

FEDERAL
FINANCIAL RELATIONS
1999-2000

CIRCULATED BY
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FOR THE INFORMATION OF HONOURABLE MEMBERS
ON THE OCCASION OF THE BUDGET 1999-2000
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BUDGET PAPER NO. 3: FEDERAL FINANCIAL RELATIONS

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Preface

This Budget Paper presents information on the Commonwealth Government's financial relations with State, Territory and local governments.

Figures for 1998-99 and 1999-2000 are estimates.

Relationship with Other Budget Papers and Terminology

Chapter I of this Paper examines trends in the States' cash underlying deficits. This measure approximates the national accounts net lending measure and hence provides an estimate of the savings-investment gap for the relevant sector. Data on the Commonwealth's underlying cash position is provided in Statement 1 of *Budget Paper No. 1*. As explained in Statement 9 of *Budget Paper No. 1*, the definition of the underlying deficit differs from the Australian Bureau of Statistics' (ABS) definition of the adjusted deficit in the treatment of provisions.

Appendix A to this Paper provides information on the level and interstate distribution of specific purpose payments, repayments of advances, advances and interest payments. Information on the level and interstate distribution of Commonwealth payments to local government authorities is also included.

Appendix B to this Paper provides a copy of the historic *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* signed by all Heads of Governments at the 1999 Premiers' Conference.

Parameter Estimates Used in this Paper

Table 1 sets out the population series and index factors used in this Budget Paper.

Table 1: Parameters

	Index Factors (per cent)			Population by State (000's)								
	CPI	Popul- ation	Real Per Capita	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
1998-99	1.25	1.25	2.51	6376	4685	3482	1847	1491	471	309	191	18852
1999-00	1.75	1.18	2.95	6447	4737	3537	1880	1499	470	311	195	19075

The population series that underlie per capita estimates in this Budget Paper for 1998-99 and 1999-2000 are projections at 31 December 1998 and 31 December 1999 respectively. These projections were prepared by the ABS and are on the basis of assumptions agreed to by the Treasury. The index factors for population in 1998-99 and 1999-2000 are based on the estimated annual growth in the Australian population to 31 December 1998 and 31 December 1999 respectively.

The index factors for prices in 1998-99 and 1999-2000 are based on estimated year-average growth in the headline consumer price index (CPI) in the year to the March quarter 1999 and in the year to the March quarter 2000, respectively.

Further Information

A number of ABS publications also provide information that is relevant to analysing Commonwealth financial relations with other levels of Government, including:

- *Government Financial Estimates, Australia* (Cat. No. 5501.0);
- *Taxation Revenue, Australia* (Cat. No. 5506.0);
- *Government Finance Statistics, Australia* (Cat. No. 5512.0);
- *Public Sector Financial Assets and Liabilities, Australia* (Cat. No. 5513.0);
- *Government Finance Statistics — Concepts, Sources and Methods* (Cat. No. 5514.0); and
- *Information Paper: Developments in Government Finance Statistics, Australia* (Cat. No. 5516.0).

Some of the data presented in this Paper are drawn from ABS government finance statistics (preliminary) data and the Commonwealth Grants Commission's *Report on General Revenue Grant Relativities 1999*.

Style Conventions

The following style conventions are employed in this Paper.

- The Australian Capital Territory and the Northern Territory are referred to as 'the Territories'. References to the 'States' or 'each State' include the Territories.
- The State and local government sector is denoted as the 'State/local sector'. References to the 'State/local sector' include the Australian Capital Territory and the Northern Territory unless otherwise stated.
- Figures in tables, and generally in the text, have been rounded. Discrepancies in tables between totals and sums of components reflect rounding. Percentage changes in all tables are based on the underlying unrounded amounts and not the rounded amounts.
- The following notations are used in the tables.

na	not applicable
0	zero
..	not zero, but rounded to zero
-	indicating negative amounts

- The following abbreviations are used for the names of the States, where appropriate, in tables:

NSW New South Wales

VIC Victoria

QLD Queensland

WA Western Australia

SA South Australia

TAS Tasmania

ACT Australian Capital Territory

NT Northern Territory

Budget Paper No. 3 is one of a series of Budget Papers, the purpose of which is to provide information supplementary to that in the Budget Speech. A full list of the series is printed on the inside cover of this Paper.

Chapter I: Recent Developments

This chapter provides an overview of:

- the proposed changes to Commonwealth-State financial arrangements to commence in 2000-01 as part of *A New Tax System*;
- the decisions taken at the 1999 Premiers' Conference and Loan Council Meeting on financial arrangements for 1999-2000; and
- public sector finances and fiscal developments in the States.

REFORM OF COMMONWEALTH-STATE FINANCIAL RELATIONS

On 13 August 1998, the Commonwealth Government announced its plan to reform the Australian taxation system. A key element of the *A New Tax System* package is the reform of Commonwealth-State financial relations. The principal objectives of these reforms are to:

- achieve a more efficient national tax system, including the elimination of a number of existing taxes which are impeding economic activity; and
- improve the financial position of all State Governments by providing access to a more robust tax base that can be expected to grow over time. This enhanced revenue security will ensure that the States can provide a sustainable level of quality services — such as hospitals, schools and law enforcement — into the future.

Implementation of the reforms requires the active involvement and support of both the Commonwealth Government and the State Governments. At a Special Premiers' Conference convened on 13 November 1998, Heads of Governments developed an *Agreement on Principles for the Reform of Commonwealth-State Financial Relations*, which established a set of guiding principles for progressing the reforms.

At the 9 April 1999 Premiers' Conference, Heads of Governments signed an *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (a copy of the Intergovernmental Agreement is at Appendix B) which gives effect to the following reform measures:

- From 1 July 2000, the Commonwealth will appropriate all of the Goods and Services Tax (GST) revenues to the States so that no State is worse off than under current arrangements. After 2001-02, the GST revenues will be distributed amongst the States on a pure horizontal fiscal equalisation (HFE) basis.
- Financial Assistance Grants and payments of revenue associated with the safety net surcharge arrangements for alcohol, petroleum and tobacco products will cease from 1 July 2000.

- The States will adjust their gambling tax revenues to the extent of the impact of the GST on gambling operators from 1 July 2000 and abolish:
 - bed taxes from 1 July 2000;
 - Financial Institutions Duty and debits tax from 1 January 2001;
 - a number of business-related stamp duties from 1 July 2001; and
 - stamp duty on non-residential conveyances on real property from a date to be determined.
- The States' receipt of the GST revenues is also subject to their meeting other obligations.
 - The States will fund and administer a First Home Owners Scheme from 1 July 2000 to offset the impact of the GST on house prices for first home buyers. The Scheme will involve the provision of \$7,000 to eligible applicants who are buying or building their first home as their principal place of residence.
 - The States will assume responsibility for local government funding. To ensure adequate funding arrangements for local government, the States will maintain the growth in general purpose assistance to local government on a real per capita basis and meet existing Commonwealth conditions on the payment of assistance to local government.
 - The States will pay to the Commonwealth the cost of administering the GST. To promote accountability between the parties, the States and the Australian Taxation Office (ATO) will develop a performance agreement that establishes an agreed basis against which the administration of the GST by the ATO and its agents can be assessed.
- As the GST revenues will not be sufficient initially to fund the States' current expenditure and the new responsibilities they are assuming, the Commonwealth has guaranteed that in each of the transitional years following the introduction of the GST, each State's budgetary position will be no worse off under the new arrangements.

The Intergovernmental Agreement also provides for the establishment of a Ministerial Council from 1 July 1999, comprising Commonwealth and State Treasurers, to oversight the implementation and operation of the Intergovernmental Agreement and to ensure compliance with its terms. The Ministerial Council will also provide a forum for the discussion of the per capita relativities to apply to the distribution of the GST revenues among the States and obviate the need for the annual Premiers' Conference process.

The reforms to Commonwealth-State financial arrangements require the passage of legislation by the Commonwealth and the States. The Intergovernmental Agreement will be attached as a schedule to relevant Commonwealth and State legislation.

On 31 March 1999 the Commonwealth House of Representatives passed two Bills to give effect to the Commonwealth's commitments: *A New Tax System (Commonwealth-State Financial Arrangements) Bill 1999*; and *A New Tax System (Commonwealth-State Financial Arrangements — Consequential Provisions) Bill 1999*.

The *A New Tax System (Commonwealth-State Financial Arrangements) Bill 1999* (the Bill) fulfils the Government's commitment to appropriate all the GST revenues to the States and includes provisions to ensure that the GST revenues are distributed across the States on the basis of HFE principles after the second year following the introduction of the GST.

The Bill also makes provision for the Commonwealth to provide State Governments with transitional assistance to offset any revenue shortfalls in the initial years following the introduction of the reforms. This transitional assistance will ensure that no State budget will be worse off as a result of the reforms to Commonwealth-State financial arrangements and will take the form of one-year interest-free loans to the States in 2000-01 and grants to the States in subsequent years.

The Bill also establishes arrangements which 'lock-in' the GST rate and base. Consistent with the Intergovernmental Agreement, the Bill provides that the GST rate and, in most cases, the GST base cannot be altered without the unanimous support of all State Governments. However, in order to facilitate the administration of the GST in the initial months of operation, the Commonwealth will reserve the right to make unilateral changes to the GST base in the first 12 months of operation. These changes will have to be of an administrative nature, necessary to facilitate minor adjustments to the GST and made having regard to the need to protect the revenue of the States. From July 2001, changes to the GST base of an administrative nature will require the majority support of the Commonwealth and States.

Finally, the Bill maintains the States' entitlement to National Competition Payments and the protection provided by the business franchise fees windfall tax from 1 July 2000 following the repeal of the existing *States Grants (General Purposes) Act 1994*.

The States have agreed to enact legislation to fulfil their commitments including the abolition of certain indirect taxes, the provision of funding to local government and the introduction of a First Home Owners Scheme.

The *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* will commence on 1 July 1999, with most reform measures taking effect from 1 July 2000.

1999 PREMIERS' CONFERENCE

At the 1999 Premiers' Conference, it was agreed that the level of Financial Assistance Grants (FAGs) to the States will be maintained in real per capita terms in 1999-2000. On the basis of current estimates, Commonwealth general revenue assistance to the States is expected to be \$17,719.6 million in 1999-2000, an increase of \$706.2 million or 4.2 per cent on the previous year, as shown in Table 2.

Other key elements of the 1999 Premiers' Conference agreement on financial arrangements in 1999-2000 are as follows:

- The pool of FAGs and unquarantined Health Care Grants (HCGs) will be distributed using the per capita relativities calculated by the Commonwealth Grants Commission (CGC) based on a five year assessment period and including an assessment for depreciation.
- The Commonwealth will provide National Competition Payments (NCPs) to the States as specified in the *Agreement to Implement the National Competition Policy and Related Reforms*. NCPs of up to \$439.1 million will be made in 1999-2000 and will be determined after the National Competition Council (NCC) reports in June 1999. These payments, like the per capita component of the indexation of FAGs, are conditional on the States achieving satisfactory progress in the implementation of National Competition Policy reforms.
- The Commonwealth will provide the Australian Capital Territory with Special Revenue Assistance (SRA) of \$13.2 million, in the form of transitional allowances of \$9.3 million and \$3.9 million as special fiscal needs. These amounts are in accordance with the CGC's recommendations and will be funded directly by the Commonwealth.

Estimates of general revenue assistance to be provided to the States in 1998-99 and 1999-2000 are shown in Table 2.

Further details of the Commonwealth's financial assistance to the States are contained in Chapter III.

