

CHAPTER 7: FINANCIAL ARRANGEMENTS WITH THE COMMONWEALTH

- ◆ At the 2002 Treasurers' Conference, the Commonwealth advised it had made a unilateral decision to change the arrangements for calculating payments of transitional assistance to the States. This decision will cost New South Wales \$43 million in 2002-03 and \$416 million over the period to 2006-07.
- ◆ The changed arrangements will impose a net cost on New South Wales from tax reform. New South Wales is disproportionately affected by the change, bearing almost half the total cost to the States. The shortfall in Commonwealth payments will delay by one year – from 2007-08 to 2008-09 – the time when the NSW Budget is expected to obtain net gains from GST revenue.
- ◆ New South Wales' share of Commonwealth grants will be reduced by \$203 million in 2002-03 as a result of the Commonwealth Grants Commission's recommended relativities. Compared with an equal per capita distribution of GST revenue grants, the revised relativities increase the cross-subsidy from New South Wales to recipient States to \$1.2 billion in 2002-03.
- ◆ The Commonwealth and the States agreed to national arrangements to subsidise low alcohol beer relative to full strength beer, in place of existing State subsidies.
- ◆ The NSW Government continues to argue for reform of the current system for allocating Commonwealth funding to the States. In 2001-02, the State joined with Victoria and Western Australia in commissioning an independent review of the allocation of Commonwealth grants to the States and Territories.
 - Research commissioned by the Review has shown that the current arrangements for allocating funding among the States fail to achieve improved equity between individuals in different States and that annual gains of up to \$250 million a year could be achieved through reforming the arrangements to promote greater economic efficiency.
 - The NSW submission to the Review argues that reforms to the current arrangements should provide more certainty and transparency and outcomes better supported by evidence with less reliance on judgement. The reformed arrangements should pay greater attention to the efficiency implications of the distribution of Commonwealth grants and impose a lower burden on donor States, by focusing on assisting States with clear natural disadvantages.

7.1 INTRODUCTION

The NSW Government is dependent on Commonwealth grants for half its revenue (see 3.4 for details of Commonwealth payments to the States). Consequently, financial relations with the Commonwealth are a key factor influencing the financial position of the State.

This chapter explains the financial arrangements between the Commonwealth and the States including key recent developments. Section 7.2 discusses the current framework for Commonwealth-State financial relations following the agreement of the States to implement taxation reform in exchange for the receipt of GST revenue.

Section 7.3 discusses the outcomes of the March 2002 Treasurers' Conference and the current estimate of the net impact of national taxation reform on the State budget. This section explains why New South Wales is not expected to receive net financial benefits from the reforms until 2008-09.

Section 7.4 outlines the arrangements for allocating Commonwealth funding to the States, and the outcome of the 2002 update of Commonwealth Grants Commission relativities, which will reduce New South Wales' share of Commonwealth funding.

The current arrangements for allocating Commonwealth funding among the States has long been a concern for New South Wales. To raise public awareness of the adverse implications of these arrangements, New South Wales, Victoria and Western Australia commissioned an independent review of this issue by respected economists Ross Garnaut and Vince FitzGerald. This review is discussed in Section 7.5.

7.2 COMMONWEALTH-STATE FINANCIAL ARRANGEMENTS

The current Commonwealth-State financial arrangements were set in place by the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (the Agreement), signed in June 1999. The arrangements took effect from 2000-01.

Under the Agreement, the Commonwealth agreed to pay the States all GST revenue. In exchange, the States agreed to:

- ◆ abolish some taxes (including financial institutions duty and stamp duty on quoted marketable securities);

- ◆ forgo a number of Commonwealth grants, including financial assistance grants and revenue replacement payments¹; and
- ◆ take on additional expenditure responsibilities including the payment of Australian Tax Office (ATO) GST administration costs and the first home owners scheme.

Initially, the GST revenue will not be sufficient to offset the abolished revenue sources and additional State costs. A key feature of the agreement was the Commonwealth's commitment that no State would be worse off under the new arrangements. To ensure no State was disadvantaged, the Commonwealth agreed to pay transitional assistance (termed budget balancing assistance) to make up any shortfall in GST revenue relative to estimates of the revenue forgone and additional expenses taken on.

