

## CHAPTER 2

---

### WHAT STATES DO

#### INTRODUCTION

- 1 State governments provide services to their populations, funded by revenues they raise and by transfers of GST, Specific Purpose Payments (SPPs) and other payments from the Australian Government.
- 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 HCG pool among the States<sup>1</sup>. 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 and 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 expenses and revenue from their own sources, on an annual average per capita basis, for 2001-02 to 2005-06. It compares each State’s annual average per capita expense and revenue with the Australian average expense and revenue. It also compares:

---

<sup>1</sup> Commonwealth Grants Commission, *Report on State Revenue Sharing, 2007 Update*, Canberra, 2007.

- 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 gross expenses and revenues, average for 2001-02 to 2005-06**

	NSW	Vic	Qld	WA	SA	Tas	ACT (a)	NT	Aust (b)
Expense (\$pc)	5 374	5 227	5 144	6 067	6 040	6 120	7 103	13 162	5 536
Relative to Australian average expense	0.971	0.944	0.932	1.095	1.090	1.105	1.281	2.376	1.000
Level of service provision (c)	0.981	1.018	0.925	1.024	1.096	1.034	1.302	1.047	1.000
Own source revenue (\$pc)	2 362	2 044	2 039	2 929	1 876	1 543	1 943	1 900	2 209
Relative to Australian average revenue	1.072	0.927	0.921	1.317	0.849	0.698	0.875	0.855	1.000
Tax effort (d)	1.006	1.003	0.911	1.080	1.071	1.044	1.027	0.972	1.000

(a) ACT expenses include municipal expenses.

(b) Australian average per capita.

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

(d) 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 (annual average for 2001-02 to 2005-06) and Attachment E.

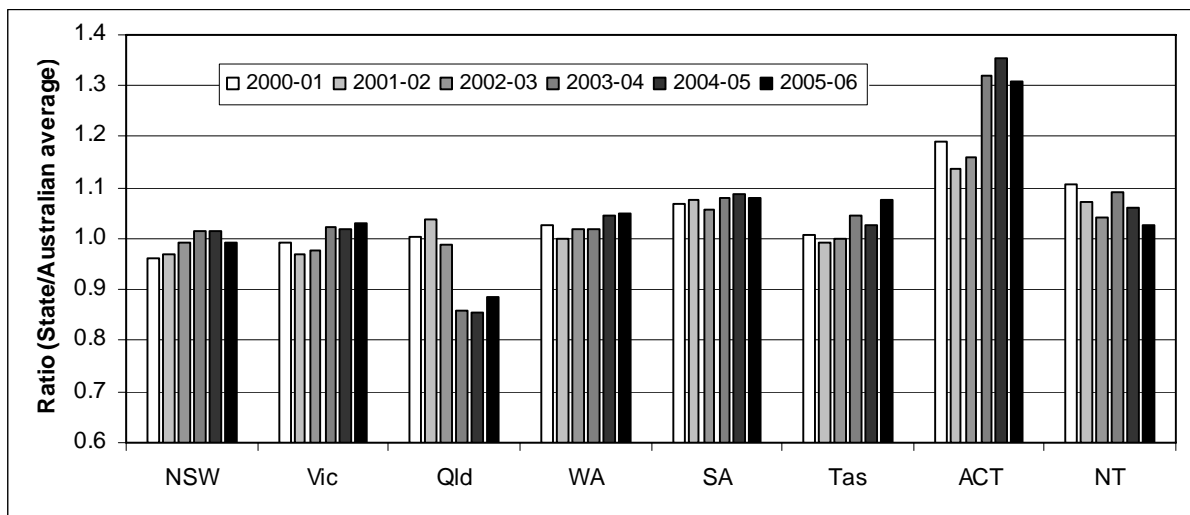
- 5 The table shows that the Northern Territory had the highest per capita expenses, which were around twice or more than the expenses of the other States. Expenses for New South Wales, Victoria and Queensland were below the Australian average, while those of other States were above.
- 6 Western Australia 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. Compared with this benchmark on the expense side of the budget, the ACT spent 30 per cent more<sup>2</sup>, South Australia 10 per cent more and the Northern Territory 5 per cent more. Only Queensland (8 per cent less) and New South Wales

<sup>2</sup> ACT expenses include municipal items so caution should be applied in interpreting any comparisons involving ACT actual expense data.

