Submission to the Legislative Council Government Administration Committee A - *Inquiry into the impact of the Commonwealth Grants Commission Horizontal Fiscal Equalisation System in Tasmania*

Department of Treasury and Finance

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Tasmania
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Contents

Executive Summary

The Department of Treasury and Finance welcomes the opportunity to respond to the Legislative Council Government Administration Committee A - *Inquiry into the impact of the Commonwealth Grants Commission Horizontal Fiscal Equalisation (HFE) System in Tasmania*.

General comment

1. HFE is a complex issue that has generated a degree of misunderstanding as to its purpose and how it works in practice.

2. While HFE is extremely important to Tasmania in ensuring it has the fiscal capacity to provide services at the national average standard, the principle of HFE, and the choices that Tasmania makes as to where it wishes to spend its untied GST allocation, are two separate and distinct issues.

Assessed and actual expenditure

3. The expenditure assessments made by the CGC are not intended to be a measure of what States should spend on particular service areas.

4. The CGC's assessed expenditures are only an assessment. The CGC itself recommends caution in making comparisons between assessed and actual expenditure and revenue as these concepts are only intended for equalisation purposes to support the equalisation process.

5. Nevertheless, comparisons have been made between Tasmania's actual and assessed expenditures and, based on these comparisons, have erroneously argued that Tasmania is underspending in certain service delivery areas such as health.

Impact of Commonwealth payments on Tasmania's GST

6. The Commonwealth Treasurer's Terms of Reference for the CGC direct it to take account of payments for specific purposes and give direction on the treatment of specific (quarantined) payments.

7. The CGC treats all Commonwealth payments to the States on a case-by-case basis, guided by the HFE objective, and using the following guideline:

   > *'Payments which support State services, and for which expenditure needs are assessed, will have an impact on the relativities.*[1]*'*

8. This submission provides examples of various types of Commonwealth payments and the method that the CGC uses to determine whether they are assessable or non-assessable.

9. A State will ultimately have all but its population share of a Commonwealth payment equalised to other States through the GST redistribution system unless that payment is quarantined by the Commonwealth Treasurer.

[1] CGC, *2015 Methodology Review*, Volume 2, Chapter 2, *Treatment of Commonwealth Payments,* 2015, page 37.

Introduction

As the Committee would be aware, HFE is a complex issue that has generated a degree of misunderstanding as to its purpose and how it works in practice. Treasury has prepared a number of discussion papers and submissions into HFE, including recent major submissions to the Productivity Commission (PC) Inquiry into HFE, and the Commonwealth Grants Commission (CGC) 2020 Methodology Review. These submissions provide a significant amount of background on HFE and the CGC's assessment processes and its importance to Tasmania. These documents can be found on the Department of Treasury and Finance website at https://www.treasury.tas.gov.au/gst-distribution-to-tasmania.

By way of introduction, it is worth summarising the purpose of HFE and how it is currently implemented by the CGC.[2]

The objective of HFE is to equalise the capacity of governments to provide services, taking into consideration individual State costs of providing those services and related infrastructure, and their revenue raising capacity.

The CGC defines the principle of HFE as follows:

> *State governments should receive funding from the pool of GST revenue such that, after allowing for material factors affecting revenues and expenditures, each would have the fiscal capacity to provide services and the associated infrastructure at the same standard, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency*[3].

In this way, the smaller jurisdictions such as South Australia, Tasmania and the Northern Territory, which, on the whole, face higher than average per capita costs and/or lower than average revenue raising abilities, are granted a greater than proportional share of general revenue assistance. This enables them to discharge their standard functions without necessarily having to impose above average revenue raising measures on their communities.

HFE provides each State and Territory with the same capacity to provide services. It does not 'compensate' for differences attributable to policy, practice and relative inefficiency.

Differences in the economic, social and demographic characteristics of the States affect their expenditures and revenues and contribute to differences in GST distributions. As can be seen from Table 1, Western Australia's above average revenue raising capacity drives its fiscal strength, despite the fact that it has higher than average costs of providing services - meaning that it needs significantly less than its population share of the GST pool.

The relative fiscal strengths of New South Wales and Victoria (and to a lesser extent, the ACT) are their below average cost of providing services, although this is offset to some extent in Victoria (and completely in the ACT) by a below average strength in revenue raising. South Australia, Tasmania and the Northern Territory have relatively low fiscal capacities as a result of their below average capacities to raise revenue and their above average cost of providing services.

[2] In response to the Productivity Commission Inquiry into HFE the Commonwealth Government has changed the current objective of HFE to be equalising the States to the stronger of NSW or Victoria. This will take effect from 2021-22.

[3] Commonwealth Grants Commission. *Report on GST Revenue Sharing Relativities*. 2015 Review. Vol 1, page 34.

Table 1 - Difference from an equal per capita distribution of GST, 2019-20

	NSW	VIC	Qld	WA	SA	Tas	ACT	NT	Redist
	$m	$m	$m	$m	$m	$m	$m	$m	$m
Expense Requirement (a)	-2 278	-4 791	1 406	1 994	548	587	- 139	2 672	7 208
Investment requirement (b)	379	1 303	- 455	- 529	- 442	- 164	- 13	- 79	1 682
Net borrowing (c)	7	- 176	20	77	53	17	- 6	9	183
Revenue raising capacity (d)	-1 206	2 432	510	-4 972	2 122	731	335	48	6 178
Commonwealth payments (e)	263	953	- 714	12	- 67	- 86	100	- 460	1 327
Total	-2 836	- 279	767	-3 419	2 215	1 084	278	2 191	6 534

Source: CGC, 2019 Update: Analysis of Relativities (difference from EPC), Tables S5-1:S5-5, February 2019.

NOTES

(a) Expense requirement is the operating outlays of the States.

(b) Investment requirement refers to acquisition of new infrastructure.

(c) Net borrowing is the outcome of an operating budget calculated as expenses and expenditure on non-financial assets less State own source revenues and revenues received from the Australian Government.

(d) Revenue raising capacity is the capacity of a State to raise revenue relative to the average. It reflects the size of a State's revenue base per capita relative to the average.

(e) Commonwealth payments are payments to States made by the Australian Government, including general revenue grants, National specific purpose payments (SPPs), National partnership payments (NPPs) and Commonwealth own purpose expenses. The Commission examines the purpose of each payment using established guidelines to decide whether the payment has an impact on State fiscal capacities.

Legislative Council Select Committee Terms of Reference

The focus of the Legislative Council Select Committee Terms of Reference is on the impact of the HFE system as assessed by the CGC as it applies to Tasmania's expenses and delivery of services with particular regard to:

1. Tasmania's assessed and actual expense per capita per category compared to the national average expense per capita per category; and
2. The impact of direct Commonwealth payments on Tasmania's GST receipts.

These two issues are discussed below.

Assessed and Actual Expenditures

HFE provides untied GST funding

The first observation that Treasury would make is that the expenditure assessments made by the CGC are not intended to be a measure of what States should spend on particular service areas. GST is provided to the States under the Intergovernmental Agreement on Federal Financial Relations on the basis that is untied, general-purpose revenue. While the amount of GST funding that Tasmania receives is untied, State governments are ultimately accountable to their communities in relation to how they spend this revenue.

The CGC undertakes its assessments to enable it to recommend a GST distribution based on HFE so that States have the fiscal capacity to fund services to the average standard provided they make the same effort to raise revenue.

