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Commonwealth Grants Commission

Occasional Paper

No.6: Why are some Commonwealth payments to states included in calculations of GST needs?

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A copy of this paper is available on the Commission's website (<http://www.cgc.gov.au>).

Summary

- Commonwealth payments are a significant source of revenue for states and territories (states). They help states fund services and acquire assets.
- In recommending a distribution of the GST among the states, the Commonwealth Grants Commission considers Commonwealth payments that are available to the states to fund services and invest in infrastructure. Including Commonwealth payments ensures states are not disadvantaged if they have less access to this source of revenue compared to other states.
- Not all Commonwealth payments are taken into account by the Commission. For example, where they do not support state services or where the Commonwealth Treasurer instructs the Commission to exclude them.

Introduction

The Commonwealth Grants Commission (the Commission) provides independent advice to the Commonwealth government on how Goods and Services Tax (GST) revenue should be distributed to ensure each state and territory (state) has a similar fiscal capacity to provide services.

This paper provides an overview of why the Commission includes some Commonwealth payments to the states when determining states' fiscal capacities and GST distributions.

A Commission research paper will soon be published, providing additional detail on the framework the Commission uses to determine which Commonwealth payments are included in the assessment of states' GST needs and how these payments impact the GST distribution.

Basis of GST distribution to states

Each state receives a different per person share of the GST pool. This reflects their different relative revenue-raising capacities and different costs of providing services and investment needs.

States' economic, social and demographic characteristics differ, and this affects their revenue raising capacities and the expenditure they need to provide services. States also receive different levels of Commonwealth payments. The Commission takes these payments into account where they

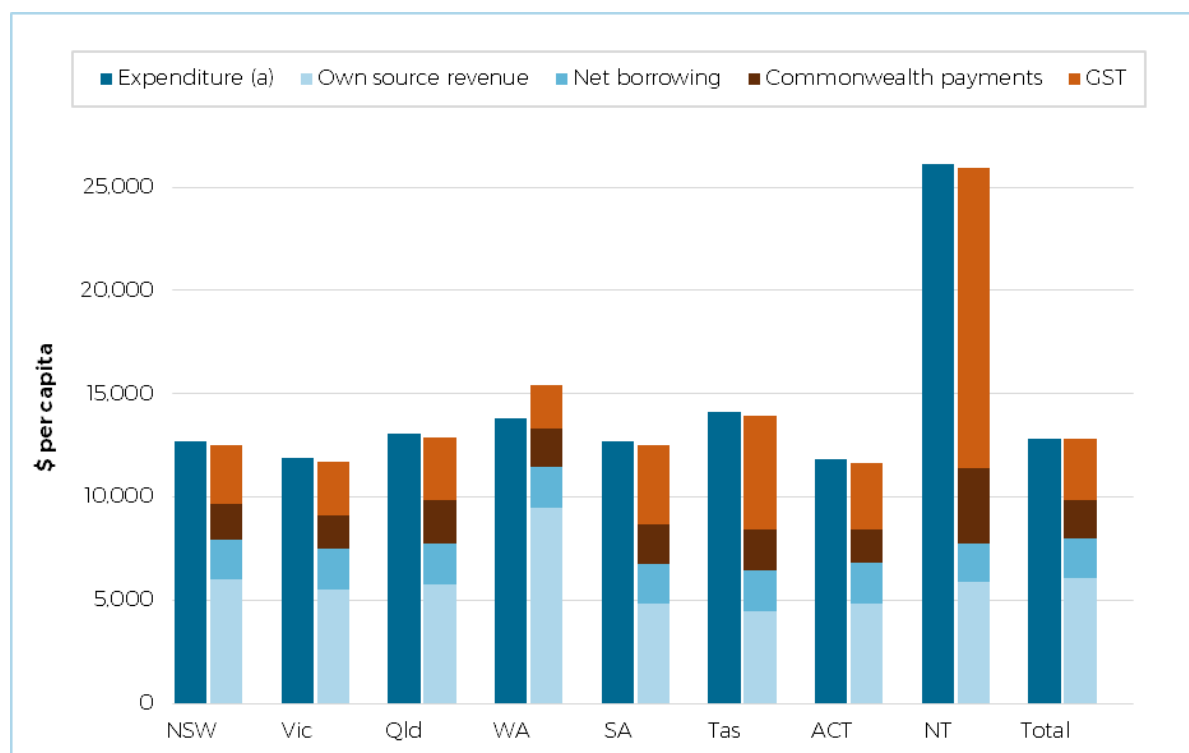
support the delivery of state-type services for which differences in the need for spending and investment are assessed.