In recognition of the difficulty in determining whether the States are made worse off by taxation reform – which involves estimating each State's financial position in the absence of reform – a methodology paper was agreed setting out the way in which transitional assistance was to be calculated.

While the Agreement offered no immediate financial benefits, GST revenue grants are expected to grow more quickly over time than the revenue sources they have replaced. This more rapid growth is expected to deliver an improvement in State finances over time. In the interim, the Agreement appeared to provide more certain financial arrangements including a guarantee that no State would be worse off from the reforms.

ADMINISTRATIVE ARRANGEMENTS

The Agreement established a number of new administrative arrangements and forums for dealing with Commonwealth-State financial arrangements.

A Ministerial Council of Commonwealth and State Treasurers (the Treasurers' Conference) was established to oversight the operation of the GST and the implementation of the Agreement.

¹ Revenue replacement payments were paid by the Commonwealth following the 1997 decision of the High Court that effectively invalidated State Business Franchise Licence Fees. The Commonwealth funded the payments through higher Commonwealth excise rates and to ensure there was no net increase in taxation State subsidies were introduced where necessary (ie where the additional uniform excise rate applied by the Commonwealth was above the rate formerly applied by a State).

The Agreement also established the GST Administration Sub-Committee (GSTAS), composed of senior Commonwealth and State officials. GSTAS reports to Commonwealth and State Treasurers. Its role is to monitor the operation of the GST, assess proposals for the modification of the GST and monitor the performance of the ATO in GST administration.

In recognition of the role of the States in funding the administration of the GST, GSTAS developed a performance agreement with the ATO. The performance agreement sets out the arrangements for determining the ATO's GST administration budget and specifies performance indicators, audit arrangements and arrangements for the provision of GST collection data to the States. The performance agreement was signed by State and Territory Treasurers and the Commissioner of Taxation in March 2002, and will take effect on 1 July 2002. The performance agreement replaces the current interim agreement.

2005 REVIEW OF STATE TAXES

In addition to the taxes already abolished, the Agreement specifies that all States will abolish Debits Tax by 1 July 2005, subject to review by the Treasurers' Conference. Of the States, New South Wales alone has acted independently and abolished this tax from 1 January 2002 – three and a half years in advance of its scheduled abolition.

The Agreement also stipulates that, by 2005, the following stamp duties will be reviewed to assess whether they should be retained: stamp duty on non-residential conveyances; on leases; on mortgages, debentures, bonds and other loan securities; on credit arrangements, instalment purchase arrangements and rental arrangements; on cheques, bills of exchange, promissory notes; and on unquoted marketable securities.

7.3 2002 TREASURERS' CONFERENCE OUTCOME

At the Treasurers' Conference, held on 22 March 2002:

- ◆ the Commonwealth advised of changed arrangements for the payment of transitional assistance;
- ◆ the Commonwealth confirmed the inter-State distribution of GST revenue grants would be based on the relativities recommended by the Commonwealth Grants Commission (see Section 7.4); and
- ◆ the Treasurers agreed new arrangements for subsidising low alcohol beer relative to full strength beer.

Table 7.1 shows that New South Wales has incurred substantially higher costs from the agreed reforms than the GST grants provided by the Commonwealth. Over the first two years of the Agreement this net cost has been fully offset by Commonwealth transitional assistance, leaving the State no worse off from the reforms.

Prior to the 2002 Treasurers' Conference, New South Wales was expected to commence receiving net financial benefits from taxation reform by 2007-08. However, at the 2002 Treasurers' Conference the Commonwealth advised its decision to override agreed arrangements for calculating payments of transitional assistance.

As a consequence, New South Wales will face a net cost from the revised financial arrangements in each year from 2002-03 to 2006-07. The cost to NSW is \$43 million in 2002-03 and \$416 million over the period to 2006-07. The new arrangements will have a proportionately larger impact on New South Wales than on any other State, largely because New South Wales will remain in receipt of transitional assistance for a longer period than most other States. New South Wales is bearing almost half the total cost of this decision.

The Commonwealth's change to the arrangements for calculating payments of transitional assistance to the States is inconsistent with the intent of the Agreement – which was based on the principle that the States should be no worse off from implementing taxation reform – and the letter of the agreed methodology for estimating transitional assistance.

