CHAPTER 8: FINANCIAL ARRANGEMENTS WITH THE COMMONWEALTH

- Gross payments from the Commonwealth to New South Wales will increase from $12,972 million in 2000-01 to $14,413 million in 2001-02.

- The Commonwealth's upward revision in the GST revenue collection estimate for 2000-01 did not benefit New South Wales. It is exactly offset by a reduction in Budget Balancing Assistance payments from the Commonwealth.

- The New South Wales Budget is not expected to see net gains from GST revenue until 2007-08.

- In 2001-02 New South Wales will receive $8,487 million in GST revenue grants (out of a total of $28 billion for all States). This is $110m less than would have been received had the Commonwealth Grants Commission's 2001 Update report not recommended a reduction in New South Wales' share of Commonwealth grants.

- New South Wales will receive $940 million in Budget Balancing Assistance in 2001-02, out of an estimated total of $1,853 million for all States. This is required to compensate New South Wales for the State budgetary losses resulting from tax reform. The disproportionate share of the total reflects the disproportionate share of the losses borne by New South Wales.

- The new Commonwealth-State funding arrangements leave in place the New South Wales cross-subsidy to other States under horizontal fiscal equalisation. The new arrangements also considerably increase the problem of vertical fiscal imbalance because the GST is a Commonwealth tax.

- Total Specific Purpose Payments to New South Wales will increase by 4.3 percent to $4,751 million in 2001-02. Total General Purpose Payments will be $9,661 million, an increase of 14.8 percent largely due to Commonwealth compensation for the abolition of FID and stamp duty on marketable securities under the Intergovernmental Agreement.

- Estimates used in this chapter are the latest available at the time of finalising these Budget papers. The estimates may have been subsequently revised in the Commonwealth Budget, released on 22 May 2001.

8.1 INTRODUCTION

The *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (the IGA), signed in June 1999, established new Commonwealth-State financial arrangements. The first year of these new arrangements was 2000-01.

Under these new arrangements, the Commonwealth pays the revenue raised from the Goods and Services Tax (GST) to the States and Territories. In return, States and Territories agreed to forgo Financial Assistance Grants from the Commonwealth, abolish a number of their own taxes and to take on additional expenditure responsibilities. The New South Wales Budget is not expected to gain from these new arrangements until 2007-08.

Although the new arrangements give States access to revenue from a broad-based tax, they also:

- exacerbate the problem of vertical fiscal imbalance (VFI, that is, the mismatch between Commonwealth and State tax powers and expenditure responsibilities); and

- continue the practice of horizontal fiscal equalisation (HFE), whereby the Commonwealth Grants Commission recommends the transfer of over $2 billion annually from donor States (New South Wales, Victoria and Western Australia) to other States and Territories.

This chapter outlines the operation of the new financial arrangements and their effect on New South Wales' finances in 2000-01 and 2001-02, and examines key developments and prospects in relation to Commonwealth-State financial relations.

8.2 RECENT DEVELOPMENTS

NATIONAL TAX REFORM – FINANCIAL EFFECTS

A key feature of the reformed tax arrangements is that States must forgo a number of their own revenue sources, and take on additional expenditure responsibilities, in order to receive the GST revenue from the Commonwealth. On current estimates, the costs to New South Wales of the forgone revenue and new responsibilities will exceed the revenue from the GST in each of the first seven years.

The shortfall in GST revenue below the costs to New South Wales will be funded by the Commonwealth, which agreed to ensure that no State would be worse off under the new arrangements.

The Commonwealth's guarantee that States will be no worse off means that during the transition period the Commonwealth must make payments of Budget Balancing Assistance (BBA) to the States. The BBA payments are calculated as the difference between what States would have received under the old arrangements and the GST revenue they receive under the new arrangements.

Table 8.1 shows all the expected effects of tax reform on the New South Wales Budget encompassed by the IGA, including the aggregate losses and gains, and the net shortfall. The net shortfall is the amount that is covered by BBA payments.

There are no net gains to the New South Wales Budget from tax reform expected until 2007-08. In the absence of Commonwealth transitional assistance, the New South Wales Budget would be worse off by about $3.8 billion in total over the next seven years. On current estimates, only Queensland is expected to begin to benefit from the new arrangements within the first three years.