Figure 1 shows the differences between states in the assessment of how much they need to spend, how much of their own revenue they can raise (for example, from mining royalties, payroll tax and stamp duties) and the Commonwealth payments they receive that support their spending needs.

For example, the Commission’s assessment is that the Northern Territory needs to spend more per person than other states to deliver services. It is assessed to have a lower capacity to raise revenue from its own sources and it receives an above-average level of Commonwealth payments. Its revenue capacity, including Commonwealth payments, is not enough to meet its assessed spending needs, and therefore it receives more GST per person than other states.

An estimate of assessed spending needs, capacity to raise revenue, and receipts of Commonwealth payments to support state services are the building blocks the Commission uses to determine the distribution of GST.

Figure 1 Commission calculation of state revenue and expenditure sources, 2022 Update



(a) Includes expenses and investment.

Notes: The 2022 Update was based on an average of 2018-19, 2019-20 and 2020-21. Commonwealth Payments that do not impact the GST distribution are not included in this calculation.

Source: Commission calculation.

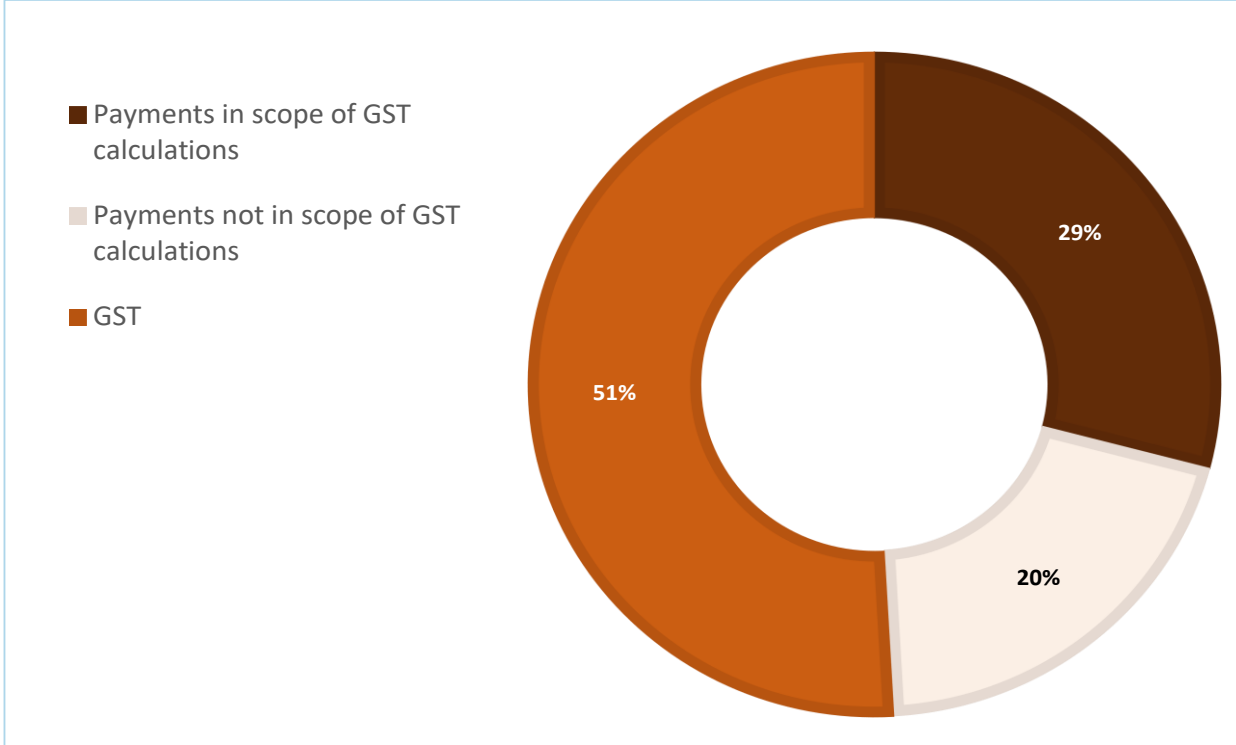
Scope of Commonwealth payments to states