Table 2: General Revenue Assistance to the States, 1998-99 and 1999-2000 (estimated)

	Financial Assistance Grants	Special Revenue Assistance	National Competition Payments	General Revenue Assistance			State Fiscal Contributions	General Revenue Assistance Net of State Fiscal Contributions		
	(a)	(b)	(c)	Change			(d)	Change		
	\$m	\$m	\$m	\$m	\$m	Per cent	\$m	\$m	\$m	Per cent
1998-99										
NSW	4727.8	0.0	73.0	4800.8	-7.3	-0.2	101.5	4699.3	107.9	2.4
VIC	3528.8	0.0	53.6	3582.5	-51.7	-1.4	74.5	3507.9	32.7	0.9
QLD	3194.7	0.0	39.9	3234.5	96.0	3.1	55.4	3179.1	158.4	5.2
WA	1614.3	0.0	21.1	1635.5	46.7	2.9	29.4	1606.1	79.5	5.2
SA	1668.1	0.0	17.1	1685.2	117.2	7.5	23.7	1661.4	144.4	9.5
TAS	736.7	0.0	5.4	742.1	56.2	8.2	15.6	726.5	48.7	7.2
ACT	278.6	25.0	3.5	307.2	32.2	11.7	10.2	296.9	27.3	10.1
NT	1023.5	0.0	2.2	1025.7	53.3	5.5	3.0	1022.7	56.8	5.9
Total	16772.5	25.0	215.8	17013.3	342.7	2.1	313.4	16699.9	655.8	4.1
1999-2000										
NSW	5031.1	0.0	148.4	5179.5	378.7	7.9	0.0	5179.5	480.2	10.2
VIC	3527.5	0.0	109.1	3636.5	54.1	1.5	0.0	3636.5	128.6	3.7
QLD	3237.4	0.0	81.4	3318.9	84.3	2.6	0.0	3318.9	139.7	4.4
WA	1594.1	0.0	43.3	1637.4	1.9	0.1	0.0	1637.4	31.3	1.9
SA	1681.4	0.0	34.5	1715.9	30.8	1.8	0.0	1715.9	54.5	3.3
TAS	782.6	0.0	10.8	793.5	51.4	6.9	0.0	793.5	67.0	9.2
ACT	341.8	13.2	7.2	362.1	55.0	17.9	0.0	362.1	65.2	22.0
NT	1071.3	0.0	4.5	1075.8	50.1	4.9	0.0	1075.8	53.2	5.2
Total	17267.2	13.2	439.1	17719.6	706.2	4.2	0.0	17719.6	1019.7	6.1

(a) These FAGs estimates do not include offsets for State fiscal contributions.

(b) Transitional allowances and special fiscal needs paid to the ACT in accordance with CGC recommendations.

(c) The *Agreement to Implement the National Competition Policy and Related Reforms* specifies that \$200 million and \$400 million in 1994-95 prices is to be distributed between the States on an equal per capita basis in 1998-99 and 1999-2000 respectively. The receipt of the payment is conditional on a State meeting the obligations of the Agreement.

(d) State fiscal contributions cease in 1998-99.

LOAN COUNCIL

At its meeting on 9 April 1999, Loan Council endorsed the Loan Council Allocations (LCAs) nominated by the Commonwealth and each State for 1999-2000.

Loan Council noted its decision (originally reached by correspondence) to discontinue the *National Fiscal Outlook* (NFO) report. When the NFO was first published in 1993, it provided fiscal forecasts for all States and for the total public sector. Since this information was prepared on a consistent basis, the NFO promoted greater transparency in the fiscal positions of all governments. However, in recent years there has been a significant improvement in the standard and consistency of budget reporting. In particular, the revised *Uniform Presentation Framework*, agreed by Loan Council in 1997, ensures standardised budget reporting across States, including the release of mid-year budget reports. These reports, which were first published in 1998-99, contain most of the information previously included in the NFO. Statement 9 of *Budget Paper No. 1* draws on some of this data (updated with the Commonwealth Budget and available State budgets) to present an overview of the national general government sector fiscal position. In these circumstances, Loan Council agreed that the NFO was no longer required.

Loan Council issues — including the Commonwealth's 1999-2000 budget time LCA and the estimated 1998-99 LCA outcome — are discussed further in Chapter IV.

FISCAL DEVELOPMENTS IN THE STATES

The underlying budget position, on a cash basis, of the State non-financial public sector — which comprises the general government and public trading enterprise sectors of all States — is shown in Chart 1¹. In 1998-99, an underlying deficit of \$6.7 billion is expected, representing 1.1 per cent of GDP. This follows a surplus of \$3.6 billion, or 0.6 per cent of GDP, in 1997-98.

However, the inclusion of certain 'one-off' transactions in the 1998-99 deficit means that this estimate is not directly comparable to the 1997-98 result. These transactions related to the funding of superannuation liabilities in New South Wales and Victoria. This has inflated total underlying outlays, making the underlying deficit larger than it would have been in the absence of such transactions. Adjusting for the effects of these superannuation payments yields a 1998-99 underlying surplus of around 0.4 per cent of GDP.

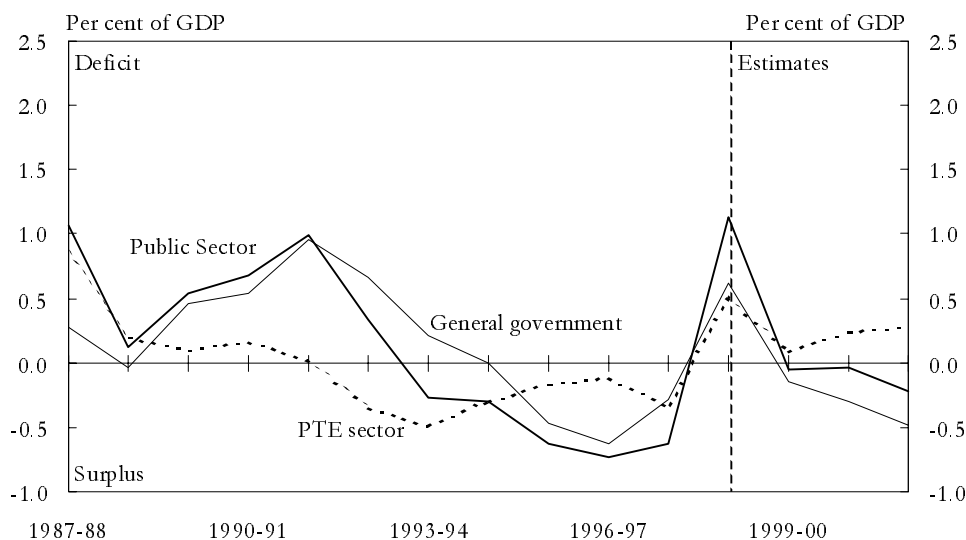
Abstracting from superannuation funding, the change in the State non-financial public sector underlying balance has been precipitated by developments in the PTE sector. There has been little change in the (adjusted) fiscal position of the aggregate State general government sector. PTE sector underlying outlays have, however, increased substantially

1 As not all States have adopted accruals-based budget reporting, the analysis included herein focuses on developments in the States' budgets on a cash, rather than an accrual, basis.

while revenues have fallen. The PTE sector has accordingly shifted from a surplus of 0.3 per cent of GDP in 1997-98 to a deficit of 0.5 per cent in 1998-99, the first underlying deficit result since 1991-92.

The latest forecasts for the State non-financial public sector suggest a movement back to a modest surplus position (cash basis) in 1999-2000. Subsequent years' projections show the PTE sector remaining in an underlying deficit position. In contrast, the position of the general government sector is expected to improve steadily over the medium term, helping the non-financial sector to a further modest surplus in 2000-01 and larger surpluses in the following two years.

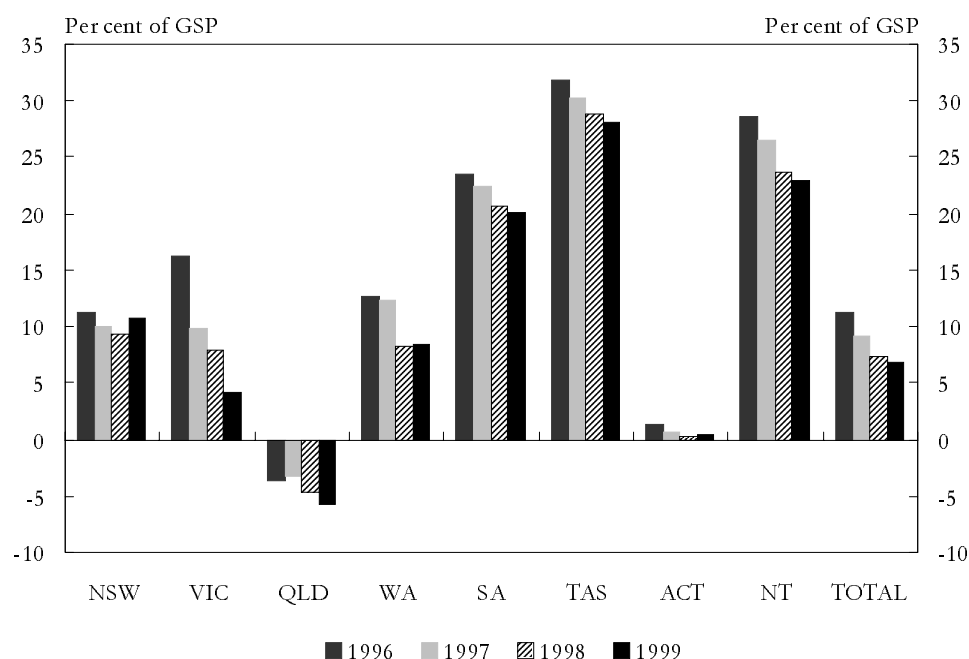
Chart 1: State Underlying Deficit by Sector^(a)



(a) The general government sector underlying deficit (cash basis) is defined as underlying outlays less revenue. Source: 1998-99 State mid-year reports, 1999-2000 State budgets where available, and Commonwealth Treasury estimates.

The ratio of aggregate State net debt to GDP has fallen steadily since 1992-93, with an overall improvement in State underlying budget positions, and the application of these funds — plus the proceeds from equity and asset sales — to debt retirement. This trend is expected to continue. Chart 2 shows recent trends in the net debt to Gross State Product (GSP) ratio of each State alongside the aggregate State net debt to GDP ratio.

**Chart 2: State Public Sector Net Debt
as at 30 June^(a)**



(a) Net debt is defined as gross debt less financial assets. The total is the total of State debt as a percentage of GDP.

Source: 1998-99 State mid-year reports and 1999-2000 State budgets where available.

Fiscal developments and strategies in individual States are outlined below.

New South Wales' 1998-99 Half-Yearly Budget Review shows that a modest general government underlying budget surplus (cash basis) is expected for 1998-99, after allowing for the impact of the Government's superannuation conversion offer. This represents a small improvement on the 1997-98 underlying deficit outcome.

New South Wales is expected to maintain a relatively sound fiscal position over the next few years, with the underlying surplus growing steadily. It is anticipated that capital outlays will peak in 1998-99, but current outlays restraint will also be required to compensate for an expected easing in growth in own-source revenue during this period.

The State's non-financial public sector is expected to record an underlying deficit (cash basis) in 1998-99, due to the PTE sector balance moving from surplus into deficit. The non-financial public sector net debt to GSP ratio is expected to decline in the medium term, reflecting a return to underlying surpluses, but is likely to remain above the States' average in 1998-99 and 1999-2000.

New South Wales' *General Government Debt Elimination Act 1995* includes a short-term fiscal target that the general government sector be operating in a position of sustainable underlying surplus by 1998-99. The State's long-term target is to eliminate general

government net debt by 2020, while fully funding accruing superannuation liabilities and maintaining general government net worth.

Victoria's 1999-2000 Budget shows that the general government sector is set to record an underlying deficit (cash basis) of 0.2 per cent of GSP in 1998-99, the first deficit since 1994-95. However, this result is influenced by the application of \$2.5 billion in privatisation proceeds towards unfunded superannuation liabilities. The underlying balance is projected to return to a surplus of 0.4 per cent of GSP in 1999-2000 and to remain in surplus over the medium term.

Victoria's total non-financial public sector underlying surplus is expected to record a large underlying deficit in 1998-99, largely as a result of the superannuation funding transaction described above. A small underlying surplus is forecast for 1999-2000.

Victoria's energy privatisation programme, now nearing completion, has generated close to \$30 billion in proceeds for the State Government, most of which has been used to retire State debt. Non-financial public sector net debt is estimated to fall to 4.0 per cent of GSP by the end of 1999-2000, compared with 30.7 per cent of GSP at the end of 1991-92.

The Victorian Government has a number of long-term fiscal objectives including maintaining public sector debt at a level consistent with a AAA credit rating, maintaining a sustainable accrual based operating surplus, and bringing tax rates into line with national averages.

Queensland continues to have the strongest financial position of all the States, and remains the only jurisdiction in a positive net asset position (that is, where financial assets exceed financial liabilities).

Queensland's *1998-99 Mid-Year Fiscal and Economic Review* shows that the general government sector is expected to record an underlying budget surplus (cash basis) of 0.8 per cent of GSP, lower than the surplus recorded in 1997-98 but higher than forecast at budget time. The forecasts published in Queensland's mid-year review project ongoing underlying surpluses over the forecast period to 2001-02.

The total non-financial public sector underlying surplus is expected to decline in 1998-99 and 1999-2000 to reach its lowest point since 1986-87. Declining general government underlying surpluses drive this result.

