



Australian Government

Commonwealth Grants Commission

**Report on
State Revenue Sharing Relativities
2007 Update**

Canberra

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2007 REPORTS

| | |
|---|------------------|
| Report on State Revenue Sharing Relativities, 2007 Update | ISBN 1741 954258 |
| Relative Fiscal Capacities of the States 2007 | ISBN 1741 954266 |
| Set of two volumes | ISBN 1741 954274 |

2007 WORKING PAPERS

The reports are supplemented by the following working papers:

| | |
|----------|--|
| Volume 1 | Assessment methods and the equalisation budget |
| Volume 2 | Assessment results — revenue |
| Volume 3 | Assessment results — expense |
| Volume 4 | Assessment results — user charges and common factors |

ELECTRONIC VERSIONS

The reports and working papers are available on the Commission's web site at <http://www.cgc.gov.au>

ACKNOWLEDGMENTS

We are grateful for the ready co-operation extended to the Commission and its staff during this update by Australian, State and Territory Treasury officers and by staff of the Australian Bureau of Statistics.

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MAIN REPORT

OVERVIEW

The Commission is required to base its recommendations on the five years 2001-02 to 2005-06.

Over those years, the relative fiscal circumstances of the States have changed substantially. These changes are reflected in this update. This year, Western Australia joins New South Wales (the State with the strongest fiscal capacity) and Victoria in warranting less than an average per capita amount from the pool of GST revenue and Health Care Grants for 2007-08. Queensland will also need less than in the past, requiring only slightly more than the average. Compared to last year, a smaller part of the pool is needed to equalise the fiscal capacities of all States.

Over the five years, the Commission's calculations have tracked a larger change in the relative fiscal capacities of the States than observed in last year's update. Most changes were due to changes in State revenues. Notable has been an unprecedented strengthening of the fiscal capacity of Western Australia and to a lesser extent Queensland.

Features of this update are:

- The conveyancing revenue base of Western Australia grew rapidly in 2005-06, greatly increasing its relative fiscal capacity in that year. A high level of activity in the property market, reflecting overall buoyancy of the State economy, rather than the direct impact of mining on State revenues, is the principal driver of Western Australia's higher fiscal capacity.
- Coal royalties increased markedly in 2005-06, strengthening Queensland's revenue capacity. That was supplemented by an ongoing strong conveyancing base. However, changing social and demographic conditions moderate that revenue effect by increasing the costs of delivering the average level of services.
- The phased abolition of some State taxes has changed relative fiscal capacities by moderating the assessed revenue capacity of New South Wales, Victoria and the ACT.
- Underlying wage differentials have changed, lowering relative service costs for New South Wales, the ACT and the Northern Territory and increasing them for other States.

THE TASK

- 1 The Commission received terms of reference asking it to recommend relativities for distributing the pool of GST revenue and Health Care Grants (the pool) among the States and Territories¹ in 2007-08. The reference also asked for relativities that would have been applicable if the Commonwealth-State financial arrangements that applied in 1999-2000, before the implementation of the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (IGA), had continued — called the Financial Assistance Grant (FAG) relativities.
- 2 The reference required us to calculate relativities using:
 - the same principles and methods as used in the 2006 Update — as such, the relativities are intended to provide all States with the same fiscal capacity to provide services to their populations, if they make the Australian average effort to raise revenue and operate at the average level of efficiency; and
 - the latest available data for the years 2001-02 to 2005-06, thereby reflecting an average of State circumstances over this five year period.
- 3 Details of the Commission's task and the principles used in undertaking it are provided in Chapters 1 and 2.

THE RELATIVITIES

- 4 Table 1 shows the per capita relativities the Commission recommends for use in 2007-08 and those used in 2006-07. These are the relativities used in the rest of this report. Table 2 shows the FAG relativities.
- 5 Relativities use the average of all States ('the Australian average') as the benchmark. States with relativities above one require more than the Australian average per capita amount from the pool to deliver services at Australian average levels. Those below one require less than the Australian average per capita amount. All States but New South Wales, Victoria and Western Australia require more than the Australian average per capita amount in 2007-08.
- 6 We observe that rapid growth in Queensland and Western Australia's revenue raising capacities has increased their relative fiscal capacities and reduced the relative fiscal capacities of other States. This mirrors the impact of the New South Wales property boom in earlier years when it received substantially less per capita than other States.

¹ In this report, the words 'State' and 'States' include the Australian Capital Territory and the Northern Territory unless the context indicates otherwise.

Table 1 GST relativities

| | Used in 2006-07 | 2007 Update |
|------------------------------|-----------------|-------------|
| New South Wales | 0.87332 | 0.89079 |
| Victoria | 0.89559 | 0.90096 |
| Queensland | 1.02387 | 1.00607 |
| Western Australia | 1.00480 | 0.94747 |
| South Australia | 1.18862 | 1.20791 |
| Tasmania | 1.54931 | 1.54465 |
| Australian Capital Territory | 1.14575 | 1.16293 |
| Northern Territory | 4.32755 | 4.36824 |

Note: Details of the calculation of these relativities are in Attachment B of the supplementary information.

Table 2 FAG relativities

| | 2006 Update | 2007 Update |
|------------------------------|-------------|-------------|
| New South Wales | 0.80914 | 0.82028 |
| Victoria | 0.87421 | 0.87572 |
| Queensland | 1.05662 | 1.04406 |
| Western Australia | 0.96870 | 0.88815 |
| South Australia | 1.28167 | 1.32813 |
| Tasmania | 1.75672 | 1.79171 |
| Australian Capital Territory | 1.17840 | 1.18808 |
| Northern Territory | 5.47847 | 5.66456 |

Note: Details of the calculation of these relativities are in Attachment C of the supplementary information.

ILLUSTRATIVE CHANGE IN GST AND HCG ALLOCATIONS

- 7 Table 3 compares the amounts each State would receive from the illustrative pool in 2007-08 with the latest estimates for 2006-07. Table 4 shows the implied State shares of the pool in each year. All the amounts will change with later estimates of the GST revenue and State populations for those years.
- 8 Table 3 also shows that the amounts States are estimated to receive in 2006-07 and 2007-08 differ because:
- the relativities used to allocate the 2006-07 pool among the States would be replaced by those recommended in this update;
 - the estimated State populations would be updated from December 2006 to December 2007; and
 - the amount of GST revenue and HCGs available for distribution has grown.

Table 3 Distribution of 2006–07 pool and illustrative 2007–08 pool

| Distribution | NSW | Vic | Qld | WA | SA | Tas | ACT | NT | Aust |
|-----------------------------|----------|----------|----------|---------|---------|---------|-------|---------|----------|
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| Estimated 2006-07 | 13 786.3 | 10 527.1 | 9 617.3 | 4 768.0 | 4 250.1 | 1 745.1 | 868.1 | 2 072.7 | 47 634.7 |
| Changes caused by new: | | | | | | | | | |
| relativities ^(a) | 277.0 | 64.0 | - 166.4 | - 271.6 | 69.3 | - 5.1 | 13.1 | 19.7 | 0.0 |
| population ^(b) | - 44.4 | - 11.7 | 72.9 | 19.5 | - 28.4 | - 12.3 | - 3.4 | 7.9 | 0.0 |
| pool ^(c) | 877.0 | 661.8 | 595.8 | 282.5 | 268.4 | 108.1 | 54.9 | 131.4 | 2 979.9 |
| Illustrative 2007-08 | 14 895.9 | 11 241.2 | 10 119.6 | 4 798.4 | 4 559.5 | 1 835.7 | 932.7 | 2 231.6 | 50 614.6 |
| Increase | 1 109.6 | 714.1 | 502.3 | 30.4 | 309.4 | 90.6 | 64.6 | 158.9 | 2 979.9 |

(a) Effects on the distribution of the 2006-07 estimated pool of using the 2007 Update relativities instead of those used in 2006-07.

(b) Effects on the distribution of the 2006-07 estimated pool of using estimated December 2007 State populations instead of December 2006 populations.

(c) Effect of applying the 2007 Update relativities to the estimated growth in the pool.

Source: The GST and HCG pools for 2006-07 and 2007-08 are taken from the *Mid-Year Economic and Fiscal Outlook* 2006-07. The allocation of the 2006-07 pool is based on 2006 Update relativities.