Expenditure priorities are a matter of State policy and sovereignty. Therefore, HFE as such does not directly impact on how Tasmania funds its delivery of services. The principle of HFE and the choices that Tasmania makes as to where it wishes to spend its GST allocation are two separate and distinct issues.

It is not the role of the CGC's assessments to be the benchmark for State spending priorities, a point made strongly by the CGC:

> ***Is a State required to spend its GST revenue on the service needs that drive its GST share?***
>
> *The Commission's role does not involve forming an opinion on how much a State should spend on any particular service it provides to its population, nor on how much tax it should raise under the revenue heads available to States. The Commission does not have a view on how a State should spend its GST revenue.*
>
> *One of the principles that the Commission applies in assessing the funding needs of States is to reflect what States do. The Commission observes the range of services that States provide and collects data on how much it costs States to provide those services, given the circumstances of each State. From those data, it is able to derive an Australian average standard of service for each service sector. The Commission then looks at the fiscal capacity of each State – what it is capable of raising from its own revenue sources and receives from the Commonwealth in specific payments – and identifies the funding shortfall that each State has between that fiscal capacity and what it would require to be able to provide that Australian average standard of service. The aim of HFE is to provide each State with the fiscal capacity, through the distribution of GST revenue, to provide the same standard of service as every other State. Our work should not be understood as identifying the desired level of spending that each State should fund for particular services.*
>
> *The GST revenue provided by the Commonwealth is general revenue assistance – that is, it is an established part of the federal financial agreements between the Commonwealth and the States that GST revenue is untied and each State can spend in accordance with its own spending priorities. States are accountable to their electorates and not to the Commission or the Commonwealth more generally, for how GST revenue is spent.*
>
> *Source: Commonwealth Grants Commission website, https://www.cgc.gov.au/, February 2019.*

Comparing actual and assessed expenditure

The PC[4] and other commentators have noted that there is a divergence between the CGC's actual and assessed expenditure for some categories. The PC did not make any recommendations on how States should spend their GST, noting that:

> *At the aggregate level, there is also a divergence between actual and assessed expenditures. However, caution should be exercised when interpreting differences between actual and assessed expenditures. Differences between actual and assessed expenses can be due to: State policy choices, efficiency of service provision, and disabilities not assessed (either because they could not be reliably measured or because they were not material) (CGC 2008, p. 2). Hence, part of any difference between actual and assessed expenditures may be attributable to efficiency considerations, but the extent of this attribution cannot be factually established.*
>
> *Source: Productivity Commission Inquiry Report into Horizontal Fiscal Equalisation, May 2019, page 95.*

[4] Productivity Commission, *Final Inquiry Report into Horizontal Fiscal Equalisation*, July 2018, pages 95-97 & 245-246.

And,

> ***States may choose to reorient spending of GST payments***
>
> *States can prioritise, as they currently do, the way they spend their GST payments to ensure key service areas continue to be funded. As the Victorian Treasurer remarked:*
>
> > *… HFE does not impose particular policy choices on States and each of them is free to make choices about how it raises revenue and its expenditure priorities (transcript of public hearings, page 139).*
>
> *Similarly, the Tasmanian Treasurer stated:*
>
> > *HFE provides the States with a level of revenue and at the end of the day, then priorities and choices are made (transcript of public hearings, page 455).*
>
> *GST payments are untied, and there are many areas where States' ratios of actual to assessed expenses are either above or below 100 per cent as assessed by the CGC (chapter 2), often by more than the change in GST payments outlined above. While in some categories of spending, divergences from 100 per cent may be due to relative efficiency or inefficiency in service delivery, there are likely to be others where States have made a conscious choice to spend more or less in certain areas, and thus provide a higher or lower standard of services than other States. There are therefore many ways that funds could be prioritised to manage the budget implications of a move to a new equalisation benchmark. For example, services to industry (such as tourism and trade promotion) could be reduced to enable other services, such as health and education, to be provided either at the level assessed as required by the CGC, or at the current level (which may already be higher or lower than that assessed by the CGC), if this is what a State Government decides is in the best interests of its community.*
>
> *Source: Productivity Commission Inquiry Report into Horizontal Fiscal Equalisation, May 2019, pages 245-246.*

Nevertheless, there has been criticism that Tasmania has not spent as much as it has been assessed by the CGC. The health category[5] is a recurring example.

The CGC's expenditure assessments are based on a notional average level of service provision, using the average of 'what States do' to determine the national average per capita cost of service provision. This is then adjusted for State specific service delivery cost disabilities. The CGC's notional average level of service provision is not an observable service or expenditure level, but rather a mathematical construct developed to give effect to the principle of HFE.

The CGC calculates a GST requirement taking into account specific State demographic, geographical and other non-policy related influences to determine whether a State would need to spend more or less than the national average level of expenditure in order to have the capacity to deliver the national average service level.

As the CGC equalises service delivery expenditure capacity based on the average of 'what States do', this incorporates the national average level of efficiency in delivering those services. The difference between actual and assessed expenditure could mean that a State is delivering services more or less efficiently than the average level of efficiency. It could therefore be inefficient for a State to increase its actual expenditure to the CGC's assessed level of expenditure if it was able to deliver the services at a lower cost.

Differences between actual and assessed expenditure could also reflect policy differences in the way services are delivered.

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[5] Martyn Goddard, *State of Health 2018: An Analysis of the Adequacy of Public Hospital Services in Tasmania*, October 2018, pages 15-16.
Saul Eslake, TCCI Tasmania Report 2018, November 2018, pages 79-80.

As expenditure assessments are based on the average of 'what States do', those States having a particular disadvantage for an expenditure category will be assessed as requiring higher than equal per capita (EPC) expenditure. Therefore, other States with less disadvantage are assessed as requiring less than an EPC expenditure.

The CGC sets out this information for each expenditure and revenue category in tables as part of its adjusted and assessed budgets. The CGC however notes the following caution on using the data in the tables:

> ***The Assessed Budget***[6]
>
> *'The data in these tables are for the Commission's calculations only. The actual figures are not necessarily the same as in State budget documents or in Australian Bureau of Statistics (ABS) publications as they have been adjusted for equalisation purposes.*
>
> *Comparisons between the averages, actual and assessed should be made with caution. In particular, the assessed data reflect only these adjustments to the averages which the Commission could quantify reliably. Not all non-policy influences on State figures have been taken into account*[7]*.'*

The CGC's adjusted and assessed budgets are discussed in more detail in Appendix A.

Notwithstanding the CGC's above caution, Table 2 shows that, for many expenditure assessments, Tasmania receives more than its per capita share. However, in some areas it receives less.

For example, as Tasmania is assessed as having greater than average costs for delivering education and health services as a result of its inherent cost disabilities (such as an ageing population, and lower than average socio-economic status) the CGC methodology distributes GST towards Tasmania and away from other States.

However, due to it being less urbanised and having lower population growth and lower costs, GST is distributed away from Tasmania and towards other States for other assessments such as infrastructure, public transport and roads.

[6] *CGC, 2019 Update: 4. The Assessed Budget (category tables), Tables S4-1 to S4-27, February 2019.* The Assessed Budget contains the CGC's assessments and actual data for each category of expenditure, revenue, investment and net borrowing.

