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Federal-State Financial Relations: After the GST

by

John Wilkinson

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1 INTRODUCTION

In the 1998 federal election, the federal Prime Minister, John Howard, went to the electorate to seek approval to introduce a new form of revenue raising: a goods and services tax. His government was returned with a majority, albeit it a smaller one than after the 1996 election. At the end of 1998 the Howard government introduced legislation to provide for the introduction of this tax. A significant component of the Prime Minister's advocacy of the GST was that it would enable innovations in federal state financial relations: in particular a lessening of state dependency on federal funding.

This paper looks at the background to revenue raising on the basis of consumption and at the overall outcome for state finances in New South Wales. It looks at the shares of the GST revenue gained by the states, and at the rationale for the basis of the division of those shares.

2 ESSENTIAL FEATURES OF FEDERAL-STATE FINANCIAL RELATIONS BEFORE THE GST

(a) Before the GST: Federal Government Assumption of Revenue Raising

Until the end of the nineteenth century, Britain's appropriation of Australia (into its empire) took place through the establishment of individual British colonies on Australian soil: each of these colonies acquiring individual revenue raising systems of their own. Up to the time of federation, as W.J. Campbell has described, "taxation revenue in New South Wales was derived from customs and excise, stamp and death duties, and land and income taxes". Customs and excise, as Brian Galligan has pointed out, "yielded 75% of" the colony's revenue.[1]

With federation, however, a fundamental change began to occur in the former colonies' capacity to be financially self-contained. Although, as Julie Smith has written, NSW and Victoria "expected to exercise. . .control" over the new federal institution - particularly since the principal proportion of business activity took place in these states – on the other hand, to ensure the financial viability of the federal sphere of government, the states not only agreed to surrender the greatest source of their revenue (customs and exercise) to (what would become) the government in Canberra but their representatives, who had framed the new federal constitution, as Gordon Greenwood has pointed out, came to an agreement that, "over all other sources of taxation" the new Commonwealth would have[2]

[1] W.J. Campbell, *Australian State Public Finance* (Law Book Company of Australasia, Sydney, 1954), pp.64-71: Brian Galligan, "Federal Renewal, Tax Reform and the States" in *Upholding the Australian Constitution*, vol.10, *Proceedings of the Tenth Conference of the Samuel Griffith Society* (Samuel Griffith Society, Melbourne, 1998), p.228.

[2] Julie Smith, *Taxing Popularity: The Story of Taxation in Australia* (Federalism Research Centre, Australian National University, Canberra, 1993), p.41; Gordon Greenwood, *The Future of Australian Federalism: A Commentary on the Working of the Constitution*, second edition (University of Queensland Press, Brisbane, 1976), p.80.

Although the arrangements made at federation still left the states with income tax (the second biggest source of revenue, after customs and excise), the federal level of government had been placed in a position of potential financial ascendancy and this was consummated by the Curtin government, in 1942, when it gained passage of four Acts which essentially appropriated income tax powers to the federal government. These powers were ostensibly for the purposes of resourcing Australia's participation in the war against Japan but, since a High Court challenge (mounted by the states) against this legislation proved unsuccessful, the Chifley government was able to retain control over income tax after the war.[3]

(b) Federal Financial Assistance Grants, and Specific Purpose Payments

Financial Assistance Grants

An additional measure, agreed to by the colonial premiers in establishing federation, was that the new federal parliament would be able to grant financial assistance to any state, on such terms and conditions as it saw fit. The initial application of this power was to support a somewhat over-optimistic condition (the Braddon Clause) placed on the new federal government: that for the first ten years of its functioning it should give back to the (new) states 75% of the amount left over from its own use of the newly gained customs and excise revenue. After the 10 years requirement lapsed, the then ALP federal government (led by Fisher) obtained passage of the *Surplus Revenue Act 1910* which established that the federal government would reimburse the states (for the revenue foregone) to an amount of 25 shillings per person in each state. Subsequent federal governments, however, became frustrated with this obligation to return a dedicated proportion of federal revenue to the states and, by means of the 1928 Financial Agreement (under which the states agreed that the federal government would take the lead in the area of borrowing within Australia) the then Bruce-Page government was able to collapse the population payments into a commitment to supplement the public debt repayments of the states.