(2 per cent less) spent less. That does not necessarily mean that the actual service levels were lower in those States. 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).

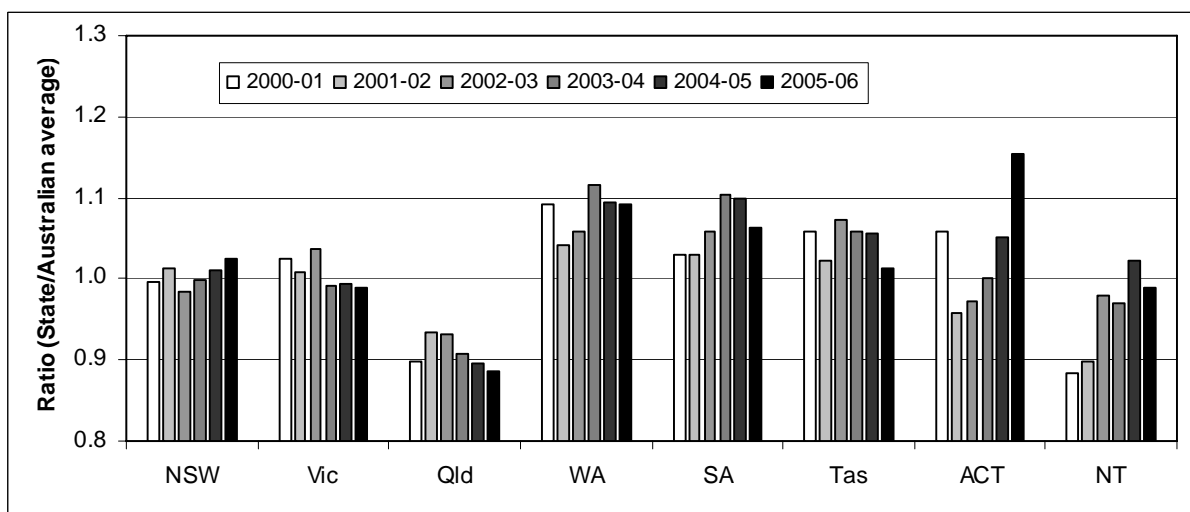
- 10 The revenue comparison suggests that Western Australia made the highest effective tax effort, raising some 8 per cent more per capita than what would have been raised at average tax rates, followed by South Australia (7 per cent more), Tasmania (4 per cent more), and the ACT (3 per cent more). New 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.
- 11 Figure 2-1 and Figure 2-2 show the annual movements in level of service ratios and revenue effort ratios respectively.

