

# **The Impact of the GST on State Revenue: 2006-07 Federal Budget update**

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## Overview

### Introduction

This updated paper explains the current estimates of GST revenue to the states and how the GST works. Revenue estimates have been updated by the information provided in the 2006 Federal Budget.

The Commonwealth Government collects the GST but all GST revenue is paid to the states and territories. Under the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations, the decisions on how to allocate this revenue are made by the states and territories on the basis of their own policy priorities. In practice, the Commonwealth is endeavouring to exert increased control over state activities through funding mechanisms including the application of Special Purpose Payments.

The GST replaces Commonwealth Financial Assistance Grants and a range of state taxes. Agreement has now been reached on the abolition of additional state taxes. The Commonwealth has extended the safety net of guaranteed Budget Balancing Assistance to 2009 to ensure that no state is worse off as a result of the taxation changes.

The Budget has forecast that in 2006-07, all states and territories will receive more revenue from the GST than they would have from the previous system. Any additional funds accruing to the states and territories as a result of the introduction of the GST are described as 'windfall' gains in the Commonwealth budget papers. The states and territories received an estimated aggregate \$1.2 billion of additional funds in 2005-06.

For the past few years, actual and expected revenue outcomes accruing to the states and territories from the GST have been revised downwards. The revenue estimate for 2006-07 has been revised down since the Mid-Year Economic and Fiscal Outlook by \$240m, reflecting lower forecasts for consumption and dwelling investment and moderation in receivables.

Previous over-estimation of GST revenue and the impact of the timetable of tax changes on the net gains from taxation change mean that the latest forward estimates should be treated with considerable caution.

### Key Points

- Total revenue from the GST was estimated at \$36.8 billion in 2005-06 and the Budget has estimated that this will rise to \$39.1 billion in 2006-07.
- The 2005-06 Budget predicted that all states and territories would receive more revenue from the GST than under the previous taxation system from 2004-05 on: however NSW required Budget Balancing Assistance of \$77m in 2005-06.
- In 2006-07, total GST revenue is projected to be \$1.9 billion more than revenue levels that would have been available under the previous taxation system, rising from \$1.2 billion in 2005-06.

- From 2006-07 on, all states and territories are projected to receive more revenue from the GST than they would have prior to the changes to the taxation system.
- Agreement has been reached on timetables for the abolition of a number of additional state taxes, which is projected to reduce taxation revenue by \$4.4 billion over the four years from July 2006. The Commonwealth has extended the safety-net of guaranteed Budget Balancing Assistance to June 2009.
- The latest forecast projects additional revenue for the states and territories as a result of the taxation changes increasing each year, to \$4.1 billion in 2009-10. Final outcomes will be dependent on the timetable for abolition of the additional state taxes.
- The 2005-06 Mid-Year Economic and Fiscal Outlook forecasts factored in the abolition of all the state and territory taxes which are now subject to abolition on agreed timetables. The projected additional revenue accruing to the states in 2006-07 was estimated at \$723m, rather than the \$1.9 billion of the latest forecast. This may give some indication of the likely impact of the abolition of these taxes over the next few years.
- The distribution of GST across the states and territories remains an issue and the Commonwealth Grants Commission is undertaking a review of horizontal fiscal equalisation methodology.
- Total Commonwealth transfers to the states (including the GST) have not grown as a proportion of GDP over the last four years. (Vic DTF 2006)
- The Australian Government's underlying cash surplus is estimated at \$10.8 billion in 2006-07, or 1.1% of GDP.
- Commonwealth revenue and expenditure have grown at a greater rate than that of the states and territories, reflecting broader revenue sources which tend to grow at a faster rate. Vertical Fiscal Imbalance has increased since the introduction of the GST.
- The Council of Australian Governments (COAG) has agreed to a new National Reform Agenda and agreed that the Commonwealth will provide funding to the states on a case-by-case basis as required to ensure 'a fair sharing of the costs and benefits of reform'. Assessment of these costs and benefits will be undertaken by an independent COAG Reform Council.

