sources to that growth

28 Figure 2-5 and Figure 2-6 together illustrate that:

- taxes on conveyances comprised 22 per cent of revenue, but contributed 29 per cent to the growth;
- payroll tax, at 25 per cent of average revenue, contributed 24 per cent to the growth;
- taxes on mining were only 6 per cent of total own-source revenue, but provided 11 per cent of the growth; and
- taxes on land comprised 7 per cent of revenue, but caused 11 per cent of the growth.

29 Over recent years, revenues from land-related taxes and mining have become more important to State own-source revenue. Payroll tax has become less important. Table 2-4 compares the annual average proportions of State revenues attributable to each of those taxes over the years 2001-02 to 2005-06 and 2002-03 to 2006-07. The size and the volatility of the land-related and mining tax bases may lead to wider volatility in State own-source revenue in the future.

Figure 2-6 State own-source revenue — contribution to growth in total State own-source revenue for 2001-02 to 2006-07 (all States)



Note: 'Other taxes and revenue' includes taxes on insurance, taxes on financial transactions and other revenue.
Source: CGC adjusted budget.

Table 2-4 Comparison of importance of State own-source revenue in State budgets — 2001-02 to 2005-06 and 2002-03 to 2006-07

	Annual average proportion of State revenue	
	2001-02 to 2005-06	2002-03 to 2006-07
	%	%
Land-related taxes	27.8	28.8
Payroll tax	25.1	25.0
Mining	5.9	6.3
Financial transactions and insurance	5.0	5.0

Source: CGC adjusted budget.

30 Table 2-5 shows how important the different types of own-source revenue are for each State. It shows that the main sources of revenue⁶ for all States were payrolls, property transfers and motor vehicle taxes (apart from Victoria whose gambling taxes were higher than its motor vehicle taxes). Together, they accounted for over 50 per cent of total revenue for each State.

⁶ 'Other revenue' is not considered in this discussion because this group includes mainly miscellaneous taxes and revenue, and contributions by trading enterprises.

Table 2-5 State own-source revenue — average percentage of total revenue for 2002-03 to 2006-07^(a)

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	%	%	%	%	%	%	%	%
Payroll tax	28.4	27.9	19.8	19.1	23.6	23.5	27.0	26.9
Taxes on land	9.2	8.2	4.3	5.5	7.6	5.1	7.7	0.0
Taxes on conveyances	21.7	22.2	21.7	21.3	18.0	15.8	25.1	17.6
Taxes on financial transactions	0.6	0.0	1.5	0.3	0.7	0.0	0.6	0.0
Taxes on insurance	2.8	6.2	4.2	4.6	7.0	4.3	4.5	5.1
Motor vehicle taxes	11.5	11.3	12.0	10.7	12.9	14.7	12.6	9.8
Taxes on gambling	8.5	12.9	8.9	2.1	12.2	9.9	7.5	11.9
Taxes on mining	2.2	0.2	11.6	22.2	3.2	2.1	0.0	12.5
Other revenue (b)	15.2	11.1	16.0	14.2	14.7	24.6	15.0	16.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

(a) Some variability from year to year, but patterns are stable.

(b) Includes miscellaneous taxes and revenue, and contributions by trading enterprises.

Source: CGC adjusted budget.

- 31 Tax on mining was the most important source of income for Western Australia. It accounted for more than 22 per cent of Western Australia's total revenue. This was higher than its income from payroll tax or stamp duty on conveyances.
- 32 Tasmania's income from other revenue was the highest percentage among the States. This group of revenue sources included dividends and tax equivalent contributions by trading enterprises and miscellaneous taxes and revenue.
- 33 The amount of revenue each State can raise depends on:
- circumstances outside its control, such as its natural endowments and the strength and nature of its economy;
 - its policies, such as the rate of, and manner in which the tax is imposed; and
 - the efficiency of its tax collection process, including its collection systems, monitoring and compliance procedures.
- 34 Chapters 3 and 4 discuss the main policy neutral drivers of differences between the States in their revenue bases and Attachment G summarises State taxation policies. Attachment E provides information on how State revenue bases compare with the Australian average and the effort States make to use their bases.