**Figure 2-1 Level of service ratio, 2000-01 to 2005-06**



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

**Figure 2-2 Revenue effort ratio, 2000-01 to 2005-06**

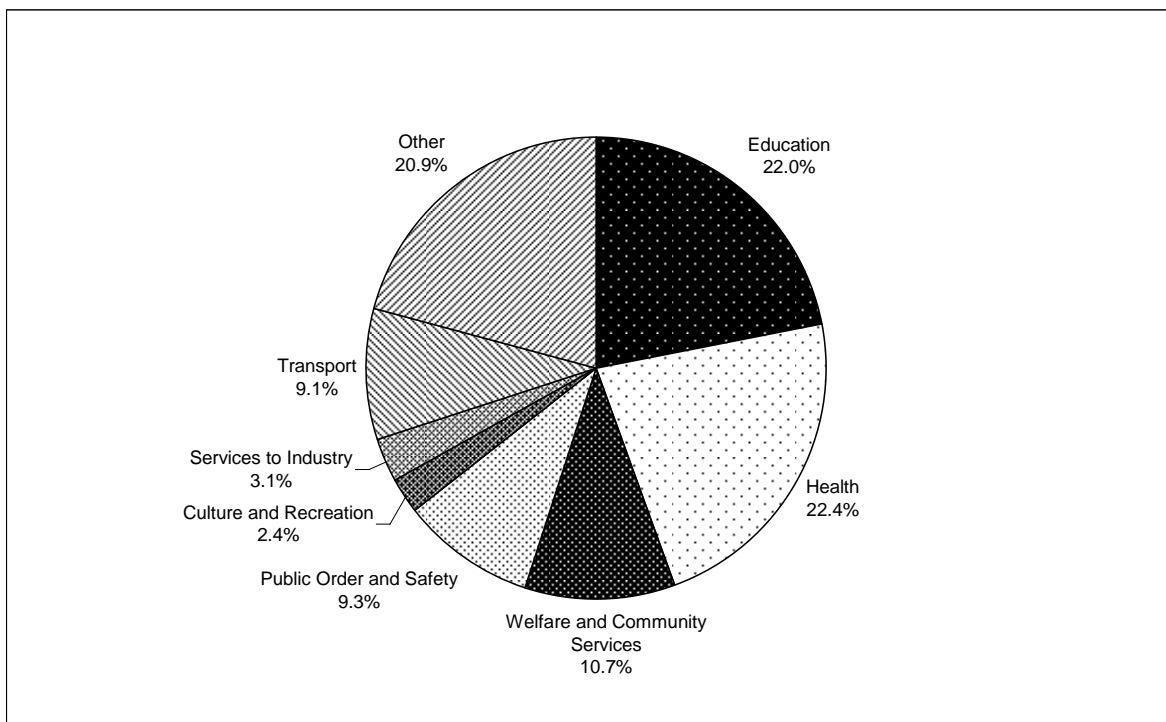


12 The rest of the chapter examines the composition of State budgets.

## SERVICES

13 Figure 2-3 illustrates the average importance of different State services across all States for the period 2001-02 to 2005-06. Figure 2-3 shows that education and health services were the largest areas of expenditure, each comprising 22 per cent of total State expenses.

**Figure 2-3 Gross State expenses by type of service — annual average proportion of total expenses for 2001-02 to 2005-06 (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.