- ◆ The change to the calculation of transitional assistance to the States involves varying the way in which revenue forgone by the States is calculated in relation to petroleum franchise fee revenue replacement payments. Prior to taxation reform, these revenue replacement payments were paid by the Commonwealth following a High Court decision that such State fees were unconstitutional.
- ◆ At the Treasurers' Conference, the Commonwealth advised the States that it would no longer include CPI indexation in the calculation of the value of petroleum revenue replacement payments forgone as specified by the agreed methodology.
- ◆ In doing so, the Commonwealth linked its decision to override the agreed methodology to its decision to cease indexation of petroleum excise rates to the CPI from March 2001. However, the agreed arrangements stipulate CPI indexation consistent with past State government practice. Under the Agreement there is no link between Commonwealth excise revenue and the States' entitlement to transitional assistance in respect of petroleum business franchise fees.

Table 7.1: Estimated Financial Impact of National Tax Reform on the New South Wales Budget, 2000-01 to 2008-09

Year ended 30 June	2001 \$m	2002 \$m	2003 \$m	2004 \$m	2005 \$m	2006 \$m	2007 \$m	2008 \$m	2009 \$m
Losses									
Revenue Forgone									
Financial Assistance Grants	5,224	5,341	5,337	5,395	5,542	5,723	5,950	6,158	6,355
Gross Safety-Net Revenue ^(a)	2,135	2,388	2,487	2,576	2,671	2,759	2,850	2,781	2,856
State taxes abolished	72	1,035	1,155	1,217	1,281	1,675	1,786	1,875	1,961
Reduction in gambling taxation	476	558	581	599	621	652	685	719	755
Loss of Interest Income	3	3	4						
WST Equivalents	38	38	38						
Additional Expenditures									
First Home Owners Scheme ^(b)	307	438	294	298	303	308	313	318	323
Additional First Home Owners Scheme	7								
GST Administration Costs	335	174	188	192	195	199	204	208	212
Total Losses	8,597	9,975	10,084	10,277	10,613	11,316	11,788	12,059	12,462
Gains									
Additional Revenue									
GST Revenue	7,258	8,134	8,718	9,140	9,650	10,295	10,929	11,572	12,240
Growth Dividend - State Taxes	42	57	77	99	123	149	177	206	237
Reduced Expenditures									
Off-road Diesel Subsidies ^(a)	119	137	144	150	156	162	164	147	149
Savings from Tax Reform	147	157	168	179	191	204	218	233	248
Beer Subsidy Scheme Deduction			25	25	26	27	27	28	29
Total Gains	7,566	8,485	9,132	9,593	10,146	10,837	11,515	12,186	12,903
Net Losses/Gains	(1,031)	(1,490)	(952)	(684)	(467)	(479)	(273)	127	441
Commonwealth Transitional Assistance ^(c)									
	1,007	1,515	910	621	380	377	151
SHORTFALL/GAIN FOR NSW BUDGET	^(d)	^(d)	(43)	(63)	(86)	(102)	(122)	127	441
CUMULATIVE SHORTFALL/GAIN	(43)	(106)	(192)	(294)	(416)	(289)	152

(a) The Commonwealth's changed arrangements for determining revenue replacement payments will impact on NSW between 2002-03 and 2006-07; however, the estimates shown here include the State's entitlement to indexation in these years consistent with the agreed methodology referred to in the Intergovernmental Agreement.