<b>Revised estimate of additional revenue for the states from the GST and tax changes, 2005-06 and 2006-07</b>		
	<b>2005-06</b>	<b>2006-07</b>
	<b>\$m</b>	<b>\$m</b>
NSW	0	160.1
VIC	102.6	298.2
QLD	525.2	664.9
WA	184.8	270.2
SA	139.8	193.4
TAS	86.3	102.4
ACT	46.7	60.6

NT	1117.3	122.8
<b>Total</b>	<b>1202.7</b>	<b>1,872.6</b>

Source: Commonwealth Budget 2006-07, Budget paper No. 3

## The GST Framework

The Special Premiers' Conference in November 1998 developed principles for the reform of Commonwealth-State financial relations, which led to an Agreement between the Commonwealth and the states and territories in April 1999. Changes to the proposed new tax system required revision to the Agreement.

The revised Intergovernmental Agreement on the Reform of Commonwealth – State Financial Relations (IGA) commenced on 1 July 1999.

The objectives of the Agreement are stated as:

- (i) *the achievement of a new national tax system, including the elimination of a number of existing inefficient taxes which are impeding economic activity;*
- (ii) *the provision to State and Territory Governments of revenue from a more robust tax base that can be expected to grow over time; and*
- (iii) *an improvement in the financial position of all State and Territory Governments, once the transitional changes have been completed, relative to that which would have existed had the current arrangements continued.*

The Agreement states that the Commonwealth will provide all of the GST revenue to the states and territories and that such grants 'will be freely available for use by the States and Territories for any purpose'.

GST revenue going to the states and territories replaced the Financial Assistance Grants previously provided by the Commonwealth Government, valued at an estimated \$23 billion in 2006-07. Given that the GST is a new tax, the Commonwealth has had increased revenue available for expenditure decisions, including income tax cuts.

As part of the taxation reform process, a number of state taxes were abolished, including Financial Institutions Duty, accommodation taxes and stamp duty on marketable securities. Bank Account Debits Tax was abolished by July 2005.

Timetables for the abolition of a range of further state taxes have now been agreed. The Commonwealth will pursue abolition of the one remaining tax listed for review under the Intergovernmental Agreement.

## Guaranteed minimum revenue

Under the Agreement between the Commonwealth and the states when the GST was introduced, each state was guaranteed that they would be no worse off under the new system.

In order to meet this guarantee, the Commonwealth has paid the states Budget Balancing Assistance to cover any shortfall of GST revenue compared to each state's Guaranteed Minimum Amount. The Guaranteed Minimum Amount for each state is the amount each would have had if the tax reform had not been implemented. The initial guarantee applied until 30 June 2006 and it has now been extended until 30 June 2009 to ensure no financial disadvantage to the states as a result of their agreement to abolish state taxes.

The GST is a growing revenue base and so this Budget Balancing Assistance program was seen as a transitional one, to be removed when the GST revenue exceeded the amount that each state would have had under the previous system. In 2005-06, only NSW needed to receive Budget Balancing Assistance to ensure that the state was no worse off financially as a result of the taxation changes. The current forecasts suggest that no state or territory will require Budget Balancing Assistance from 2006-07 on. However, previous forecasts to this effect have not been realised.

Residual adjustments ensure that any underestimate or overestimate of payments are offset. In 2005-06, NSW was required to pay a negative residual adjustment amount of \$43.8m because of GST overpayment in 2004-05. The Budget estimated that payments to NSW in 2005-06 will exceed final entitlements by \$30.8m and this will be deducted from 2006-07 payments to NSW.

The Commonwealth also provided compensation to the states and territories for the decision to allow certain small businesses and not for profit organisations to be able to lodge annual GST payments from 2004-05, which means a deferral of some GST payments. The Commonwealth provides an advance on payments, adjusted once final data is available. The Budget estimates that \$17.2m will be paid to the states in 2006-07.

### **The Federal push for further state tax cuts**

In addition to the taxes that have been abolished to date, the 1999 Agreement provided for the review by July 2005 of stamp duty on non-residential conveyances, leases, mortgages, debentures, bonds and other loan securities; credit arrangements, instalment purchase arrangements and rental arrangements; and on cheques, bills of exchange, promissory notes; and unquoted marketable securities.