The estimates are based on assumptions agreed between the Commonwealth and States for the purposes of calculating the BBA payments to the States. They assume for working purposes that all States that have not already done so will abolish debits tax from 1 July 2005. New South Wales' decision to abolish debits tax from 1 January 2002 has been made conditional on the Commonwealth's guarantee that New South Wales' compensation under the IGA will not be adversely affected. These estimates are broadly indicative only, and are subject to continuous revision.

Table 8.1: Estimated Financial Impact of National Tax Reform on the NSW Budget, 2000-01 to 2007-08

Year ended 30 June	*2001 $m*	*2002 $m*	*2003 $m*	*2004 $m*	*2005 $m*	*2006 $m*	*2007 $m*	*2008 $m*
Losses								
Revenue Forgone								
Financial Assistance Grants	5,211	5,283	5,289	5,324	5,445	5,587	5,777	5,962
Gross Safety-Net Revenue	2,140	2,361	2,455	2,552	2,653	2,759	2,869	2,985
State taxes abolished	72	1,034	1,163	1,226	1,292	1,688	1,797	1,882
Reduction in gambling taxation	480	572	599	617	639	673	699	725
Loss of Interest Income	3	3	4	…	…	…	…	…
WST Equivalents	38	38	38	…	…	…	…	…
Additional Expenditures								
First Home Owners' Scheme	297	312	318	325	331	338	344	351
GST Administration Costs	335	174	126	124	122	120	119	117
Total Losses	**8,577**	**9,778**	**9,992**	**10,168**	**10,482**	**11,165**	**11,605**	**12,022**
Gains								
Additional Revenue								
GST Revenue	7,863	8,487	8,677	9,074	9,623	10,281	10,927	11,606
Growth Dividend - State Taxes	42	57	77	99	123	149	177	206
Reduced Expenditures								
Off-road Diesel Subsidies	120	137	145	152	160	169	178	188
Savings from Tax Reform	147	157	168	179	191	204	218	233
Total Gains	**8,173**	**8,838**	**9,067**	**9,505**	**10,097**	**10,803**	**11,499**	**12,232**
SHORTFALL	**404**	**940**	**924**	**663**	**385**	**362**	**106**	**- 211**

2000-01 – The First Year

In the first year of the IGA, New South Wales is now expected to receive $7,863m in GST revenue and $404m in BBA payments. This year saw the abolition of the Accommodation Levy on 1 July 2000. States also commenced payment of First Home Owners Scheme Grants of $7000 to compensate homebuyers for the effects of the GST and payments to the Commonwealth to fund the administration of the GST by the Australian Taxation Office (ATO).

The amount of BBA to be received by New South Wales in 2000-01 is estimated to be $578m less than the original 2000-01 Budget estimate of $982m. This change is driven primarily by an increase of $683m in estimated GST revenue, partially offset by an increase in the ATO's GST administration costs. Since neither of these changes affects what New South Wales would have received under the old system of Commonwealth-State financial relations, they do not affect the total grants received from the Commonwealth.

The Commonwealth's guarantee that States will be no worse off under tax reform means that States are protected from any increase in the costs of their new expenditure responsibilities, and from any reduction in GST revenue. However it also means that States do not benefit from the Commonwealth's upward revision of estimated GST revenue in 2000-01. The Commonwealth receives this benefit, in the form of reduced BBA payments required to States.

2001-02 – The Second Year

Consistent with the IGA, FID and stamp duty on marketable securities will be abolished from 1 July 2001. This additional revenue forgone is the main reason for the $536m increase in the BBA payment to New South Wales in 2001-02.

GST collections across the whole of Australia are estimated by the Commonwealth to total about $28 billion in 2001-02. But revenue forgone by the States, and their additional expenditure responsibilities, are estimated to cost $30 billion. Additional funding will be provided by the Commonwealth to cover this $2 billion gap. However, according to the agreed estimates, no State will see any immediate benefit to their budget bottom line.