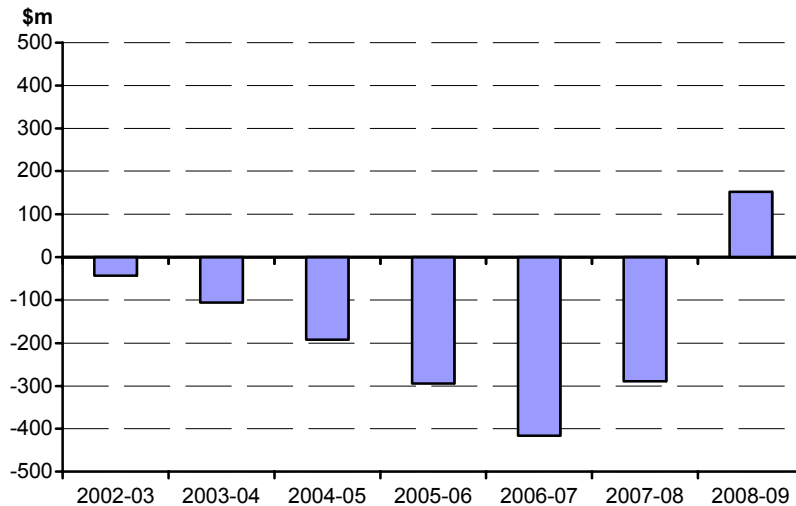
(b) Amounts shown for the First Home Owners Scheme for 2002-03 onwards are internal NSW Treasury estimates, not Commonwealth Treasury estimates.

(c) Amounts shown are based on the methodology imposed by the Commonwealth.

(d) Under the guarantee provisions of the Intergovernmental Agreement, the Commonwealth payments are intended to ensure no State is worse off as a result of the agreed tax reforms. The \$25 million difference between the \$1,031 million that New South Wales was entitled to in 2000-01 and the \$1,007 million that New South Wales was actually paid is reimbursed by the Commonwealth in 2001-02.

- ◆ The Commonwealth's decision to link the change in transitional assistance to its decision to abolish excise indexation is also inexplicable, given the Commonwealth's decision to abolish excise indexation was taken a year earlier and at that time no change was made to the calculation of transitional assistance.

Chart 7.1: Cumulative Shortfall / Gain From Tax Reform Arrangements for New South Wales



It is evident that the new financial arrangements with the Commonwealth have fallen short of providing the sought for increased fiscal certainty for the States. On current estimates, the Commonwealth will cease to pay transitional assistance to New South Wales from 2007-08. However, it is not until 2008-09 that the shortfall in Commonwealth funding arising from the changed methodology will be offset by GST revenue grants. Chart 7.1 shows the cumulative financial impact of the revised tax reform arrangements, including the shortfall in Commonwealth transitional assistance to New South Wales reflecting the changed Commonwealth methodology.

LOW ALCOHOL BEER

The 2002 Treasurers' Conference agreed to revised arrangements for subsidising low alcohol beer relative to full strength beer. The Conference agreed to replace existing State subsidies for low alcohol beer with a lower Commonwealth excise rate, to commence from 1 July 2002. Development of the new arrangements was an initiative of New South Wales made in the context of the transfer of responsibility for the taxation of alcohol products from the States to the Commonwealth as part of national taxation reform.

The revised arrangements will apply a lower Commonwealth excise rate to beer with 3 percent or less alcohol per volume. Providing the concession through excise rates will reduce the costs to businesses of accessing the concession while providing a more consistent national scheme. The new scheme will not affect the price of low alcohol beer in New South Wales. The States agreed to contribute to funding the national scheme in line with their current subsidy costs while they are in receipt of transitional assistance, with funding of the concession beyond this period to be the responsibility of the Commonwealth.

7.4 NEW SOUTH WALES' SHARE OF COMMONWEALTH FUNDING

GST revenue grants are allocated among the States according to the principle of horizontal fiscal equalisation (HFE). Under the current system this means that the share of funding allocated to each State is determined taking account of the perceived expenditure needs and revenue capacity of each State as estimated by the Commonwealth Grants Commission (the Commission).

COMMONWEALTH GRANTS COMMISSION 2002 UPDATE OF STATE RELATIVITIES

Each year the Commission updates its recommended distribution of Commonwealth funding to take account of changed expenditure and revenue patterns. The recommendations are in the form of 'relativities', which determine the ratio of per capita GST revenue grants that each State will receive compared with the Australian average.

The Commission released the 2002 Update Report in February 2002. The Commonwealth accepted the Commission's recommendations at the Annual Treasurers' Conference meeting in March 2002.

The Commission's 2002 relativities will reduce the funding received by New South Wales by \$203 million in 2002-03 compared with the 2001 relativities.

The reduction in funding reflects the Commission's assessment that New South Wales has increased its ability to raise State revenue relative to other States. Apart from Victoria, other States' revenue capacities generally grew much more slowly compared with New South Wales.