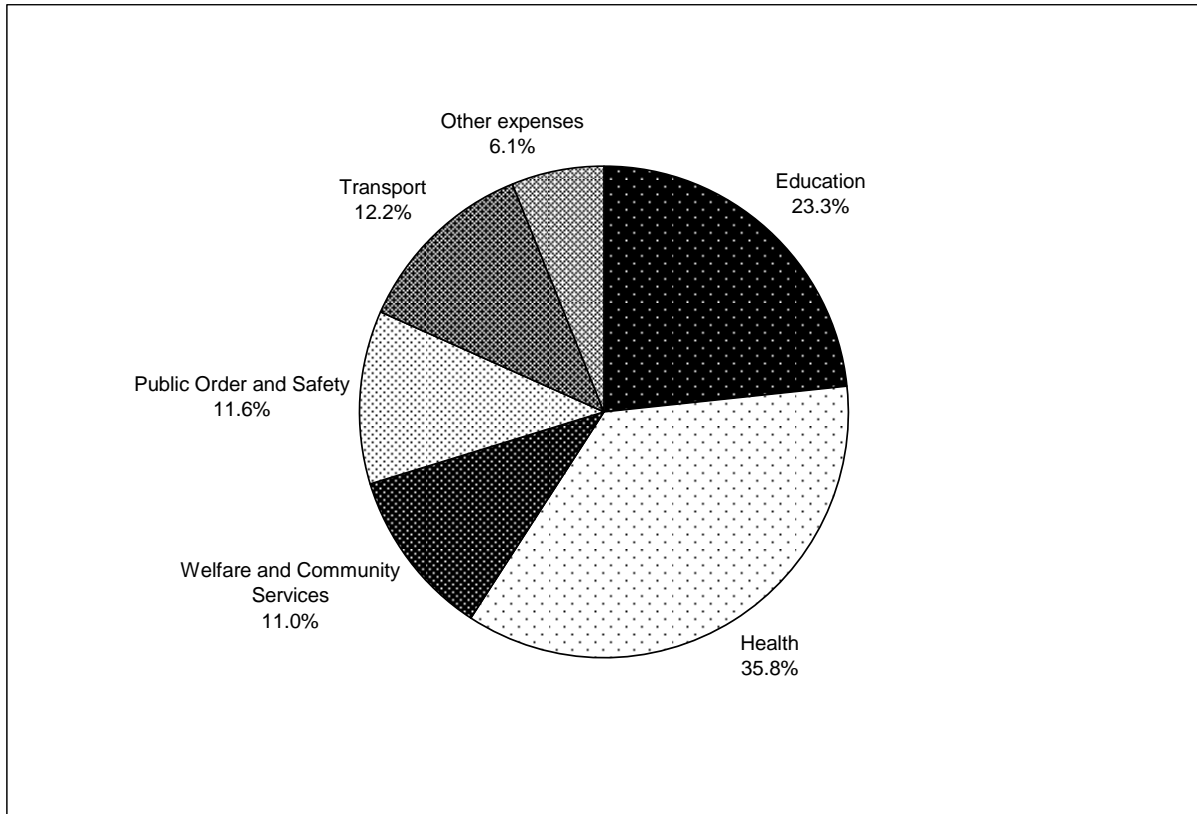
14 Other expenses constituted 21 per cent of State expenses. The main components were superannuation<sup>3</sup> and general public services.

15 The next most important services were welfare and community services (11 per cent), public order and safety (9 per cent) and transport (9 per cent).

<sup>3</sup> Superannuation expenses are a cost of providing all other services and ideally should be allocated to those services. The 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.

16 Between 2000-01 and 2005-06, gross expenses grew by 23 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 22 per cent of expenses but accounted for 36 per cent of growth, indicating above average growth. Education expenses contributed a further 23 per cent to growth, which is close to average growth.

**Figure 2-4 Gross State expenses by type of service — contribution to growth in total expenses for 2000-01 to 2005-06 (all States)**



Note: 'Other expenses' includes the groups of Culture and Recreation, Services to Industry and Other.

17 Over time, all services except 'other expenses' are becoming more important areas in State budgets. Table 2-2 compares the annual average proportions of State expenses attributable to each of those groups of expenses over the years 2000-01 to 2004-05 and 2001-02 to 2005-06.

**Table 2-2 Comparison of importance of State expenses in State budgets — 2000-01 to 2004-05 and 2001-02 to 2005-06**

	Annual average proportion of State expenses	
	2000-01 to 2004-05	2001-02 to 2005-06
	%	%
Health	21.7	22.4
Education	21.9	22.0
Welfare and Community Services	10.6	10.7
Public Order and Safety	9.2	9.3
Transport	9.0	9.1
Other expenses	21.9	20.9

Source: CGC adjusted budget

18 Table 2-3 provides details on expenses for each State. It shows that the relative importance of different services varies among the States. Education and health are the most important services<sup>4</sup> for all States. Western Australia and the Northern Territory spent the same percentage of their total expenses on health and education. Queensland and Tasmania spent more on education, and the other States spent more on health. Both services together accounted for over 40 per cent of State expenses, with the exception of the Northern Territory (33 per cent).