Queensland has adopted a fiscal strategy of maintaining a public sector underlying surplus and achieving full actuarial funding of all accruing employee entitlements, while preserving Queensland's low tax status.

Western Australia's *1998-99 Mid-Year Review* indicates a general government underlying budget deficit (cash basis) of 0.7 per cent of GSP in 1998-99, compared with 0.3 per cent of GSP in 1997-98. A further small deterioration is expected in 1999-2000, prior to an improvement in later years.

Small expected deficits in Western Australia's PTE underlying balance imply that movements in the non-financial public sector underlying deficit will broadly mirror those in the general government sector.

Western Australia's combined PTE and general government net debt is currently marginally above the States' average and is expected to remain stable for the medium term.

Western Australia's fiscal strategy is to achieve a whole of government accrual-based operating surplus over the forward estimates period, while achieving Consolidated Fund and general government underlying cash surpluses. The Government is aiming to maintain or increase net assets and to reduce net interest costs as a proportion of gross own-source revenue.

South Australia's *Mid-Year Budget Review 1998-99* projections indicate that the general government sector will remain in an underlying deficit position (cash basis) for the foreseeable future. However, the deficit is projected to decline from 0.9 per cent of GSP in 1998-99 to 0.4 per cent in 1999-2000, largely as a result of outlays restraint.

The total non-financial public sector in South Australia is expected to be in underlying deficit in 1998-99 and beyond. This result is driven primarily by the fiscal position of the general government sector.

South Australia's net debt position, which as a proportion of GSP currently ranks third highest of the States, is expected to show modest improvement in the near future, as the general government sector reduces the size of its underlying cash deficit.

The Government's fiscal objectives are to maintain the government sector in underlying balance over the medium term, reduce government debt with the aim of achieving a AAA credit rating and eliminate the State's unfunded superannuation liability over thirty years.

The recent consolidation in **Tasmania's** government finances is continuing notwithstanding budgetary pressures associated with slow economic growth. In 1997-98, outlays restraint and increased public authority income occasioned Tasmania's first general government underlying budget surplus (cash basis) in 22 years. Tasmania's *Mid-Year Report* predicts increasing underlying surpluses in 1998-99 and beyond.

Reflecting continued, although declining, PTE sector underlying surpluses, the non-financial public sector in 1998-99 is set to record an underlying surplus for the fifth successive year.

Tasmania's non-financial public sector net debt to GSP ratio should fall over the medium term but will remain substantially higher than the States' average.

Tasmania's fiscal objectives are to maintain a budget sector underlying surplus and to reduce general government and total State government net debt, while not introducing new taxes or raising existing tax rates.

The **Australian Capital Territory's** 1999-2000 Budget indicates the general government sector moving from an underlying deficit (cash basis) of 0.6 per cent of GSP in 1998-99 to an underlying surplus of 0.4 per cent of GSP in 1999-2000. This improvement reflects a combination of declining capital outlays and rising revenue (particularly grants from the Commonwealth), which is expected to outweigh higher current outlays. The Budget projects continued improvement in the underlying balance, based on outlays restraint and further growth in revenues.

The Australian Capital Territory's fiscal objectives include achieving a zero accruals-based operating loss by the 2004-05 budget and fully funding superannuation liabilities by the 2001-02 budget.

The **Northern Territory's** general government underlying balance (cash basis) has deteriorated over 1998-99, due to difficulties on both revenue and outlays. The Territory's 1999-2000 Budget estimates suggest an underlying deficit of around 0.8 per cent of GSP in 1998-99, following four successive years of underlying surpluses. An increase in the deficit to 1 per cent of GSP is forecast for 1999-2000, as growth in outlays outpaces an expected rise in revenues.

As a result of developments in the general government sector, and notwithstanding ongoing surpluses in the PTE sector, the Northern Territory's total non-financial public sector is also expected to record underlying deficits in 1998-99 and 1999-2000. However, non-financial public sector net debt is expected to decline slightly as a proportion of GSP by the end of 1998-99 to around 23 per cent.

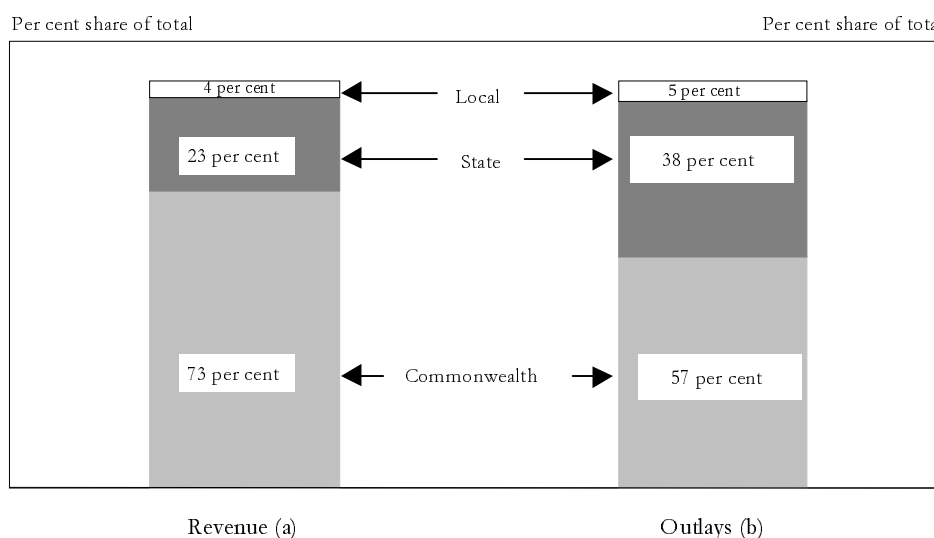
The Northern Territory's fiscal strategy embodies a range of fiscal targets including not increasing per capita current expenditure in real terms, maintaining an own-source revenue effort broadly comparable to that of the States and reducing Territory debt as a proportion of economic output.

Chapter II: Overview of Federal Financial Relations

COMPOSITION OF PUBLIC SECTOR REVENUES AND OUTLAYS

Federal fiscal arrangements in Australia are characterised by a significant difference between the relative revenue and expenditure responsibilities of the Commonwealth and the States, often referred to as vertical fiscal imbalance (VFI). The amount of own-source revenue raised by the Commonwealth is considerably larger than its own-purpose outlays. In contrast, the States' own-purpose outlays outweigh the amount which they raise in own-source revenue, with Commonwealth grants to the States forming a considerable portion of total State revenues. Chart 3 shows the estimated composition of general government own-source revenue and own-purpose outlays in Australia in 1998-99. Own-purpose outlays have been adjusted to include Commonwealth grants 'through' the States (other than for local government purposes) and grants to the multi-jurisdictional sector and to exclude net advances.

Chart 3: Composition of General Government Own-Source Revenue and Adjusted Own-Purpose Outlays, 1998-99 (estimated)

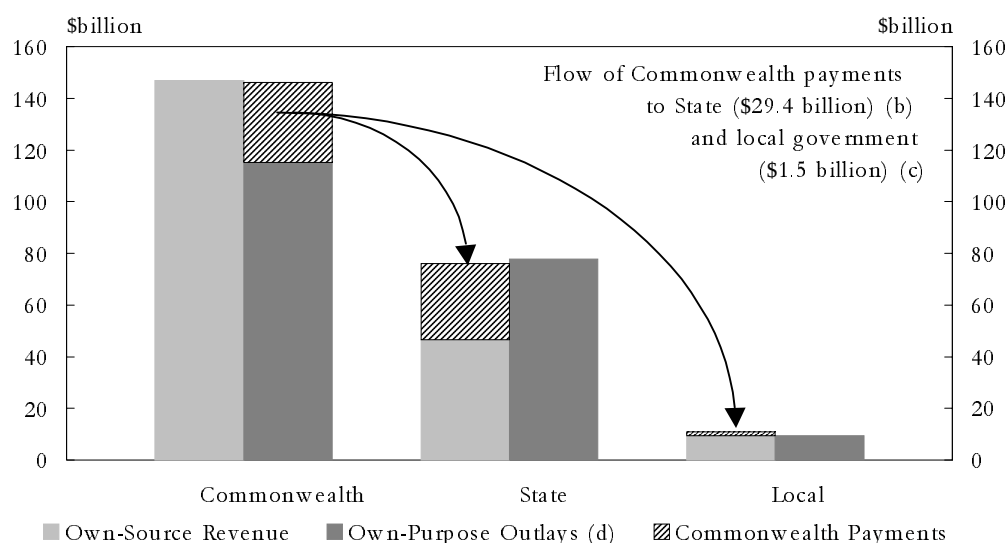


- (a) Own-source revenue excludes the receipt of payments from other levels of government.
- (b) The ABS measure of general government own-purpose outlays excludes payments to other levels of government, public trading enterprises (PTEs) and public financial enterprises (PFEs), such as general revenue assistance, Specific Purpose Payments and advances and subsidies, and interest payments on borrowings for other governments and PTEs. The adjusted measure adds back in to Commonwealth outlays Specific Purpose Payments 'through' the States (other than those for local government purposes) and includes grants to the multi-jurisdictional sector. A corresponding adjustment is made to the State/local series. The adjusted measures for both Commonwealth and State levels of government abstract from all net advances.

Source: ABS, *Government Finance Statistics*, unpublished data.

Chart 4 shows the impact of Commonwealth general government payments to State and local government. Commonwealth payments to other levels of government (excluding Specific Purpose Payments 'through' the States except for local government general purpose assistance grants) accounted for around 22 per cent of the total outlays of the Commonwealth general government sector in 1998-99. These payments also accounted for around 37 per cent of the total revenue of the State general government sector and for around 16 per cent of the total revenue of the local government sector.

Chart 4: Impact of Commonwealth General Government Payments to Other Levels of Government, 1998-99 (estimated)^(a)



- (a) Commonwealth payments comprise general purpose payments and Specific Purpose Payments.
 (b) Excludes grants 'through' the States.
 (c) Comprises grants made 'through' the States to local government and direct payments to local government.
 (d) Commonwealth grants 'through' the States, except grants for local government purposes, and grants to the multi-jurisdictional sector have been treated as Commonwealth government own-purpose outlays.
- Source: ABS, *Government Finance Statistics*, unpublished data.

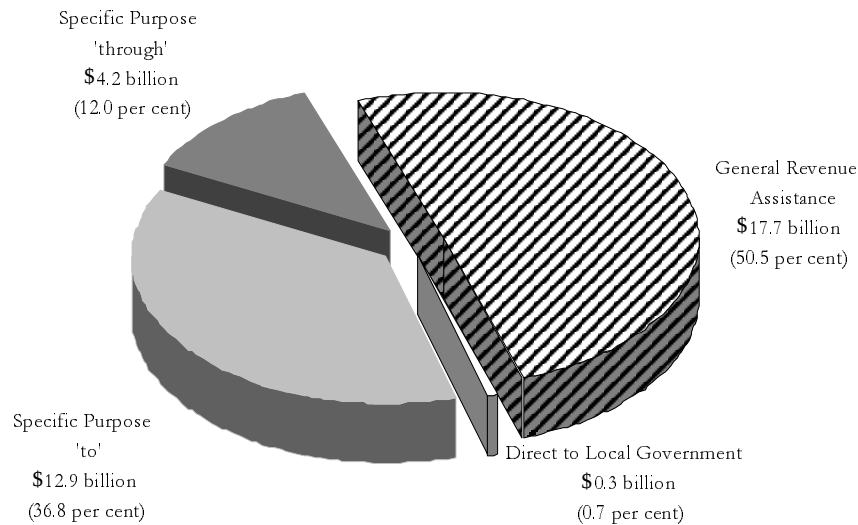
The pattern of Commonwealth and State revenue raising and expenditure responsibilities is longstanding, but will be fundamentally reformed under the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* which was signed by Heads of Government at the 1999 Premiers' Conference.

As noted in Chapter I, from 2000-01 the States will receive all of the revenues from the GST. In addition, the unanimous agreement of all States and Territories will be required for significant changes to the GST base or any change to the GST rate. Over time, the growth in GST revenues will exceed the growth in existing Commonwealth grants and improve the balance between the States' revenue capacities and expenditure responsibilities.

Composition of Commonwealth Payments to State/Local Sector

Chart 5 shows the composition of Commonwealth payments to the State/local sector in 1999-2000. Chapter III discusses these payments in detail.

