



*Treasurer
Minister for Infrastructure
Minister for the Hunter*



Mr Stephen Palethorpe
Secretary
Senate Standing Committee on
Finance and Public Administration
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Dear Mr Palethorpe

**SENATE STANDING COMMITTEE INQUIRY INTO STATE AND TERRITORY
GOVERNMENT FINANCIAL MANGEMENT**

I am writing in response to your recent invitation to Mr John Pierce, Secretary to the NSW Treasury, to make a submission to the Senate Standing Committee Inquiry into State and Territory Government Financial Management.

One of the key issues in managing State finances is the financial relationship between the Commonwealth and State Governments. Grants from the Commonwealth to NSW in 2007-08 are estimated to be \$19.2 billion, consisting GST revenue grants of \$11.9 billion and Specific Purpose Payments of \$7.3 billion. Grants from the Commonwealth account for approximately 43 per cent of total NSW Government revenue.

In view of the central importance of grants of financial assistance from the Commonwealth to the States, the NSW Government commissioned Professor Neil Warren, an eminent expert in the field of taxation and Commonwealth-State financial relations, to carry out an independent benchmarking study in 2006 into Australia's intergovernmental fiscal arrangements.

Attached for your information is a copy of Professor Warren's final report *Benchmarking Australia's Intergovernmental Fiscal Arrangements*. Also attached is an outline of the key findings and outcomes of Professor Warren's report. I trust the Senate's inquiry will take into account this information in preparing its final report.

Yours sincerely

MICHAEL COSTA

ATTACHMENT A

BENCHMARKING AUSTRALIA'S INTERGOVERNMENTAL FISCAL ARRANGEMENTS: KEY FINDINGS AND OUTCOMES

Introduction

Professor Warren's Report compares and benchmarks Australian and international arrangements for the allocation of taxation powers and expenditure responsibilities between central and subnational (State) governments, and mechanisms for fiscal transfers between governments. Warren found that:

"Australia performs comparatively poorly in international comparisons of intergovernmental fiscal arrangements. A review in the national interest is overdue and essential if Australia is to adequately meet the challenges of an ageing population. International experience shows that comprehensive reform to intergovernmental fiscal arrangements is being undertaken in many federations."

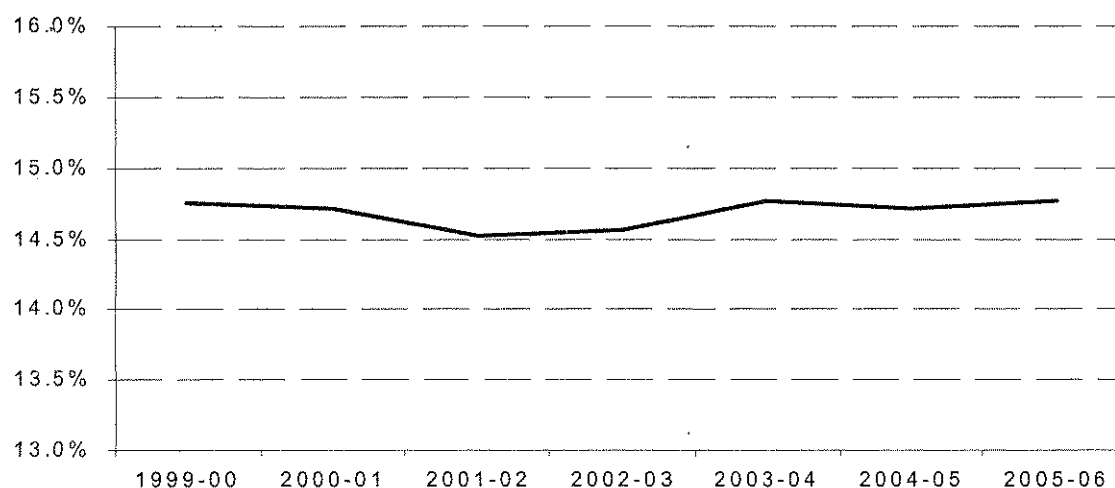
"Australia's system of intergovernmental fiscal arrangements is characterised by very high vertical fiscal imbalance (VFI) due to inadequate State tax powers, and complex and high level equalisation. These arrangements hinder adjustments in the economy that are essential for the economy to develop and grow, as it must if Australia is to meet future challenges." (page xix)

The range of reforms associated with the introduction of the GST increased the degree of VFI in Australia. Warren also found that there has been a trend towards greater concentration of taxing powers in the hands of the Commonwealth since Federation.

New South Wales believes the current Commonwealth-State financial arrangements to be unstable in the longer term. The GST-based funding arrangements were supposed to provide States and Territories with a better deal than the previous system. It is, however, a myth that there has been a funding windfall to all States and Territories.

The introduction of the GST in 2000-01 has not been accompanied by higher overall State revenue. The share of all States' total revenue to gross domestic product (GDP) is relatively unchanged since the introduction of the GST, as shown in the chart below.

All States' Total Revenue as a Share of GDP, 1999-2000 to 2005-06 ¹



¹ Total revenue data are sourced from the Australian Bureau of Statistics, Government Finance Statistics, Australia, 2005-06, Cat No. 5512.0. GDP data are from the Australian Bureau of Statistics, Australian National Accounts: State Accounts, 2005-06 (Reissue), Cat No. 5220.0.

The GST has delivered New South Wales less funding from the Commonwealth than was expected when the new arrangements were implemented in 2000. In the seven years to 2006-07, New South Wales will have received around \$980 million less than was expected in 2000. New South Wales has fared worst by far, being the only State to have received less than was initially expected.

Furthermore, the annual average growth rate for New South Wales total revenue is broadly unchanged in the five years before and after the introduction of the GST.

Independent economic analysis by Rory Robertson also shows how the States have been short changed by the Commonwealth over the GST arrangements. According to Mr Robertson:

"The States' current funding from Canberra amounts to only 5.1% of GDP in each of the past four years..."

...That's down from 5.3% of GDP in 1996-97 and around 6-7% of GDP in the late 1980s.

*Indeed... the 5.1% of GDP figure remains a three-decade low."*²

Mr Robertson also calculates that the Commonwealth's own tax revenue, made up of all revenues collected by the Commonwealth less all revenues it transfers to the States and local governments, is at an all time high.

Mr Robertson calculates that the Commonwealth's own tax revenue was 18.4 per cent of GDP in both 2004-05 and 2005-06 and that over the six full years since the introduction of the GST in 2000-01 it has averaged 18 per cent of GDP, that is, almost two per cent higher than the average of the previous two decades.

² Rory Robertson, "Budget/Federalism Watch – 23 April 2007", Macquarie Bank.