[7] *CGC, Report on GST Revenue Sharing Relativities - 2017 Update, The Assessed Budget (categories tables), March 2017.*

Table 2 - Assessed and Actual Expenditure Per Capita (average 2015-16 to 2017-18)

	Tasmania		National
	Assessed ($pc)	Actual ($pc)	EPC ($pc)
Category			
Schools education	2 341.8	2 394.8	2 160.3
Post-secondary education	218.6	163.1	214.2
Health	3 024.1	2 748.6	2 472.8
Housing	169.5	127.9	146.5
Welfare	864.2	758.0	730.2
Services to communities	288.6	90.8	271.7
Justice	824.1	724.9	785.1
Roads	261.3	174.7	278.5
Transport	200.7	134.9	557.9
Services to industry	272.8	414.6	256.2
Depreciation	611.0	501.4	569.4
Other expenses	1 644.4	1 737.2	1 284.6
Investment	276.9	115.4	558.2
Total Expenditure	**10 997.9**	**10 086.3**	**10 285.6**

Source: CGC, 2019 Update: 4.The Assessed Budget (category tables), Tables S4-1 to S4-27, February 2019.

There is a notable divergence between actual and assessed expenditure in the CGC categories, Services to Communities, and Services to Industry.

The Services to Communities category covers State subsidies for the provision of electricity, water and wastewater services (utilities subsidies) and a range of expenses for administration of communities, community amenities and environmental services. It does not include welfare or housing services as they are covered elsewhere.

Tasmania's actual expenditure is significantly below its assessed expenditure because the CGC assessment is based on 'what States do' on average, and that is to provide electricity and water subsidies to smaller geographically isolated communities where full cost recovery is most difficult. Because Tasmania is assessed to have small isolated communities under the CGC's geographic assessment, it is assessed to have an above EPC requirement to provide water and electricity subsidies. However, in practice Tasmania provides electricity subsidies through Hydro Tasmania for diesel generation on the Bass Strait islands only and there are no water subsidies.

The Services to Industry category covers State spending on the regulation and development of businesses and industries, and other economic affairs. Because State expenditure on business development and economic affairs is highly policy influenced, the CGC does not assess it and treats it as EPC. However, regulation expenses for agriculture (including forestry and fishing) and other industries are assessed.

Tasmania's actual expenditure on the Services to Industry category is about 50 per cent higher than assessed. This higher spending compared to the CGC's assessed spending could reflect policy choice because of the importance the Government places on the agriculture and tourism industries.

More detail on the CGC's methodology for determining the distribution of the GST can be found in an information paper on its website https://www.cgc.gov.au/about-us/fiscal-equalisation.

The CGC's assessed expenditure is therefore only an assessment. The CGC recommends caution in making comparisons between assessed and actual expenditure and revenue as these concepts are only intended for equalisation purposes to support the equalisation process.

Therefore, comparing the CGC's assessed expenditure with actual expenditure does not reflect reality, as State Budgets record actual expenditure according to GFS expense categories with actual revenue including GST received.

Further, Annual Financial Statements of State Governments are prepared in accordance with the principles of *Australian Accounting Standards* and, in particular, *AASB 1049 Whole of Government and General Government Sector Financial Reporting*. This is not the same as the CGC's Adjusted Budget, which is based on data to construct its stylized budget used for HFE purposes.

Assessed revenue also determines the amount of GST received

The CGC's definition of HFE that drives its assessment methodology is that:

> *'State governments should receive funding from the pool of GST revenue such that, after allowing for material factors affecting revenues and expenditures, each would have the fiscal capacity to provide services and the associated infrastructure at the same standard, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency.'*

The amount of GST that Tasmania receives is such that it provides it with the capacity to meet its assessed expenditure including infrastructure spending, on the basis that it is able to raise revenue at its assessed revenue raising capacity. Thus, to compare Tasmania's assessed expenditure with its actual expenditure in isolation does not give the full picture. It ignores other components that the CGC uses to determine GST requirements such as assessed and actual revenue, and investment and net borrowings. For example, Tasmania's above per capita share of GST it receives for many of its expenditure categories is offset by a less than per capita share for the investment in infrastructure category as shown in Table 2.

Tasmania's actual revenue is less than the CGC's assessment of what it is able to raise. However, for most assessed taxation revenue categories, Tasmania's actual revenue is similar to its assessed revenue. In the Other Revenue category, which is over half of Tasmania's own-source revenue, it raises significantly less than it is assessed to be able to raise.

Other Revenue includes revenues for which reliable data could not be found by the CGC to make an assessment, an assessment method could not be developed, or an assessment was not material, and so it is assessed on an EPC basis. That is, all States are assumed to raise Other Revenue at the national average. In Tasmania's case, this could be overstating its actual revenue raising capacity in this category for a range of reasons, including its weaker tax bases compared to the national average, or the less than average capacity of its citizens to pay.

Table 3 compares the CGC's actual and assessed estimates by expenditure and revenue category. While again noting the CGC's caution when making comparisons with its Assessed Budget Tables, the table shows that on a recurrent basis, while Tasmania is assessed to spend $390 million more than it does, the total own-source actual revenue was $303 million less than it was assessed to be able to raise. If total revenue and expenditure is taken into account (that is, including GST, investment and net borrowing), Tasmania's actual revenue was $474 million less than it was assessed to spend.

This further highlights that it is inappropriate to use the CGC's assessed expenditure categories as a guide to the amount States should be spending in each category.

Finally, the difference between Tasmania's average assessed and actual net borrowing over the three-year period could have resulted in a $234 million deficit. This deficit would have to be met by either increasing existing taxes, increasing debt or by finding other new sources of revenue.

Table 3: CGC Assessed and Actual expenditure and revenue estimates (average 2015-16 to 2017-18)[8]