Chart 5: Payments to the State/Local Sector in 1999-2000 (estimated)
Total Gross Payments \$35.1 billion



REVENUE COLLECTED BY THE COMMONWEALTH ON BEHALF OF THE STATES AND TERRITORIES

The Commonwealth collects a range of taxes on behalf of State and Territory Governments. These include revenues collected under the Section 90 'safety net' arrangements (following the 5 August 1997 High Court decision on Business Franchise Fees in the case of *Ha and Lim v. New South Wales*), mirror taxes at Commonwealth places (following the 14 November 1996 High Court decision in the *Allders* case), and from 2000-01, the GST.

Table 3 provides estimates of the taxes to be collected on an agency basis by the Commonwealth for the States and Territories between 1998-99 and 2002-03. The estimates of revenues for the GST are based on the proposed tax arrangements set out in *A New Tax System*, and take account of proposed technical and other amendments introduced in the Senate prior to the 1999-2000 Budget.

Table 3: Revenue Collected by the Commonwealth on Behalf of the States, 1998-99 to 2002-03 (\$million, estimated)

	1998-99	1999-00	2000-01	2001-02	2002-03
'Safety Net' Surcharge Collections(a)	6646	6759	348	na	na
Mirror Taxes	123	127	111	115	120
GST	na	na	27409	32290	33259
Total	6769	6886	27868	32405	33379

(a) These collections (less administration costs) are paid to the States and Territories as Revenue Replacement Payments.

HORIZONTAL FISCAL EQUALISATION

The general revenue assistance provided to the States by the Commonwealth is largely distributed on the basis of the horizontal fiscal equalisation (HFE) principles which are embodied in the per capita relativities recommended by the Commonwealth Grants Commission (CGC). The CGC is an independent statutory authority established by the *Commonwealth Grants Commission Act 1973*. The objective of HFE is to improve equity for all Australian residents.

In its assessments, the CGC uses a complex methodology that takes account of differences in the per capita capacities of the States to raise revenues and differences in the per capita amounts required to be spent by the States in providing an average standard of government services. A State's actual per capita expenditure or revenue generally differs from the average of all States for two reasons:

- influences that are beyond a State's control (referred to as 'disabilities') affect the cost at which it can provide services and its capacity for raising revenue; and
- a State's policies, practices and operating efficiency differ from those of other States.

HFE requires that only those factors beyond a State's control be taken into account in determining a State's relative needs and hence the distribution of Commonwealth general revenue grants. The CGC's recommendations seek to ensure that each State has the capacity to provide the average standard of State-type public services if it makes the same effort to raise revenue as the States on average and operates at an average level of efficiency.

An update of the relativities is conducted annually by the CGC in response to terms of reference provided to it each year by the Commonwealth Government. The CGC also conducts broader methodology reviews every five years and completed its most recent review in February 1999 (see Box 1). The resulting changes to the CGC's methodology were incorporated into the CGC's recommended relativities for 1999-2000. As noted in Chapter I, the 1999 Premiers' Conference agreed that the per capita relativities to be applied in 1999-2000 would continue to be based on the five year assessment period which has been used since 1990-91. Accordingly, the assessment period for the per capita relativities to be applied in 1999-2000 spans the years 1993-94 to 1997-98.

By international standards, the extent of HFE in Australia is pronounced and the methodology is complex. The complexity of the CGC's processes has arisen in response to the requirements of the States and the Commonwealth over time for a comprehensive and rigorous approach to HFE. For its part, the CGC has sought to maximise the transparency of its methodology and to provide the opportunity for input and comment by the States and the Commonwealth.

Further information on HFE is provided in the CGC's *Report on General Revenue Grant Relativities 1999*.

Box 1: Commonwealth Grants Commission's 1999 Methodology Review

- Every five years, the CGC conducts a comprehensive review of its methodology for assessing the per capita relativities for the distribution of the pool of FAGs and HCGs. The CGC completed the '1999 Review' in February 1999.
 - These longer-term reviews contrast with the annual updates of relativities which revise the data upon which the CGC's assessments are based.
- The key outcomes of the CGC's 1999 Review included:
 - the introduction of an assessment of the relative depreciation costs of the States;
 - changes in assessments to reflect the impact of micro-economic reform and National Competition Policy;
 - specific targeting of disabilities and associated expenditures to improve the accuracy and transparency of the CGC's assessments;
 - the use of 1996 Census data which indicated increased indigenous populations (and related needs) in New South Wales, Tasmania and the Australian Capital Territory; and
 - the inclusion of additional national capital factors to recognise the costs to the Australian Capital Territory associated with Canberra's status as the national capital.
- The CGC provided per capita relativities on the basis of both five and three year assessment periods in the 1999 Review.
 - The CGC considered that either set of relativities would be consistent with HFE, provided they are applied consistently over time.
 - However, the CGC noted that the advantages, if any, of moving from a five year period (which has been in use since 1990-91) to a three year period should be weighed against the detriment to long-term equalisation of changing the period.

EFFECTS OF HORIZONTAL FISCAL EQUALISATION

The distribution of the pool of FAGs and HCGs in accordance with the CGC's relativities means that New South Wales, Victoria and Western Australia receive less than an equal per capita share of the pool, and the other States (particularly the Northern Territory and Tasmania) receive more. This reflects the CGC's assessment that the 'donor' States have greater relative revenue capacities and/or less significant expenditure disabilities than the other States.

Table 4 shows the amount of FAGs and HCGs received by each State under HFE relative to the amount that they would receive on the basis of an equal per capita distribution or a distribution based on personal income tax collections. The table shows that in 1999-2000, around \$1,690 million (or 7.4 per cent) of the FAGs/HCGs pool is to be redistributed among the States as a result of the application of the CGC's relativities, compared with an equal per capita distribution.

Table 4: Impact of Horizontal Fiscal Equalisation on the Distribution of the Pool of Financial Assistance Grants and Health Care Grants in 1999-2000^(a)

	Distribution Using CGC Relativities		Distribution on an Equal Per Capita Basis ^(b)		Difference in Distribution (1)-(2)	Distribution on the Basis of Personal Income Tax Paid ^(c)		Difference in Distribution (1)-(4)
	(1)		(2)		(3)	(4)		(5)
	\$m	Per cent	\$m	Per cent	\$m	\$m	Per cent	\$m
NSW	6974	30.4	7754	33.8	-780	8432	36.8	-1458
VIC	4910	21.4	5698	24.8	-788	5733	25.0	-823
QLD	4284	18.7	4255	18.5	29	3661	16.0	623
WA	2143	9.3	2261	9.9	-118	2286	10.0	-143
SA	2176	9.5	1803	7.9	373	1587	6.9	589
TAS	910	4.0	565	2.5	344	471	2.1	439
ACT	412	1.8	374	1.6	38	555	2.4	-143
NT	1135	4.9	234	1.0	901	220	1.0	916
Total	22944	100.0	22944	100.0		22944	100.0	

(a) The pool consists of \$17,267.2 million in FAGs and \$5,676.5 million in HCGs (see Table 12 in Chapter III).

(b) Based on ABS population projections — see Table 1.

(c) Based on each State's contribution to personal income tax paid in 1996-97, sourced from Table 9 of Australian Taxation Office, *Taxation Statistics 1996-97*.

Table 5 shows the per capita relativities used to distribute the combined pool of FAGs and HCGs since 1994.

- Western Australia and Queensland have experienced the largest declines in per capita relativities, reflecting relatively strong economic growth in those States, which has contributed to an increase in their assessed fiscal capacities.

- The per capita relativities of the remaining States have increased, particularly those of the Australian Capital Territory and Tasmania.
 - The Australian Capital Territory, became a ‘recipient’ jurisdiction for the first time in 1999-2000.

Table 5: Commonwealth Grants Commission Relativities, 1994 to 1999

	1994 Update	1995 Update	1996 Update(a)	1997 Update	1998 Update(b)	1999 Report(c)	Per cent Change 1994-1999
NSW	0.8756	0.8743	0.87472	0.87819	0.87765	0.89948	2.7
VIC	0.8374	0.8506	0.87577	0.87835	0.88042	0.86184	2.9
QLD	1.0441	1.0435	1.04176	1.03737	1.02186	1.00687	-3.6
WA	1.0839	1.0521	1.01409	0.99589	0.98252	0.94793	-12.5
SA	1.2186	1.2047	1.18772	1.19100	1.22194	1.20680	-1.0
TAS	1.5173	1.5437	1.54644	1.54974	1.55086	1.60905	6.0
ACT	0.8968	0.8916	0.88883	0.88435	0.95145	1.10270	23.0
NT	4.9863	5.0332	4.87829	4.89353	4.81869	4.84429	-2.8

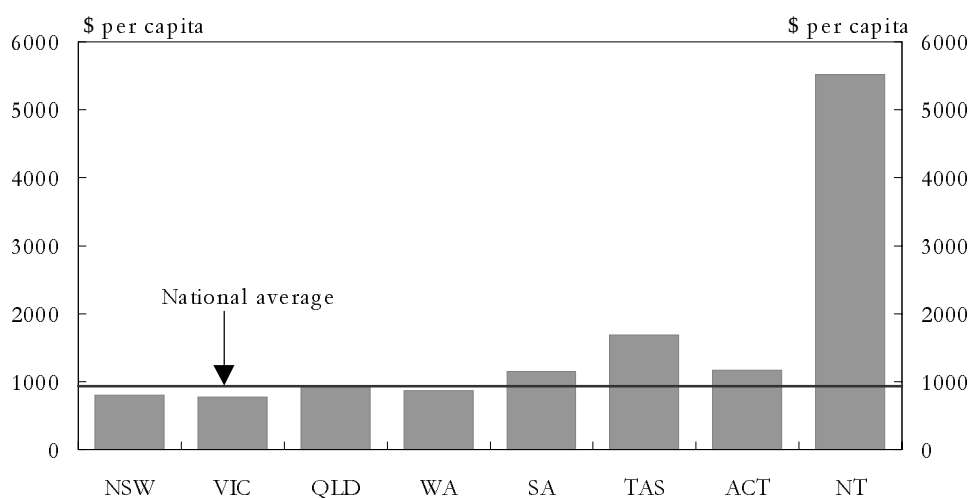
(a) The 1996 Update relativities as amended by the CGC’s subsequent alternative calculation of 29 May 1996 relating to the treatment of Section 130 payments to Western Australia by deduction.

(b) The 1998 Update ‘equalisation’ relativities.

(c) Relativities based on a five year review period and the inclusion of a depreciation assessment, as provided by the CGC to the Commonwealth, States and Territories on 29 March 1999.

The estimated State distribution of general revenue assistance on a per capita basis for 1999-2000 is shown in Chart 6. It indicates that New South Wales, Victoria and Western Australia receive less than average per capita payments while Queensland receives just above the average level of per capita payments. The Northern Territory receives over five times the national average and Tasmania, the Australian Capital Territory and South Australia also benefit from above average per capita payments.

Chart 6: General Revenue Assistance, 1999-2000



FISCAL EQUALISATION AND SPECIFIC PURPOSE PAYMENTS

In determining per capita relativities for the distribution of general revenue assistance, the CGC takes account of the interstate distribution of most current Specific Purpose Payments (SPPs). Within the CGC's methodology there are three approaches to dealing with SPPs:

- **Inclusion** is used for SPPs which are considered to go towards meeting the States' expenditure needs as assessed by the CGC (for example, SPPs for funding government schools). In general, while the effect of the Inclusion method on the overall distribution of funding depends on a number of factors, a State receiving a higher (lower) share of an 'included' SPP than the CGC considers appropriate to satisfy its relative 'needs' in the area will be assessed as requiring a commensurately lower (higher) share of the FAGs/HCGs pool.
- **Absorption** is a variant of the Inclusion approach with the main difference being that SPPs treated by this method are added to the pool of FAGs and the CGC's recommended per capita relativities are determined with regard to the combined pool in that year. Unquarantined HCGs are treated in this manner.
- **Exclusion** is used where an SPP is considered to finance expenditure in addition to that which States would otherwise have undertaken or where an SPP is distributed in accordance with the CGC's assessment of State needs. Under this approach, the SPP does not enter into the CGC's calculation of needs — only the State-funded portion of expenditure is taken into account in the CGC's assessments of expenditure needs.

As part of a process to improve the simplification and transparency of the HFE process, the CGC has changed the terminology in relation to the treatment of SPPs as used in the 1998 Update. Absorption and Inclusion remain the same as in the 1998 Update and Deduction has been renamed Exclusion. Previously, the CGC used the term Exclusion to define SPPs which were directed to areas in which the Commonwealth had largely accepted financial responsibility (for example, most SPPs 'through' the States) or were outside the scope of the CGC's assessments of recurrent expenditures and revenues (such as most capital SPPs).