The Commission noted, in particular, the increased volume and value of property sales in New South Wales, which it considers has increased the capacity to generate revenue from stamp duty on conveyances. The Commission also took account of above average sales of shares and marketable securities (leading to an increased capacity to generate revenue from stamp duty on shares and marketable securities) and an increase in the value and volume of financial transactions in New South Wales (increasing the State's capacity to raise financial transactions revenue).²

A direct implication of the 2002 revenue assessment is that higher revenue in New South Wales, due to increased economic activity in the State, has effectively been transferred to other States through lower Commonwealth funding for New South Wales and increased funding for the other States.

On the expenditure side, the Commission considered New South Wales needed less funding for debt-servicing expenses, due to the reduced relative importance of debt servicing in State budgets. Partly offsetting these reductions in relative funding, was provision for the increased cost of providing services in New South Wales relative to other States, due to above average increases in construction costs and higher levels of fire insurance claims.

As discussed in Section 7.5, the NSW Government has major concerns with the current system of fiscal equalisation.

COMMONWEALTH GRANTS COMMISSION 2004 REVIEW

In addition to the annual update of relativities discussed above, the Commission reviews its method for determining relativities every five years. Such a review, the 2004 Review, is currently under way and will be implemented for the 2004-05 financial year. The process of review extends over a number of years, with work on the 2004 Review commencing during 2000-01.

Particular areas being reviewed include the estimation of each State's relative need for funding to meet urban transit costs and to fund debt and depreciation costs. These aspects of the current methodology are important to the determination of New South Wales' grant share, as the current methodology recognises the relatively high costs faced in New South Wales.

² *Although stamp duty on the transfer of quoted marketable securities and financial institutions duty were abolished from 1 July 2001, the capacity to collect these taxes remains relevant under the new taxation arrangements. This is because the Agreement provides for transitional assistance to be paid to the States to ensure no State is worse off from implementing national taxation reform. Under these provisions, relativities are assessed assuming the continuation of the arrangements that were in place before the Agreement.*

As part of the 2004 Review, New South Wales hosted workplace discussions with the Commission in the week 19-23 November 2001. The workplace discussions are conducted so that the Commission is able to personally inspect the delivery of State government services and discuss the costs of service provision directly with agency officers.

The three main themes of the NSW workplace discussions included the relatively higher costs in New South Wales arising from: congestion; the above average number of migrants settling in New South Wales; and the tendency of Sydney, as Australia's largest and most densely populated city, to have a greater incidence of drug use than other State capital cities.

- ◆ The Commission discussed the costs of congestion with officers from the Departments of Housing and Transport, Planning NSW, the Roads and Traffic Authority, the State Rail Authority and the State Transit Authority.
- ◆ The Commission heard from the Departments of Health, Education and Training, Community Services and Ageing, Disability and Home Care how the culturally and linguistically diverse backgrounds of New South Wales' residents create extra needs for State services.
- ◆ The Commission also learnt how Sydney's status as the major entry point for illegal drugs into Australia increased the availability of drugs in the community, which increases the demands on the justice, health, education and community services sectors.

7.5 THE NEED FOR REFORM

New South Wales' level of funding has been reduced by the Commonwealth's decision to change the calculation of transitional assistance while the Commission's latest relativities have reduced its share of GST revenue grants. The vulnerability of the State to these decisions reflects the incidence of two features of Commonwealth-State financial arrangements – vertical fiscal imbalance and horizontal fiscal equalisation.

- ◆ Vertical fiscal imbalance (VFI) refers to the mismatch between revenue capacity and spending responsibilities between the Commonwealth and the States.
- ◆ Horizontal fiscal equalisation (as discussed earlier) refers to the allocation of funding to each State on the basis of the perceived expenditure needs and revenue capacity of each State.

VERTICAL FISCAL IMBALANCE

Vertical fiscal imbalance between the Commonwealth and the State is significant because Australian State governments have access to only a small number of taxes relative to their expenditure responsibilities. In contrast, the Commonwealth Government collects significantly more revenue than it needs for its own purposes. This imbalance results in the States relying on grants from the Commonwealth to be able to fund their expenditure responsibilities.