**Table 2-3 Gross State expenses by type of service — annual average proportion of total expenses for 2001-02 to 2005-06<sup>(a)</sup>**

	NSW	Vic	Qld	WA	SA	Tas	ACT (b)	NT
	%	%	%	%	%	%	%	%
Education	22.2	22.2	22.9	22.3	20.8	22.7	19.5	16.7
Health	22.8	23.6	20.8	22.3	23.7	21.5	20.1	16.7
Welfare and Community Services (c)	11.3	11.7	8.9	9.0	11.2	9.6	10.2	12.1
Public Order and Safety	9.6	9.1	9.1	9.8	9.2	8.1	10.0	9.4
Culture and Recreation	2.2	2.2	2.2	2.7	2.8	3.3	3.2	4.2
Services to Industry	2.1	1.8	6.4	4.0	3.1	3.8	0.9	3.8
Transport	11.6	7.7	10.5	7.1	6.2	5.3	5.7	6.1
Other (d)	18.1	21.8	19.2	22.8	23.1	25.7	30.6	30.9
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 (annual average of 2001-02 to 2005-06).

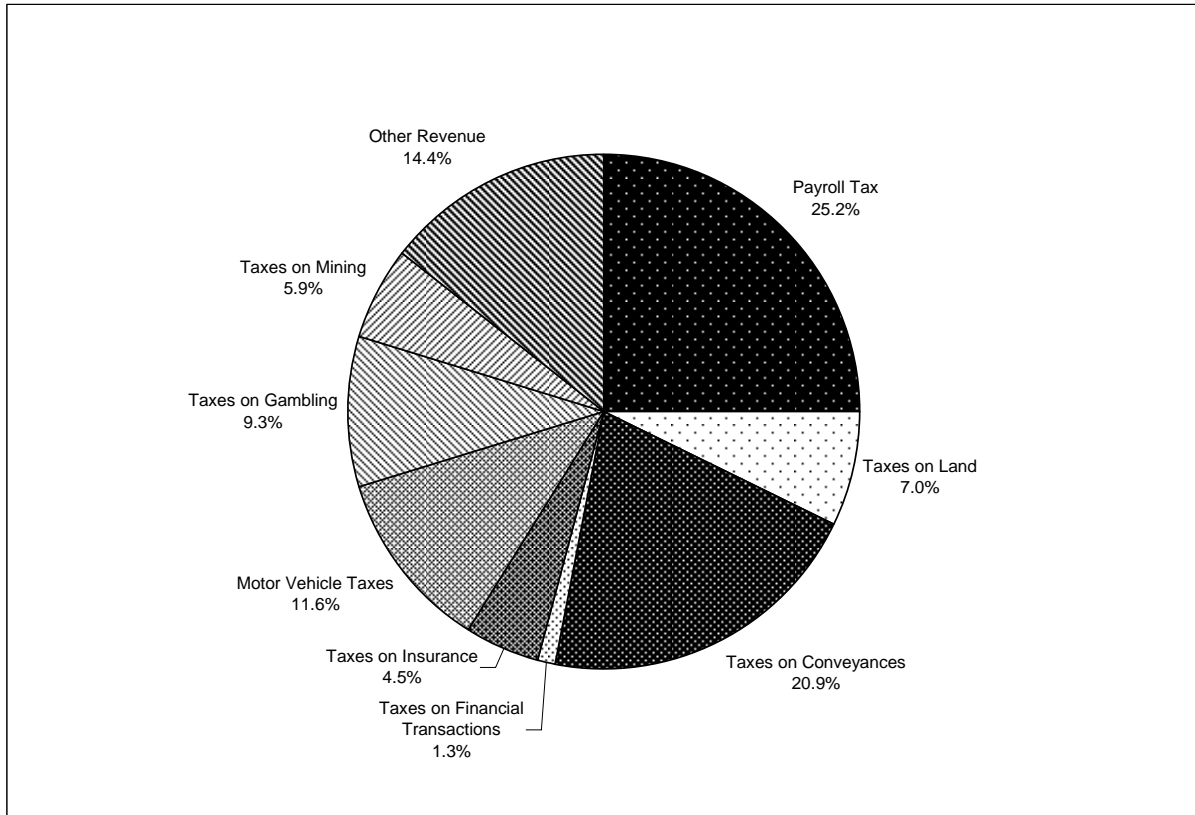
<sup>4</sup> 'Other' is not considered in this discussion because this group includes mainly general public services and miscellaneous services.