In 2020-21, the Commonwealth government provided states with more than \$140 billion in financial assistance.

Around half of this was the distribution of GST revenue (see Figure 2). States are free to choose how they spend their GST revenue.

The remaining assistance was mainly payments to states for specific purposes. These payments must only be used by states for the purpose agreed with the Commonwealth.

Figure 2 Commonwealth assistance to states, 2020-21



Source: Commission calculation.

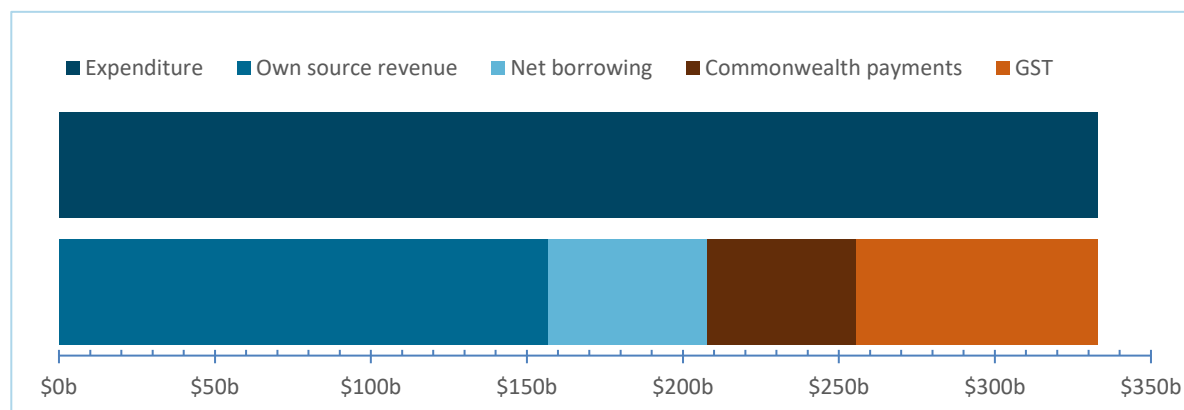
The following sections outline why some of these Commonwealth payments are considered in the GST calculations, examples of these payments, and why some payments are not included.

Why the Commission takes account of some Commonwealth payments

Commonwealth payments are an important source of revenue available to states to provide services and invest in infrastructure.

In its 2022 Update, the Commission calculated states as having \$333 billion of expenses. Figure 3 shows the revenue sources states had to fund this expenditure on services and infrastructure, with around 15% coming from Commonwealth payments taken into account by the Commission (see more detail on this below).

Figure 3 Sources of revenue to fund state services, Australia, 2022 Update



Notes: The 2022 Update was based on an average of 2018-19, 2019-20 and 2020-21. Commonwealth Payments that do not impact the GST distribution are not included in this figure.

Source: Commission calculation.

The Commission considers Commonwealth payments, like other revenue sources, are available to states to fund services and invest in infrastructure. Given the importance of these payments to state budgets, they need to be taken into account by the Commission when determining each state's fiscal capacity and GST share. If they were excluded, state fiscal capacities would not be similar and states that receive less revenue in the form of Commonwealth payments would be disadvantaged.