The introduction of the GST has worsened VFI through the requirement in the Agreement for the States to abolish a number of their own taxes and their replacement with Commonwealth grants of GST revenue. Commonwealth grants now account for half of aggregate State revenues in New South Wales, compared with slightly over one-third before the introduction of the GST.

The Commonwealth's decision to change the arrangements for paying transitional assistance to the States raises some questions about the future operation of the Intergovernmental Agreement. While the basic architecture of the Agreement remains in place, there is a risk that the Commonwealth may seek to further change the agreed arrangements in the future. If this were to increase the financial pressure on the States, there is a risk that the commitment of the States to the Agreement could be affected.

HORIZONTAL FISCAL EQUALISATION

The application of horizontal fiscal equalisation results in a substantially lower funding share for New South Wales.

Comparison with Equal Per Capita Funding

New South Wales receives significantly less in GST revenue grants than if funding were provided on an equal per capita basis (see Table 7.2 and Chart 7.2).

- ◆ New South Wales' GST revenue grants in 2002-03 will be \$1,316 per capita or about 30 percent less than the average of the five recipient States.
- ◆ The average GST revenue grant in 2002-03 for New South Wales, Victoria and Western Australia (the donor States) will be \$1,313 per head, compared with an average of \$1,878 for the other jurisdictions.
- ◆ In per capita terms Queensland will receive 16 percent more than the donor State average, whilst the Northern Territory will receive 468 percent more.

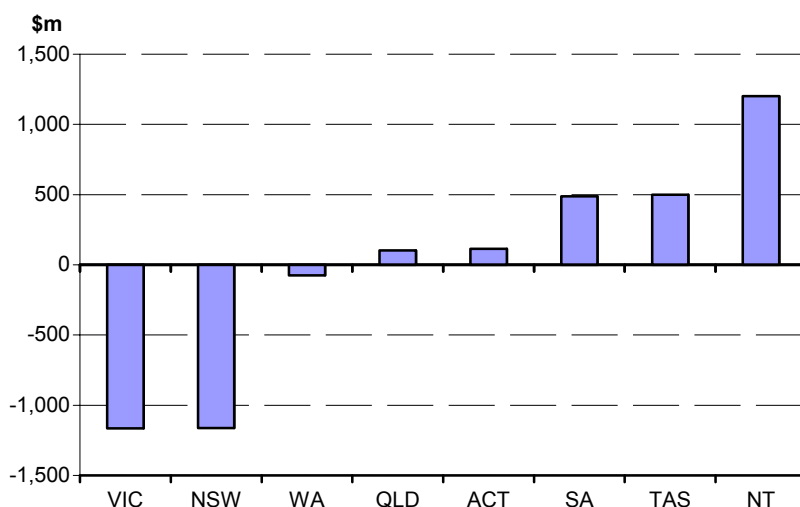
Table 7.2: GST Revenue Grants Per Capita by State, 2002-03

<i>State/Territory</i>	<i>GST Revenue Grants (In \$ per capita)</i>
New South Wales	1,316
Victoria	1,255
Queensland	1,519
Western Australia	1,453
South Australia	1,814
Tasmania	2,550
Australian Capital Territory	1,851
Northern Territory	7,464
Average, 3 donor States	1,313
Average, 5 recipient States	1,878
AUSTRALIAN AVERAGE	1,492

The per capita figures outlined in Table 7.2 can be used to calculate the total subsidy paid to the recipient States. New South Wales will be transferring to other States \$1,163 million or \$176 per capita in 2002-03. The combined transfer from New South Wales, Victoria and Western Australia is estimated at about \$2.4 billion.³ 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.

³ The estimated cross-subsidies in this chapter differ from those in the 2002-03 Commonwealth Budget papers because the latter calculates the cross-subsidy based on the sum of FAGS and unquarantined Health Care Grants. The estimates in this chapter are based solely on GST revenue grants.

Chart 7.2: Actual GST Revenue Received, compared with an Equal Per Capita Share, 2002-03



Comparison with State GST Payments

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 (estimated using household final consumption expenditure).⁴

On this basis, the total transfer from donor States (New South Wales and Victoria) in 2002-03 is about \$3.4 billion, of which New South Wales will contribute \$2.3 billion or \$350 per capita.