The distribution of SPPs treated by Inclusion or Absorption affects the distribution of FAGs. Concerns have been expressed that this may in some instances result in the Commonwealth's policy objectives with respect to SPPs being overridden. The Commonwealth attempts to balance the objectives of SPPs with the objectives of fiscal equalisation. Accordingly, the Commonwealth has sometimes instructed the CGC to treat certain SPPs in a different way from how the CGC may otherwise have treated them. For example, the financial assistance provided under the Natural Heritage Trust of Australia has been excluded from the CGC's assessments to ensure that the benefit of the assistance is not partly offset by a redistribution of FAGs amongst the States.

It is not necessarily the case that the Commonwealth's policy objectives will be forgone where an SPP's distribution may be overridden over time in a financial sense. The objective of an SPP may be achieved by the fulfillment of the related conditions which the Commonwealth has agreed with the State receiving the payment.

Chapter III: Commonwealth Payments to the States and Territories

This chapter discusses trends in Commonwealth payments to the States and outlines the arrangements for payments to the States and local government in 1998-99 and 1999-2000.

Table 6 shows estimated Commonwealth total payments to the States after allowing for State fiscal contributions to the Commonwealth and payments associated with the Gun Buyback Scheme.

- Total payments to the States are estimated to be \$34.8 billion in 1999-2000. General revenue assistance is expected to account for around 51 per cent of total payments to the States and SPPs for around 49 per cent.

Total payments are estimated to increase by \$1,503.8 million or 4.5 per cent in nominal terms and 2.5 per cent in real terms in 1999-2000.

Table 6: Commonwealth Payments to the States, 1998-99 and 1999-2000 (\$million, estimated)

	General Revenue Assistance	Specific Purpose Payments (a)	State Fiscal Contributions (3)	Total Payments (1)+(2)-(3)	Change		
	(1)	(2)				Nominal \$m	Real (b) Per cent
1998-99	17013.3	16642.0	313.4	33341.9	1817.5	5.8	4.3
1999-00	17719.6	17126.2	0.0	34845.7	1503.8	4.5	2.5

(a) Data excludes SPPs direct to local government authorities, deductions for State fiscal contributions and the Gun Buyback Scheme.

(b) 1989-90 prices, based on forecast CPI growth.

Table 7 shows estimated total Commonwealth payments for each State in 1998-99 and 1999-2000.

In net terms, Commonwealth payments to the States are estimated to be \$34.4 billion in 1999-2000, an increase of \$2,337.0 million or 7.3 per cent on 1998-99. The estimated net increase incorporates SPPs direct to local government authorities (\$241.0 million in 1998-99 and \$258.3 million in 1999-2000) and total repayments to the Commonwealth by the States of \$1,549.4 million in 1998-99 and \$733.5 million in 1999-2000.

Table 7: Total Commonwealth Payments to the States, 1998-99 and 1999-2000 (\$million, estimated)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
1998-99									
(1) General Revenue Assistance	4800.8	3582.5	3234.5	1635.5	1685.2	742.1	307.2	1025.7	17013.3
(2) Total Specific Purpose Payments	5452.2	3813.9	2990.8	1843.6	1433.9	494.6	290.4	322.8	16642.0
Specific Purpose Payments 'to' the States (a)	4179.7	2820.5	2289.6	1434.0	1148.6	394.9	206.6	267.1	12740.9
Specific Purpose Payments 'through' the States (b)	1272.5	993.5	701.1	409.6	285.3	99.6	83.8	55.6	3901.1
(3) Gross Payments to the States (1) + (2)	10252.9	7396.4	6225.3	3479.1	3119.0	1236.6	597.6	1348.5	33655.3
(4) State Fiscal Contributions	101.5	74.5	55.4	29.4	23.7	15.6	10.2	3.0	313.4
(5) Total Payments to States (3) - (4)	10151.5	7321.8	6169.9	3449.7	3095.3	1221.0	587.3	1345.4	33341.9
1999-00									
(1) General Revenue Assistance	5179.5	3636.5	3318.9	1637.4	1715.9	793.5	362.1	1075.8	17719.6
(2) Total Specific Purpose Payments	5615.6	3967.9	3082.3	1879.3	1451.2	490.9	316.9	322.1	17126.2
Specific Purpose Payments 'to' the States (a)	4238.1	2896.6	2326.2	1441.1	1141.8	382.9	226.7	260.6	12914.2
Specific Purpose Payments 'through' the States (b)	1377.4	1071.2	756.1	438.2	309.4	108.0	90.2	61.5	4212.0
(3) Gross Payments to the States (1) + (2)	10795.1	7604.4	6401.1	3516.7	3167.1	1284.4	679.1	1397.9	34845.7
(4) State Fiscal Contributions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(5) Total Payments to States (3) - (4)	10795.1	7604.4	6401.1	3516.7	3167.1	1284.4	679.1	1397.9	34845.7
Change in Total Payments, 1998-99 to 1999-00									
\$million	643.6	282.6	231.2	67.0	71.8	63.4	91.7	52.5	1503.8
Nominal change, per cent	6.3	3.9	3.7	1.9	2.3	5.2	15.6	3.9	4.5

(a) Data exclude SPPs direct to local government authorities, deductions for State fiscal contributions in 1998-99 and SPPs for the Gun Buyback Scheme in 1998-99.

(b) Payments 'through' are payments that are made to the States to be passed on to local government, other bodies and individuals.

GENERAL REVENUE ASSISTANCE

In 1999-2000, general revenue assistance to the States will take the form of FAGs, SRA and NCPs. In contrast to most SPPs, general revenue assistance is 'untied', that is, it is not required to be spent by the States in a specified area.

General revenue assistance is estimated to amount to \$17.7 billion in 1999-2000, an increase of 4.2 per cent on the previous year. The estimates of general revenue assistance for 1999-2000 have varied from those presented at the 1999 Premiers' Conference in line with movements in the CPI.

- **FAGs** will account for nearly all of general revenue assistance in 1999-2000. The level of FAGs is indexed to movements in the CPI in the year to the March quarter and in accordance with projections of the population as at 31 December each year. A State's receipt of the per capita element of FAGs indexation is conditional upon compliance with the *Agreement to Implement the National Competition Policy and Related Reforms*.
- **SRA** in 1999-2000 will comprise payments to the Australian Capital Territory for transitional allowances and special fiscal needs.
- **NCPs** are provided in accordance with the *Agreement to Implement the National Competition Policy and Related Reforms*. A State's receipt of NCPs is conditional on compliance with the obligations of the Agreement.

Table 8 sets out general revenue assistance by type of payment and State for the period 1995-96 to 1999-2000.

Table 8: General Revenue Assistance to the States, 1995-96 to 1999-2000 (\$million)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
Financial Assistance Grants (a)									
1995-96	4225	2997	2884	1546	1501	651	227	891	14921
1996-97	4372	3220	2981	1538	1503	666	233	921	15435
1997-98	4546	3339	3099	1568	1551	680	237	970	15991
1998-99 (b)	4728	3529	3195	1614	1668	737	279	1024	16773
1999-00 (b)	5031	3527	3237	1594	1681	783	342	1071	17267
Special Revenue Assistance									
1995-96	182	232	0	0	0	0	61	10	485
1996-97	188	240	0	0	0	0	42	10	480
1997-98	190	242	0	0	0	0	35	0	467
1998-99 (b)	0	0	0	0	0	0	25	0	25
1999-00 (b)	0	0	0	0	0	0	13	0	13
National Competition Payments									
1995-96	0	0	0	0	0	0	0	0	0
1996-97	0	0	0	0	0	0	0	0	0
1997-98	72	53	39	21	17	5	4	2	213
1998-99 (b)	73	54	40	21	17	5	4	2	216
1999-00 (b)	148	109	81	43	35	11	7	4	439
Identified Road Grants (c)									
1995-96	110	99	68	43	28	11	3	9	371
1996-97	113	93	72	41	33	13	4	14	383
1997-98	0	0	0	0	0	0	0	0	0
1998-99	0	0	0	0	0	0	0	0	0
1999-00	0	0	0	0	0	0	0	0	0
Total General Revenue Assistance									
1995-96	4517	3328	2952	1589	1529	662	291	910	15777
1996-97	4673	3553	3053	1579	1535	680	279	945	16298
1997-98	4808	3634	3139	1589	1568	686	275	972	16671
1998-99 (b)	4801	3582	3235	1635	1685	742	307	1026	17013
1999-00 (b)	5179	3637	3319	1637	1716	793	362	1076	17720

(a) The table shows the gross level of FAGs to the States, without deductions for State fiscal contributions.

(b) Estimates – final figures (except for transitional allowances and special fiscal needs for the ACT) will depend on the actual increase in the CPI in the four quarters to March 1999 and March 2000, and the Statistician's determination of the population as at 31 December 1998 and 31 December 1999. Final figures for FAGs will also depend on final figures for HCGs.

(c) In 1997-98, these payments were absorbed into FAGs.

Table 9 sets out general revenue assistance by type of payment for the period 1998-99 to 2002-03.

Table 9: General Revenue Assistance to the States, 1998-99 to 2002-03 (\$million, estimated)

	1998-99	1999-00	2000-01	2001-02	2002-03
Financial Assistance Grants	16772.5	17267.2	na	na	na
Special Revenue Assistance	25.0	13.2	13.5	13.9	14.2
National Competition Payments	215.8	439.1	450.1	692.1	709.4
Grants to Balance State Budgets (a)(b)	na	na	na	1217.6	516.7
Total	17013.3	17719.6	463.7	1923.6	1240.3

(a) See Chapter I for more information on this element of *A New Tax System*.

(b) The States will receive interest-free loans, rather than grants in 2000-01, repayable the following year. The total of these loans is estimated to be \$1,119 million.

Level of Financial Assistance Grants

At the 1999 Premiers' Conference, the Commonwealth maintained total FAGs for 1999-2000 in real per capita terms. In 1999-2000, FAGs to the States are expected to total \$17,267.2 million with the real terms adjustment and the per capita adjustment estimated to contribute \$293.2 million and \$201.5 million respectively. Final amounts will depend on the actual increase in the CPI for the four quarters to March 1999 and March 2000, the Australian Statistician's determination of the population at 31 December 1998 and 31 December 1999 and final figures for HCGs.

The 1996 Premiers' Conference agreed that the untied funds, which were previously paid to the States as identified road grants, would be absorbed into the FAGs pool from 1997-98. Table 10 shows the equivalent amount of each State's FAGs in 1999-2000.

Table 10: Addition to FAGs from the Absorption of Untied Identified Road Grants, 1999-2000 (\$million, estimated)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
1999-00	124.3	87.5	76.3	38.2	38.8	16.2	7.3	20.2	408.8

Distribution of Financial Assistance Grants

The distribution of FAGs among the States is based on the States' populations as at 31 December of each year and the corrected per capita relativities assessed by the Commonwealth Grants Commission (CGC) in the *Report on General Revenue Grant Relativities 1999*. (The CGC issued corrected relativities on 29 March 1999, which took into account revisions to State revenues.)

The per capita relativities are applied to the State populations in order to arrive at a weighted population share for each State. A State's FAGs are equal to its weighted population share of the combined pool of FAGs and unquarantined HCGs, less the unquarantined HCGs it receives.

Tables 11 and 12 set out the estimated distribution of FAGs for 1998-99 and 1999-2000, respectively.

The redistribution of the combined pool of FAGs and HCGs among the States implied by the 1999 relativities reflects a number of broad influences.

- Changes in States' grant shares arise from routine updating of the CGC's assessments, incorporating revisions and corrections to data and the advancement of the review period to replace 1992-93 data with 1997-98 data. These adjustments can affect both the composition of the CGC's standard budget and the assessment of revenue raising and expenditure disabilities by the CGC.
- Changes in States' grant shares also arise as a result of the CGC's five year review of the methodology underlying the HFE process. In particular, the new arrangements affect the structure of the CGC's standard budget and its assessments of disabilities (see Box 1 in Chapter II of this Paper).

Table 11: Financial Assistance Grants to the States, 1998-99 (estimated)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
(1) Estimated population as at 31 December 1998 (000's) (a)	6376.4	4684.6	3482.4	1846.8	1490.7	471.1	308.8	191.5	18852.3
(2) Per capita relativities (b)	0.87765	0.88042	1.02186	0.98252	1.22194	1.55086	0.95145	4.81869	na
(3) Weighted populations (000's) – (1) times (2)	5596.3	4124.4	3558.5	1814.5	1821.6	730.7	293.8	922.6	18862.3
(4) Share of each State in weighted population (per cent) (c)	29.7	21.9	18.9	9.6	9.7	3.9	1.6	4.9	100.0
(5) Pool of FAGs and unquarantined HCGs distributed according to (4) (\$m) (d)	6573.4	4844.5	4179.9	2131.4	2139.6	858.2	345.1	1083.6	22155.8
(6) Unquarantined HCGs (\$m) (d)	1845.6	1315.7	985.2	517.0	471.5	121.6	66.5	60.1	5383.2
(7) Total FAGs – (5) less (6) (\$m) (e)	4727.8	3528.8	3194.7	1614.3	1668.1	736.7	278.6	1023.5	16772.5

(a) The projected population as at 31 December 1998 has been prepared by the ABS on the basis of assumptions agreed to by Treasury. These projections are subject to revision.