- 9 The Commission's work affects only the relativities. Table 3 indicates that the change between the 2006 and 2007 Update relativities redistributes \$443.1 million away from Queensland, Western Australia and Tasmania towards the other States, especially to New South Wales.

Table 4 State shares of 2006-07 pool and illustrative 2007-08 pool

| State shares | NSW | Vic | Qld | WA | SA | Tas | ACT | NT | Aust |
|----------------------|------|------|------|------|-----|-----|-----|-----|-------|
| | % | % | % | % | % | % | % | % | % |
| Estimated 2006-07 | 28.9 | 22.1 | 20.2 | 10.0 | 8.9 | 3.7 | 1.8 | 4.4 | 100.0 |
| Illustrative 2007-08 | 29.4 | 22.2 | 20.0 | 9.5 | 9.0 | 3.7 | 1.8 | 4.4 | 100.0 |
| Difference | 0.5 | 0.1 | -0.2 | -0.5 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 |

- 10 Compared to last year's relativities, \$95.7 million less is needed to equalise State fiscal capacities. This continues the trend observed in the past few updates and reflects convergence of the fiscal capacities (and recommended relativities) of the four more populous States. Data for the most recent years used in this update suggest this convergence might be slowing.
- 11 **The GST and HCG components of State allocations.** Table 5 dissects each State's illustrative 2007-08 revenue from the pool into its GST and HCG components. The HCG component is determined by the Health Care Agreement between the Australian Government and each State.

Table 5 Dissection of illustrative 2007-08 pool into GST and HCG components

| | NSW | Vic | Qld | WA | SA | Tas | ACT | NT | Aust |
|-------------|----------|----------|----------|---------|---------|---------|-------|---------|----------|
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| GST revenue | 11 962.1 | 9 120.9 | 8 412.8 | 3 924.5 | 3 837.4 | 1 647.9 | 821.5 | 2 132.9 | 41 860.0 |
| HCGs | 2 933.7 | 2 120.3 | 1 706.8 | 873.9 | 722.1 | 187.8 | 111.2 | 98.7 | 8 754.6 |
| Total | 14 895.9 | 11 241.2 | 10 119.6 | 4 798.4 | 4 559.5 | 1 835.7 | 932.7 | 2 231.6 | 50 614.6 |

WHAT DETERMINES STATE ALLOCATIONS OF THE POOL?

12 Table 6 compares the illustrative allocation of the 2007-08 pool with the allocation that would have arisen if all States had the same fiscal capacity — that is, an equal per capita allocation. It indicates that equalisation leads to \$3339 million being redistributed, about half of which is distributed to the Northern Territory.

Table 6 Illustrative and equal per capita allocations of 2007-08 pool

| | NSW | Vic | Qld | WA | SA | Tas | ACT | NT | Aust |
|------------------|----------|----------|----------|---------|---------|---------|-------|---------|----------|
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| Equal per capita | 16 727.6 | 12 481.0 | 10 061.8 | 5 066.1 | 3 775.9 | 1 188.8 | 802.3 | 511.0 | 50 614.6 |
| Illustrative | 14 895.9 | 11 241.2 | 10 119.6 | 4 798.4 | 4 559.5 | 1 835.7 | 932.7 | 2 231.6 | 50 614.6 |
| Total | -1 831.7 | -1 239.8 | 57.8 | - 267.7 | 783.6 | 646.9 | 130.4 | 1 720.5 | 0.0 |

13 The differences in relative fiscal capacity assessed by the Commission cause the States to receive differing per capita allocations of the illustrative pool for 2007-08, as shown in Table 7. Each State's allocation consists of a base per capita amount received by all States and an equalisation amount required to bring each State to the average fiscal capacity.

Table 7 Illustrative allocation of 2007-08 pool

| | NSW | Vic | Qld | WA | SA | Tas | ACT | NT | Aust |
|-----------------------|-------|-------|-------|-------|-------|-------|-------|--------|-------|
| | \$pc | \$pc | \$pc | \$pc | \$pc | \$pc | \$pc | \$pc | \$pc |
| Base per capita | 2 152 | 2 152 | 2 152 | 2 152 | 2 152 | 2 152 | 2 152 | 2 152 | 2 152 |
| Equalisation addition | 0 | 25 | 278 | 137 | 766 | 1 580 | 657 | 8 401 | 265 |
| Per capita allocation | 2 152 | 2 177 | 2 430 | 2 289 | 2 918 | 3 731 | 2 809 | 10 553 | 2 417 |

14 Table 7 and Figure 1 show that, in 2007-08, New South Wales, the State with the strongest fiscal capacity over the years 2001-02 to 2005-06, would receive \$2152 per capita to give it the Australian average capacity to deliver services. The Northern Territory requires \$8401 per capita more to give it the same capacity.

15 The differences in revenue raising capacity, illustrated in Figure 2, and costs of providing services, illustrated in Figure 3, cause the States to receive different per capita amounts from the pool. The demographic, geographic and economic circumstances of each State drive the differences in revenue raising capacity and cost of providing services.

Figure 1 Illustrative allocation of the 2007-08 pool

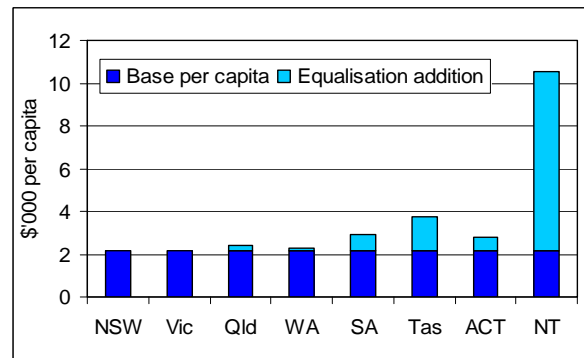


Figure 2 Relative revenue raising capacities, average, 2001-02 to 2005-06

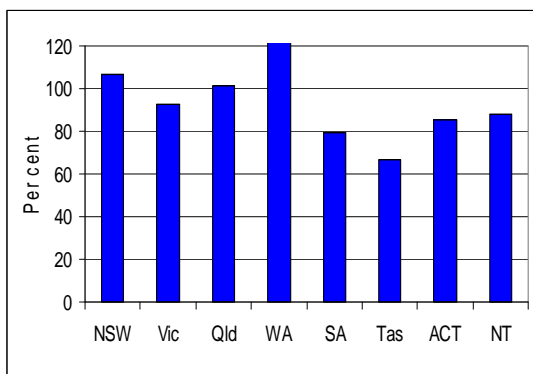
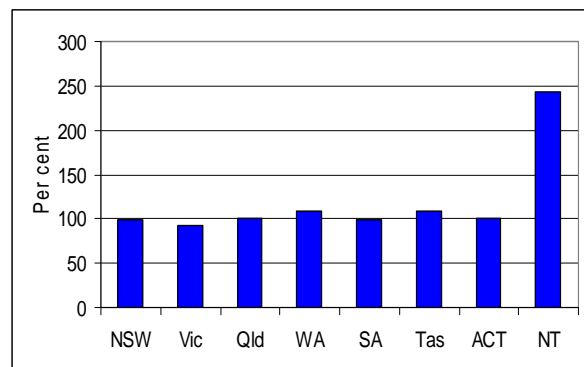
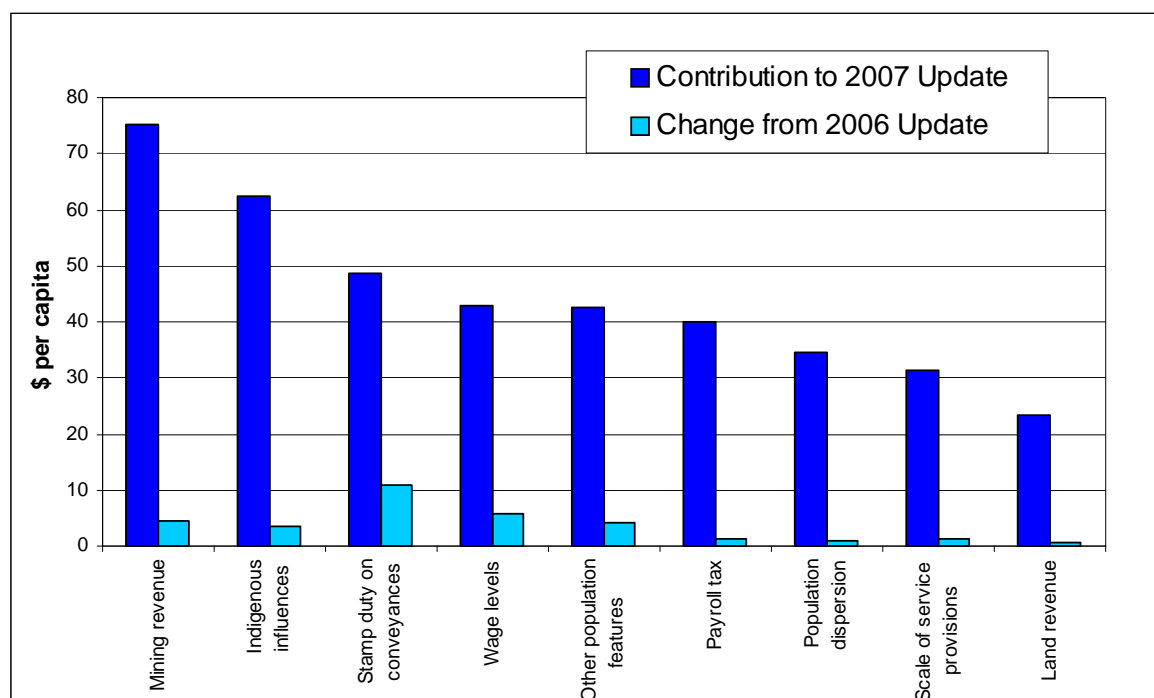