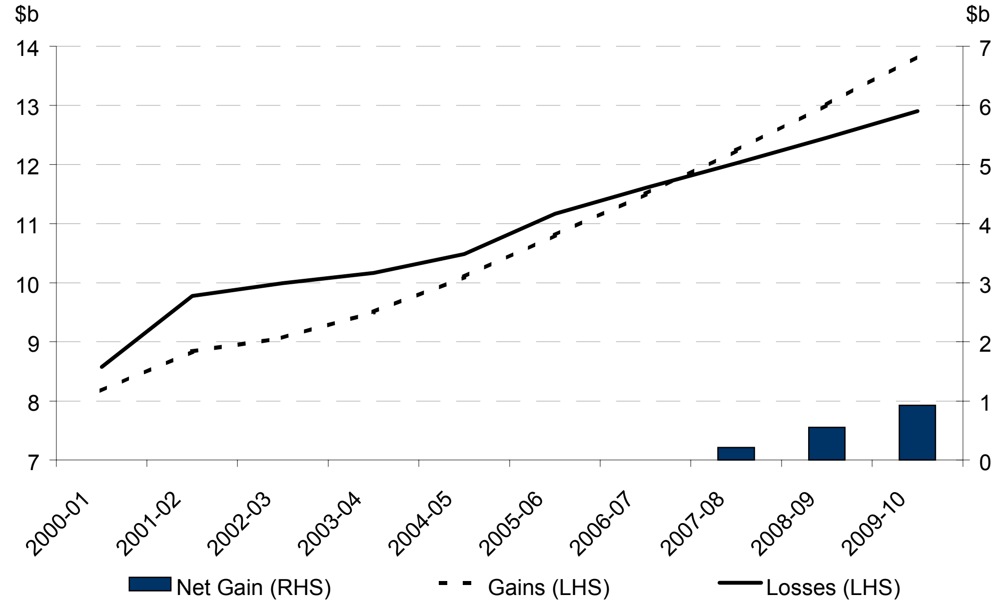
Longer Term Outlook

As noted above, the States have a guarantee that they will be no worse off financially under tax reform. As a result, the Commonwealth bears all of the risk associated with any downward revision of GST revenue collections, but is the first beneficiary of any increase in collections. The New South Wales Budget is not expected to gain from tax reform for the entire Budget forward estimates period. There is no scope to apply the GST revenue towards reducing State taxes or to fund increases in outlays.

GST revenue will grow in the years ahead as the economy grows, but so too will the revenue forgone and additional expenses charged to the States. Eventually the GST revenue should exceed what the States are giving up, but at the moment in New South Wales' case that is not expected to be until 2007-08. It is only when that occurs that New South Wales will be in a position to gain any additional budgetary flexibility from growth in GST revenue.

Chart 8.1 shows the estimated losses and gains from tax reform for the New South Wales Budget until 2009-10.

Chart 8.1: Overall Effects of Tax Reform on the NSW Budget, 2000-01 to 2009-10



LOSS OF $110 MILLION DUE TO COMMONWEALTH GRANTS COMMISSION 2001 UPDATE

The reforms described above are revenue neutral for New South Wales. However, the latest Commonwealth Grants Commission recommendations will redistribute $110.3 million in revenue from New South Wales to other States in 2001-02.

The Commonwealth Grants Commission (the Commission) recommends to the Commonwealth Treasurer the appropriate distribution of GST revenue amongst the States. These recommendations are in the form of 'relativities', which describe the ratio of per capita revenue that each State will receive compared with the Australian average. The Commission bases its recommendations on its interpretation of the principle of horizontal fiscal equalisation (HFE) and on the terms of reference provided to it by the Commonwealth.

The Commission also advises States and the Commonwealth what its recommendations would have been under the old system of Financial Assistance Grants (FAGs), which existed before the GST was introduced. The Commonwealth has guaranteed that the States will be at least as well off as they would have been if the FAGs scheme had continued. As a result, changes in the FAGs-based recommendations affect the Guaranteed Minimum Amount that the Commonwealth has promised, since they affect what New South Wales would have received under the old FAGs system.