Table 7.3 indicates the amounts expected to be transferred from donor States to recipient States in 2002-03 using the benchmarks of equal per capita (EPC) and household final consumption expenditure (HFCE).

⁴ State contributions to GST revenue are estimated using information on consumption in each State. 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.

Table 7.3: Estimates of Cross-Subsidies between States, 2002-03

	RECIPIENT STATES						
	<i>Qld</i> \$m	<i>WA</i> \$m	<i>SA</i> \$m	<i>Tas</i> \$m	<i>ACT</i> \$m	<i>NT</i> \$m	<i>Total</i> \$m
EPC ^(a) Benchmark							
NSW	49	na	236	241	55	581	1,163
Vic	49	na	236	242	55	582	1,164
WA	3	na	15	16	4	38	76
TOTAL	102	na	488	499	114	1,200	2,402
HFCE ^(b) Benchmark							
NSW	454	146	454	407	9	851	2,321
Vic	214	69	214	192	4	401	1,095
TOTAL	669	214	668	600	14	1,252	3,416
NSW PER CAPITA CONTRIBUTION (in \$)							
EPC ^(a) Benchmark	7	na	36	36	8	88	176
HFCE ^(b) Benchmark	69	22	68	61	1	128	350

(a) *Equal Per Capita.*

(b) *Household Final Consumption Expenditure.*

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

REVIEW OF COMMONWEALTH-STATE FUNDING

Reflecting major concerns with the current system of horizontal fiscal equalisation, New South Wales and Victoria agreed to commission a *Review of Commonwealth-State Funding* at an historic meeting in Albury-Wodonga on 26 March 2001. Western Australia subsequently joined New South Wales and Victoria as co-sponsor of this Review.

The Review has sought submissions from all interested parties and consulted widely with the community. New South Wales provided a submission to the Review in February 2002.

New South Wales Submission to the Review

The current system of horizontal fiscal equalisation (HFE) is often defended as desirable to achieve equity objectives. However, New South Wales' Submission argues that its ability to achieve this is flawed because the system allocates funding in order to achieve inter-governmental equity, which does not translate into achieving improved equity between citizens of different States. In addition, the Submission raises concerns about the failure of the current system to take into account efficiency considerations.

Even if equity between governments were accepted as desirable in its own right, the Submission argues that Australia's current implementation of HFE is deficient, as data limitations result in an excessive reliance on judgement while the complexity of the analysis results in a lack of transparency and accountability.

The Submission argues that a reformed system of HFE would involve:

- ◆ a reduced scope for judgement, providing more certainty, transparency and better supported outcomes;
- ◆ a lower burden on donor States, by focusing on assisting States with clear natural disadvantages; and
- ◆ greater attention to the efficiency implications of HFE.

The Submission recognises the need for a degree of intergovernmental revenue transfer to support States with natural disadvantages. Neither Queensland nor the Australian Capital Territory (ACT) satisfies this requirement, and in fact they enjoy significant natural advantages. The Submission also argues that the current transfers under HFE to South Australia, Tasmania and the Northern Territory (NT) are excessive.

The Submission argues for revised arrangements for the Territories, to directly assist with their special features. These include the ACT's role as the national capital and the NT's earlier stage of economic development and strategic role in populating northern Australia. The Submission contends that such arrangements should include an explicit funding role for the Commonwealth, and that GST revenue grants to the States should not be used to address these special features of the Territories.

Commissioned Research

In addition to inviting submissions and meeting with interested parties, the Review has also commissioned research into the efficiency and equity implications of the current arrangements, which was discussed at a national public forum held in Canberra in March 2002.

- ◆ Research by the Centre of Policy Studies at Monash University on the efficiency implications of the current system found that national gains of up to \$250 million a year could be achieved by moving to an equal per capita distribution of Commonwealth grants.

- ◆ Analysis of the distributional effects of Commonwealth grant distribution by the National Centre for Social and Economic Modelling concluded that the current system did not result in any benefits to equity for individuals compared to an equal per capita distribution of grants. Distribution of grants according to GST revenue contributions was found to have some implications for equity, with losses at the top and middle income deciles relative to the current system.

The Review released an interim report in April 2002. The final report is expected to be completed around the middle of 2002.