All states abolished debits tax by July 2005. During 2005 the Federal Treasurer sought to pressure/persuade all state and territory governments to abolish the remaining taxes which were subject to review under the Intergovernmental Agreement. The Mid-Year Economic and Fiscal Outlook estimated that abolition of these taxes would reduce taxation by \$8.8 billion over the four years from 2006-07. The states' net gain from the tax changes would then be around \$1.4 billion by 2008-09. (This contrasts with the latest forecast of an additional \$3.7 billion revenue in 2008-09 and \$4.1 billion in 2009-10 – forecasts which do not factor in all of the proposed tax changes.)

Agreement was reached at the March 2006 Ministerial Council for Commonwealth-State Financial Relations on timetables for abolition of a number of the additional state taxes listed for review under the Intergovernmental Agreement, which is projected to reduce state taxation revenue by \$4.4 billion over the four years from July 2006. (The agreement with NSW came after that meeting).

The Commonwealth has indicated that it will continue to pursue the abolition of stamp duty on business conveyances of real property which is the last tax listed for review under the Intergovernmental Agreement.

Although the Budget forecasts additional funds for all states and territories over the next few years, the Commonwealth has extended the safety-net of guaranteed Budget Balancing Assistance to June 2009.

## **The growth in GST revenue**

One of the other objectives outlined in the 1999 Agreement is provision of a revenue base that can be expected to grow over time. However it has been argued that the nature of the GST's revenue base creates built-in constraints on the extent of such growth.

The Queensland Council of Unions' Budget submission to the Queensland Government for 2005-06 argued, for example, that while GST revenue in the first years may have grown more rapidly than GDP, this may have reflected improvements in compliance as initial problems in implementation were overcome. Because the GST is a broad-based consumption tax, in the longer term it will grow in line with GDP. 'This feature of the GST protects the state from a decline in revenue relative to expenditure needs but, conversely, provides no scope for expansion.'

In 2002-03, the Commonwealth provided Budget Balancing Assistance of \$1,004 million. It was distributed to every system apart from Queensland and the Northern Territory, where the GST revenue exceeded the Guaranteed Minimum Amount. Queensland GST revenue exceeded the minimum by \$97.5m and the Northern Territory GST revenue by \$9.2m.

In 2003-04 Budget Balancing Assistance of \$46m was paid only to NSW.

The other states and territories no longer accessed such assistance in 2003-04 because their GST revenue exceeded the level of revenue they would previously have had. The total additional revenue for these states and territories was \$1.2 billion in 2003-04.

No Budget Balancing Assistance was paid to any state or territory in 2004-05 since all were receiving more revenue than they would have under the previous tax system. The May 2005 Commonwealth budget reported that GST revenue had grown from \$24.4 billion in 2000-01 to an estimated \$37.3 billion in 2005-06, an increase of \$12.99 billion, or 53.3%. This is an average increase of 9% per year.

In 2005-06, however, NSW again required Budget Balancing Assistance of \$43.8m in order to maintain the level of revenue available prior to the tax changes.

NSW Treasury has calculated that the states and territories have received an aggregate \$4.4 billion in additional revenue since the introduction of the GST (see table). It noted that the Guaranteed Minimum Amount is itself affected by the distribution relativities determined by the Commonwealth Grants Commission. NSW has argued that NSW has 'lost significantly more revenue from abolished state taxes and abolished Commonwealth grants (in addition to facing new costs) than the GST revenue grants which replaced these revenue sources.'(NSW Budget Statement 2006-07)

<b>GST revenue additional to the guaranteed minimum amount, 00-01 to 05-06</b>							
	<b>00-01</b>	<b>01-02</b>	<b>02-03</b>	<b>03-04</b>	<b>04-05</b>	<b>05-06</b>	<b>Total</b>
	<b>\$m</b>	<b>\$m</b>	<b>\$m</b>	<b>\$m</b>	<b>\$m</b>	<b>\$m</b>	<b>\$m</b>
NSW	0	0	0	0	209	0	<b>209</b>
VIC	0	0	0	112	296	103	<b>511</b>
QLD	0	0	76	502	769	525	<b>1872</b>
WA	0	0	0	150	250	185	<b>585</b>
SA	0	0	0	95	175	140	<b>410</b>
TAS	0	0	0	70	106	86	<b>262</b>
ACT	0	0	0	39	56	47	<b>142</b>
NT	0	0	10	110	141	117	<b>378</b>
<b>TOTAL</b>	<b>0</b>	<b>0</b>	<b>86</b>	<b>1,078</b>	<b>2,002</b>	<b>1,203</b>	<b>4,369</b>

Source: NSW Budget Statement 2006-07

The 2006-07 Budget has estimated that annual growth in GST revenue has averaged 8.3% since its introduction in 2000-01. This has varied between an average annual increase of 7.1% for NSW to 9.5% for Queensland as a result of decisions re the distribution of revenue between states.

