

# **The Impact of the GST on State Revenue: 2005-06 Federal Budget update**

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## Overview

**This 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 2005-06 Federal Budget. From 2004-05, all states and territories have been receiving more revenue from the GST than they have from the previous system. However, the Commonwealth has been pressuring the states and territories to abolish additional state taxes that the Intergovernmental Agreement required them to review. This would reduce the projected GST revenue available to the states and territories over the next four years by \$7.4 billion. Over the three years from 2006-07, this will require payment of Budget Balancing Assistance of \$563.1 million to ensure that all states and territories are not worse off than they were under the previous system. All of those monies will be paid to NSW.**

The Commonwealth Government collects the GST but all GST revenue is paid to the states and territories. Under the Agreement, the decisions on how to allocate this revenue are made by the states and territories on the basis of their own policy priorities.

Total revenue from the GST was \$35.5 billion in 2004-05 and the Budget has estimated that this will rise to \$37.3 billion in 2005-06.

- From 2004-05 onwards, all states and territories have received more revenue from the GST than they would have prior to the changes to the taxation system.
- In 2005-06, GST revenue is estimated to be \$1.5 billion more than revenue levels that would have been available under the previous taxation system.
- Additional revenue from the GST has fallen from \$2.2 billion in 2004-05 to \$ 1.5 billion in 2005-06 as a result of the agreement to abolish bank accounts debit tax (\$1.1 billion) from 1 July 2005.
- Given the Commonwealth demands for further state taxes to be abolished, the Federal Budget indicates that GST revenue is projected to provide the states and territories with a lower return over the next years, returning to \$1.4 billion over the previous system in 2008-09.

### **Revised estimate of 2004-05 and 2005-06 additional revenue for the states from the GST and tax changes:**

	2004-05	2005-06
	\$m	\$m
NSW	257.8	60.4
VIC	319.4	198.5
QLD	798.3	594.8
WA	271.3	230.3
SA	187.0	166.5
TAS	111.9	97.9
ACT	57.3	53.6
NT	148.1	137.9
Total	2,151.1	1,540.0

## **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 \$22 billion in 2005-06. (Given that the GST is a new tax, the FAGS revenue has presumably been largely available to the Commonwealth for expenditure decisions, including income tax cuts. The total level of additional revenue available to the Commonwealth as a result of the introduction of the GST requires further investigation.)

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. Other changes were also implemented. Bank Account Debits Tax is scheduled to be abolished by July 2005 and this is included in the Guaranteed Minimum Amounts from 2005-06. It was agreed that some other state taxes would be the subject of Ministerial Council review in 2005.

### **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 current guarantee applies until 30 June 2006 although there is now an offer to extend it in conjunction with further tax abolitions.

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. It has no longer been applied from 2004-05 in practice.

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 provided an advance on payments, adjusted once final data is available.

## **The growth in GST revenue**

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.

The Federal Treasurer has proposed extending the transitional period under which the Commonwealth guarantees that no state or territory would be worse off, until 30 June 2009, if the states agree to abolish taxes subject to review under the 1999 Agreement.

## **The Federal push for further 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.

The Federal Treasurer, Peter Costello, has been endeavouring to pressure/persuade all state and territory governments to abolish these taxes given what he describes as the 'growing windfall' of GST revenue. Six states and territories have agreed to a timeline for the abolition of these taxes, where they had not already done so. NSW and Western Australia continue to maintain their right to continue these stamp duties, arguing that they have met the terms of the Agreement by reviewing those taxes. The Treasurer has not indicated the Federal response to any states refusing to abolish those stamp duties.

Abolition of these various stamp duties by all states and territories would cost a total of \$7.4 billion in revenue that would otherwise have been available over the next four years. The transitional period will be extended to June 2009 if the states agree and thus Budget Balancing Assistance would be provided during this period if revenue failed to match what would have been available under the previous system.

One of the other objectives outlined in the 1999 Agreement is provision of a revenue base that can be expected to grow over time.

The Queensland Council of Unions Budget submission to the Queensland Government for 2005-06 has 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.'

It follows, the QCU argued, 'that there is no case for the state government to give up revenue sources, in addition to those already agreed, as an offset for GST revenue.'  
([http://www.qcu.asn.au/Budget\\_Submission05final.pdf](http://www.qcu.asn.au/Budget_Submission05final.pdf).)

## **GST revenue forecasts**

The revised estimates for 2004-05 indicate the GST will have provided an additional \$2.2 billion to the states and territories over the Guaranteed Minimum Amount. This is up from the \$1.9 billion estimated in the mid-year forecast. It includes compensation for the deferral of some GST payments until 2005-06.

Taking into account the abolition of bank accounts debit tax by 1 July 2005, GST revenue for 2005-06 is estimated to grow to \$37.3 billion, \$1.5 billion more than the Guaranteed Minimum Amount.

Revenue forecasts have been adjusted to take account of the Federal proposal to abolish a range of stamp duties from 2006-07.

The revised aggregate revenue forecasts are:

2006-07: \$39.2 billion, or \$705.7 million over the Guaranteed Minimum Amount  
2007-08: \$41.3 billion, or \$909.9 million over the Guaranteed Minimum Amount.  
2008-09: \$43.5 billion, or \$1,440.0 million over the Guaranteed Minimum Amount.