Expenditure	*Actual*	*Assessed*	*Diff.*	*Category description*
	$M	$M	$M	
Schools education	1 246.0	1 218.3	27.7	*State spending on government pre-schools, primary and secondary schools, student transport, and non-government schools*
Post-secondary education	84.8	113.8	-29.0	*State spending on vocational education and training (VET) and higher education*
Health	1 430.3	1 573.6	-143.3	*State spending on public hospitals and community and public health services*
Housing	66.5	88.3	-21.7	*State spending on and revenue received from social housing services and expenses on home purchase assistance for first home buyers*
Welfare	394.4	449.7	-55.3	*State expenses on family and child services, services for people with a disability and general welfare services*
Services to communities	47.2	150.1	-102.9	*State subsidies for the provision of electricity, water and wastewater services (utilities subsidies) and a range of expenses for administration of communities, community amenities and environmental services*
Justice	377.3	428.8	-51.5	*State spending on police services, law courts, legal services, prisons and corrective services*
Roads	91.1	136.0	-44.9	*State spending on the maintenance of roads, bridges (including tunnels) and other related services*
Transport	70.1	104.4	-34.3	*State spending on bus, rail (passenger and freight), and ferry services, ports and other maritime related services, and air transport*
Services to industry	215.9	142.0	74.0	*State spending on the regulation and development of businesses and industries, and other economic affairs*
Depreciation	260.8	317.8	-57.0	*This recognises the extent of State usage of existing infrastructure each year*
Other expenses	903.5	855.4	48.0	*A residual category and includes expenses on general public services, natural disasters, capital grants to local governments for community amenities, assessed administrative scale expenses, native title and land rights expenses, national capital expenses (except those relating to police) and a location adjustment*
Assessed Expenditure	**5 188.0**	**5 578.1**	**-390.1**	
Investment	60.2	144.4	-84.2	*Total capital expenditure of the general government sector on non-financial assets such as extra, or upgraded, infrastructure and land.*
Total Expenditure	**5 248.3**	**5 722.5**	**-474.3**	
Revenue	***Actual***	***Assessed***	***Diff.***	***Category description***
Payroll tax	335.5	319.2	16.3	*A broad based tax imposed by States on the wages and related benefits (remuneration) paid by employers*
Land tax	141.7	127.4	14.3	*State land tax on residential investment, commercial and industrial land*
Stamp duty	275.0	315.3	-40.3	*Stamp duties raised by States when ownership of property and motor vehicles is transferred.*
Insurance tax	104.7	95.0	9.6	*Insurance tax levied on the premiums of a range of insurance products and emergency service levies*
Motor taxes	137.0	194.3	-57.3	*Annual registration and associated charges levied by States on vehicle owners or collected by the Commonwealth on behalf of States. It also includes fire and emergency services levies for States*
Mining revenue	35.3	60.4	-25.0	*Royalties levied by States on mining production*
Other revenue	842.2	1 062.8	-220.6	*A residual category for revenues not assessed in other revenue categories. It comprises revenues for which reliable data could not be found to make an assessment, an assessment method could not be developed, or an assessment was not material. Revenues assessed in this category are assessed equal per capita and have no impact on States' GST distributions*
Own-source revenue	**1 871.4**	**2 174.4**	**-303.0**	
Net borrowing	32.1	266.5	-234.4	*Net borrowing reflects the extent to which the States' total outlays on service delivery and investment in infrastructure exceed their total revenue.*
Commonwealth Grants	1 030.9	1 030.9	-	*Payments to States made by the Australian Government, including general revenue grants, payments for specific purpose (PSPs) and Commonwealth own purpose expenses. The CGC examines the purpose of each payment using established guidelines to decide whether the payment has an impact on State fiscal capacities*
GST[9]	2 314.0	2 250.8	63.2	*Funds made available by the Australian Government for transfer to the States as untied financial assistance, consistent with the principle of horizontal fiscal equalisation*
Total Revenue	**5 248.3**	**5 722.5**	**-474.3**	

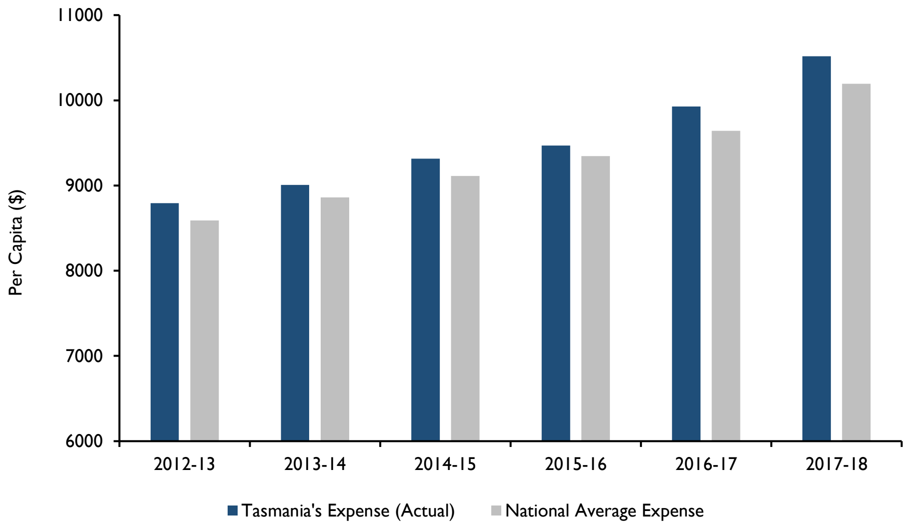
Source: CGC, 2019 Update: 4.The Assessed Budget (category tables), Tables S4-1 to S4-27, February 2019.

[8] The impact of the Commonwealth Government payment to the Mersey Community Hospital of $730 million is excluded from the data as the payment is a one-off upfront payment to meet future health expenditure.

[9] While within an assessment year the total actual GST will match total assessed GST, actual and assessed GST will vary across States. This is because the actual GST is a reflection of the GST distribution when that assessment year was an application year.

It should also be noted that, although Tasmania's average actual expenditure was less than the CGC's average assessed expenditure, actual total spending on a per capita basis was above the national average during the 2012-13 to 2017-18 period, as demonstrated in Chart 1.

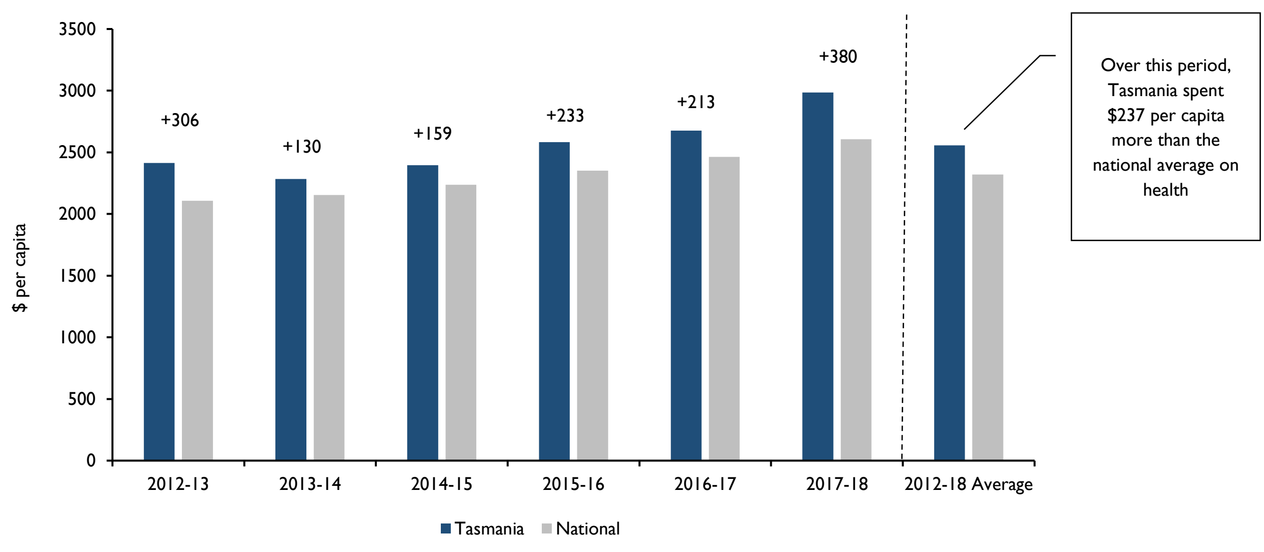
Chart 1 - Total Per Capita Expense Category (average 2012-13 to 2017-18)



Source: CGC, 2016-2019 Updates: 4.The Assessed Budget (category tables), Table S4-24 Total Expenses, April 2016 to February 2019.