This increase must be seen in the context of the abolished state taxes which have lowered states' own-revenue, and in the context of overall movements in public sector finances, particularly the aggregate Commonwealth payments to the states.

In a similar vein, the Victorian Department of Treasury and Finance has recently argued that:

'Claims that the GST has provided a revenue windfall for the States and Territories are without foundation. The GST has replaced a number of state taxes, and because GST revenue grows broadly in line with household expenditure and is a flat rate tax, there is little prospect that it will reduce VFI' (Vertical Fiscal Imbalance). (Vic DFT 2006)

It is also worthy of note that GST revenue outcomes for the states and territories over recent years have been revised downwards from earlier forecasts. Payments for 2005-06 were adjusted to account for the final 2004-05 outcome, which was \$287m lower than expected. The 2005-06 outcome is now estimated to be \$337.3m lower than the projection in the previous budget. The revenue estimate for 2006-07 has been revised down since the Mid-Year Economic and Fiscal Outlook by \$240m, reflecting lower forecasts for consumption and dwelling investment and moderation in receivables.

## **GST revenue forecasts**

Latest revised estimates indicate that, in 2005-06, the GST and tax changes will have provided an additional \$1.2 billion to the states and territories over the Guaranteed Minimum Amount, noting that within this total, NSW required Budget Balancing Assistance of \$43.8m. This is \$337.3m less than the amount forecast in the 2005-06 Budget. The forecast level of actual GST revenue for 2005-06 has now been estimated at \$36.8 billion, or \$527.4m lower than previously forecast.

Latest revenue forecasts for 2006-07 and on have been adjusted to take account of the further state taxes which have been abolished in all states and territories. Revenue foregone from the abolition of additional state taxes has been included in the forecasts for 2009-10.

The revised aggregate revenue forecasts are:

2006-07: \$39.1 billion, or \$1,872.6 million over the Guaranteed Minimum Amount  
 2007-08: \$41.3 billion, or \$2,854.9 million over the Guaranteed Minimum Amount.  
 2008-09: \$43.5 billion, or \$3,710.1 million over the Guaranteed Minimum Amount.  
 2009-10: \$45.7 billion, or \$4,061.9 million over the Guaranteed Minimum Amount.

These revised forecasts of additional revenue resulting from the GST and taxation reform have increased markedly over those provided in the 2005-06 Budget and in the January 2006 mid-year forecast, mainly because the previous forecasts incorporated Commonwealth proposals for further abolition of state taxes from 2006-07. These further tax changes, most of which are now agreed, have been only partially factored into the latest forward estimates at later stages.

The 2005-06 mid-year Budget estimate had previously forecast additional revenue of \$723 million in 2006-07 and \$918 million in 2007-08, which factored in the effects of the abolition of all other state taxes subject to review under the IGA from 2006-07 with the exception of stamp duty on business conveyances of real property which was factored in from 2006-07. This is the only state tax still subject to review since timelines for the abolition of all other taxes under the IGA have now been agreed.

For NSW, the previous forecasts provided for no additional revenue above the level provided by the previous arrangements. The 2005-06 MidYear forecasts incorporated Budget Balancing Assistance for NSW from 2006-07 on, when all the state taxes subject to review were to be abolished under the federal plan.