- 19 Welfare and community services were the third most important group of services for most States except New South Wales, Queensland and Western Australia. New South Wales spent more on transport, Queensland spent more on transport and public order and safety, Western Australia spent more on public order and safety.
- 20 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 affected by diseconomies of small scale that are greater than 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.
- 21 What each State spends on particular services depends on:
- 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.
- 22 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.
- 23 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 5. Attachment E shows how the Commission's assessed cost of providing services for each State for each service, which take account of these policy neutral drivers, differ from the Australian average.

## REVENUES

- 24 Figure 2-5 shows the important State own-source revenues for 2001-02 to 2005-06. This figure shows that payroll tax was the most important, constituting 25 per cent of total State revenue.

**Figure 2-5 State own-source revenue — annual average percentage of total for 2001-02 to 2005-06 (all States)**

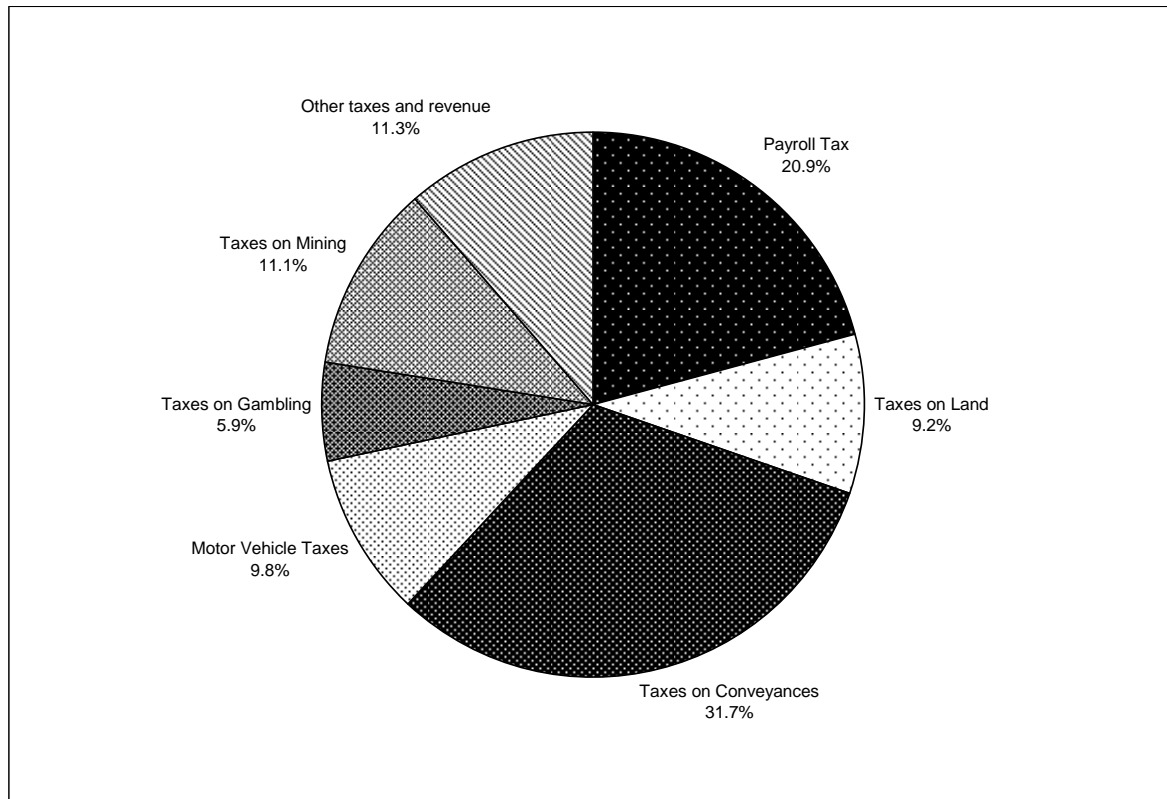


Notes: There is more variation across the years in proportions of revenue raised by each group of taxes than for services. 'Taxes on financial transactions' have been adjusted to reflect that most States will abolish components of these taxes in 2007-08. 'Other revenue' includes miscellaneous taxes and revenue and contributions by trading enterprises.