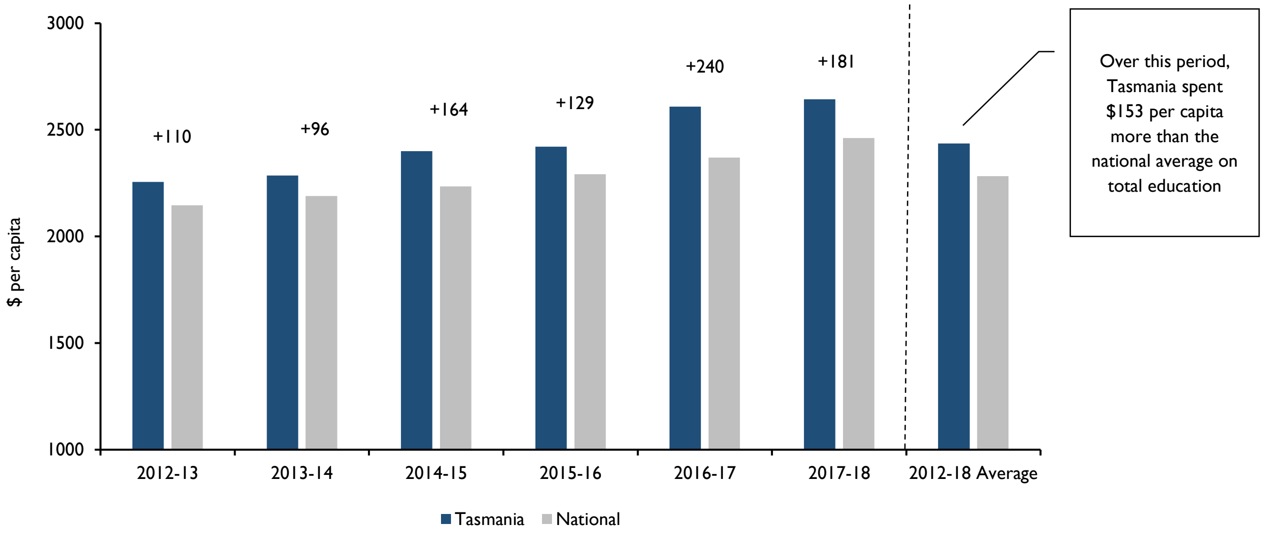
Additionally, from 2012-13 onwards, Tasmania has spent more per capita than the national average on key assessment categories, such as total education and health (Charts 2 and 3).

Chart 2 - CGC Health Expense Category - Tasmania versus National (average 2012-13 to 2017-18)



Source: CGC, 2016-2019 Updates: 4.The Assessed Budget (category tables), Table S4-14, Health, April 2016 to February 2019.

Chart 3 - CGC Total Education Expense Category - Tasmania versus National (average 2012-13 to 2017-18)



Source: CGC, 2016-2019 Updates: 4.The Assessed Budget (category tables), Table S4-13, Total Education, April 2016 to February 2019.

Change to the objective of HFE

The Commonwealth Government has, in response to the PC Inquiry into HFE, changed the objective of HFE to be equalising the States to the strongest of either New South Wales or Victoria. The legislated changes begin to take effect from 2021-22, transitioning to full effect in 2026-27.

While the GST received will no longer have a direct relationship to the CGC's initial assessment of fiscal capacity, the 'no worse-off' provisions of the legislation mean that Tasmania's overall budget result will not be effected and it will receive additional untied funding on top of the GST if required.

This further questions the relevance of making any future comparison with the CGC's assessed and actual expenditure.

Impact of Commonwealth payments on Tasmania's GST

A significant imbalance exists between the revenue raising and expenditure powers of the Commonwealth and the States and Territories. The Commonwealth raises a larger amount of revenue than it requires for its own-purpose outlays. The States, on the other hand, have own-purpose outlays that exceed the revenue they raise.

This vertical fiscal imbalance is addressed by the Commonwealth making payments to the States in the form of either untied general purpose payments (through the CGC assessment process as outlined earlier) or specific purpose payments (SPPs) and National partnership payments (NPPs) where the Commonwealth seeks to achieve national aims in certain areas of State responsibility or provides funds for particular purposes.

On this basis, the Commonwealth provides payments to the States to assist in the funding of services delivered by State government departments or through instrumentalities. It also provides services or payments to third parties in the Local Government, private and not-for-profit sectors. This can reduce the call on State budgets in relation to the services these bodies provide.

The Terms of Reference direct the CGC to take account of payments for specific purposes. The CGC uses a set of guidelines to assist it when making decisions on the treatment of any payment (i.e. impact or no impact). They also give direction on the treatment of specific payments (i.e. quarantined payments).

The CGC treats all Commonwealth payments to the States on a case-by-case basis, guided by the HFE objective, and using the following guideline:

> *'Payments which support State services, and for which expenditure needs are assessed, will have an impact on the relativities.[10]'*

Assessed expenditure needs are differences between States that affect the cost of delivering services. In some cases, on conceptual grounds, the CGC concludes that there are no differences in per capita service delivery costs and it assesses the expenditure on an EPC basis.

Where an assessment is made, related Commonwealth payments should affect the GST distribution. However, where needs have not been assessed because they are not material, or because the CGC has been unable to assess them, any associated payments do not affect the GST distribution.

The impact of Commonwealth payments to the States on the GST distribution is discussed later.

Quarantined payments

An exception to the CGC's guidelines for the treatment of Commonwealth payments is where the payment has been quarantined. A payment can be specifically excluded (or quarantined) so as to have no impact on State GST relativities. This means that the State retains all of the Commonwealth payment and no GST is redistributed, as it would normally be if it was considered by the CGC as a payment that would otherwise support State services. These exceptions are uncommon[11] as quarantining is generally considered detrimental to the principle of HFE. This is because the quarantined payment provides the State with an additional fiscal advantage over other States in excess of HFE.

On occasion, the Commonwealth has quarantined certain payments because to not do so would undermine its own program objective. For example, the Commonwealth Government's asset recycling program provides States with an additional payment from the Commonwealth if they agree to sell State assets and use the proceeds to build new assets. If the payment had not been quarantined, there would be no incentive for States to participate in the program.

A more recent example is the top-up payments made to the Northern Territory and Western Australia as part of the Commonwealth Government's response to the PC Inquiry into HFE. If those payments were not quarantined, they would have impacted on the GST shares of Western Australia and the Northern Territory, thereby undermining the Commonwealth Government's policy intent.

The quarantining of a payment is implemented in practice by including a statement in the CGC's Terms of Reference in its Annual Update of the GST distribution for a particular year.

[10] CGC, *2015 Methodology Review*, Volume 2, Chapter 2, *Treatment of Commonwealth Payments,* 2015, page 37.

[11] Over recent years, on average, around 3% of payments have been quarantined by Terms of Reference, while around 60% have affected State GST shares, with the balance having no effect. CGC, *Staff Discussion paper: The Principle of HFE and its Implementation,* May 2017, page 43.

For example, in the Terms of Reference for the *2019 Update* of GST Revenue Sharing Relativities the following directive was included:

> *'The Commission should prepare its assessment on a basis consistent with the Commonwealth's intention that the following Commonwealth payments should not directly influence the per capita relativities:*
>
> *(a) Payments to New South Wales and Victoria relating to the sale of Snowy Hyrdo Ltd to the Commonwealth.*
>
> *(b) Payments relating to the Project Agreement for the Health Innovation Fund – Stage 1.*
>
> *(c) Payments to South Australia relating to the Project Agreement for the Proton Beam Facility.*
>
> *(d) Payments to Tasmania relating to the Project Agreement for Queensland Fruit Fly Response in Tasmania.*
>
> *(e) Payments to the Australian Capital Territory relating to the Project Agreement for the Expansion of Clare Holland House.*
>
> *(f) Payments relating to the Project Agreement for the Western Australian Hospital Infrastructure Package.*
>
> *(g) $259.6 million in additional General Revenue Assistance to the Northern Territory to offset the reduction in its GST share.*
>
> *(h) Additional General Revenue Assistance relating to GST transitional support and top up payments under the Commonwealth's HFE reform package:*
>
> *i. to the Northern Territory to effectively lift its GST relativity to 4.66;*
> *ii. to any other State or Territory to effectively lift their GST relativities to 0.7;*
> *iii. to any State or Territory under subsection 5(3) of the Federal Financial Relations Act 2009 (the cumulative 'no worse off' guarantee).*

The matter of quarantining has been the subject of much debate and, although all jurisdictions have benefited directly from it at some point, it is generally accepted that it is challenging to agree on criteria that are unanimously acceptable to all States and Territories.