The Commission bases its recommendations on a complex revenue and expenditure model. The assumptions underlying this model are revised every five years, with the next Review due to be completed in 2004. The model is also updated annually to take account of the most recent data. The Commission released the most recent Update Report in February 2001. Its recommendations were accepted by the Commonwealth at the Annual Treasurers' Conference meeting in March 2001, subject to clarification of a data related issue identified by Western Australia.

Features of the 2001 Update include:

- A loss of $110.3 million for New South Wales due to changes in the FAGs relativities. Households and families in New South Wales will receive $110.3 million less in 2001-02 than if the previous year's FAGs relativities had continued to apply. This change does not affect New South Wales' share of GST revenue but it reduces the amount of BBA paid under the Commonwealth's guarantee.

- A change to the treatment of the superannuation expense category, involving the adoption of a hybrid cash and accrual measure to account for accrued unfunded liabilities. New South Wales argued against this change because it equalises expenses that have been incurred in the past, double counts disabilities which have already been assessed in previous years and rewards those States that have not addressed their unfunded liabilities. This change caused about $23.5 million of the $110.3 million loss to New South Wales.

- Continued cross subsidies from New South Wales, Victoria and Western Australia to the other States. In 2001-02 New South Wales will receive $1.7 billion less in GST revenue than is generated by its residents. New South Wales will receive only 30.3 percent of total Australia-wide GST revenue, while it will generate an estimated 36 percent of total GST paid Australia-wide.

- Incorrect data relating to stamp duty in Western Australia. If the original recommendations had been allowed to stand, Western Australia would have been underpaid by $41.7 million in 2001-02 because data supplied by Western Australia overstated the capacity of that State to collect stamp duty levied on corporate reconstructions. The Commission has revised the relativities to rectify this error, which caused the loss to New South Wales to increase by $17.7 million, from $92.6m in the original report to $110.3 million.

- A reliance on poor quality data for the calculations in the report. This is due to the Commission requiring accrual expenditure data to a higher level of detail than States are able to provide. The Commission has frequently been forced to estimate data itself, since States' budgeting systems do not produce all the figures that the Commission's processes require.

COMPOSITION OF COMMONWEALTH GRANTS TO NEW SOUTH WALES

The following table shows the composition of Commonwealth grants to New South Wales.

Table 8.2: Commonwealth Payments to New South Wales, 1999-2000 to 2004-05

Year ended 30 June	*2000 $m*	*2001 $m*	*2002 $m*	*2003 $m*	*2004 $m*	*2005 $m*
General Purpose Payments						
FAGs	5,034	…	…	…	…	…
GST Revenue	…	7,863	8,487	8,677	9,074	9,623
BBA	…	404	940	924	663	385
Other general purpose payments	149	152	234	239	245	251
Total general purpose payments	**5,183**	**8,419**	**9,661**	**9,841**	**9,982**	**10,258**
SPPs	4,278	4,554	4,751	4,951	4,998	5,187
GROSS PAYMENTS	**9,460**	**12,972**	**14,413**	**14,792**	**14,980**	**15,447**

As shown in Table 8.2, Commonwealth grants can be divided into two broad categories, namely general purpose payments and specific purpose payments. General purpose payments are untied funds that States are free to spend in the same manner as own-source revenues. Specific purpose payments consist of funds that must be spent as the Commonwealth directs. They typically have stringent conditions on their use, and often require States to contribute a matching amount of their own funds towards the specified purpose.

General Purpose Payments

GST Revenue grants are the single largest component of general purpose payments. GST Revenue Grants in 2001-02 will amount to $28,029 million for all States and $8,487 million for New South Wales. The remainder of general purpose payments to New South Wales consists of BBA of $940 million and competition payments totalling $234 million.

Under the *Agreement to Implement the National Competition Policy and Related Reforms*, signed by States and the Commonwealth in April 1995, States receive competition payments from the Commonwealth. The first tranche of these payments, with a total value of $200m in 1994-95 prices, commenced in 1997-98. These annual payments doubled in value in the second tranche in 1999-2000, to $400m in 1994-95 prices. The third tranche is scheduled to commence in July 2001, with a total annual value of $600 million in 1994-95 prices. The Agreement specifies that the payments are made quarterly and are distributed to the States on an equal per capita basis.