Figure 3 Relative cost of providing services, average, 2001-02 to 2005-06



16 The main drivers of differences in revenue raising capacity are mineral wealth, turnover in property markets, payrolls of medium and large businesses and land values (from which mining royalties, stamp duty on conveyances, payroll tax and land revenues are raised). The main drivers of cost differences are Indigeneity, wage levels, other population features, population dispersion and scale of operation. Figure 4 shows the contribution of those drivers to the 2007 Update relativities and to the changes in State allocations from the pool between the 2006 and 2007 Updates.

Figure 4 Contribution of major drivers to redistributions in the 2007 Update and changes between 2006 and 2007 Updates



WHY HAVE STATE ALLOCATIONS AND RELATIVITIES CHANGED?

- 17 The year to year changes in relativities reflect changes in the economic and social conditions in the States as they affect the relative costs States incur in providing services or their relative capacity to raise revenue from their own taxes.
- 18 The changes in the relativities are examined from two perspectives:
- revisions to data and the inclusion of more recent State circumstances (by replacing data for 2000-01 with data for 2005-06 in the five year moving average) and including the effects of the phased abolition of some State taxes; and
 - changes to assessments of revenue, expenses and specific purpose payments (SPPs).

Effects of data revisions, including more recent data and abolition of State taxes

- 19 As required by the terms of reference, we used revised and updated data for 2001-02 to 2004-05 — years that were common to the 2006 and 2007 Updates. This changed the distribution among the States by \$174.2 million. In most cases, the revisions arose because data providers, such as the Australian Bureau of Statistics (ABS) and the States, revised or updated their data — our use of updated data on relative wage levels was the largest of these changes. However, our ongoing work aimed at reviewing and improving the quality of data used in the assessments also led to some revisions to data or to changes in the way we have used some data.

- 20 Table 8 disaggregates the effects of changing relativities on the distribution of the pool into those caused by:
- revisions to data;
 - including the effects of the phased abolition of State taxes on financial transactions and marketable securities; and
 - including the effects of recent changes in State circumstances by replacing economic, social and demographic data for 2000-01 with data for 2005-06 in the five year moving average used in the calculations.
- 21 In the current update, changes to the relativities are heavily influenced by changed State circumstances between 2000-01 and 2005-06. In particular, changes in activity in property markets and the mining sector had a large effect on the revenue assessments. The effects of the decision to phase out taxes on financial transactions and marketable securities played a smaller role. These effects are discussed below.
- 22 Consistent with the terms of reference, there were no changes in methods except to reflect the abolition of some State taxes (a change to Commonwealth-State relations) and when necessary to overcome concerns about data quality, following consultation with the States.

Table 8 Effect of data revisions, abolition of State taxes and changes in State circumstances on State allocations of the pool, 2006-07

| | NSW | Vic | Qld | WA | SA | Tas | ACT | NT | Change |
|--|--------------|-------------|---------------|---------------|-------------|-------------|-------------|-------------|--------------|
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| Revisions ^(a) | -75.4 | -96.9 | 108.5 | -1.9 | 26.8 | 21.0 | 0.8 | 17.0 | 174.2 |
| Abolition of some State taxes ^(b) | 101.9 | 14.9 | -62.2 | -26.3 | -17.0 | -13.7 | 7.2 | -4.8 | 123.9 |
| Changes in circumstances ^(c) | 250.5 | 146.0 | -212.7 | -243.2 | 59.5 | -12.5 | 5.1 | 7.3 | 468.4 |
| Total | 277.0 | 64.0 | -166.4 | -271.6 | 69.3 | -5.1 | 13.1 | 19.7 | 443.1 |

(a) That is, revising and updating data for 2000-01 to 2004-05.

(b) The effect of the phased abolition of some State taxes on business. It is the total effect of changes in revenue bases and actual tax rates between 2000-01 and 2005-06 and the Commission's decision to replace actual tax rates with those expected to apply in 2007-08.

(c) That is, replacing 2000-01 data with 2005-06 data.

Note: Individual rows may not add to the total because of rounding.

What revenues and expenses changed the relativities?

- 23 Table 9 shows that the 2007 Update relativities differ from those used in 2006-07 mainly because of changes in revenue assessments. Changes in expense assessments had a much smaller effect.

Table 9 Effect of changes in assessments for revenues, expenses and SPPs on State allocations of the pool

| Source of change | NSW | Vic | Qld | WA | SA | Tas | ACT | NT | Change |
|---------------------|-------|-------|--------|--------|------|-------|------|------|--------|
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| Revenue assessments | 360.8 | 92.1 | -248.5 | -220.2 | 18.7 | -10.5 | 15.0 | -7.4 | 486.6 |
| Expense assessments | -60.7 | -29.7 | 74.7 | -43.3 | 38.2 | 1.5 | -6.2 | 25.4 | 139.9 |
| SPPs | -23.1 | 1.7 | 7.4 | -8.0 | 12.4 | 3.8 | 4.2 | 1.5 | 31.1 |
| Total change (\$m) | 277.0 | 64.0 | -166.4 | -271.6 | 69.3 | -5.1 | 13.1 | 19.7 | 443.1 |
| Total change (\$pc) | 40.4 | 12.5 | -40.8 | -131.7 | 44.6 | -10.4 | 39.8 | 94.4 | 21.4 |

Note: Individual rows may not add to the total because of rounding.

24 While there are changes in every aspect of State relative revenue raising capacities and costs of providing services, the following influences account for most of the change in relativities:

- changes in States' relative capacity to raise revenue from stamp duty on conveyances;
- the effects on relative revenue raising capacities of the phasing out of some State taxes on business;
- changes in relative costs of providing services arising from the updating of interstate differences in wage levels;
- changes in States' relative capacity to raise revenue from mining royalties, especially royalties on coal; and
- changes in the use of services by different groups of people.

