Introduction to Fiscal Equalisation in Australia
Australian States and Territories

• Australia’s States and Territories (the States) have very different populations, geographies and economies
• Yet the States provide very similar services to their people
• For most of Australia’s history, government policies have aimed to give each State the capacity to provide similar levels of services
Australian States and Territories
Population, December 2018

- Western Australia: 2.6m
- Queensland: 5.0m
- South Australia: 1.7m
- Northern Territory: 0.2m
- Victoria: 6.4m
- Tasmania: 0.5m
- New South Wales: 7.9m
- Australian Capital Territory: 0.4m
State Spending

The spending by States delivers basic services in five main areas:

- Hospitals and other health services
- Schools and other education services
- Roads and transport services
- Police and justice services
- Welfare services and social housing
States levy their own taxes and charges, such as on payrolls, gambling, motor vehicles, land and property sales

Some States can also raise mining revenues through mineral royalties
The Fiscal Gap

• Collectively, State revenues provide only about half of what they spend each year

• The gap is filled by transfer payments from the Commonwealth
Commonwealth transfers to States

Commonwealth transfer payments take two forms:

- **Tied grants**, which States must spend on functions or projects specified by the Commonwealth

- **Untied grants**, which States are free to use according to their own budget priorities
## State responsibilities

<table>
<thead>
<tr>
<th>Health</th>
<th>Education</th>
<th>Roads</th>
<th>Justice</th>
<th>Investment and other</th>
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</table>

| $bn | $300bn |
Revenue

Taxes, fees, other income

Net borrowing

Mining

Tied payments

Untied payments

$bn

$300bn
Expenditure and revenue

Expenditure

Own revenue

Tied payments

Untied payments

$bn $300bn

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Expenditure and revenue

Expenditure

= 

Revenue

$bn

$300bn
Goods and Services Tax (GST)

• Since 2000, revenue from the GST is the main source of untied funding for the States

• Under agreed arrangements, the GST revenue is distributed in accordance with the principle of horizontal fiscal equalisation (HFE)

• This is the mechanism for giving every State the same capacity to provide services
Why have HFE?

- States have varying capacities to fund the services they provide
- Left to themselves, the type and quality of services provided by States, or taxes they impose, would vary greatly between States
Examples of differences between States

**REVENUE**
- Amount of minerals within a state’s borders (affects the amount of royalties collected)
- Number and value of residential and commercial land/properties (affects the amount of land tax and stamp duty collected)
- Wages paid by businesses (affects the amount of payroll tax collected)

**EXPENSE**
- Number of elderly people (requires more health services)
- Number and location of remote and regional areas (it is more expensive to provide services and infrastructure in these locations)
- Number of school children (dictates the number of schools and teachers needed)

Source: hfe.org.au
HFE levels the playing-field

• The Commonwealth uses GST revenue to offset the natural capacity differences between the States

• The Commonwealth Grants Commission (CGC) recommends to the Commonwealth the share of GST revenue each State requires to achieve HFE
How much GST do States receive?

• First the GST provides all States with the same fiscal capacity (the stronger States require less GST)

• Any remaining GST is then allocated equally across the States
Simplified version of how HFE works

Note: In this simplified example it is assumed that all States have the same assessed service delivery costs per capita, which is indicated by the red line.
Simplified version of how HFE works

![Graph showing the relationship between own-source revenue, GST to equalise States, and average cost of service delivery across different states.](image)

- **Own-source revenue**
- **GST to equalise States**
- **Average cost of service delivery**

**States**: Average, A, B, C

**$ per capita**

- **Average**
- **A**
- **B**
- **C**

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Simplified version of how HFE works

![Graph showing Own-source revenue, GST to equalise States, GST remaining (equal per capita), and Average cost of service delivery for States A, B, and C. Each state's revenue sources are broken down into these categories, with the average cost of service delivery marked.]
HFE in practice

- In practice, State service delivery costs vary from the average due to factors (or disabilities) beyond State control.

- The GST distribution recommended by the Commission recognises that States have different:
  - Revenue raising capacity
  - Service delivery costs
Assessed GST requirement per person

![Chart showing assessed GST requirement per person for different states and territories in Australia.]

- Expenditure
- Own source revenue
- Net borrowing
- Commonwealth payments
- GST

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Can States ‘game’ the system?

- A State’s GST share reflects the average tax and spending policies adopted across all States, not its individual policy choices

- It is the Commission’s job to determine each State’s revenue raising capacity and service delivery costs under average policy, and distribute GST accordingly

- This means States are neither penalised with less GST, nor rewarded with more GST, for their individual policy choices
Want to know more?

- For more information view our presentation

How the CGC does its job