Each State's share of the payments is conditional on satisfactory progress in implementing the reforms specified in the Agreement. The National Competition Council assesses progress. New South Wales has been assessed as having complied with the Agreement in each of the past four years. At this stage, New South Wales can foresee no constraints to receiving its full competition payment in 2001-02.

Specific Purpose Payments

In 2000-01, the Commonwealth complied with its commitment in the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (the IGA) not to cut Specific Purpose Payments (SPPs).

Total SPPs "to" New South Wales are expected to increase by 4.3 percent in 2001-02 following an increase of 6.5 percent in the previous year.[1] Total SPPs for New South Wales (including SPPs both "to" and "through" New South Wales) are expected to increase by 4.8 percent in 2001-02 following an increase of 7.6 percent in the previous year.

State Treasuries have worked closely with the Commonwealth throughout the year to improve the exchange of information between all parties and facilitate the process of future SPP reform. Significant achievements have been the development of a database of SPP information, the formulation of 'best practice' principles and guidelines for SPP agreements, and a pilot project to promote outcomes-based SPP agreements.

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[1] *SPPs "to" the State are payments made directly to the State. SPPs "through" the State are payments that must be passed on to local governments, other bodies and individuals.*

The development of the SPP database is significant because it brings together detailed financial and descriptive data on all SPPs for the first time. The benefits of using the SPP database will flow to both the Commonwealth and the States. The main benefit for the States of using the database is that it will assist them in monitoring the Commonwealth's commitment not to cut SPPs.

The 'best practice' principles and guidelines are designed to provide SPP negotiators in the Commonwealth and all States with practical advice about the desirable features of good SPP agreements. The guidelines are important because they change the focus of SPP agreements from the amount of money being spent, ie. inputs, to service delivery outcomes. The States benefit from an approach based on outcomes because it gives them more of an incentive to achieve efficiency savings and also more flexibility to apply such savings to other areas of need.

The aim of the pilot project is to promote SPP agreements based on outcomes. A project team has been established, consisting of Victoria, South Australia, and the Commonwealth, which is examining the existing Supported Accommodation Assistance Program (SAAP) agreement to determine the extent to which it conforms to the SPP 'best practice' principles and guidelines. The project team is also working towards developing alternative outcome measures, restating the reporting requirements of the agreement using the outcome measures, and seeking to identify any costs or risks associated with the outcome approach.

8.3 THE TASKS AHEAD

Major challenges over the coming year are to finalise the remaining tasks associated with national tax reform and to continue to seek changes in the levels of vertical fiscal imbalance and horizontal fiscal equalisation in Australia.

NATIONAL TAX REFORM

The States and Territories are required to pay the Australian Taxation Office (ATO) for the costs of collecting and administering the GST. An interim performance agreement to cover this arrangement has been negotiated between the States and the ATO. This interim agreement sets out a process for the States to approve the ATO's GST administration plan and budget. It also specifies performance indicators, audit arrangements and the provision of annual data to the States.

The interim agreement will assist the monitoring of the ATO during 2001-02, and allow a trial of the arrangements for the final agreement. The final agreement is expected to contain a more robust set of performance indicators, and to establish a clear framework for the ATO to attribute its costs. The final performance agreement is due to take effect on 1 July 2002.

In the longer term, the IGA specifies that all States that have not already done so will cease to apply debits tax by 1 July 2005, subject to review by the Treasurers' Conference. In addition, a number of stamp duties will be reviewed as part of national tax reform, to assess whether they should be retained. This review is scheduled to occur by 2005.

VERTICAL FISCAL IMBALANCE

Vertical fiscal imbalance (VFI) refers to the mismatch between revenue capacity and spending responsibilities of different levels of government. Australian State governments have access to only a small number of taxes, and are forced to rely on grants from the Commonwealth to be able to fund their expenditure responsibilities. On the other hand, the Commonwealth Government collects significantly more revenue than it needs for its own purposes.