25 Table 10 shows the contributions of these influences to the total changes in State allocations from the pool.

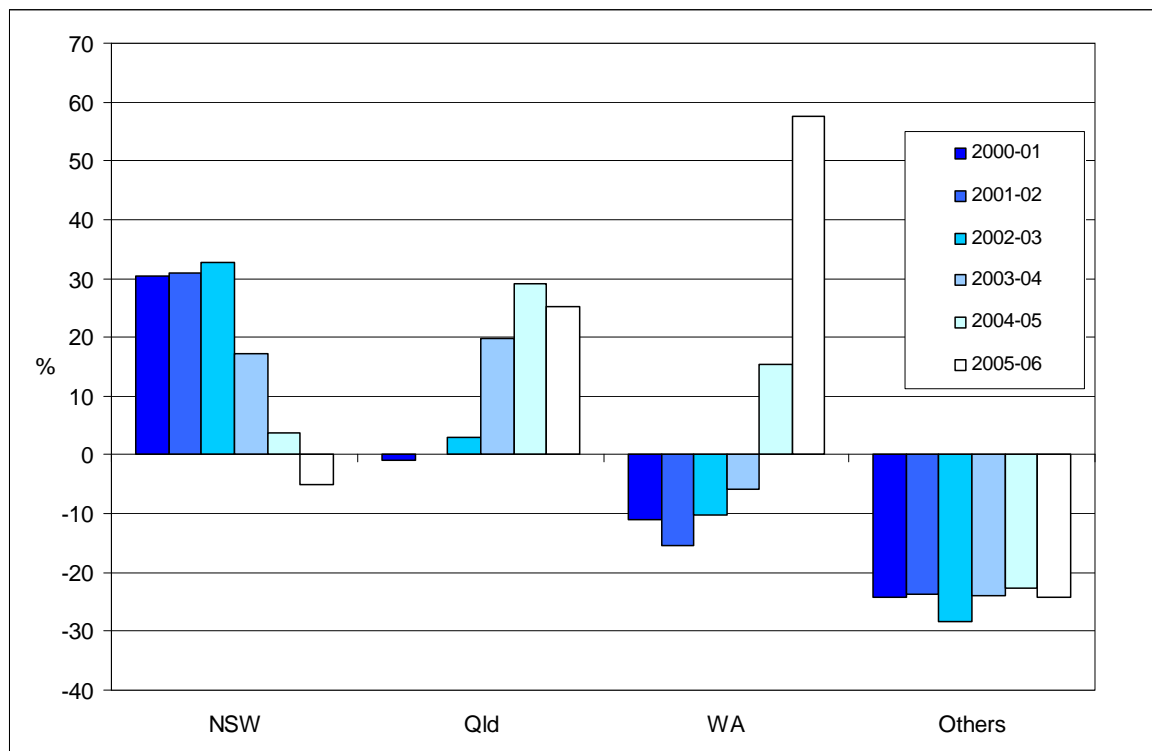
Table 10 Main influences on changes in State allocations from the pool

| | NSW | Vic | Qld | WA | SA | Tas | ACT | NT | Change |
|-------------------------------|--------|-------|--------|--------|-------|-------|------|-------|--------|
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m | \$m |
| Stamp duty on conveyances | 201.9 | 0.8 | -60.4 | -161.1 | 16.5 | 5.1 | 3.2 | -6.0 | 227.5 |
| Abolition of some State taxes | 101.9 | 14.9 | -62.2 | -26.3 | -17.0 | -13.7 | 7.2 | -4.8 | 123.9 |
| Wages input costs | -107.7 | 1.4 | 67.2 | 4.8 | 45.4 | 1.1 | -2.1 | -10.0 | 119.8 |
| Mining revenue | 24.2 | 48.0 | -82.2 | -10.1 | 13.8 | 1.8 | 3.0 | 1.4 | 92.3 |
| Population characteristics | 39.4 | -21.5 | -9.3 | -34.1 | -9.9 | -0.5 | 0.0 | 35.9 | 75.2 |
| All other changes | 17.3 | 20.5 | -19.5 | -44.8 | 20.5 | 1.0 | 1.9 | 3.1 | 64.3 |
| Total ^(a) | 277.0 | 64.0 | -166.4 | -271.6 | 69.3 | -5.1 | 13.1 | 19.7 | 443.1 |

(a) More details are in Tables 4-8 to 4-11.

26 **Stamp duty on conveyances.** This tax became a more important source of State revenue over the years 2000-01 to 2005-06, increasing from 15.2 to 20.6 per cent of State tax revenue. More importantly, different trends in State property markets changed their relative capacities to raise revenue from the tax. The largest change was in Western Australia, where a substantial rise in market activity in 2005-06 (the year included in the relativities for the first time in this update) led to its revenue raising capacity in that year being 58 per cent above the average, compared to 15 per cent above average in 2004-05, and 11 per cent below average in 2000-01 (the year that drops out of the relativities). Queensland's revenue raising capacity in 2005-06 was marginally lower than in 2004-05 but much higher than in 2000-01. By contrast, New South Wales' revenue raising capacity fell from 31 per cent above average in 2000-01 to 5 per cent below average in 2005-06. These movements are illustrated in Figure 5.

Figure 5 States' relative capacity to raise revenue from Stamp duty on conveyances



27 **Abolition of taxes on business.** The Australian Government and each State have agreed on a timetable for phasing out taxes on financial transactions and marketable securities. We consider the relativities recommended for use in 2007-08 should reflect the importance these taxes will have in State budgets for 2007-08. Our estimates of State revenue capacities are based on the average tax rates expected to exist in 2007-08. This means that the above average capacities of New South Wales, Victoria and the ACT to raise revenue from these taxes (because the revenue

bases were concentrated in those States) received less weight in the 2007 Update than they did previously. This increased their shares of the pool and reduced the shares of the other States. Details of the Commission's decision are in Chapter 3 of the supplementary information.

- 28 **Changes in relative wage levels.** Interstate differences in wage rates have a major effect on the relative costs of providing services. The Commission uses data from the ABS Survey of Education and Training (SET) to measure the differences between States in wages paid to comparable employees. Data from the most recent survey (conducted in 2005) became available during the year. Our analysis, based on those data, indicates that, relative to the average: wage levels in New South Wales, the ACT and the Northern Territory have fallen since the previous survey in 2001; wage levels in Queensland and South Australia have risen; and those in the other States rose a little. A new annual survey with similar data to the SET has become available and the Commission will consider if it can be used to update the relative wage costs in future years. More details of the Commission's decisions on this issue are in Chapter 3 of the supplementary information.
- 29 **Mining revenue.** Mining revenue also increased in importance in State budgets over the years 2000-01 to 2005-06 (from 6.2 to 7.8 per cent of State revenues). The revenue raising capacity of States with large mining industries has remained strong. The increasing importance of coal as a source of mining revenue and the large increase in value of production in Queensland between 2000-01 and 2005-06 (much of which was in 2005-06) increased its relative revenue raising capacity, thereby reducing its share of the pool and increasing that of all other States. For Western Australia, that increase, together with a relatively low growth in revenue from offshore oil and gas, offset much of the reduction in its share of the pool arising from the growth in its royalties on value-based minerals. In total, mining revenue led to only a small net reduction in Western Australia's share of the pool.
- 30 **Population characteristics.** Population characteristics affect State allocations in many ways. The use of State services by different groups of people, such as the young, the old and Indigenous people, changes over time. In this update, changes in the proportion of students at government schools raised New South Wales' allocation and reduced those for Western Australia and South Australia. Changes in the use of vocational education services raised allocations for New South Wales and Victoria and reduced them for Queensland and Western Australia. An increasing use of inpatient services by older people and/or those on lower incomes raised the allocation for New South Wales and reduced the allocations for Victoria and Western Australia.
- 31 Changes in the level of expenses directed to particular groups of people also affect State allocations of the pool. For example, increases in State average expenses on services to Indigenous communities between 2000-01 and 2005-06 raised the

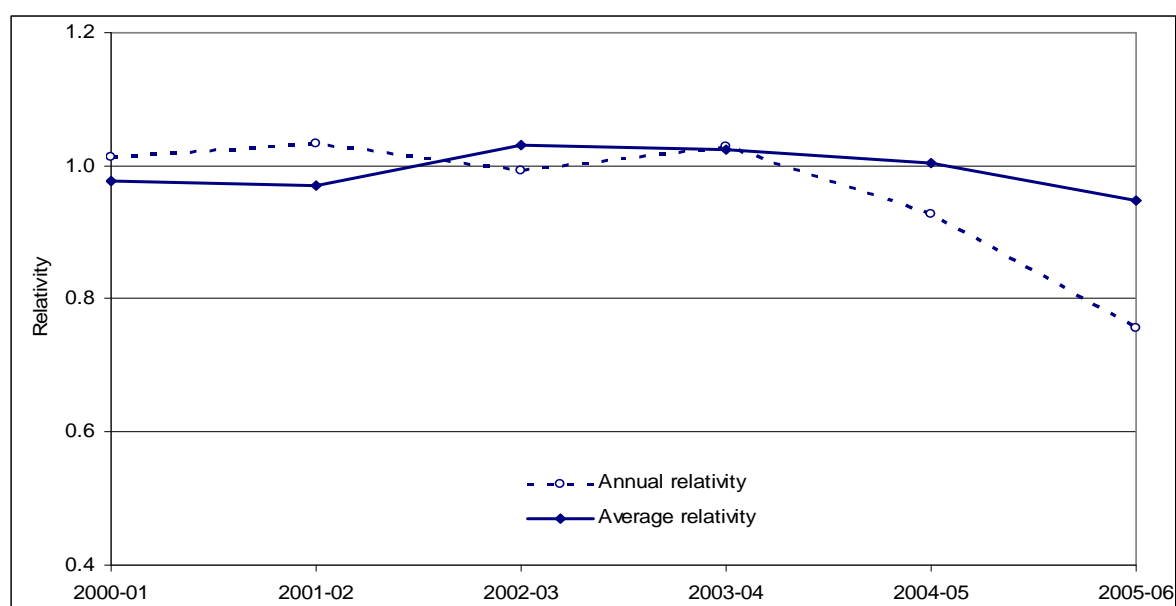
Northern Territory's allocation (and reduced Victoria's) because a well above (well below) average proportion of its population is Indigenous.