The 2006-07 revised forecasts, using different timelines for the abolition of those state taxes, project additional revenue for NSW and all other states and territories from 2006-07. The previous 2005-06 Budget forecasts are available in the 2005 Update report at <http://www.aefederal.org.au/Publications/impgst2006.pdf>

<b>Revised GST/tax reform revenue forecasts 2006-07 to 2009-10</b>								
	<b>GST/tax reform revenue</b>				<b>Net additional revenue over the Guaranteed Minimum Amount</b>			
	<b>2006-07</b>	<b>2007-08</b>	<b>2008-09</b>	<b>2009-10</b>	<b>2006-07</b>	<b>2007-08</b>	<b>2008-09</b>	<b>2009-10</b>
	<b>\$m</b>	<b>\$m</b>	<b>\$m</b>	<b>\$m</b>	<b>\$m</b>	<b>\$m</b>	<b>\$m</b>	<b>\$m</b>
NSW	10,941.4	11,728.3	12,614.0	13,533.2	160.1	498.3	806.7	946.2
VIC	8,465.4	8,993.4	9,536.7	9,949.6	298.2	572.8	815.7	899.6
QLD	7,968.9	8,288.6	8,564.0	8,888.6	664.9	828.8	949.7	971.6
WA	3,921.8	4,080.3	4,224.3	4,391.5	270.2	386.1	482.5	521.8
SA	3,543.5	3,719.9	3,871.2	4,029.2	193.4	257.6	319.1	352.9
TAS	1,556.7	1,605.4	1,650.8	1,697.3	102.4	113.5	124.8	133.9
ACT	758.0	799.2	836.2	879.6	60.6	78.5	92.4	100.6
NT	1,974.4	2,084.9	2,182.8	2,301.1	122.8	119.2	119.4	135.2
AUST	39,130.0	41,300.0	43,480.0	45,670.0	1,872.6	2,854.9	3,710.1	4,061.9

Source: Commonwealth Budget 2006-07, Budget paper No. 3

These projections will be affected by the timelines for the abolition of further state taxes and by the recommendations by the Commonwealth Grants Commission on the distribution of GST revenue between the states.

While the Budget forecasts additional revenue to the states and territories to rise to \$4.1 billion by 2009-10, the Commonwealth has extended the transitional period under which the Commonwealth guarantees that no state or territory would be worse off until 30 June 2009.

## Distribution of GST revenue

The GST is distributed between the states and territories on the basis of recommendations made by the Commonwealth Grants Commission, which take the various cost disabilities and advantages of each system into account. It is far more expensive, for example, to provide services in the Northern Territory than it is in the larger states.

The intention is to share the funding in such a way that if all systems made the same effort to raise revenue and operated at the same level of efficiency, they should have the capacity to provide services at the same standard. This method of distribution is called Horizontal Fiscal Equalisation.

NSW and Victoria receive less than equal per capita shares and the other states and territories receive more to various degrees.

The Commonwealth Budget estimated that about \$3.2 billion, or 6.8% of the total pool of GST revenue and Health Care Grants, would be redistributed in this way in 2006-07.

Following a review undertaken by the Heads of Treasuries, the 2005 meeting of the Ministerial Council for Commonwealth-State Financial relations agreed that, while the Commonwealth Grants Commission methodology was 'generally robust', work would be undertaken to simplify the methodology by 2010, without compromising the underlying principle of Horizontal Fiscal Equalisation. The Commonwealth Grants Commission reported to the Ministerial Council in March 2006 and will report again on progress in 2007. The Progress report ([www.cgc.gov.au](http://www.cgc.gov.au)) acknowledged that states had differing views about how equalisation should be approached and measured. Both Victoria and NSW continue to argue for more fundamental reform to the national approach to horizontal fiscal equalisation.

<b>GST revenue and Horizontal Fiscal Equalisation effects, 2006-07</b>				
	Per capita relativities	Population (million)	GST/Health Care grants to be distributed  \$m	Difference between distributed grants and equal per capita distribution  \$m
NSW	0.87332	6.9	13,728.8	-1,997.9
VIC	0.89559	5.1	10,477.3	-1,266.3
QLD	1.02387	4.1	9,573.9	219.4
WA	1.00480	2.1	4,745.1	20.7
SA	1.18862	1.6	4,231.6	670.0
TAS	1.54931	0.5	1,735.4	614.8
ACT	1.14575	0.3	863.3	109.5
NT	4.32755	0.2	2,067.7	1,589.7

Source: Commonwealth Budget 2006-07, Budget paper No. 3

## Other Commonwealth funding to the states and territories

The Australian system of government funding operates within a framework of what is called Vertical Fiscal Imbalance. That is, the revenue base of the Commonwealth is significantly larger and broader than that available to the states and territories. Federal taxes are based on progressive tax scales and therefore increase at a greater rate. For example, in the last four years 'the ratio of income tax to GDP has increased substantially despite some income tax cuts over that period' and income tax cuts 'have largely amounted to de facto indexation' (Vic DTF 2006).