Table 8.3: Ratio of Share of Own-source Tax Revenue to Share of Own-purpose Outlays, 1999-2000 to 2001-02

	1999-2000	*2000-01*	*2001-02*
Commonwealth	1.41	1.44	1.46
States	0.42	0.32	0.28
Local Government	0.68	0.66	0.63

Sources: Commonwealth and State Budget Papers, various years; ABS Cat 5501.0, various years; NSW Treasury estimates.

The Effect of Tax Reform on Vertical Fiscal Imbalance

The introduction of the GST has worsened VFI. In order to receive GST revenue, the States were required to abolish a number of their own taxes. Whilst the Commonwealth will compensate States for this lost revenue, the States are now dependent on the Commonwealth for these funds rather than on their own revenue bases. Commonwealth grants now account for close to 40 percent of aggregate State revenues, compared with slightly over one third before the introduction of the GST.

Although the Commonwealth has agreed to provide all GST revenue to the States, this agreement is not a legally enforceable document. The Commonwealth has the constitutional power to unilaterally change the GST rate or the base without consulting the States. The Commonwealth also has the power to veto any changes proposed by the States. Nonetheless, the States must pay the Commonwealth for the costs of administering and collecting the GST.

Effects of Vertical Fiscal Imbalance

VFI undermines governmental accountability for taxing and spending decisions because governments that seek to adopt policies relating to service provision are not necessarily responsible for actually delivering the service. This results in costly duplication and overlap of services and encourages cost shifting between levels of government.

VFI also restricts States' ability to respond to community needs in a timely and effective manner. Commonwealth conditions on specific purpose payments (SPPs) create obstacles to flexible service delivery. For example, the Commonwealth may set conditions that require services to be delivered in a particular way, at a particular price or to a particular group of people. This can lead to implicit rationing and under- or over-utilisation of some services, which can reduce allocative efficiency.

Many SPP agreements require States to contribute a matching amount of State own-source revenue to the service delivery. These matching requirements reduce States' ability to fund their own policy priorities and produce a bias to over-expenditure in some areas. Matching requirements focus on the amount spent on the provision of a service, rather than the level of service actually delivered. This is a disincentive to eliminating waste and inefficiency.

Similarly, reporting requirements for Commonwealth SPPs tend to be structured to meet the Commonwealth's need for information rather than to measure the efficiency or effectiveness of service delivery. Continued payment of the SPPs is typically conditional on States spending the whole amount of the grant, rather than being conditional on the delivery of services or the achievement of outcomes.

Historically, VFI has also been a disincentive to the pursuit of microeconomic reform. This has occurred because States must bear most of the costs of undertaking reform, whereas the increased revenue that results from these reforms generally accrues to the Commonwealth.

The VFI problem could be remedied through a redistribution of either taxation powers or expenditure responsibilities. New South Wales remains open to pursuing such options in future, in cooperation with the Commonwealth and other States.

HORIZONTAL FISCAL EQUALISATION

The Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations states:

"The Commonwealth will distribute GST revenue grants among the States and Territories in accordance with horizontal fiscal equalisation (HFE) principles." (IGA, clause 8)

Historically, the Commonwealth Treasurer has accepted the recommendations of the Commonwealth Grants Commission in this respect. The Commission applies HFE principles in such a way that New South Wales, Victoria and Western Australia provide subsidies, not only to financially weaker States such as South Australia, Tasmania and the Northern Territory, but also to the stronger States of Queensland and the Australian Capital Territory.

The average GST revenue grant in 2001-02 for New South Wales, Victoria and Western Australia (the donor States) in 2001-02 will be $1,283 per head, compared with an average of $1,776 for the other jurisdictions. In per capita terms Queensland will receive 13 percent more than the donor State average, whilst the Northern Territory will receive 429 percent more.