- 32 **Other changes.** There were numerous other smaller changes in individual revenues and expenses.
- 33 Details of the many influences that caused changes in the recommended relativities since the 2006 Update are in Chapters 3 and 4 of the supplementary information.

RELATIVITIES OVER TIME

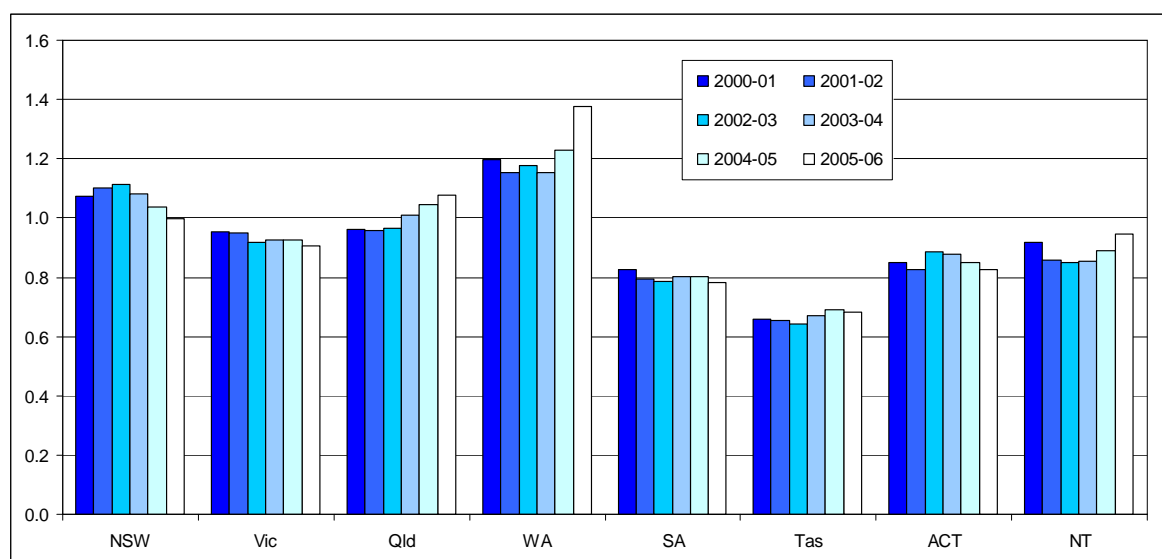
- 34 The terms of reference require the recommended relativities to be based on an average of relativities derived for the five years 2001-02 to 2005-06. This smooths the effects of annual fluctuations in State fiscal capacities. The annual movements in fiscal capacities through that period reveal some noteworthy changes. Most striking are the data for Western Australia. Figure 6 shows there are substantial differences between the annual and the average relativities for Western Australia, mainly in the latter years.

Figure 6 Western Australia, annual^(a) and average^(b) relativities



- (a) Relativities based on data for the year.
- (b) Average of the annual relativities for the year and the preceding four years.

- 35 The six years covered by the 2006 and 2007 Updates have seen quite large changes in economic conditions which happened at different times and speeds across the States. Some of their effects on State finances are summarised in Figure 7, which shows State revenue raising capacities in each year — we concentrate on revenue raising capacities because they have greater effects on the changes in relativities in an update.

Figure 7 Revenue capacity ratios, annual data for 2000-01 to 2005-06

36 The figure shows:

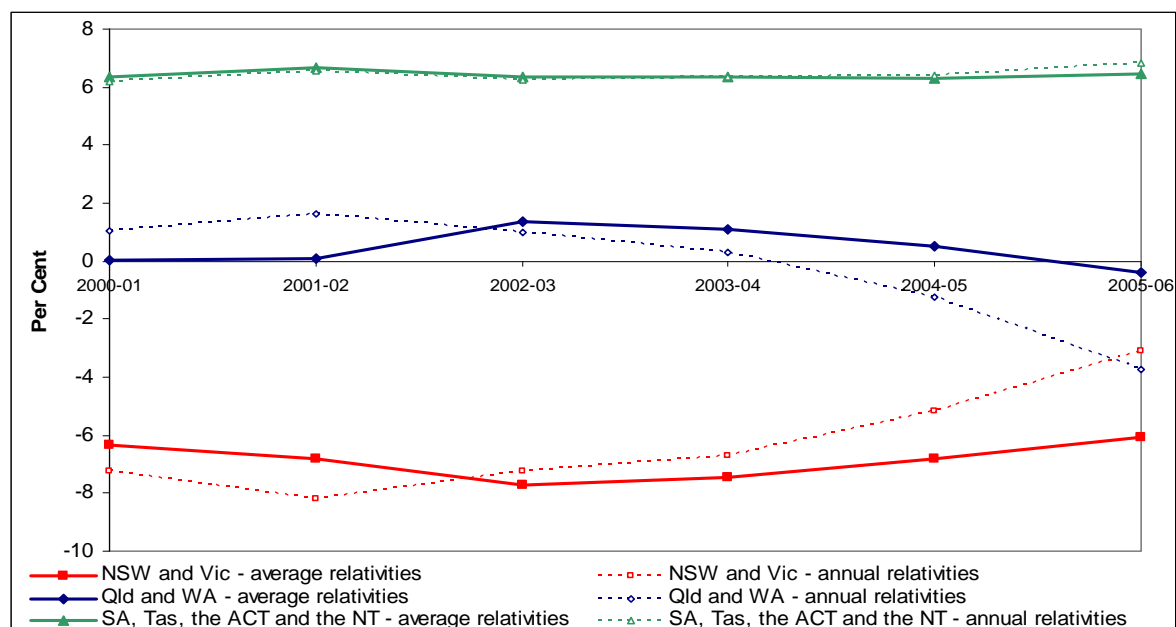
- Western Australia had the highest relative revenue raising capacity over the whole period but a property boom, combined with a strengthening of its mining sector and the flow-on effects to other parts of its economy, saw an increase in its capacity in 2004-05 and a further large increase in 2005-06.
- Queensland had a below average revenue raising capacity up to and including 2002-03, but growth in its property market, mining sector and payrolls have seen its capacity increase quickly and continuously since then. Its relative capacity exceeded that of New South Wales in 2004-05 and it strengthened further in 2005-06.
- New South Wales' relative revenue raising capacity declined to be slightly below average in 2005-06 because of slower growth in its property market and in most other areas of economic activity that States tax.
- Victoria's relative revenue raising capacity declined over the period. It had below average growth in its property market and mining sector, which to some extent arose because Western Australia and Queensland increased the average position.
- The Northern Territory's relative revenue raising capacity declined in 2001-02 because of below average growth in its mining sector and property market. It has risen steadily since then due to a strong upturn in its property market.
- The other States had below average revenue raising capacities in all years.

37 These dynamics, especially those for Western Australia, Queensland and New South Wales, are reflected in the annual relativities. Figure 8 shows hypothetical redistributions, relative to an equal per capita allocation, for New South Wales and

Victoria together, Queensland and Western Australia together, and the other States that would arise if the illustrative 2007-08 pool had been distributed on the basis of:

- the annual relativities for the years 2000-01 to 2005-06; and
- average relativities for five years ended 2000-01 to 2005-06.