(b) The per capita relativities adopted at the 1998 Premiers' Conference.

(c) For ease of presentation, weighted population shares rounded to one decimal place are shown. However, in calculating row (5) unrounded shares are used in accordance with the *States Grants (General Purposes) Act 1994*.

(d) Estimated unquarantined health care grants (HCGs).

(e) The table shows the gross level of FAGs to the States. The actual payments made to some States will be reduced by the amount of their fiscal contribution to the Commonwealth.

Table 12: Financial Assistance Grants to the States, 1999-2000 (estimated)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
(1) Estimated population as at 31 December 1999 (000's) (a)	6446.6	4736.9	3537.3	1879.5	1499.0	470.0	310.7	194.9	19074.9
(2) Per capita relativities (b)	0.89948	0.86184	1.00687	0.94793	1.20680	1.60905	1.10270	4.84429	na
(3) Weighted populations (000's) – (1) times (2)	5798.6	4082.4	3561.6	1781.6	1809.0	756.3	342.6	944.0	19076.1
(4) Share of each State in weighted population (per cent) (c)	30.4	21.4	18.7	9.3	9.5	4.0	1.8	4.9	100.0
(5) Pool of FAGs and unquarantined HCGs distributed according to (4) (\$m) (d)	6974.2	4910.1	4283.7	2142.9	2175.8	909.6	412.1	1135.3	22943.7
(6) Unquarantined HCGs (\$m) (d)	1943.2	1382.6	1046.3	548.8	494.3	127.0	70.4	64.0	5676.5
(7) Total FAGs – (5) less (6) (\$m)	5031.1	3527.5	3237.4	1594.1	1681.4	782.6	341.8	1071.3	17267.2

(a) The projected population as at 31 December 1999 has been prepared by the ABS on the basis of assumptions agreed to by Treasury. These projections are subject to revision.

(b) The corrected per capita relativities for 1999-2000 as adopted at the 1999 Premiers' Conference.

(c) For ease of presentation, weighted population shares rounded to one decimal place are shown. However, in calculating row (5) unrounded shares are used in accordance with the *States Grants (General Purposes) Act 1994*.

(d) Estimated unquarantined health care grants (HCGs).

Table 13 shows that the redistribution of the FAGs and HCGs pool between the States implied by the 1999 relativities is \$259.0 million. This is significantly larger than the redistribution implied by the CGC's recent annual updates of the per capita relativities, due mainly to the impact of methodology changes.

The 1999 relativities mainly redistribute funding away from Victoria and Western Australia to New South Wales and the smaller States.

- New South Wales gained the largest increase in grant share, benefiting most from the introduction of an assessment of depreciation costs.
- Victoria's decline in grant share is due mainly to the effects of data and methodology changes, although the impact was partly offset by a fall in Victoria's revenue raising capacity.
- The decline in Western Australia's grant share was largely due to strong growth in its revenue raising capacity relative to the other States.
- The decline in Queensland's grant share is largely attributable to the effects of data and methodology changes affecting revenue and expenditure assessments, although the effect is partly offset by a decline in their revenue raising capacity.
- The ACT became a recipient under the HFE process due to changes in method and data, including the CGC's decision to include a number of additional national capital factors and to adjust the payroll tax base to exclude the defence forces.

Further information is provided in Table 13 below and in the CGC's *Report on General Revenue Grant Relativities 1999*.

Table 13: Effects of the Commonwealth Grants Commission's 1999 Review Relativities (\$million)^{(a)(b)}

Cause	NSW	VIC	QLD	WA	SA	TAS	ACT	NT
Data Changes								
Changed Financial Data	3.8	-21.0	40.5	0.6	-2.2	2.8	-7.8	-16.7
Adoption of 1996 Census Data	-3.1	26.4	-43.2	-20.2	43.7	8.0	3.1	-14.7
Methodology Changes								
Inclusion of Depreciation	113.7	-27.9	-67.1	-18.4	-10.8	-12.2	-6.6	29.2
Changed SPP Treatment	-1.6	-54.4	37.2	-2.4	18.1	7.1	-15.1	11.2
Changed Revenue Methods	59.0	-19.4	-56.3	6.4	-12.5	-15.9	18.5	20.2
Changed Expenditure Methods	105.3	-35.9	-17.3	14.7	-100.6	25.8	38.9	-30.7
Sub-Total	277.0	-132.3	-106.2	-19.2	-64.3	15.6	31.0	-1.5
Advancing the Review Period (substituting 1997-98 for 1992-93)	-111.6	32.4	46.5	-54.5	38.7	16.8	24.0	7.7
Total Redistribution	165.3	-99.9	-59.7	-73.8	-25.6	32.4	55.1	6.2

(a) From revised Table No. 5-6 (incorporating changes to the assessment of Land Revenue, Stamp Duty on Conveyances and Financial Transactions Taxes) of the CGC's *Report on General Revenue Grant Relativities 1999*.

(b) Based on estimates of the level and distribution of the 1998-99 combined pool of FAGs and unquarantined HCGs.

National Competition Payments

At the April 1995 Council of Australian Governments meeting, the Commonwealth and the States concluded the *Agreement to Implement the National Competition Policy and Related Reforms*. Under the Agreement the States are eligible for three tranches of ongoing NCPs. The NCPs commenced in July 1997 at an annual level of \$200 million and are scheduled to increase to \$400 million and \$600 million in July 1999 and July 2001 respectively, in 1994-95 prices. The Agreement specifies that the NCPs be paid quarterly and be distributed to the States on an equal per capita basis.

Each State's NCPs are subject to the State making satisfactory progress with the implementation of specified reform conditions in the Agreement. Prior to the scheduled payment of NCPs in 1999-2000, the National Competition Council (NCC) will assess whether each State has met these conditions and provide a report for consideration by the Commonwealth.

Subject to satisfactory progress in the areas to be reviewed by the NCC, the Commonwealth will provide the States with NCPs estimated to total \$439.1 million in 1999-2000. Table 14 shows the allocation of NCPs in 1998-99 and 1999-2000.

Table 14: National Competition Payments, 1998-99 and 1999-2000 (\$million, estimated)^(a)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
1998-99	73.0	53.6	39.9	21.1	17.1	5.4	3.5	2.2	215.8
1999-00	148.4	109.1	81.4	43.3	34.5	10.8	7.2	4.5	439.1

(a) Estimates. Figures will depend on actual increases in the CPI and the Statistician's determination of population as at 31 December 1998 and 31 December 1999.

Special Revenue Assistance

In 1999-2000 SRA will comprise funding to the Australian Capital Territory (ACT) in the form of transitional allowances and special fiscal needs. The level of these payments will reflect the recommendations of the CGC in its *Report on General Revenue Grant Relativities 1999*.

Transitional allowances are designed to assist with the ACT's transition to 'State-like' funding from the generous levels of Commonwealth funding which existed before self-government. In 1999-2000, transitional allowances will amount to \$9.3 million, a reduction of \$1.8 million. This amount recognises that the ACT continues to have limited policy control over policing, and will be reassessed once Stage Two of the Commonwealth-ACT review of policing is completed around mid 1999.

Special fiscal needs are payments to the ACT in recognition that certain functions (for example, the Family Court) are not funded by the Commonwealth, whereas in other States funding arrangements exist between the Commonwealth and the State. In 1999-2000, special fiscal needs will amount to \$3.9 million, a decrease of \$10.0 million from 1998-99. This decrease reflects the CGC's decision not to continue assessing a special fiscal need for items of a capital nature. In the view of the CGC, the introduction of a depreciation assessment into its standard budget framework will take into account the ACT's need to fund recurrent expenditure associated with capital needs.

Changes in the Distribution of General Revenue Assistance

Table 15 sets out the impact on the distribution of general revenue assistance of revised population figures for 1999-2000, the 1999 per capita relativities, changes in the level of NCPs and changes in the distributions of HCGs and SRA.

Table 15: Factors Affecting the Change in General Revenue Assistance, 1998-99 to 1999-2000 (\$million, estimated)

	FAGs Pool Redistributions							1999-00 General Revenue Assistance
	1998-99 General Revenue Assistance	Relativities(a)	New Population Estimates	Change in Distribution of Health Care Grants(b)	FAGs Indexation	Special Revenue Assistance(c)	National Competition Payments	
NSW	4800.8	166.2	-4.8	-8.4	150.4	0.0	75.4	5179.5
VIC	3582.5	-100.4	-2.7	-4.2	105.9	0.0	55.4	3636.5
QLD	3234.5	-59.7	16.4	-6.3	92.4	0.0	41.6	3318.9
WA	1635.5	-74.2	12.1	-4.3	46.2	0.0	22.1	1637.4
SA	1685.2	-25.7	-12.9	5.0	46.9	0.0	17.4	1715.9
TAS	742.1	32.6	-12.4	6.2	19.6	0.0	5.4	793.5
ACT	307.2	55.0	-2.2	1.4	8.9	-11.8	3.6	362.1
NT	1025.7	6.2	6.5	10.6	24.5	0.0	2.3	1075.8
Total	17013.3	0.0	0.0	0.0	494.7	-11.8	223.3	17719.6

(a) Total impact of change from the 1998 equalisation relativities to the 1999 relativities. This data may differ from Table 13 due to the use of the most recent estimates of the 1999-2000 FAGs/HCGs pool.

(b) Estimated distribution of unquarantined HCGs based on the Commonwealth's health funding to the States under the Australian Health Care Agreements (AHCAs).

(c) Reduction in transitional allowance and special fiscal needs payments to the ACT.

REVENUE REPLACEMENT PAYMENTS

On 5 August 1997 the High Court ruling on tobacco franchise fees in New South Wales (*Ha and Lim v. New South Wales* and *Walter Hammond & Associates Pty Ltd v. New South Wales*) cast into doubt the constitutional validity of all State business franchise fees (BFFs). BFFs on tobacco, alcohol and petroleum generated State revenues of around \$5 billion annually.

On 6 August 1997, at the unanimous request of the States, the Commonwealth announced 'safety net' arrangements to protect State finances. These arrangements provided for:

- an increase in the rate of Commonwealth customs and excise duty on tobacco and petroleum products and an increase in the rate of wholesale sales tax on alcoholic beverages; and
- a one hundred per cent windfall gains tax to protect the States from claims for refunds of past BFF payments.

All revenue collected by the Commonwealth under these arrangements is returned to the States (less administrative costs) as revenue replacement payments (RRPs).

The States have acknowledged that these arrangements represent State taxes imposed and collected by the Commonwealth at the request and on behalf of the States. The distribution of RRP between the States was agreed among the States.

Details of estimated RRP for 1998-99 and 1999-2000 are set out in Table 16. Actual RRP in 1998-99 and 1999-2000 will be in accordance with formal determinations to be made by the Commissioner of Taxation and the Chief Executive Officer of the Australian Customs Service under the *States Grants (General Purposes) Act 1994*.

These 'safety net' arrangements will cease from 1 July 2000 under the proposed reforms to Commonwealth-State financial relations.