If the revised forecasts are accurate, this is the additional revenue that the states and territories can anticipate from the GST over the next few years. These forecasts are considerably lower than earlier projections.

The 2004-05 mid-year Budget estimate had previously forecast additional revenue of \$2,283.5 million in 2006-07 and \$3,172.9 million in 2007-08.

For NSW, the forecasts indicate no additional revenue above the level provided by the previous arrangements. The forecasts incorporate Budget Balancing Assistance for NSW from 2006-07 on, when the state taxes would be abolished under the federal plan. In order to receive the same level of revenue as under the previous system were the various stamp taxes to be abolished as the Commonwealth demands, NSW would go from receiving an additional \$60.4m in 2005-06 to requiring Budget Balancing Assistance of \$240.9m in 2006-07, \$244m in 2007-08 and \$78.2m in 2008-09. The revenue foregone were NSW to accede to the Federal demands to abolish stamp duty taxes would be \$410.0 m in 2006-07 and \$681.3m in 2007-08, or \$1.1 billion over the two years.

All other states and territories would receive (reduced) additional monies from the GST during that period. Across all states and territories, the revenue foregone by the abolition of the reviewable taxes would be \$1.6 billion in 2006-07 and \$2.3 billion in 2007-08.

<b>Revised GST/tax reform revenue forecasts 2005-06 to 2008-09</b>								
	<b>GST/tax reform revenue</b>				<b>Net additional revenue over the Guaranteed Minimum Amount</b>			
	<b>2005-06 \$m</b>	<b>2006-07 \$m</b>	<b>2007-08 \$m</b>	<b>2008-09 \$m</b>	<b>2005-06 \$m</b>	<b>2006-07 \$m</b>	<b>2007-08 \$m</b>	<b>2008-09 \$m</b>
NSW	10,426.7	11,136.7	11,733.5	12,378.5	60.4	0.0*	0.0*	0.0*
VIC	7,864.5	8,397.2	8,904.8	9,452.7	198.5	57.1	244.5	483.9
QLD	7,721.1	7,957.7	8,399.7	8,789.4	594.8	289.4	307.1	423.7
WA	3,822.1	3,925.3	4,172.9	4,422.4	230.3	71.5	75.1	160.4
SA	3,449.0	3,574.3	3,722.0	3,869.6	166.5	69.1	65.5	119.0
TAS	1,501.4	1,535.4	1,581.4	1,633.4	97.9	65.6	62.4	76.8
ACT	722.6	756.8	792.7	825.8	53.6	44.4	59.0	74.4
NT	1,832.7	1,916.6	2,012.9	2,108.1	137.9	108.6	96.4	101.7
AUST	37,340.0	39,200.0	41,320.0	43,480.0	1,540.0	705.7	909.9	1,440.0

*Projections from 2006-07 on will be affected by recommendations of the Commonwealth Grants Commission on the distribution between states.*

## **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 \$3.4 billion, or 7.4% of the total pool of GST revenue and Health Care Grants, would be redistributed in this way in 2005-06.

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.

<b>GST revenue and Horizontal Fiscal Equalisation effects, 2005-06 (Budget Paper no. 3, May 2005)</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	0.86846	6.8	13,090.3	-1,979.3
VIC	0.87552	5.1	9,782.5	-1,388.3
QLD	1.04389	4.0	9,240.0	390.5
WA	1.02500	2.0	4,603.5	113.3
SA	1.20325	1.5	4,107.1	694.5
TAS	1.55299	0.5	1,672.1	595.6
ACT	1.14300	0.3	822.5	103.0
NT	4.26682	0.2	1,920.5	1,470.5

### **Other Commonwealth funding to the states and territories**

The Commonwealth also provides to the states and territories the following funds as set out in the 2005-06 Budget:

National Competition Policy Payments	\$799.2m
Specific Purpose Payments to the states (eg public education)	\$19,065.6m
Specific Purpose Payments through the states (eg nongov't schools)	\$7,025.4m
Specific Purpose Payments direct to local government	\$439.9m
Compensation for GST deferral (2004-05, conditional)	\$127.0m

### **Commonwealth revenue**

The Australian Government's underlying cash surplus for 2004-05 is now expected to be \$9.2 billion. This is \$3 billion more than the \$6.2 billion revised surplus projected in the 2004-05 Mid-year statement and \$6.8 billion more than projected in the May 2004 Budget. In accrual terms, the estimated surplus for 2004-05 is \$7 billion, up by \$6.3 billion since the May 2004 Budget estimate.

The projected underlying cash surplus for 2005-06 is \$8.9 billion, falling to \$7.9 billion in 2006-07. The headline cash balance for 2006-07 is projected to be \$18.2 billion – the difference is the decision to commit accumulated surpluses of around \$16 billion to the Future Fund as seed capital, to offset unfunded superannuation liabilities estimated at \$91 billion. The Government intends to invest future budget surpluses in the Fund, which can only be drawn down to meet superannuation payments.

The Commonwealth determines the allocation of the surplus in accordance with government priorities.

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