In 2004-05, the Commonwealth collected taxation revenue of \$229.1 billion, or 85 % of total taxation revenue, compared to the states and territories' own-source taxation revenue of \$41.6 billion, or 15%. GST is a Commonwealth tax but even if it is considered as transferred to the states, the Commonwealth still holds 72% of taxation revenue and 66% of total revenue (ie including non-taxation revenue). (Vic DTF 2006). The removal of a number of state taxes in conjunction with the introduction of the GST has increased the states' reliance on grants from the Commonwealth.

The states have greater service responsibilities than does the Commonwealth, and collectively employ 1.2 million workers compared to the 248,600 employed by the Commonwealth. (Vic DTF 2006).

GST revenue, which replaces the former Financial Assistance Grants, is only one element of the Commonwealth funding provided to the states and territories.

The Commonwealth also provides to the states and territories the following funds as set out in the 2006-7 Budget:

Specific Purpose Payments to the states (eg public education)	\$20,464.3m
Specific Purpose Payments paid through the states (eg non gov't schools)	\$7,363.0m
Specific Purpose Payments direct to local government	\$497.1m
Compensation for GST deferral	\$17.2m

The Commonwealth Government has decided to discontinue National Competition Policy Payments from 2006-07. The final payment for 2005-06 was \$820.4 million.

As the Victorian Department of Treasury and Finance has argued, total transfers to the states (which include the GST and other grants) have not grown as a share of Gross Domestic Product over the last four years. (Vic DTF 2006)

The Victorian Department argues that:

'More generally, the States and Territories have demonstrated more restraint in their expenditure growth than the Commonwealth in recent years. From 2000-01 to 2004-05, total State & Territory gross operating expenditure grew at an average annual rate of 6.3%. Over the same period, total revenue grew at an annual rate of 6.9%.

...Over the same period, Australia's nominal GDP grew at an annual rate of 6.7%, implying that the State & Territory Governments have merely maintained, if not reduced, their share of the national economy. In contrast, the Commonwealth Government increased its relative size over this period, with average annual growth in spending of 8 per cent'. (Vic DTF 2006)

The COAG Agreement on a new National Reform Agenda may lead to additional payments to the states and territories. The February 2006 meeting of COAG agreed to a new National Reform Agenda and agreed that the Commonwealth will provide funding to the states on a case-by-case basis as required to ensure 'a fair sharing of the costs and benefits of reform'. The July 2006 COAG meeting agreed that additional payments would be made to the states and territories linked to agreed actions or progress measures, taking into account the relative costs and benefits to the Commonwealth and States. Assessment of these costs and benefits will be undertaken by an independent COAG Reform Council. (COAG 2006)

## **Commonwealth revenue and expenditure**

### **Surplus**

The Australian Government's underlying cash surplus for 2005-06 is now expected to be \$14.8 billion. This is \$5.9 billion more than the \$8.9 billion surplus projected in the May 2005 Budget.

The headline cash balance for 2005-06 is an estimated surplus of \$13.5 billion, up from the \$7.9 billion projected in the last budget. The difference between the two figures is that the headline cash balance includes cash flows from investments in financial assets for policy purposes and Future Fund earnings as well as the underlying cash balance. The Future Fund was established to meet unfunded superannuation liabilities and is intended to be quarantined from the rest of the budget. The 2005 Budget indicated that future budget surpluses would be invested in the Fund.

The projected underlying cash surplus for 2006-07 is \$10.8 billion or 1.1% of GDP, rising to \$12 billion by 2009-10. This is \$2.9 billion more than the \$7.9 billion projected in last year's budget for this financial year. The forecast surplus is despite the 2006-07 Budget policy decisions which will reduce revenue by an estimated \$7 billion in 2006-07 (including personal income tax cuts worth \$6.4 billion) and around \$39.1 billion over the forecast period to 2009-10.