Table 16: Revenue Replacement Payments, 1998-99 and 1999-2000 (\$million, estimated)

			NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
1998-99											
Tobacco	Share	(Per cent)	0.32492	0.21803	0.19065	0.11100	0.08988	0.03226	0.01456	0.01870	1.00000
	Amount	(\$m)	1013.8	680.3	594.9	346.3	280.4	100.7	45.4	58.3	3120.2
Petroleum	Share	(Per cent)	0.30039	0.20153	0.19593	0.17118	0.07549	0.02453	0.01291	0.01804	1.00000
	Amount	(\$m)	757.2	508.0	493.9	431.5	190.3	61.8	32.5	45.5	2520.7
Alcohol	Share	(Per cent)	0.33796	0.22332	0.19314	0.11147	0.07857	0.02415	0.01569	0.01569	1.00000
	Amount	(\$m)	337.1	222.7	192.6	111.2	78.4	24.1	15.6	15.6	997.4
Total			2108.1	1411.0	1281.4	889.0	549.1	186.6	93.6	119.5	6638.3
1999-00											
Tobacco(a)	Share	(Per cent)	0.32492	0.21803	0.19065	0.11100	0.08988	0.03226	0.01456	0.01870	1.00000
	Amount	(\$m)	1004.1	673.8	589.2	343.0	277.8	99.7	45.0	57.8	3090.3
Petroleum	Share	(Per cent)	0.30039	0.20153	0.19593	0.17118	0.07549	0.02453	0.01291	0.01804	1.00000
	Amount	(\$m)	783.7	525.8	511.2	446.6	197.0	64.0	33.7	47.1	2609.0
Alcohol	Share	(Per cent)	0.33796	0.22332	0.19314	0.11147	0.07857	0.02415	0.01569	0.01569	1.00000
	Amount	(\$m)	355.4	234.8	203.1	117.2	82.6	25.4	16.5	16.5	1051.5
Total			2143.2	1434.4	1303.5	906.9	557.3	189.1	95.2	121.4	6750.9

(a) The tobacco component of RRP's is based on projected full year collections under safety net surcharge arrangements which will apply prior to the introduction of a 'per stick' excise regime on 1 November 1999.

GENERAL PURPOSE ASSISTANCE TO LOCAL GOVERNMENT

General purpose assistance to local government has been provided by the Commonwealth since 1974-75, but will become the responsibility of the States and the Northern Territory from 1 July 2000 under the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (see Appendix B). Under current arrangements, the Commonwealth provides general purpose assistance to local government in the form of local government financial assistance grants and local government untied road funding. This assistance is paid to the States as an SPP on the condition that the funds are passed on to local government.

General purpose assistance is provided to local government authorities under the *Local Government (Financial Assistance) Act 1995* (the Act). Under the Act, the Treasurer is responsible for determining the annual increase in Commonwealth general purpose assistance paid to local government. The Act provides for general purpose assistance to be increased each year by an escalation factor which reflects the underlying movement in general revenue assistance provided to the States. The escalation factor reflects the percentage increase in the States' FAGs pool in the current year, which in turn reflects indexation for population growth and the CPI.

The Commonwealth will provide **\$1,227.8 million** in local government general purpose assistance in 1998-99. These payments have been based upon the estimated escalation factor of 3.0 per cent determined by the Treasurer and take into account an overpayment of \$10.0 million in 1997-98. In June 1999, the Treasurer will determine the 1998-99 final escalation factor on the basis of the actual payments made to the States in 1998-99.

In 1999-2000, general purpose assistance to local government will be based upon an estimated escalation factor of 2.9 per cent determined by the Treasurer. The 1999-2000 escalation factor reflects both the estimated CPI increase and population growth. General purpose assistance to local government is estimated to be \$1,263.3 million in 1999-2000, after allowing for an estimated overpayment of \$5.7 million in 1998-99. The Treasurer will determine the final escalation factor for 1999-2000 in June 2000, on the basis of the actual payments made to the States in 1999-2000.

Table 17 sets out the payments of general purpose assistance to local government in 1998-99 and 1999-2000.

As in the past, the interstate distribution of local government FAGs for 1999-2000 will be on an equal per capita basis, using the State populations at 31 December in the previous financial year. Untied local government road funding is to be distributed between the States on the basis of the criteria established under the *Australian Land Transport Development Act 1988*. In both cases, State Grants Commissions determine the intrastate distribution of these payments to local governments on the basis of fiscal equalisation.

Table 17: General Purpose Assistance for Local Government, 1998-99 and 1999-2000, (\$million, estimated)

	NSW	VIC	QLD	WA	SA	TAS	ACT	NT	Total
1998-99									
Financial Assistance Grants	287.9	211.2	156.6	82.7	67.7	21.5	14.1	8.6	850.4
Identified Road Grants	109.5	77.8	70.7	57.7	20.7	20.0	12.1	8.8	377.4
Total General Purpose Assistance (a)	397.4	289.0	227.3	140.4	88.4	41.5	26.2	17.5	1227.8
1999-00									
Financial Assistance Grants	296.0	217.0	162.1	85.5	69.2	21.9	14.4	9.0	875.0
Identified Road Grants	112.7	80.0	72.7	59.4	21.3	20.6	12.5	9.1	388.3
Total General Purpose Assistance (a)	408.6	297.0	234.8	144.9	90.5	42.4	26.9	18.1	1263.3

(a) Total general purpose assistance is the actual cash payment that the State receives on behalf of local government in the given year. It is equal to the estimated entitlement for the given year adjusted for an over or under payment from the previous year.

SPECIFIC PURPOSE PAYMENTS

Nature and Purpose

Specific Purpose Payments (SPPs) are payments for policy purposes related to particular functional activities (for example, health and education). SPPs are made under Section 96 of the Constitution, which states that the Parliament may grant financial assistance to any State on such terms as it sees fit.

There are around 120 SPPs which can be classified into three groups:

- SPPs paid **to** the States — payments direct to State Governments, representing around 74 per cent of total SPPs;
- SPPs **through** the States — payments to State Governments to be passed on to local government, other bodies and individuals, representing around 24 per cent of total SPPs. The main payments in this category relate to non-government schools and local government general purpose assistance; and
- a small number of SPPs made direct to local government, representing around 2 per cent of total SPPs. The main payments in this category relate to child care programmes administered by local governments on behalf of the Commonwealth and funding for aged and disabled persons' homes and hostels.

SPPs are reviewed every year in the Budget context. Indexation arrangements and the distribution of SPPs among States vary for each SPP.

In most cases SPPs are subject to conditions reflecting Commonwealth policy objectives or national policy objectives agreed to between the Commonwealth and the States. It is because of the conditions attached to SPPs that they are sometimes called 'tied grants'. Such conditions may include:

- general policy requirements on States (for example, that the States provide free public hospital treatment to Medicare patients as a condition of receiving health care grants);
- a requirement that a payment be expended for a specific purpose (for example, housing assistance for homeless people);
- meeting broad Commonwealth-State agreements covering principles and programme delivery mechanisms (for example, the Commonwealth-State Housing Agreement); and
- conditions of joint expenditure programmes including project approval, matching funding arrangements and performance information.

SPPs also include some payments which are not subject to conditions. These typically relate to revenue sharing arrangements or compensation (either for the transfer of responsibilities or for other Commonwealth action). For example, compensation payments are made to the States for revenue forgone as a result of the national system of companies and securities regulation.

Trends in Level and Composition of Specific Purpose Payments

In 1999-2000 SPPs are estimated to total around \$17.1 billion, an increase of \$474.5 million or 2.8 per cent, on 1998-99. SPPs 'to' the States are expected to increase by around \$173.3 million in 1999-2000 or 1.4 per cent, after abstracting from SPPs associated with the Gun Buyback Scheme (\$78.8 million in 1998-99) and deductions from Commonwealth-State Housing Agreement funding for State fiscal contributions (\$69.1 million in 1998-99).

Measures in the 1999-2000 Budget have increased SPPs 'to' the States by \$94.0 million in 1999-2000 and by \$716.8 million over the forward estimates period.

SPPs are expected to account for around 49 per cent of total gross payments to the States in 1999-2000. SPPs 'to' the States are expected to total \$12.9 billion or around 37 per cent of the total. Chart 7 shows trends in SPPs as a proportion of total gross payments 'to' and 'through' the States. The chart also contains adjustments for a number of classification changes and large one-off factors so as to allow comparisons on a consistent basis².

Chart 7 shows that although SPPs have increased as a percentage of total Commonwealth payments to the States by around 12 percentage points over the last twenty years, most of this increase occurred in the period to the early 1990s. In recent years, SPPs have declined as a percentage of gross payments to the States. In the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* which was signed by the Commonwealth and the States at the 1999 Premiers' Conference, the Commonwealth has indicated that it has no intention of cutting aggregate SPPs as part of the reform process set out in the Agreement.

2 Incorporates the reclassification of funding under higher education from SPPs through the States to grants to the multi-jurisdictional sector. Chart 7 also contains adjustments for reclassifications such as: payments to the States under the *Vocational Education and Training Funding Act 1992*; the transfer in 1989-90 of nominated housing advances into Commonwealth-State Housing Agreement grants; and significant changes in the structure of Commonwealth hospital funding (such as the 1988 decision to combine States' Medicare compensation grants (introduced in 1984) and identified health grants into a single new SPP). Adjustments have been made to the level of general purpose payments to account for Commonwealth policy decisions which transferred some taxing powers to the States.

Chart 7: Specific Purpose Payments as a Percentage of Total Gross Payments to the States, 1979-80 to 1999-2000

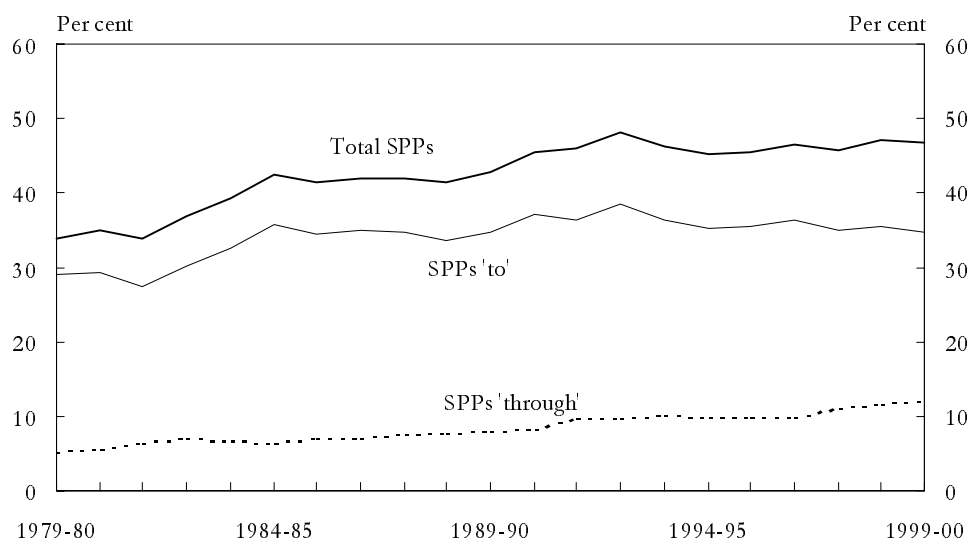
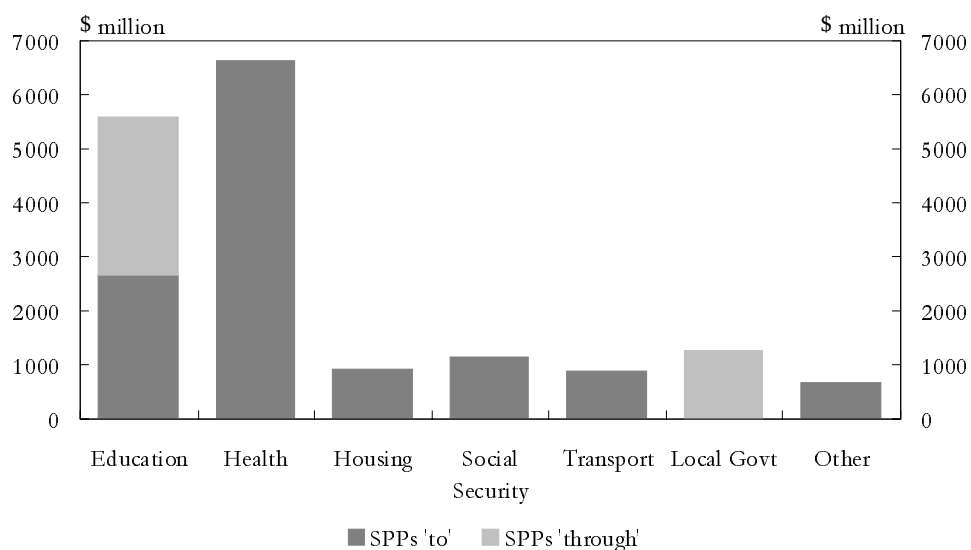


Chart 8 illustrates the composition of major specific purpose programmes ('to' and 'through' the States) in 1999-2000. Health accounts for 51 per cent (or over \$6.5 billion) of SPPs 'to' the States. More detailed information on SPPs including estimated State splits for 1998-99 and 1999-2000 and data on repayments of advances, advances and interest payments are contained in Appendix A.

Chart 8: Composition of Estimated Specific Purpose Payments 'To' and 'Through' the States, 1999-2000



Chapter IV: Loan Council Oversight of Commonwealth and State Borrowings

This chapter sets out the Loan Council Allocations (LCAs) nominated by the Commonwealth and each State for 1999-2000 and endorsed by Loan Council at its meeting on 9 April 1999. It also reports the Commonwealth's 1998-99 expected LCA outcome and its 1999-2000 Budget time LCA. Background on Loan Council arrangements is provided in Box 2.