- 25 Stamp duty on conveyances was the second most important tax (21 per cent), and together with taxes on land, comprised more than a quarter of own-source revenue.
- 26 Between 2000-01 and 2005-06, State own-source revenue increased by 40 per cent on a per capita basis. Figure 2-6 shows the contribution of the main State revenue sources to that growth. Figure 2-5 and Figure 2-6 together illustrate that:
  - taxes on conveyances comprised 21 per cent of revenue, but contributed 32 per cent to the growth;
  - payroll tax, at 25 per cent of average revenue, contributed 21 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 9 per cent of the growth.
- 27 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

2000-01 to 2004-05 and 2001-02 to 2005-06. 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 2000-01 to 2005-06 (all States)**



Note: 'Other taxes and revenue' includes Taxes on Insurance, Taxes on Financial Transactions and Other Revenue.

**Table 2-4 Comparison of importance of State own-source revenue in State budgets — 2000-01 to 2004-05 and 2001-02 to 2005-06**

	Annual average proportion of State revenue	
	2000-01 to 2004-05	2001-02 to 2005-06
	%	%
Land-related taxes	26.6	27.9
Payroll tax	25.6	25.2
Mining	5.6	5.9

Source: CGC adjusted budget

28 Table 2-5 shows how important the different types of own-source revenue are for each State. It shows that the main sources of revenue<sup>5</sup> for all States (except Western Australia) were payrolls,

<sup>5</sup> 'Other Revenue' is not considered in this discussion because this group includes mainly miscellaneous taxes and revenue, and contributions by trading enterprises.

property transfers and motor vehicle taxes<sup>6</sup>. Together, they accounted for over 50 per cent of total revenue for each State.

**Table 2-5 State own-source revenue – average percentage of total revenue for 2001-02 to 2005-06<sup>(a)</sup>**

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
	%	%	%	%	%	%	%	%
Payroll Tax	28.4	28.1	19.4	19.4	24.5	24.0	27.9	27.4
Taxes on Land	8.6	7.8	4.1	5.7	7.1	4.6	7.5	0.0
Taxes on Conveyances	21.9	22.0	20.1	19.4	17.4	14.8	24.5	16.6
Taxes on Financial Transactions	2.1	0.0	1.8	1.4	1.4	0.0	0.6	0.2
Taxes on Insurance	2.9	6.2	4.3	4.7	7.2	4.3	4.7	5.2
Motor Vehicle Taxes	11.3	11.4	12.2	11.0	13.8	15.1	12.8	10.3
Taxes on Gambling	8.5	13.6	9.1	2.3	12.8	10.2	8.0	11.3
Taxes on Mining	2.0	0.2	11.3	21.7	3.2	1.5	0.0	11.8
Other Revenue (b)	14.4	10.7	17.6	14.6	12.6	25.5	14.0	17.2
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

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

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

Source: CGC's adjusted budget (annual average of 2001-02 to 2005-06).

- 29 Tax on mining was the most important source of income for Western Australia. It accounted for almost 22 per cent of Western Australia's total revenue. This was higher than its income from payroll tax or stamp duty on conveyances.
- 30 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.
- 31 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.
- 32 Chapters 3 and 5 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. Chapter 4 examines the volatility in State revenue in more detail.

<sup>6</sup> Except Victoria. Its revenue from gambling is higher than motor vehicle taxes.