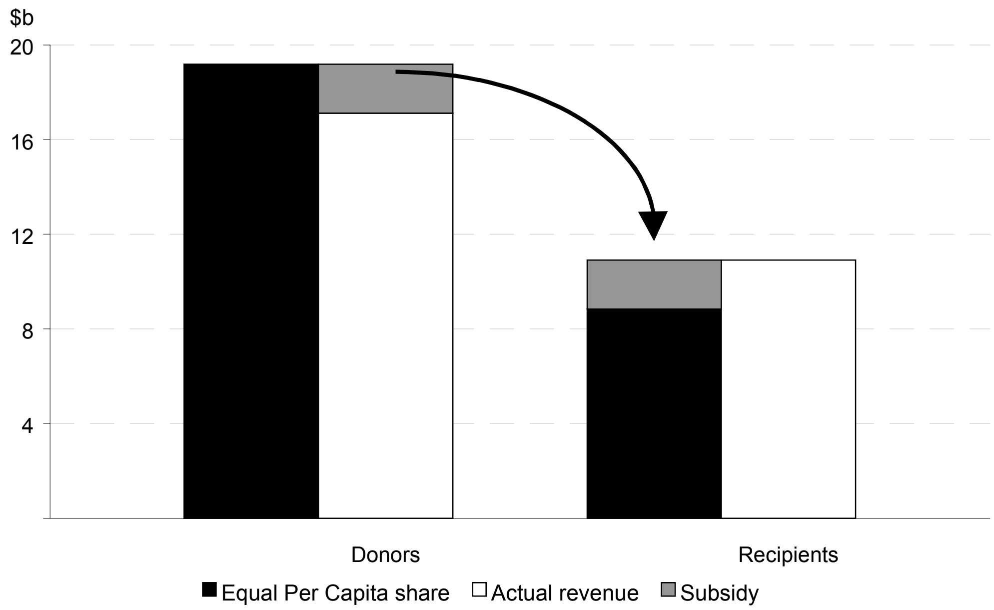
New South Wales' GST revenue grants in 2001-02 will be $1,293 per capita or about 27 percent less than the average of the five recipient States. States' estimated per capita GST revenue grants for 2001-02 are shown in Table 8.4.

Table 8.4: GST Revenue Grants Per Capita by State, 2001-02

State/Territory	*GST Revenue Grants (In $ per capita)*
New South Wales	1,293
Victoria	1,223
Queensland	1,450
Western Australia	1,401
South Australia	1,722
Tasmania	2,359
Australian Capital Territory	1,770
Northern Territory	6,781
Average, 3 donor States	**1,283**
Average, 5 recipient States	**1,776**
AUSTRALIAN AVERAGE	**1,439**

These per capita figures can be used to calculate the total subsidy paid to the recipient States. New South Wales will be transferring to other States $955 million or $145 per capita in 2001-02. The combined transfer from New South Wales, Victoria and Western Australia is estimated at about $2.1 billion.[2] The payment of this subsidy is shown in the following chart, which compares actual GST received with the benchmark of an equal per capita (EPC) share.

Chart 8.2: Actual GST Revenue Received, compared with an Equal Per Capita Share, 2001-02



The donor States of New South Wales, Victoria and Western Australian have agreed that the current system of determining the distribution of GST revenue amongst the States and Territories is no longer appropriate. In particular, the governments of Queensland and the ACT both have strong fiscal positions and a demonstrated capacity to contribute to the Federation, rather than draw on its wealth.

The donor States are commissioning a major review of the distribution of Commonwealth grants. The review will assess whether the current system: efficiently allocates resources across Australia to enhance national employment and economic growth; whether it achieves equitable outcomes for all Australians; and whether it is simple and transparent.

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[2] *The estimated cross-subsidies in this chapter may differ from those in Commonwealth Budget papers because the latter calculates the cross-subsidy based on the sum of FAGS (or GST revenue grants) and unquarantined Health Care Grants. The estimates in this chapter are based solely on FAGs (or GST revenue grants).*

An alternative method of measuring the level of transfers from donor States to recipient States is to compare the GST revenue grant distribution with the amount of GST generated by each State's residents. At this early stage of the GST there is no reliable data available on the amount of GST collected in each State. Instead, household final consumption expenditure has been used as a rough proxy[3] of interstate shares of GST revenue.

On this basis, the total transfer from donor States (New South Wales and Victoria) in 2001-02 is about $2.9 billion, of which New South Wales will contribute $1.7 billion or $252 per capita.

This means that, despite the GST being characterised by the Commonwealth as the States' tax, every person in New South Wales pays an average of $252 more GST each year than the amount that goes to the New South Wales Government. This $252 per capita goes to the governments of other States. Table 8.5 indicates the amounts expected to be transferred from donor States to recipient States in 2001-02 using the benchmarks of equal per capita (EPC) and household final consumption expenditure (HFCE).