LOAN COUNCIL ALLOCATIONS FOR 1999-2000

Under the Loan Council arrangements, each jurisdiction nominates an LCA comprising:

- the estimated general government deficit/surplus (based on its mid-year report projections);
- its public trading enterprise (PTE) sector net financing requirement (also based on mid-year report projections); and
- memorandum items (such as transactions that, while not formally borrowings, have many of the characteristics of borrowings).

These nominations are considered by Loan Council having regard to each jurisdiction's fiscal position and reasonable infrastructure requirements, as well as to the macroeconomic implications of the aggregate figure. LCAs are on a headline rather than an underlying basis as they seek to measure a government's call on financial markets.

The LCAs nominated for 1999-2000 are set out in Table 18. In aggregate, they represent a surplus of \$15.6 billion compared with an estimated surplus for 1998-99 of \$15.0 billion.

Loan Council considered that the process of fiscal consolidation has been important in helping to shield the domestic economy from the instability experienced in our region and noted the need for continued perseverance with sound fiscal policies. Against this background, the aggregate of 1999-2000 LCA nominations was judged consistent with current macroeconomic policy objectives and Loan Council endorsed each jurisdiction's nomination without change.

LCA nominations for all jurisdictions were prepared on a no policy change basis. They thus provide an indication of the public sector's likely call on financial markets. The actual call may vary from the nomination primarily because of changes in economic parameters and policy measures. Updated information will be provided to financial markets through publication by each jurisdiction of its budget time LCA and a mid-year update of its expected LCA outcome.

A tolerance limit of 2 per cent of total non-financial public sector revenue applies between the LCA approved by Loan Council and the budget time LCA, and again

between the budget time LCA and the LCA outcome. Tolerance limits recognise that LCAs are nominated at an early stage of budget processes and that estimates are likely to change as a result of policy and parameter changes before and after budgets are brought down. If a jurisdiction expects to exceed the upper or lower bound of the tolerance limit around its LCA estimate, it is obliged to provide an explanation to Loan Council and to make this explanation public. While Loan Council would not be required formally to approve the change, it would have the opportunity to pursue with the particular jurisdiction any concerns raised by the new LCA estimate.

In making their LCA nominations to the Loan Council, the Commonwealth, States and Territories also provide information on government contingent exposures under infrastructure projects with private sector involvement. These exposures, which are measured as the government's contractual liabilities in the event of termination of the project, are not included as a component of the LCA as they are unlikely to be realised and are thus materially different from actual borrowings undertaken to finance the public sector deficit. Government outlays under these projects, such as equity contributions and ongoing commercial payments to the private sector, continue to be included in the annual total public sector deficit, and hence the LCA.

Box 2: Loan Council — History and Objectives

The Australian Loan Council is a Commonwealth-State Ministerial Council which co-ordinates public sector borrowings under voluntarily agreed arrangements. It comprises the Commonwealth Treasurer as Chairman and his counterparts from the States and Territories, and usually meets in conjunction with the annual Premiers' Conference. Loan Council was established in 1927 under the *Financial Agreement between the Commonwealth and the States* and was continued in existence under the *Financial Agreement between the Commonwealth, States and Territories*, which came into effect in 1995.

Commonwealth-State cooperation in this area derives from a common interest in ensuring that overall public sector borrowing in Australia is consistent with sound macroeconomic policy and that borrowings by each government are consistent with a sustainable fiscal strategy.

The present Loan Council arrangements, introduced in 1993-94, are designed to enhance the role of financial market scrutiny as a discipline on borrowings by the public sector. In doing so, they build on changes instituted in the late 1980s which gave individual States responsibility for managing their own borrowings, with the aim of making them more accountable to the markets for their actions. The arrangements therefore emphasise transparency of public sector finances rather than adherence to strict borrowing limits.

The Loan Council process is supported by uniform, comprehensive reporting of public sector finances to assist Parliaments, financial markets and the public to make informed judgements about each government's financial performance.

ESTIMATED COMMONWEALTH LCA OUTCOME FOR 1998-99

In May 1998, Loan Council endorsed the Commonwealth's 1998-99 LCA nomination of a \$6.9 billion surplus, provided on a no policy change basis. The Commonwealth subsequently estimated a budget time LCA surplus of \$17.3 billion, incorporating the then estimated headline budget surplus of \$18.7 billion (see Chapter IV of *Budget Paper No. 3 1998-99*). This comprised in large part proceeds from the planned sale of the Government's remaining equity in Telstra in 1998-99.

In December 1998, a revised LCA estimate was provided in Table E5 of the *Mid-Year Economic and Fiscal Outlook 1998-99* (MYEFO). This showed a surplus of \$6.1 billion, incorporating a revised estimate for the headline budget surplus of \$8.7 billion. The revisions to the budget and LCA estimates in the MYEFO mainly reflected changes in the planned timing of the Telstra sale. The MYEFO indicated that, as a result, the Commonwealth expected to exceed the upper bound of the 2 per cent of revenue tolerance limit that applies on either side of its budget time LCA estimate.

The current estimate of the Commonwealth's 1998-99 LCA outcome is a surplus of \$8.0 billion. The increase in this figure since MYEFO mainly reflects improvements in the estimated general government underlying surplus and a lower estimated PTE net financing requirement.

The changes through the course of the year in the Commonwealth's 1998-99 LCA and its main components are shown in Table 19. The Commonwealth's actual LCA outcome will be reported in *Final Budget Outcome 1998-99*.

BUDGET TIME COMMONWEALTH LCA FOR 1999-2000

Each jurisdiction is required to take into account its Loan Council approved LCA in formulating its budget, and to report a budget time LCA estimate in its budget papers.

The Commonwealth's budget time LCA estimate for 1999-2000 is a \$22.3 billion surplus, compared with the nominated surplus of \$14.4 billion approved by Loan Council. The change in the LCA estimate primarily reflects improvements in the general government headline balance due to the re-appraisal of the market value of Telstra and changes to the proposed method and timing of its sale. The budget time LCA estimate exceeds the lower bound of the tolerance limit of 2 per cent of total non-financial public sector revenue. The components of the Commonwealth's nominated and budget time LCAs for 1999-2000 are shown in Table 20.

Under the Loan Council arrangements, jurisdictions are required to disclose, as a footnote to their LCA, government termination liabilities under infrastructure projects with private sector involvement which operate for 10 years or longer and involve gross project liabilities of at least \$5 million. The Commonwealth plans no such projects in 1999-2000.

OTHER LOAN COUNCIL DEVELOPMENTS

The current *Uniform Presentation Framework* was agreed by Loan Council in 1997. In accordance with this framework, all jurisdictions published mid-year budget reports for the first time in 1998-99. The *Uniform Presentation Framework* tables included in these mid-year reports, like those published in State and Territory budgets, feature consistent cash-based budget estimates.

The move of the States and Territories and the Commonwealth to accrual based budget reporting, together with the shift by the ABS later in 1999 to accrual based Government Finance Statistics, has necessitated a review of the uniform presentation framework. Such a review is to be undertaken over the course of 1999.

During 1998-99, Loan Council members agreed by correspondence to cease publication of the *National Fiscal Outlook* Report. Some background to this development is given in Chapter I.

Table 18: Loan Council Allocations — 1999-2000 Nominations (\$million)^(a)

	NSW (c)	VIC(d)	QLD	WA	SA(e)	TAS	ACT	NT	C/wlth(f)	Agg
Nominated 1999-2000 LCAs										
General government deficit	-1133	-945	-25	467	72	-102	-57	47	-15135	-16811
PTE net financing requirement	287	-193	-12	207	-14	111	10	-2	651	1045
Total public sector deficit	-846	-1138	-37	674	58	9	-47	45	-14485	-15767
Memorandum items (b)	334	249	-150	30	-427	18	-13	0	115	155
Loan Council Allocation	-512	-890	-187	704	-369	26	-61	45	-14370	-15614
1999-2000 Tolerance limit	545	353	305	174	130	49	31	37	3099	
1998-99 LCAs - Feb 1999 estimates										
General government deficit	3273	-6807	-1,710	406	62	-90	-2	39	-7035	-11864
PTE net financing requirement	571	-1700	536	116	5	41	36	13	1584	1202
Total public sector deficit	3844	-8507	-1174	524	68	-49	34	52	-5452	-10660
Memorandum items (b)	-3807	373	-72	95	-338	16	34	0	-622	-4321
Loan Council Allocation	37	-8134	-1247	619	-270	-33	68	52	-6074	-14982
1998-99 Budget time estimate	-1196	170	-1761	374	-87	-30	161	14	-17342	-19697
1998-99 Nomination	-1478	-9	-867	-37	-279	17	164	24	-6918	-9383
1997-98 LCA outcome	-1239	-3746	-1272	-1437	-338	-92	104	-58	-15619	-23697

- (a) LCA nominations for 1999-2000 reflect best estimates of 1999-2000 public sector deficits/surpluses as at the 9 April 1999 Loan Council meeting. Nominations have been provided on the basis of policies announced up to and included in jurisdictions' mid year reports. With the exception of Victoria (see footnote (d)) nominations are based on preliminary estimates of general government finances provided by jurisdictions for purposes of their mid year reports, and projected bottom lines for each jurisdiction's PTE sector. Updated LCA estimates will be provided through publication by each jurisdiction of its budget time LCA as part of its budget documentation. The 2 per cent (of total non-financial public sector revenue) tolerance limits around each jurisdiction's 1999-2000 LCA are designed, inter alia, to accommodate changes to the LCA resulting from changes in policy.
- (b) Memorandum items are used to adjust the public sector deficit/surplus to include in LCAs certain transactions — such as operating leases — that have many of the characteristics of public sector borrowings but do not constitute formal borrowings. They are also used, where appropriate, to deduct from the public sector deficit/surplus certain transactions that Loan Council has agreed should not be included in LCAs — for example, the funding of more than employers' emerging costs under public sector superannuation schemes, or borrowings by entities such as statutory marketing authorities. Where relevant, memorandum items include an amount for gross new borrowings of government home finance schemes. Overfunding and underfunding of emerging superannuation liabilities is also included as a memorandum item, as are interest earnings on employer superannuation balances.

Table 18: Loan Council Allocations — 1999-2000 Nominations (\$million)(continued)

- (c) New South Wales' 1999-2000 allocations and latest 1998-99 estimates incorporate the impact of its superannuation conversion offer.
- (d) Victoria updated its 1999-2000 LCA nomination, and its latest estimate of 1998-99 LCA, on 7 April 1999. These changes were mainly due to significant privatisation receipts, which occurred after Victoria's mid-year budget report.
- (e) Changes in the measurement of overfunding of superannuation have led to a substantial upward revision in South Australia's memorandum items and in the LCA surplus estimated for 1998-99.
- (f) The revision in the Commonwealth's 1998-99 estimate since Budget time mainly reflects a change in the timing of the sale of the Government's remaining equity in Telstra.

Table 19: Commonwealth's Loan Council Allocation for 1998-99 (\$million)

	Loan Council Approved May 1998	Budget Time Estimate May 1998	MYEFO Estimate Dec 1998	Current Estimate
General government sector deficit	-7887	-17794	-7035	-8394
PTE sector net financing requirement	790	739	1584	590
Public sector deficit	-7097	-17055	-5452	-7804
Memorandum items(a)	179	-287	-622	-244
Loan Council Allocation	-6918	-17342	-6074	-8048

(a) For the Commonwealth, memorandum items comprise the change in the net present value of operating leases (with a net present value greater than \$5 million) of departments and authorities, university borrowings, overfunding of superannuation, and an adjustment to exclude the net financing requirement of statutory marketing authorities and Telstra from the LCA.

Table 20: Commonwealth's Loan Council Allocation for 1999-2000 (\$million)

	Loan Council Approved Nomination	Budget Time Estimate May 1999
General government sector deficit	-15135	-23035
PTE sector net financing requirement	651	748
Public sector deficit	-14485	-22287
Memorandum items (a)(b)	115	34
Loan Council Allocation	-14370	-22254

(a) For the Commonwealth, memorandum items comprise the change in the net present value of operating leases (with a net present value greater than \$5 million) of departments and authorities, university borrowings, overfunding of superannuation, and an adjustment to exclude the net financing requirement of statutory marketing authorities and Telstra from the LCA.

(b) The Commonwealth does not expect to enter into any infrastructure projects with private sector involvement in 1999-2000.