Figure 8 Hypothetical redistributions from annual and average relativities



38 Figure 8 shows that the four smaller States together have required a stable share of the pool to achieve equalisation. Queensland and Western Australia taken together have needed a declining share to the point that they have joined New South Wales and Victoria in having above average capacities. Together, New South Wales and Victoria have seen their share of the pool increase.

39 The annual relativities make these trends even more pronounced. Indeed, had the distribution been based on 2005-06 alone, Western Australia and Queensland together would have had a higher fiscal capacity than New South Wales and Victoria together.

WHAT HAS CHANGED IN INDIVIDUAL STATES SINCE THE 2006 UPDATE?

40 Changes that have had important effects on the assessed fiscal capacity of each State are summarised in the following sections. Chapters 3 and 4 of the supplementary information and the working papers accompanying this report provide fuller explanations.

NEW SOUTH WALES

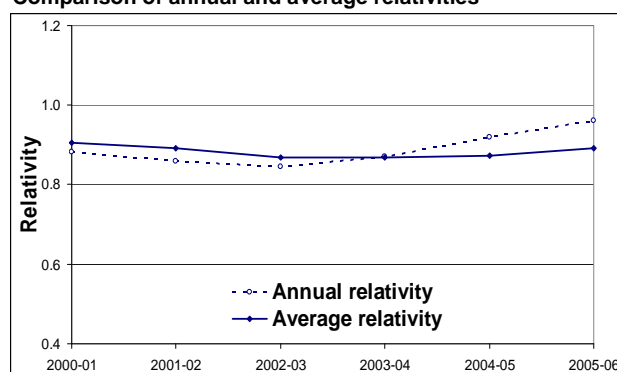
New South Wales still has the highest average fiscal capacity but, relative to the other States, its capacity declined markedly in this update. The revenue capacity of other States (Western Australia and Queensland) grew faster, reducing its advantage. The impact of that on its fiscal capacity was offset in part by faster wage growth in other States, which made it relatively cheaper to deliver services in New South Wales. As a result of all these influences, its relativity has increased, raising how much it can expect to receive from the pool in 2007-08 by \$277.0 m. The table below summarises the main changes.

Sources of change in pool revenue, \$m

| | Data revisions | Abolition of taxes | Changed circumstances | Total change |
|----------|----------------|--------------------|-----------------------|--------------|
| Expenses | -70.6 | | 9.9 | -60.7 |
| Revenue | -3.2 | 101.9 | 262.1 | 360.8 |
| SPP | -1.5 | | -21.6 | -23.1 |
| Total | -75.4 | 101.9 | 250.5 | 277.0 |

| 2006 Update | Relativity | Population | Pool | 2007 Update |
|-------------|------------|------------|-------|-------------|
| 13 786.3 | 277.0 | - 44.4 | 877.0 | 14 895.9 |

Comparison of annual and average relativities



Major changes for New South Wales

| | Change | Reason for change |
|-------------------------------|--------|---|
| | \$m | |
| Wages input costs | -107.7 | New South Wales receives less revenue from the pool to compensate for its higher wage costs because those have moved closer to the national average. |
| Urban transit | -25.7 | Urban Transit expenses are now a smaller proportion of average State budgets. As a result, New South Wales receives less revenue from the pool to compensate for its cost disadvantages. |
| Public safety | -21.9 | New South Wales' natural disaster expenses fell from \$144 million in 2000-01 to \$24 million in 2005-06, reducing its need for revenue from the pool. |
| Mining revenue | +24.2 | Because mining revenue increased as a proportion of State budgets, New South Wales requires more revenue from the pool to compensate for its below average capacity. |
| Population characteristics | +39.4 | Because New South Wales had relatively more students in government schools and users of vocational education and training and inpatient services, it requires additional funds from the pool. |
| Abolition of some State taxes | +101.9 | Because New South Wales had above average revenue raising capacity for the taxes that are being phased out, it requires additional revenue from the pool. |
| Stamp duty on conveyances | +201.9 | Because growth in the value of turnover in the property market in New South Wales between 2000-01 and 2005-06 was lower than in all other States, it requires more revenue from the pool. |

VICTORIA

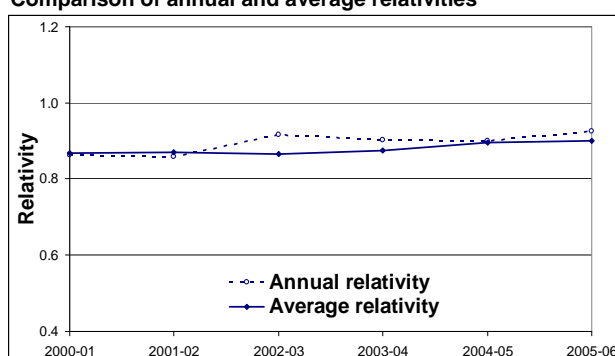
Victoria continues to have the second highest average fiscal capacity but, relative to other States, its fiscal capacity declined in this update. Its relative revenue raising capacity declined (the counterpart of increases in Western Australia and Queensland), which was only partly offset by a reduction in its relative costs of providing services. As a result, its relative has increased, raising what it could expect to receive from the 2007-08 pool by \$64.0 m. The table below summarises the main changes.

Sources of change in pool revenue, \$m

| | Data revisions | Abolition of taxes | Changed circumstances | Total change |
|----------|----------------|--------------------|-----------------------|--------------|
| Expenses | -42.5 | | 12.8 | -29.7 |
| Revenue | -53.6 | 14.9 | 130.7 | 92.1 |
| SPP | -0.8 | | 2.5 | 1.7 |
| Total | -96.9 | 14.9 | 146.0 | 64.0 |

| 2006 Update | 2007 Update | Relativity | Population | Pool |
|-------------|-------------|------------|------------|-------|
| 10 527.1 | 11 241.2 | 64.0 | - 11.7 | 661.8 |

Comparison of annual and average relativities



Major changes for Victoria

| | Change | Reason for change |
|-------------------------------|--------|--|
| | \$m | |
| Population characteristics | -21.5 | Victoria needs less revenue from the pool because expenses on providing services to Indigenous communities have increased as a proportion of State budgets and Victoria has a well below average proportion of its population which is Indigenous. |
| Payroll taxation | +12.8 | Because of its below average growth in payrolls, Victoria needs more revenue from the pool. |
| First home owner scheme | +14.6 | Because expenses in Victoria have increased while the national average fell slightly, it needs additional revenue from the pool. |
| Abolition of some State taxes | +14.9 | Because Victoria had above average raising revenue capacity for the taxes that are being phased out, it requires additional revenue from the pool. |
| Mining revenue | +48.0 | Mining revenue increased as a proportion of State budgets. Because it has below average capacity, Victoria requires more revenue from the pool. |

QUEENSLAND

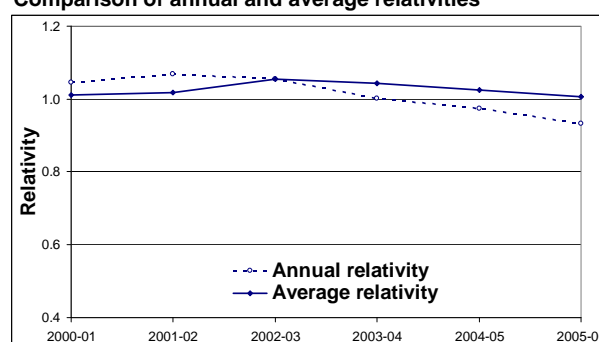
Queensland's fiscal capacity increased in this update because its relative revenue raising capacity rose (mainly in mining revenue and stamp duties on conveyances, and as a result of the abolition of taxes in other States). This was partly offset by an increase in its costs of service provision (mainly because of an above average increase in wage costs). Its relative has declined, reducing the amount it could expect to receive from the 2007-08 pool by \$166.4 m. The table below summarises the main changes.

