Introduction to Fiscal Equalisation in Australia

2021
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

30 June 2020

Source: Australian Bureau of Statistics, National, state and territory population
State spending

Spending and investment by States delivers services in five main areas:

- Hospitals and other health
- Schools and other education
- Roads and transport
- Police and justice
- Welfare services and social housing
State revenue

To fund spending and investment, States raise revenue from their tax bases

- 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

States can also borrow to fund spending and investment
The fiscal gap

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

• The gap is filled by transfer payments (also referred to as grants) 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>
</tr>
</thead>
</table>

$bn$ $300bn$
State revenue

<table>
<thead>
<tr>
<th>Taxes, fees, other income</th>
<th>Net borrowing</th>
<th>Mining</th>
<th>Tied payments</th>
<th>Untied payments</th>
</tr>
</thead>
</table>

$bn

$300bn
Expenditure and revenue

Expenditure

Own revenue

Tied payments

Untied payments

$bn

$300bn
Expenditure and revenue

Expenditure = Revenue

Expenditure

Revenue

$bn

$300bn

Tied payments

Untied payments

$bn

$300bn
Goods and Services Tax (GST)

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

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

• This is the mechanism for giving every State the capacity to provide a similar level of services
Why have horizontal fiscal equalisation?

- States have varying capacities to fund the services they provide

- Without measures to equalise capacities, the type and quality of services provided by States, or taxes they impose, would vary greatly between States
Examples of differences between States

<table>
<thead>
<tr>
<th>FACTORS BEYOND STATES’ CONTROL — EXAMPLES</th>
</tr>
</thead>
<tbody>
<tr>
<td>REVENUE</td>
</tr>
<tr>
<td>![Hammer and Sickle]</td>
</tr>
<tr>
<td>Amount of minerals within a state’s boundaries (affects the amount of royalties collected)</td>
</tr>
<tr>
<td>![House]</td>
</tr>
<tr>
<td>Amount and value of residential and commercial land/properties (affects the amount of land tax and stamp duty collected)</td>
</tr>
<tr>
<td>![Currency Symbol]</td>
</tr>
<tr>
<td>Wages paid by businesses (affects the amount of payroll tax collected)</td>
</tr>
<tr>
<td>EXPENSE</td>
</tr>
<tr>
<td>![People]</td>
</tr>
<tr>
<td>Number of elderly people (requires more health services)</td>
</tr>
<tr>
<td>![Remote Location]</td>
</tr>
<tr>
<td>Number and location of remote and regional areas (where it is more expensive to provide services and infrastructure)</td>
</tr>
<tr>
<td>![School Bag]</td>
</tr>
<tr>
<td>Number of school children (dictates the number of schools and teachers needed)</td>
</tr>
</tbody>
</table>

Adapted from a diagram previously available at hfe.org.au
Levelling the playing field

• The Commonwealth uses GST revenue to offset the differences between States’ circumstances and population characteristics

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

• First the CGC determines States’ relative fiscal capacities in each of three ‘assessment’ years
  • Assessment years are the most recent years for which reliable data are available
  • The relative fiscal capacities used by the CGC for the distribution of GST revenue are the simple average of the three assessment years

• Relative fiscal capacities reflect the GST requirement for States so that all States would then have the same fiscal capacity (the stronger States require less GST)
Simplified version of how the CGC calculates GST requirements

Note: This simplified example assumes that all States have the same assessed service delivery costs per capita, indicated by the red line.
How much GST do States receive?

• Next the CGC determines how much GST needs to be distributed to States with lower fiscal capacities to bring them up to the State with the highest fiscal capacity
Simplified version of how the CGC calculates GST requirements

- Own-source revenue
- GST to equalise States
- Ave. cost of service delivery

$ per capita

States

Average
A
B
C
How much GST do States receive?

- Then the CGC calculates an equal per capita share of the remaining GST to distribute to all States
Simplified version of how the CGC calculates GST requirements

![Graph showing the calculation of GST requirements for different states.](image)

- **Own-source revenue**
- **GST to equalise States**
- **GST remaining (equal per capita)**

**Ave. cost of service delivery**

<table>
<thead>
<tr>
<th>States</th>
<th>Average</th>
<th>A</th>
<th>B</th>
<th>C</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ per capita</td>
<td>120</td>
<td>80</td>
<td>180</td>
<td>120</td>
</tr>
</tbody>
</table>

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**Australian Government**

**Commonwealth Grants Commission**

**Introduction to Fiscal Equalisation in Australia**
Relative fiscal capacities in practice

• In practice, State service delivery costs vary from the average due to factors beyond State control
Assessed GST requirement per person (2021-22)
New arrangements for distributing GST

- From 2021-22, legislated changes will result in a 6-year transition away from distributing GST based on relative fiscal capacities.

- Over the transition, the Commission will gradually adjust its relative fiscal capacities towards ensuring no State will receive less GST than the fiscally stronger of NSW and Victoria.

- The transition will be completed in 2026-27.
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 CGC’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