Table 8.5: Estimates of Cross-subsidies between States, 2001-02

	RECIPIENT STATES						
	Qld *$m*	*WA* *$m*	*SA* *$m*	*Tas* *$m*	*ACT* *$m*	*NT* *$m*	*Total* *$m*
EPC Benchmark							
NSW	19	na	196	199	48	493	955
Vic	21	na	215	218	52	540	1,047
WA	1	na	15	15	4	37	72
TOTAL	**42**	**na**	**426**	**432**	**104**	**1,070**	**2,074**
HFCE Benchmark							
NSW	260	79	370	295	18	634	1,656
Vic	193	58	274	219	13	470	1,227
TOTAL	**453**	**137**	**644**	**513**	**31**	**1,104**	**2,883**
NSW PER CAPITA CONTRIBUTION (in $)							
EPC Benchmark	3	na	30	30	7	75	145
HFCE Benchmark	40	12	56	45	3	97	252

SOURCE: NSW Treasury estimates. Figures may not add due to rounding.

[3] *Household consumption is used as a benchmark here only for indicative purposes, on the premise that the GST is a tax on consumption and not on investment, production or transfers. Estimates of household consumption have been adjusted to remove expenditure on food, health and education services, as these are largely GST free, in an effort to more closely approximate the GST revenue base.*

Commonwealth Grants Commission 2004 Review

The other major opportunity for New South Wales to reduce the size of the subsidy it pays to other States is through convincing the Commonwealth Grants Commission (the Commission) to change its methods of calculating interstate relativities. The Commission will complete the next review of its assessment methods in 2004. The issues that the 2004 Review (the Review) is currently considering are Priority Issues of Principle, Depreciation and Debt Charges, and Urban Transit.

Priority Issues of Principle

The Commission will be holding a high level conference in June 2001 which will provide an opportunity for the Commissioners and the Heads of Treasuries to discuss priority issues of principle. The Commission originally proposed three issues for consideration at the conference, namely:

- Increasing simplicity in the HFE process. The Commission has proposed options for simplifying the methods of assessing the States' expenditure and revenue needs, in order to reduce the cost and effort of fiscal equalisation. New South Wales believes that this is an important issue for all States and is keen to see the current processes significantly simplified.

- State policies and disabilities. The States are concerned that the Commission's methods do not adequately distinguish between policy and disability influences on State revenues and expenditures. The Commission has proposed to address this on a case-by-case basis within the normal processes of the Review rather than by making wholesale changes to its methods. New South Wales believes that this is the most contentious of the priority issues and that the long-term effects of the Commission's assessments should be further explored.

- Impact of changes in public administration. Changes in public administration flow from micro-economic reform, national competition policy, and technological advances. The Commission has researched whether its current methods for assessing the needs of the States take into account the prospective major changes in public administration. The Commission believes that its current assessment methods and the normal processes of the Review will be able to take the changes into account. New South Wales and other States agree with the Commission in this regard.

Depreciation and Debt Charges Assessments

The Commission is reviewing its current assessment of the expenditure categories that are related to capital. These are the depreciation category and the debt charges category. The Commission is attempting to undertake a practical review of the existing theoretical approach to the depreciation and debt charges assessments.

The Commission is currently considering submissions by the States on the issue and will continue to consult with the States before making a decision in December 2002.

Urban Transit Assessment

The Commission is considering whether to adopt an assessment that recognises that public transport services can be viably provided by the private sector, as long as the costs of providing concession fares are recognised. New South Wales' longstanding position is that equalisation should not apply to privately provided goods and services, nor to the privately funded component of publicly provided goods.

The direction of the Commission's research is consistent with the position of New South Wales. For bus services in particular, there are a number of private sector providers. The Commission should not be seeking to equalise services that are provided in a private market.

The Commission is currently preparing a data request that will seek to establish the degree of private involvement in public transport in the States and Territories. This will be followed by a discussion paper and consultation with the States before a final decision in December 2002.