Sources of change in pool revenue, \$m

| | Data revisions | Abolition of taxes | Changed circumstances | Total change |
|----------|----------------|--------------------|-----------------------|--------------|
| Expenses | 59.6 | | 15.1 | 74.7 |
| Revenue | 49.1 | -62.2 | -235.4 | -248.5 |
| SPP | -0.2 | | 7.6 | 7.4 |
| Total | 108.5 | -62.2 | -212.7 | -166.4 |

| 2006 Update | Relativity | Population | Pool | 2007 Update |
|-------------|------------|------------|-------|-------------|
| 9 617.3 | -166.4 | 72.9 | 595.8 | 10 119.6 |

Comparison of annual and average relativities



Major changes for Queensland

| | Change | Reason for change |
|-------------------------------|--------|---|
| | \$m | |
| Mining revenue | -82.2 | A large increase in Queensland's value of coal production further increased its above average capacity to raise mining revenue. That effect was reinforced by the increase in the proportion of State budgets represented by mining revenue, reducing the amount Queensland requires from the pool. |
| Abolition of some State taxes | -62.2 | Because Queensland had below average revenue raising capacity for the taxes that are being phased out, it requires less revenue from the pool. |
| Stamp duty on conveyances | -60.4 | Because Queensland's relative revenue raising capacity was increased by above average growth in turnover in its property market between 2000-01 and 2005-06, the revenue it requires from the pool is less. That effect was partly offset by revisions which improved data comparability. |
| Population characteristics | -9.3 | Mainly because Queensland had relatively fewer users of vocational education and training services, it requires less funding from the pool. |
| Public safety | +20.3 | Queensland's natural disaster expenses increased from zero in 2000-01 to \$86 million in 2005-06, increasing its need for revenue from the pool. |
| Wages input costs | +67.2 | Queensland needs more revenue from the pool to compensate for its increasing relative wage costs. |

WESTERN AUSTRALIA

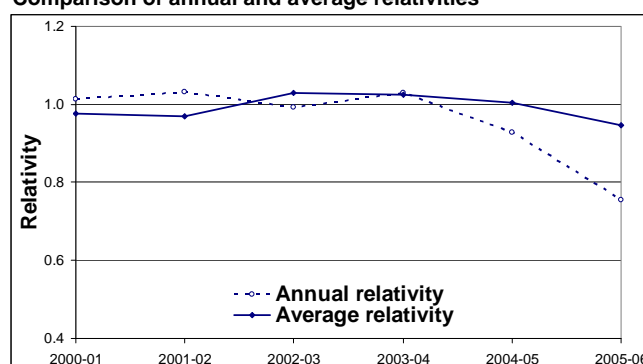
Western Australia's fiscal capacity increased in this update, because of a rise in its relative revenue raising capacity (mainly in stamp duty on conveyances and as a result of the abolition of taxes in other States). This was compounded by a fall in its relative costs of providing services and a greater share of SPPs. As a result, its relative has declined, reducing the amount it could expect to receive from the 2007-08 pool by \$271.6 m. The table below summarises the main changes.

Sources of change in pool revenue, \$m

| | Data revisions | Abolition of taxes | Changed circumstances | Total change |
|----------|----------------|--------------------|-----------------------|--------------|
| Expenses | -9.0 | | -34.4 | -43.3 |
| Revenue | 4.8 | -26.3 | -198.7 | -220.2 |
| SPP | 2.2 | | -10.2 | -8.0 |
| Total | -1.9 | -26.3 | -243.2 | -271.6 |

| 2006 Update | Relativity | Population | Pool | 2007 Update |
|-------------|------------|------------|-------|-------------|
| 4 768.0 | -271.6 | 19.5 | 282.5 | 4 798.4 |

Comparison of annual and average relativities



Major changes for Western Australia

| | Change | Reason for change |
|---|--------|---|
| | \$m | |
| Stamp duty on conveyances | -161.1 | Because growth in turnover in the property market in Western Australia between 2000-01 and 2005-06 was higher than in most other States, it requires less revenue from the pool. |
| Population characteristics | -34.1 | Mainly because Western Australia had relatively fewer students in government schools and fewer users of vocational education and training and inpatient services, it requires less revenue from the pool. |
| Abolition of some State taxes | -26.3 | Because Western Australia had below average revenue raising capacity for the taxes that are being phased out, it requires less revenue from the pool. |
| Population dispersion | -20.7 | The reduction in the proportion of State expenses affected by population dispersion means that States like Western Australia which have more dispersed populations require less revenue from the pool. |
| Payroll taxation | -17.2 | Between 2000-01 and 2005-06, growth in payrolls in Western Australia was the highest of all States, reducing its need for revenue from the pool. |
| Water, sanitation and protection of the environment | +11.0 | Because State general subsidy expenses are growing faster than other water costs, Western Australia, with above average costs, requires more revenue from the pool. |
| Roads | +12.3 | Because roads expenses have increased as a proportion of State budgets, Western Australia, with above average costs, requires more funding from the pool. |

SOUTH AUSTRALIA

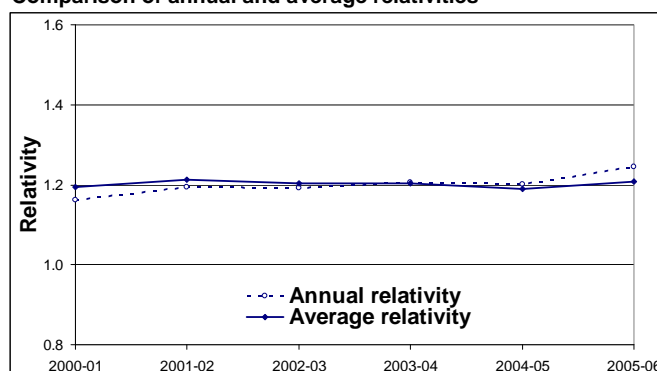
South Australia's fiscal capacity decreased in this update because of a fall in its relative capacity to raise revenue (mainly in stamp duty on conveyances and mining revenue). This was reinforced by increases in its relative costs of providing services (mainly because of an above average increase in wage levels) and a lower share of SPPs. As a result, its relative increased, raising the amount it could expect to receive from the 2007-08 pool by \$69.3 m. The table below summarises the main changes.

Sources of change in pool revenue, \$m

| | Data revisions | Abolition of taxes | Changed circumstances | Total change |
|----------|----------------|--------------------|-----------------------|--------------|
| Expenses | 32.2 | | 6.0 | 38.2 |
| Revenue | -5.7 | -17.0 | 41.3 | 18.7 |
| SPP | 0.3 | | 12.1 | 12.4 |
| Total | 26.8 | -17.0 | 59.5 | 69.3 |

| 2006 Update | 2007 Update |
|-------------------|-------------|
| 4 250.1 | 4 559.5 |
| Relativity 69.3 | Pool 268.4 |
| Population - 28.4 | |

Comparison of annual and average relativities



Major changes for South Australia

| | Change | Reason for change |
|---|--------|---|
| | \$m | |
| Abolition of some State taxes | -17.0 | Because South Australia had below average revenue raising capacity for the taxes that are being phased out, it requires less revenue from the pool. |
| Population characteristics | -9.9 | Mainly because South Australia had relatively fewer students in government schools and users of vocational education and training and inpatient services, it requires less revenue from the pool. |
| Water, sanitation and protection of the environment | +9.1 | Because general subsidy expenses are growing as a proportion of State budgets and South Australia has above average costs, it requires more revenue from the pool. |
| Mining revenue | +13.8 | Because mining revenue increased as a proportion of State budgets, and because South Australia experienced a below average growth in the value of minerals produced in the State, it requires more revenue from the pool. |
| Stamp duty on conveyances | +16.5 | Because growth in turnover in South Australia's property market between 2000-01 and 2005-06 was below average, it requires more revenue from the pool. |
| Wages input costs | +45.4 | South Australia needs more revenue from the pool because its below average wage costs have moved closer to the national average. |

TASMANIA

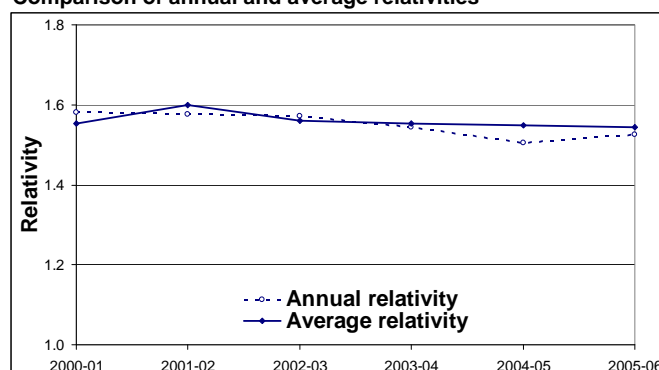
Tasmania's relative fiscal capacity increased in this update (mainly because of the effects of the abolition of taxes in other States). This was partly offset by falls in its relative revenue raising capacity and increases in its costs of providing services, arising from revisions to data, and by a lower share of SPPs. As a result, its relative decreased, reducing the amount it could expect to receive from the 2007-08 pool by \$5.1 m. The table below summarises the main changes.