A recent example of where Tasmania has benefited from the quarantining of a Commonwealth payment is when the Commonwealth Government transferred ownership of the Mersey Community Hospital back to Tasmania, with an associated one-off payment of $730.4 million. This payment was quarantined and so it did not impact Tasmania's GST share.

Treasury does not support the quarantining of Commonwealth payments except in exceptional circumstances as it undermines the principle of HFE, which provides significant benefits to Tasmania. The Mersey Community Hospital is considered to be an exceptional case.

There are currently no guidelines for the quarantining of payments. Quarantining tends to be either a result of requests from States for special funding treatment, or because the Commonwealth believes the payment would be ineffective or counterproductive in achieving its objectives if it was eroded by the HFE process.

The PC considered this issue in its report into HFE and recommended the following:

> *Recommendation 6.4*
>
> *The Commonwealth Government, in consultation with the States, should develop clear guidelines detailing the basis on which Commonwealth payments are to be quarantined from HFE by the Commonwealth Treasurer (so that they do not unnecessarily erode the efficacy of the CGC's relativities and compromise the objective of HFE).*
>
> *The guidelines should strike a balance between enhancing accountability and transparency, while not unduly affecting the Treasurer's ability to quarantine payments in exceptional circumstances that are in the national interest.* [12]

In response to the PC Inquiry Report recommendations, the Commonwealth Government, in consultation with the States, intends to develop clear guidelines detailing the basis on which Commonwealth payments are to be quarantined by the Commonwealth Treasurer.

Types of payments that are assessed and affect GST shares

National reform and Partnership Agreements

Under the Intergovernmental Agreement on Federal Financial Relations, National Partnership payments are treated by inclusion when determining a State's share of GST revenue. When the Commonwealth Government directly funds States for particular projects or to assist with the provision of State-type services, these payments are taken into account by the CGC in assessing the relative financial needs and GST requirements of each State.

Examples of these types of payments include:

- National Health Reform and Quality Schools, Quality Outcomes funding and National Housing and Homelessness payments. These affect GST because health, education and housing expenditure are differentially assessed by the CGC.
- National Partnership agreement payments that support State services and are assessed such as:
  - Redevelopment of the Royal Hobart Hospital
  - Universal access to early childhood education
  - Irrigation projects
  - Road and rail projects (not national rail or road network; projects of which 50 per cent is assessed)
  - Abt Railway (West Coast Wilderness railway)

Commonwealth payments that completely, or partially, offset the CGC's assessment of expenditure disabilities are recognised in assessing State GST requirements. That is, if State expenditure such as health is fully or partially offset by a Commonwealth payment, then both State expenditure and the offsetting revenue (the Commonwealth payment) are assessed for GST purposes.

In considering whether needs are assessed for the activity for which the payment has been made, the CGC will have regard to the rationale (or driver) applied by the Commonwealth in determining the distribution of

[12] Productivity Commission, *PC Inquiry into HFE - Final Report,* May 2018, page 40.

the payment. Where there is a particular driver applied by the Commonwealth for the distribution of the payment among States, the CGC will consider whether this driver is sufficiently reflected in its assessments so as to warrant that 'needs are assessed'. Where this is not the case, the payment will not affect GST shares.

Some payments require the CGC to exercise judgement. For example, difficulties arise when the purpose of a payment is broadly described but appears to have multiple funding elements, each addressing a different objective. Also, the nature of payments can change over time. The *Water for the Future* was such a program, aimed at assisting the agricultural industry, ensuring adequate domestic water supplies and protecting the environment. Payments that assist agriculture and water supply are assessed, while payments relating to protecting the environment are not assessed.

Another judgement adopted by the CGC is how closely the disabilities assessed correspond to the differences being addressed by a Commonwealth payment. Of necessity, the differences assessed are often measured broadly, while a Commonwealth payment can be quite narrowly focused. To decide an appropriate treatment, the CGC has to consider the extent of overlap between what it assesses and what the Commonwealth payment is designed to address.

Certain Commonwealth Own Purpose Payments (COPES) where they support State services

These are payments where the Commonwealth seeks to fund a particular program for its own purpose but does not have resources or does not want to administer the program itself, and seeks State involvement. If the program supports State services, it is assessed by the CGC.

For example, there are COPES that support indigenous services such as grants for Indigenous purposes to schools education, post-secondary education, welfare and housing. Other COPES are not assessed if they support Commonwealth rather than State programs. Examples are provided in this submission in the section on types of payments that do not affect GST shares.

GST treatment of Commonwealth payments for specific purposes

Unless the CGC is directed by the Commonwealth Treasurer in its Terms of Reference in an assessment year to quarantine a Commonwealth payment, the benefits of State-specific Commonwealth payments are largely equalised away by the CGC's methodology. If not quarantined, approximately 98 per cent (all but Tasmania's population share) of the payment will be offset in the form of reduced GST payments to Tasmania over time.

Because of the one year lag and three year averaging methodology, GST payments will be reduced by almost one third of the Commonwealth payment in each of years 2, 3 and 4 after the payment (for a single year payment) or over a number of years where the payment is received over time. The only part of the payment that is not redistributed is a State's per capita share, which, in Tasmania's case, is currently 2.1 per cent. This is particularly problematic with larger payments and has occurred in the past with the Royal Hobart Hospital funding. Because over time, all but the State's per capita share is redistributed, Tasmania in effect forgoes untied GST revenue in exchange for tied Commonwealth funding.

Table 4 provides an example of how a hypothetical $100 million payment made only to Tasmania in a particular year (Year 1) by the Commonwealth would impact on its GST revenue share in subsequent years.

Table 4 - Illustrative Example - Impact of a Commonwealth Payment Over Time

	Payment year		CGC assessment application years		
	Year 1	Year 2	Year 3	Year 4	Year 5
	$m	$m	$m	$m	$m
Commonwealth payment	100	0			
GST impact	0	0	-32.6	-32.6	-32.6
Cumulative budget impact	+100	+100	+67.4	+34.7	+2.1

Source: CGC, 2019 Update - Population Data, Table S1-1 Total ERP by State, February 2019 and Tasmanian Treasury calculations. This example ignores the impact of growth in the GST pool which would inflate the actual application year effects.

Table 4 shows Tasmania receiving a $100 million payment from the Commonwealth Government in Year 1. The CGC's assessment process is based on three-year averages and its assessments relate to the circumstances of past years, so there is a time lag before the fiscal circumstances of Year 1 affect GST revenue. The first time that a Year 1 payment will come into the CGC's assessment process will be in Year 3. The estimated GST impact is a decrease of around $32.6 million for each of the three years to Year 5, after which Year 1 falls out of the CGC's assessment period. By that time, however, the benefit of the original payment is estimated to have been reduced to less than $2.1 million, which is Tasmania's per capita share of the total payment to Tasmania.