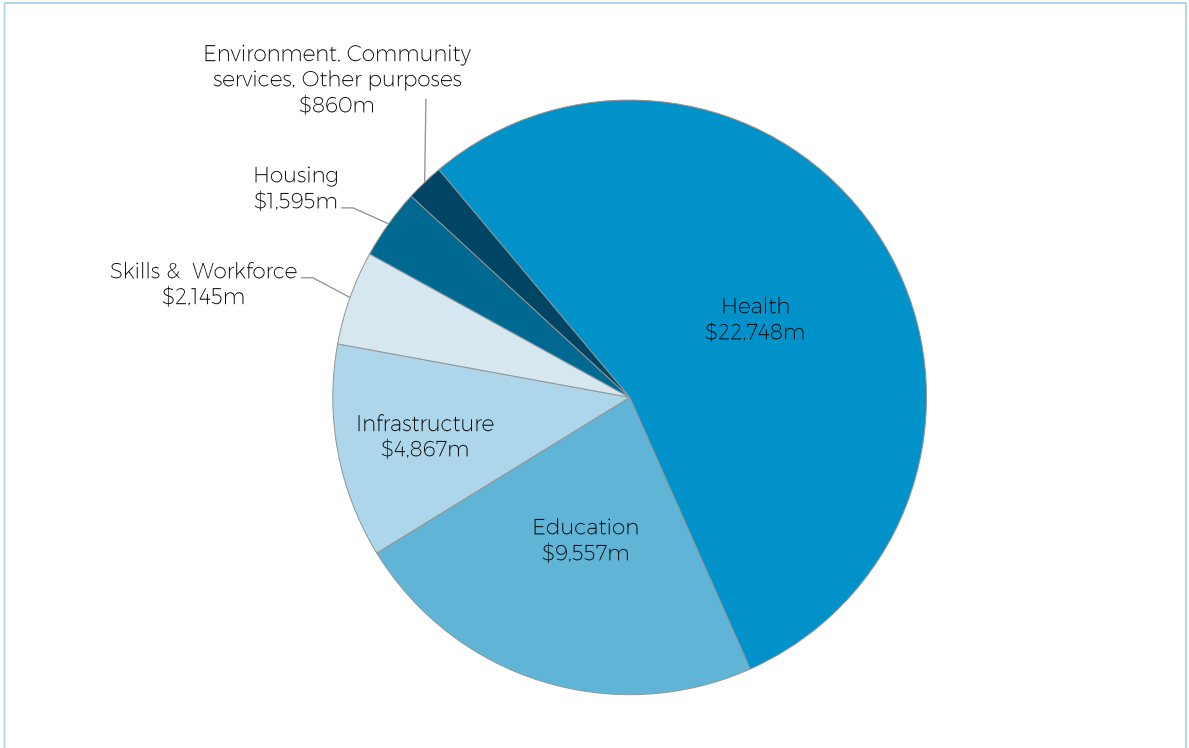
Payments included in GST calculations

Of the \$70 billion of Commonwealth payments to states in 2020-21, around \$42 billion was considered by the Commission in its GST calculations. These payments support the delivery of state services or are for investment.

More than half the payments are for health-related services and nearly a quarter for education services (see Figure 4). Of the \$23 billion for health-related services, 97% was specifically for hospital services. Quality

schools funding for government schools made up 95% of education payments. Other substantial payments include \$2.6 billion for road investment, \$1.6 billion for the National Housing and Homelessness Agreement, and \$1.6 billion for National Skills and Workforce Development.

Figure 4 Payments from the Commonwealth included in GST calculations, 2020-21



Source: Commission calculation.