Sources of change in pool revenue, \$m

| | Data revisions | Abolition of taxes | Changed circumstances | Total change |
|----------|----------------|--------------------|-----------------------|--------------|
| Expenses | 15.4 | | -13.9 | 1.5 |
| Revenue | 5.7 | -13.7 | -2.6 | -10.5 |
| SPP | -0.1 | | 3.9 | 3.8 |
| Total | 21.0 | -13.7 | -12.5 | -5.1 |

| 2006 Update | Relativity | Population | Pool | 2007 Update |
|-------------|------------|------------|-------|-------------|
| 1 745.1 | -5.1 | - 12.3 | 108.1 | 1 835.7 |

Comparison of annual and average relativities



Major changes for Tasmania

| | Change | Reason for change |
|-------------------------------|--------|---|
| | \$m | |
| Abolition of some State taxes | -13.7 | Because Tasmania had below average revenue raising capacity for the taxes that are being phased out, it requires less revenue from the pool. |
| Administrative scale | -7.7 | Because scale affected costs have fallen as a proportion of State budgets, Tasmania, which experiences diseconomies of small scale, requires less to provide head office services. |
| Payroll taxation | -3.3 | Because there was an above average increase in Tasmania's private sector employment and aggregate wages over the years 2000-01 to 2005-06, the State needs less from the pool to compensate for its below average revenue raising capacity. |
| Stamp duty on conveyances | +5.1 | When Tasmanian data were revised to improve comparability, its relative taxable capacity fell, increasing the amount of revenue it requires from the pool. |
| Urban transit | +7.2 | Tasmania needs more revenue from the pool because its cost advantages have reduced as urban transit expenses are now a smaller proportion of State budgets. |

AUSTRALIAN CAPITAL TERRITORY

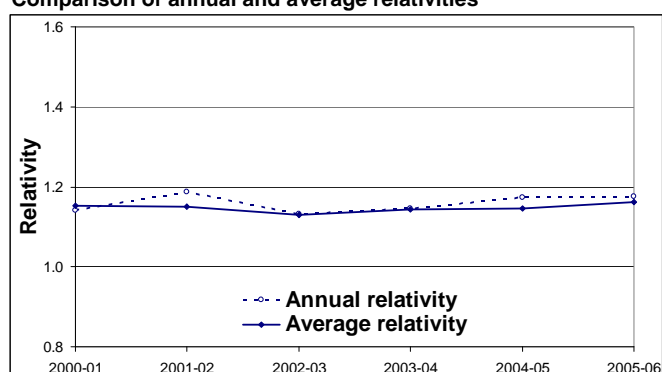
The ACT's relative fiscal capacity decreased because of a decrease in its revenue raising capacity (mainly due to the effects of the abolition of some State taxes) and a smaller share of SPPs. Those effects were partly offset by a decrease in its costs of providing services due to a decline in the importance of diseconomies of small scale. As a result, its relativity increased, raising the amount it could expect to receive from the 2007-08 pool by \$13.1 m. The table below summarises the main changes.

Sources of change in pool revenue, \$m

| | Data revisions | Abolition of taxes | Changed circumstances | Total change |
|----------|----------------|--------------------|-----------------------|--------------|
| Expenses | -1.9 | | -4.2 | -6.2 |
| Revenue | 2.8 | 7.2 | 5.1 | 15.0 |
| SPP | 0.0 | | 4.2 | 4.2 |
| Total | 0.8 | 7.2 | 5.1 | 13.1 |

| 2006 Update | Relativity | Population | Pool | 2007 Update |
|-------------|------------|------------|------|-------------|
| 868.1 | 13.1 | - 3.4 | 54.9 | 932.7 |

Comparison of annual and average relativities



Major changes for the Australian Capital Territory

| | Change | Reason for change |
|-------------------------------|--------|--|
| | \$m | |
| Administrative scale | -7.5 | Because scale affected costs have fallen as a proportion of State budgets, the ACT, which experiences diseconomies of small scale, requires less to provide head office services. |
| Indigenous influences | -4.3 | The ACT needs less revenue from the pool because expenses on providing services to Indigenous communities have increased as a proportion of State budgets and it has a well below average proportion of its population which is Indigenous. |
| Stamp duty on conveyances | +3.2 | Because growth in turnover in the ACT property market between 2000-01 and 2005-06 was the second lowest of all States, it requires more revenue from the pool. |
| SPPs | +4.2 | Because the ACT's share of SPPs per capita has declined between 2000-01 and 2005-06, it requires more from the pool. |
| Superannuation | +4.4 | The ACT faces higher costs in funding its accrued superannuation expenses and nominal interest on equalised unfunded liabilities. Because State expenses on these items now represent a larger proportion of State budgets, the ACT needs more from the pool to fund them. |
| Abolition of some State taxes | +7.2 | Because the ACT had above average revenue raising capacity for the taxes that are being phased out, it receives additional revenue from the pool. |

NORTHERN TERRITORY

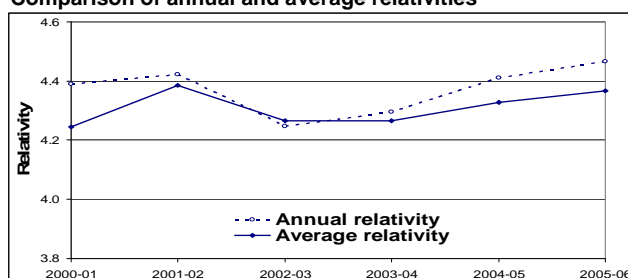
The Northern Territory's relative fiscal capacity declined in this update. The effects of an increase in its revenue raising capacity (mainly because of strong growth in its property market) were more than offset by an increase in its costs of providing services (primarily because of increases in the importance in State budgets of expenses on services for Indigenous people). As a result, its relativity increased, raising the amount it could expect to receive from the 2007-08 pool by \$19.7 m. The table below summarises the main changes.

Sources of change in pool revenue, \$m

| | Data revisions | Abolition of taxes | Changed circumstances | Total change |
|----------|----------------|--------------------|-----------------------|--------------|
| Expenses | 16.8 | | 8.6 | 25.4 |
| Revenue | 0.0 | -4.8 | -2.6 | -7.4 |
| SPP | 0.2 | | 1.3 | 1.5 |
| Total | 17.0 | -4.8 | 7.3 | 19.7 |

| 2006 Update | 2007 Update |
|-------------|-------------|
| Relativity | Relativity |
| 2 072.7 | 2 231.6 |
| Population | Population |
| 7.9 | 7.9 |
| Pool | Pool |
| 131.4 | 131.4 |

Comparison of annual and average relativities



Major changes for the Northern Territory

| | Change | Reason for change |
|---|--------|--|
| | \$m | |
| National parks and wildlife services | -9.3 | The Northern Territory needs less from the pool because the Commission decided to give less weight to differences in visitors to national parks (due to concerns about the comparability of the data) and the proportion of State expenses on national parks and wildlife services fell. |
| Housing | -7.8 | Because housing expenses have decreased as a proportion of State budgets and there are relatively fewer users of public housing services in the Northern Territory as a result of improved housing affordability, it needs less from the pool to fund the service. |
| Stamp duty on Conveyances | -6.0 | Because growth in turnover in the property market in the Northern Territory between 2000-01 and 2005-06 was greater than in most other States, it needs less revenue from the pool. |
| Superannuation | +7.7 | Because the Northern Territory has above average costs of providing superannuation and State expenses on superannuation have increased as a proportion of State budgets, the Territory needs more from the pool to fund them. |
| Non-inpatient and community health services | +8.0 | Because expenses on these services have increased as a proportion of State budgets and the Northern Territory population makes above average use of them, it needs more revenue from the pool. |
| Services to Indigenous communities | +33.4 | Because the cost of services to Indigenous communities is becoming a larger proportion of State budgets and the Northern Territory has an above average proportion of Indigenous communities, it needs more from the pool to service them. |