The recognition of Commonwealth payments to States in this way means that over the long run there are generally no 'winners' or 'losers' when the Commonwealth Government announces funding for specific purposes for particular States or Territories. If the funding is allocated on a per capita share basis, each State ends up with its per capita share of national funding as the redistribution to and away from each State ultimately balances out.

Because all the State payments in excess of per capita shares are redistributed, the net effect is that the payments do not impact each States' relativities. However, if a payment is a one-off program specifically for the benefit of one State, such as the Royal Hobart Hospital example, or if Tasmania for example, receives significantly more than its per capita share of a national program, then as mentioned, most of this funding is redistributed away to other States through HFE with no reciprocal distribution from other States to Tasmania from the same funding program.

Types of payments that are not assessed and do not affect GST shares

These are Commonwealth payments that do not offset the CGC's expense disability assessments and so do not redistribute GST revenue away from an EPC share.

Payments where the CGC does not make a differential expense assessment

These are payments where the CGC has not been able to develop a differential assessment. In these cases, the assessment is treated EPC and any Commonwealth payments do not affect relativities.

For example:

- Payments for the purpose of protecting the environment
- Municipal and essential services for remote areas

Payments for the benefit of Local Government

These are payments to Local Government such as for infrastructure and services that are not provided by State Governments. That is, payments made to Local Government for which State Government needs are not assessed.

For example:

- Redevelopment of the King George V sports and community precinct in Glenorchy
- Financial assistance grants to Local Government
- Payments to Local Government for roads

Payments to other third parties

These are payments to other parties that do not support State services.

For example:

- Temporary assistance to Tasmanian exporters in response to cessation of direct international shipping services to Tasmania

Payments to the States for Commonwealth purchases (COPES)

These tend to be payments to the States to implement Commonwealth programs such as COPES because the Commonwealth does not have resources or does not wish to administer the program.

For example:

- Commonwealth natural disaster relief payments to the States under the Natural Disaster Relief and Recovery Arrangements (NDRRA). These are netted off State expenses claimed under the NDRRA
- National public health – human quarantine services
- Essential vaccines - vaccine purchase

Payments to the States that are 'through' payments

These are payments to the States to then forward to another party on behalf of the Commonwealth.

For example:

- Education funding to non-Government schools

Payments quarantined from affecting GST share

As noted earlier, these payments would ordinarily affect GST shares but have been stipulated in the CGC's Terms of Reference not to affect GST shares.

Examples for Tasmania include, or have included:

- Payment for the transfer of the Mersey Community Hospital
- Roads of strategic importance - Midland and Bass Highways
- States' drawdowns from DisabilityCare Australia Fund
- Macquarie Point Railyards precinct remediation
- Tasmanian Forests Intergovernmental Agreement
- Improving health services in Tasmania

Commonwealth 'reward' and 'facilitation' payments

There is a general requirement in the CGC's Terms of Reference that National Partnership facilitation and reward payments should not affect relativities, so that the benefit to a State from achieving specified outputs sought by the Commonwealth, or through implementing reforms, will not be redistributed to other States through HFE. While the CGC has discretion over the treatment of facilitation payments, it does not with reward payments. Reward payments were first explicitly quarantined in the 2012 Update Terms of Reference.

For example

- Improving numeracy and literacy funding
- Seamless national economy (regulatory reforms)
- Asset recycling program

APPENDIX A

Adjusted and Assessed Budgets

The CGC bases its assessments on the average of 'what States do'. Therefore, the starting point for its assessments is to calculate national average per capita State revenues and expenditures. This is the adjusted budget.

The next step is to determine the assessed fiscal capacity for each State by applying revenue raising, or expenditure disability factors to the average expenditure and revenue categories. This is the assessed budget.

The adjusted and assessed budgets are a comprehensive representation of State budgets that take the form:

G + O + R - (E + I) = N

Where:

G = GST

O = Other Commonwealth payments

R = Own source revenue

E = expenditure

I = Investment

N = Net lending or Net borrowing

The Adjusted Budget

To determine the adjusted budget, the CGC starts with data from the Australian Bureau of Statistics (ABS) Government Finance Statistics (GFS). They are supplemented by data from the States and other sources to allow the most recently completed financial year to be included to improve comparability between States and to ensure that the composition of each revenue and expense category is consistent with CGC requirements.

However, the CGC makes some adjustments to the data for its own methodological purposes. Therefore, the outcome of the adjusted budget does not equal the outcome of State General Government sector budgets as published in GFS. The difference between these two budgets is included as a 'net balancing transaction' in the CGC's Other Revenue category.

Seven categories of State revenue and 13 categories of State expenditure are assessed in the latest *2019 Update*. Table 5 shows the adjusted budget structure and the average amount for each category for 2017-18.

The Assessed Budget

The assessed budget provides assessed revenue and expenses by category and total assessed Commonwealth payments (other than the GST). For each State, they reflect what revenue could be raised at average policy, what would need to be spent to deliver average services and the actual revenue from Commonwealth payments, which support State budgets.

The CGC then equalises service delivery capacity and revenue effort by:

- calculating, for each State expense, how much more or less than the average each State would need to spend to deliver the average service (assessed expense);

- calculating how much each State would need to invest to give it the average stock of infrastructure, recognising differences between States in the quantity they require and its costs (assessed investment);
- calculating, for each State revenue source, how much more or less than the average each State would raise if it adopted the average revenue raising policy of the States (assessed revenue); and
- taking account of the level of other Australian Government payments received by States.

A State's GST requirement is then calculated as the difference between its assessed expenditure needs and the sum of its assessed own-source revenue capacity and its actual 'tied' Australian Government funding.

Table 5: CGC Adjusted and Assessed Budgets and GST (2017-18)

	Adjusted Budget 2017-18		Assessed Budget 2017-18		∆ GST
	National	*National*	*Tasmania*	*Diff. from national EPC*	*Diff. from EPC share of GST*
Category	*$m*	*$pc*	*$pc*	*$pc*	*$m*
EXPENDITURE					
Schools education	55 346	2 234	2 428	194	101.7
Post-secondary education	5 637	228	235	7	3.8
Health	64 535	2 605	3 236	631	331.2
Housing	4 455	180	206	26	13.8
Welfare	19 649	793	945	152	79.6
Services to communities	6 728	272	285	14	7.2
Justice	20 153	814	864	50	26.4
Roads	7 322	296	284	- 12	- 6.1
Transport	14 527	586	214	- 372	- 195.3
Services to industry	6 622	267	284	17	8.9
Depreciation	14 108	570	619	49	25.8
Other expenses	33 435	1 350	1 706	357	187.2
Total expenses	**252 519**	**10 194**	**11 308**	**1 113**	**584.5**
Investment	16 517	667	355	- 312	- 163.8
Total expenditure	**269 036**	**10 861**	**11 663**	**801**	**420.7**
Net borrowing	16 806	678	662	- 16	- 8.4
REVENUE					
Own-source revenue					
Payroll tax	24 258	979	653	- 327	- 171.6
Land tax	11 581	468	261	- 206	- 108.2
Stamp duty	25 765	1 040	649	- 392	- 205.6
Insurance tax	5 553	224	184	- 40	- 21.2
Motor taxes	8 169	330	388	58	30.7
Mining revenue	12 735	514	145	- 369	- 193.6
Other revenue	53 187	2 147	2 147	-	-
Total own-source	**141 248**	**5 702**	**4 427**	**-1 275**	**- 669.5**
Commonwealth payments	47 857	1 932	2 120	188	98.7
Total revenue	**189 105**	**7 634**	**6 547**	**-1 087**	**- 570.8**
GST revenue	**63 123**	**2 548**	**4 454**	**1 906**	**1 000.5**
Tasmania's Total GST					**2 338.4**

Source: CGC, 2019 Update - The Adjusted Budget, Tab S2-1 Summary, Table S2-1-7, February 2019.
Source: CGC, 2019 Update - The Assessed Budget, Tab S3-1 Summary, Table S3-1-7, February 2019.
Source: CGC, 2019 Update - Population Data, Table S1-1 Total ERP by State, February 2019.