The headline cash balance for 2006-07 is projected to be \$37.5 billion, up from the \$18.2 billion forecast last year. This is largely based on an assumption that Telstra will be sold during 2006-07 and proceeds transferred to the Future Fund, although the forecast has increased by \$1.3 billion since the Mid Year Economic and Fiscal Outlook because of the increase in the underlying cash balance and the inclusion of expected Future Fund earnings. The forecast headline cash balance for 2007-08 is \$10.7 billion, rising to \$12.3 billion by 2009-10.

### **Revenue**

Total revenue for 2005-06 is estimated at \$222.8 billion, up by \$8.4 billion since the 2005-06 Budget.

Total revenue for 2006-07 is estimated at \$231.7 billion, up \$8.8 billion or 3.9%. This is despite the policy decisions to reduce personal income tax and to change the depreciation rate for company assets, which have reduced estimated revenue by around \$7 billion.

The growth in taxation revenue is largely due to increased corporate profitability, leading to revenue from companies increasing by \$6.4 billion. In addition, taxation revenue from individuals is expected to grow by \$810 million.

## **Expenditure**

General Federal Government expenses are expected to total \$219.7 billion in 2006-07, up \$13.7 billion from 2005-06 or 4.1% in real terms. This includes \$6.5 billion arising from policy decisions since the 2005-06 Budget.

## **A growing Commonwealth revenue base**

Australia has a relatively low taxation burden overall, about 31.6% of GDP compared to the OECD average of 36.3%.

The structure of Australia's taxation system is based on a high level of Vertical Fiscal Imbalance, which has been increasing since the introduction of the GST.

The Commonwealth Government frames and collects the GST but Budget data always categorises it as a state and territory tax. Even with the GST excluded, Australian Government revenue has increased from \$162.1 billion in 2000-01 (the year the GST was introduced) to an estimated \$231.7 billion, or 42.9%. As a proportion of GDP, Commonwealth government revenue in 1999-00 was 25.9%, falling to 23.5% in 2000-01. Notwithstanding tax cuts, Commonwealth revenue is still estimated at 23% of GDP for 2006-07.

In contrast, State and territory revenue was 16.8% of GDP in 1999-00, 16.7% in 2000-01 and has fallen to 15.9% in 2006-07, even with the GST categorised as state taxation revenue.

Yet the transfer of the GST to the states and territories has replaced the previous transfer of other taxation revenues collected by the Commonwealth. A total of \$4.4 billion in additional funds generated via the GST over six years must be considered in the context of the size of the overall public sector finances and in the context of the growth in Commonwealth revenue over that period.

The Australian Bureau of Statistics (ABS) categorises the GST as a Commonwealth tax, which replaced a range of sales taxes which were reduced by some \$13.7 billion when the GST was introduced.

In 1999-00, the year prior to the introduction of the GST, Commonwealth taxation revenue was \$152.6 billion, or 77.8% of all taxation revenue from all levels of government. Commonwealth taxation revenue was 24.1% of all taxation revenue in 1999-00, while state and local taxation revenue was 6.9% of GDP. In 2004-05, Commonwealth taxation revenue was \$229.1 billion, or 82.3% of taxation revenue for all levels of government. Commonwealth taxation revenue was 25.7% of GDP, while total taxation revenue from state and local governments was 5.6% of GDP. (ABS 5506.0)

Even when the GST is categorised as a state tax, states' revenue as a proportion of GDP has fallen at a greater rate than that of the Commonwealth. When, as the ABS does, GST is categorised as a Commonwealth tax, Commonwealth revenue has increased as a proportion of GDP while states' revenue has fallen.

While the GST, as a broad based consumption tax, is likely to grow more or less in line with GDP, Commonwealth revenues are broader and tend to grow at a greater rate. Forecast growth in GST revenue for the states is relatively modest particularly when the impact of abolishing additional state taxes is factored in. Vertical Fiscal Imbalance is likely to increase and certainly the Budget forecasts are predicting ongoing and substantial surpluses for the Commonwealth government.

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