How the CGC does its job

2021
Role of the Commonwealth Grants Commission (CGC)

• The CGC recommends the distribution of GST revenue among the States

• The CGC makes its recommendations in accordance with terms of reference provided by the Commonwealth Treasurer, which require a distribution based on Horizontal Fiscal Equalisation (HFE)
CGC assessments are comprehensive and policy neutral

• The CGC bases its assessments on
  • all State general government activities, plus
  • the activities of public non-financial corporations (PNFCs) providing social housing and urban transport services

• States are neither penalised nor rewarded for their individual policy choices
  • Instead, the CGC assesses GST requirements for each State based on the average policies of all the States
How much GST does a State receive?

• To determine how much GST a State should receive, the CGC first assesses State relative fiscal capacities (GST requirements)

• To do this, the CGC makes 4 assessments:
  • Expenditure
  • Own source revenue
  • Net borrowing
  • Commonwealth payments for specific purposes (PSPs) or ‘tied’ payments
Expenditure

• The amount a State needs to spend to provide the Australian average level of services and infrastructure
Own source revenue

• The amount of revenue a State could raise if it applied the average tax policy to its tax bases
Net borrowing

• The amount to which a State’s total expenditure on services and related infrastructure exceeds its total revenue
Commonwealth payments for specific purposes

• The amount each State receives from the Commonwealth in tied funding

• The CGC takes this into account in determining GST needs so that needs are not met twice
A State’s GST requirement

• A State’s GST requirement is the difference between its assessed expenditure and the sum of its assessed own source revenue, assessed net borrowing and actual PSPs

• That is, the GST requirement covers the gap between assessed revenue and expenditure
  • The larger the GST requirement, the fiscally weaker the State
  • The lower the GST requirement, the fiscally stronger the State
Assessed expenditure and revenue

- Expenditure
  - GST
  - CWI paymts
  - Net borrowing
  - Own source revenue

$ billion

Expenditure

Revenue
Drivers of State fiscal capacities

• The CGC identifies drivers that cause a State’s service delivery costs or revenue raising capacity to vary from the average
The CGC recognises differences in States’ expenditure needs

• There are many reasons that a State’s expenditure needs might vary. For example:
  • If a State has a greater than average proportion of children, it may need to spend more on schools
  • If a State has proportionally more elderly people, it may need to spend more on hospitals
Differences in Commonwealth payments

• States may receive more (or less) than the average amount of payments for specific purposes from the Commonwealth, and so need less (or more) GST revenue

• The CGC does not determine Commonwealth payments for specific purposes for States
The CGC recognises differences in States’ own source revenue

• A State’s ability to raise revenue can depend on many factors. For example:
  • If a State has more than average mining activity, it may be able to raise more royalties
  • If a State has more than average high value property, it may raise more revenue from stamp duties on property transfers
Largest drivers of State differences - 2021

- Mining royalties
- Level of remoteness of the population
- Property sales
- Shares of Indigenous people
- Commonwealth payments for specific purposes
- Taxable land values
- Big cities
- Payrolls of large companies
GST requirements across the States

- The following charts show the steps the CGC takes to calculate the GST requirement per person for each State for one year
Assessed GST requirement per person

Step 1: Calculate assessed expenditure
Assessed GST requirement per person

Step 2: Calculate assessed own source revenue
Assessed GST requirement per person

Step 3: Calculate assessed net borrowing
Assessed GST requirement per person
Step 4: Calculate assessed Commonwealth payments

[Bar chart showing expenditure, own source revenue, net borrowing, and Commonwealth payments per capita for different states (NSW, Vic, QLD, WA, SA, Tas, ACT, NT)]
Assessed GST requirement per person

Step 5: GST requirement is difference between expenditure and other revenue

Australian Government
Commonwealth Grants Commission

How the CGC does its job
GST requirements across the States

• The following slides show examples of the variation in GST requirement in the Northern Territory, Tasmania and Western Australia
In this example, the Northern Territory’s high GST requirement (weak fiscal capacity) reflects its high service delivery costs.
In this example, Tasmania’s above average GST requirement (below average fiscal capacity) largely reflects its low capacity to raise revenue and relatively high service delivery costs.
In this example, Western Australia’s low GST requirement (strong fiscal capacity) reflects its very high capacity to raise its own revenues, despite also having high service delivery costs.
GST requirement expressed as relative fiscal capacity

• Each State’s individual GST requirement is then expressed in a form comparable to other States.

• This measure is referred to collectively as State relative fiscal capacities

• The greater a State’s GST requirement, the larger its relative fiscal capacity
Assessment years

• The CGC uses the 3 most recent years to determine the relative fiscal capacities for the year in which its GST distribution recommendations will be applied. For example:

<table>
<thead>
<tr>
<th>Years used to calculate GST shares</th>
<th>Current year</th>
<th>Year it applies</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017-18</td>
<td>2018-19</td>
<td>2020-21</td>
</tr>
<tr>
<td>2018-19</td>
<td>2019-20</td>
<td>2021-22</td>
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<td></td>
<td>2021-22</td>
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</tbody>
</table>

• This aims to strike a balance between keeping up with current developments in State circumstances, obtaining reliable data, and smoothing individual year data volatility.
From fiscal capacities to recommended GST pool distributions

• Once the CGC has determined State relative fiscal capacities, it then uses these to calculate another set of fiscal capacities, those that would give each State at least the fiscal capacity of the fiscally stronger between New South Wales and Victoria.

• As prescribed in legislation (CGC Act 1973 as amended) the CGC blends these two sets of fiscal capacities to produce a set of relativities used to distribute the GST pool (comprising GST revenue and top-up payments).
How does the CGC make its recommendations?

• The CGC’s recommendations for GST shares take the form of a per person ‘relativity’ for each State

• A State’s relativity is a mathematical shorthand for the GST it requires per person in the year the CGC’s recommendations are applied

• Legislation (Federal Financial Relations Act 2009 as amended) states that from 2022-23 a minimum relativity of 0.7 applies
What is a relativity?

• A State’s relativity is the proportion of its population share of the GST pool that it requires to have the capacity to deliver comparable services to those in other States

• A fiscally stronger State might only need 90% of its population share of the GST pool – its relativity would be 0.9

• A fiscally weaker State might need 110% of its population share of the GST pool – its relativity would be 1.1
Why do States’ relativities differ?

• If there were no differences in the cost of providing services and ability to raise revenue, each State would have a relativity of one.
  • Each State would then get the same GST per person.
  • This is equivalent to its State population share.
• However, States have varying circumstances and population characteristics and so have different relativities.
Population distribution vs recommended distribution

Population share of GST

- 32%, NSW
- 26%, Vic
- 20%, Qld
- 10%, WA
- 7%, SA
- 2%, ACT
- 1%, NT

Recommended share of GST

- 30%, NSW
- 21%, Qld
- 24%, Vic
- 9%, SA
- 4%, WA
- 4%, Tas
- 2%, ACT
- 4%, NT