Above EPC GST share for Tasmania

Glossary of Terms

Application year

The year in which the average of the assessed GST distributions for each assessment year (expressed as relativities) is to be used to distribute the GST revenue. For example, in the 2019 Update the year of application is 2019-20.

Assessed expenses

The expenses a State would incur if it were to follow average expense policies, allowing for the disabilities it faces in providing services, and assuming it provides services at the average level of efficiency. Assessed expenses exclude differences from the average due to policy choices under the control of a State.

Assessed GST requirement

A State's requirement for funds from GST revenue in an assessment year. It is measured as its assessed expenses, plus its assessed investment, less its assessed revenue, less assessed Commonwealth payments and less assessed net borrowing.

Assessed net borrowing

The net borrowing assessment aims to provide each State with the same per capita stock of financial assets at the end of the year, assuming it started the year with the average at that time. A State with above average population growth is expected to need above average net borrowing.

Assessed revenue

The revenue a State would raise if it were to apply the average policies to its revenue base, and raised revenue at the average level of efficiency. Assessed revenue excludes differences from the average due to policy choices under the control of that State, for example a higher or lower tax rate applied by a State compared to the average.

Assessment years

The financial years used in a review or an update to calculate the assessed GST requirement, from which an annual relativity is calculated. The Commission uses data for three assessment years (where each assessment year corresponds to a financial year). For example, the GST distribution recommended in the 2019 Update (for the application year 2019-20) is based on the average of three assessment year annual relativities calculated for the most recent completed financial years at the time the relativities are released (2015-16 to 2017-18 assessment years).

Average (or Australian average)

The benchmark against which the performance or characteristics of a State are assessed. It is an average derived from the policies or financial data of all States, and hence may be a financial average or a policy average.

Average expenses

The average per capita expense, in a category, a group of categories or in total. It is calculated as the sum of expenses of all States, divided by the Australian population.

Average revenue

The average per capita revenue, in a category, a group of categories or in total. It is calculated as the sum of State revenues, divided by the Australian population.

Category

A classification of in scope transactions relating to distinct services or revenue sources, used for analytical purposes. In the 2019 Update, the adjusted budget is divided into Commonwealth payments, seven revenue categories, thirteen expenditure categories and net borrowing.

Commonwealth payments

Payments to States made by the Australian Government, including general revenue grants, payments for specific purpose (PSPs) and Commonwealth own purpose expenses. The Commission examines the purpose of each payment using established guidelines to decide whether the payment has an impact on State fiscal capacities.

Disability

An influence beyond a State's control that requires it:

- to spend more (or less) per capita than the average to provide the average level of service, or
- to make a greater (or lesser) effort than the average to raise the average amount of revenue per capita.

Disability factor

A measure of a State's use, cost or revenue raising disability, expressed as a ratio of the State's assessed expense or assessed revenue over the corresponding average figure. Policy differences between States are specifically excluded when calculating disability factors. The population weighted average of a disability factor is 1.0.

Distribution

State shares of GST revenue based on the principle of horizontal fiscal equalisation.

Equal per capita (EPC) assessment method

Each State's assessed expense or assessed revenue in a category is set equal to the Australian average per capita amount. It is typically used when there are judged to be no material disabilities between the States, or no reliable assessments could be developed due to data or other limitations. Such an assessment means that no needs are assessed for any State and that there is no impact on the GST distribution.

Equalisation

See horizontal fiscal equalisation (HFE).

Fiscal capacity

The fiscal capacity of a State is a measure of its ability to provide average services, including infrastructure, to its population if it raised revenue from its own revenue bases at average rates and received its actual Commonwealth payments, excluding the GST. Once the GST has been distributed using the Commission's recommendations, State fiscal capacities should be equal.

The relative capacity of each State is a comparison of its fiscal capacity with the average capacity.

Goods and Services Tax (GST) revenue or GST pool

The funds made available by the Australian Government for transfer to the States as untied financial assistance, consistent with the principle of horizontal fiscal equalisation.

Horizontal fiscal equalisation (equalisation)

A distribution of GST revenue to State governments such that, after allowing for material factors affecting revenues and expenditures, each would have the fiscal capacity to provide services and their associated infrastructure at the same standard, if each made the same effort to raise revenue from its own sources, operated at the same level of efficiency and maintained the average per capita net financial worth.

National partnership payments (NPPs)

Commonwealth payments to States that support the delivery of specified projects, facilitate reforms, or reward those jurisdictions that deliver on nationally-significant reforms.

National specific purpose payments (SPPs)

Commonwealth payments to States for specific purposes that enable national policy objectives to be achieved in areas that may be administered by States.

Payments for specific purposes (PSPs)

Australian government payments to the States for specific purposes in policy areas for which the States have primary responsibility. These payments cover most functional areas of State (and local government) activity, including health, education, skills and workforce development, community services, housing, Indigenous affairs, infrastructure and the environment. PSPs include SPPs, National Health Reform funding, Students First funding and NPPs.

Per capita

Population share of a total.

Redistribution

The difference between an equal per capita distribution of GST revenue and one based on the principle of horizontal fiscal equalisation.

Relativity

A per capita weight assessed by the Commission for use by the Commonwealth Treasury in calculating the share of the GST revenue a State requires to achieve horizontal fiscal equalisation.

Revenue base

A measure of the transactions, activities, or assets that are taxed by the States. Differences between the revenue bases of each State are used by the Commission to determine the relative capacities of each to raise a particular type of revenue.

Review

The process in which the Commission reconsiders the methods used to calculate the GST distribution, according to terms of reference given to it. From 1988 onwards, reviews have usually been done every five years. By contrast, an update is conducted every year other than a review year and updates the GST distribution using the methods determined in the last review and the latest financial data.

State(s)

Unless the context indicates otherwise, the term 'State(s)' includes the Australian Capital Territory and the Northern Territory.

Tax base

See revenue base.

Update

The annual assessment of the GST distribution undertaken by the Commission between reviews. Update assessments incorporate new budgetary developments and the most recent available data. In general, the methods used to calculate the GST distribution are those adopted in the most recent review.

Vertical fiscal imbalance

The imbalance between the revenue raising powers and the functional responsibilities of each level of government.

Acronyms

ABS	Australian Bureau of Statistics
CGC	Commonwealth Grants Commission
COPE	Commonwealth Own Purpose expenditure
EPC	Equal per capita
GST	Goods and Services Tax
HFE	Horizontal Fiscal Equalisation
NPPs	National partnership payments
NDRRA	Natural Disaster Relief and Recover Arrangements
PC	Productivity Commission
SPPs	Specific Purpose Payments