Payments not included in GST calculations

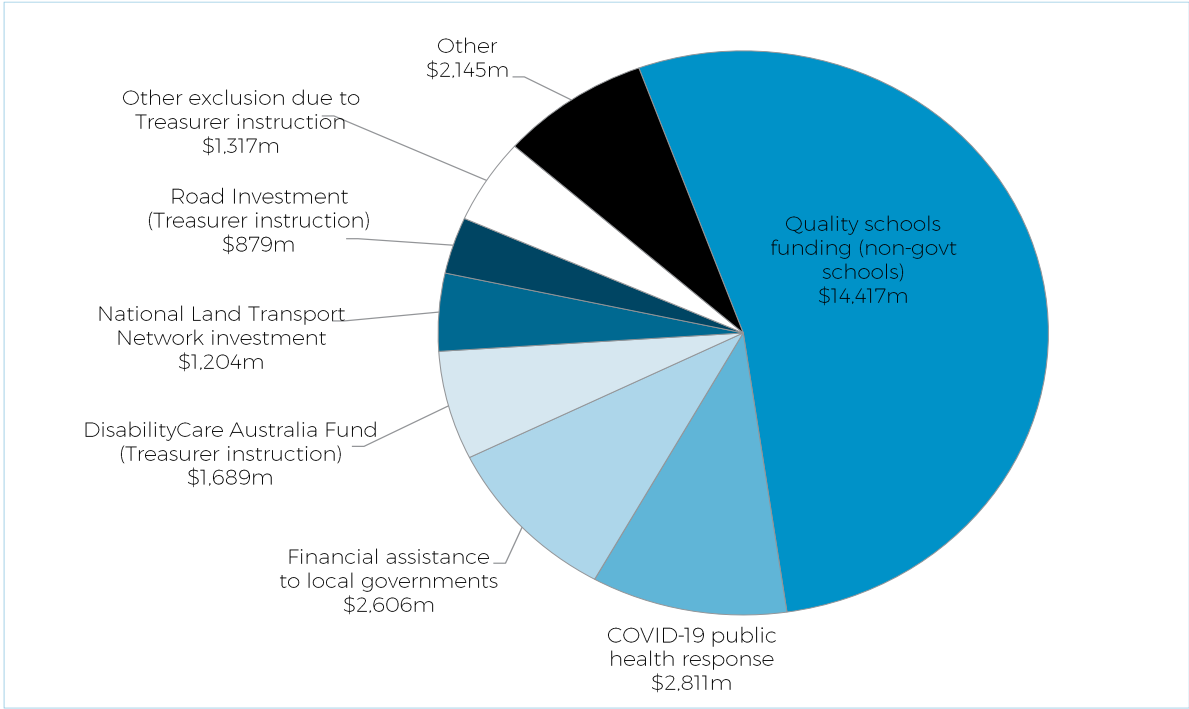
Not all Commonwealth payments are included when calculating states' GST distributions.

- Some Commonwealth payments do not support state services (for example payments for local government services) and are not taken into account.
- The Commonwealth Treasurer may also instruct the Commission to exclude certain Commonwealth payments. For example, in the 2022 Update, the Commission was asked to exclude facilitation and reward payments to states for implementing reforms to service delivery. This was to support the reforms by providing certainty to states that they would keep any financial benefits of the reform.

In 2020-21 about \$27 billion (over a third) of Commonwealth payments were excluded from the calculations and did not affect states' GST distributions.

Five payments accounted for 80% of the \$27 billion (see Figure 5). The largest of these was around \$15 billion of Commonwealth quality schools funding that states pass on to non-government schools.

Figure 5 Payments from the Commonwealth not included in GST calculations, 2020-21



Source: Commission calculation.

Conclusion

Commonwealth payments are an important source of funds for states. Many fund specific state services or are for investment in state infrastructure. This includes payments to fund hospitals, roads, education and a range of other services.

The Commission takes these Commonwealth payments into account because they are an important source of revenue used to fund state services. If they were not considered, the fiscal capacities of states would not be similar, and some states would be disadvantaged.

Not all Commonwealth payments are taken into account by the Commission, for example where they do not support state services or where the Commonwealth Treasurer instructs the Commission to exclude them.