After Chifley retained federal control of income tax, however, he decided to renew the system of federal government financial assistance to the states: this time reimbursing the states for their loss of income tax revenue. This was achieved by obtaining passage of the *States Grants (Tax Reimbursement) Act 1946*. From the late 1940s to the late 1950s these tax reimbursement grants, as they were known, increased from an all-states total of £45 million in 1947-48 to £175 million in 1958-59.[4] In 1959, the Menzies government decided to change the terminology for this assistance, and change the basis for it. Menzies secured passage of the *States Grants Act 1959* which changed the name of the assistance to "financial assistance grants" (FAGs) and altered the formula for their distribution. Whereas the Chifley government had based the distribution of the tax reimbursement grants in accordance with changes in aggregate population and changes in the level of wages

[3] Russell Mathews and Robert Jay, *Federal Finance: Intergovernmental Financial Relations in Australia since Federation* (Nelson, Melbourne, 1972), pp.174-175.

[4] James Maxwell, *Commonwealth-State Financial Relations in Australia* (Melbourne University Press, Melbourne, 1967), p.10.

throughout Australia, Menzies now decided, according to a summary later provided by the NSW Treasury, that "The financial assistance grant of each state, for each subsequent year, was to be determined by multiplying the per capita grant of the previous year by a factor reflecting the increase in the state's population, the increase in wages in Australia and a 'betterment' factor. The 'betterment' factor was designed to bring about greater increases each year in the tax grants than would otherwise have occurred."[5] By the end of the term of the Whitlam government, the total sum of yearly financial assistance grants to the states amounted to around $3 billion.[6]

In the late 1970s the Fraser government once more changed the format of the FAGs. Don Nicholls has written that, "in 1976-77 the system of financial assistance grants was replaced by tax sharing arrangements between the Commonwealth and the states. . .The initial arrangements. . .called for 33.6 per cent of the current year's personal income tax collections to be allocated to the six states. . .An agreed amount of $4,336.1 million. . .was distributed amongst the states in 1977-78."[7] The task of determining the proportions of these grants, between the states, was given to the Commonwealth Grants Commission: a body which was originally established in the depths of the Great Depression, in 1933 (after Western Australia attempted to leave the federation a year earlier) for the purpose of assessing special grants for the smaller states in the federation - as a means of redressing their reduced revenue raising capacity (in contrast to New South Wales and Victoria).[8]

Four years later, at the 1981 Premiers Conference, the arrangements were changed again and, according to Nicholls, Fraser "decided to shift from the personal income tax sharing base to total tax sharing, the main taxes included in the base being income taxes, sales tax, customs duty and excise duties."[9] This form of financial assistance, which had already increased under Fraser from $4.3 billion in 1977-78 to $6.3 billion in 1980-81, was now increased further to $8.2 billion in 1981-82 and to $9.2 billion in 1982-83.[10]

Hawke, after his election in 1983, as Peter Groenewegen has described, "preserved the general tax revenue-sharing arrangements established in 1981". However, two years after his election, according to Groenewegen, "The May 1985 Premiers Conference abandoned this procedure . . .[and] restored the concept of financial assistance grants growing at a

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[5] *An Introduction to Government Finance and Accounting in New South Wales* (NSW Treasury, Sydney, 1987), p.24.

[6] Hugh Emy, *The Politics of Australian Democracy: Fundamentals in Dispute*, second edition (MacMillan, Melbourne, 1978), p.106.

[7] Don Nicholls, *Managing State Finance: The New South Wales Experience* (NSW Treasury, Sydney, 1991), pp.118-119.

[8] J.R.G. Butler, "Specific Purpose Payments and the Commonwealth Grants Commission" in the *Economic Record*, vol.68, 1992, pp.165-166.

[9] Nicholls, op.cit., p.120.

[10] Peter Groenewegen, "Federalism" in Brian Head and Allan Patience (eds.), *From Fraser to Hawke* (Longman Cheshire, Melbourne, 1989), p.246.

specified rate." Nethertheless, the amount of financial assistance, which had already grown from $10.3 billion to $10.9 billion, in the first two years of the Hawke government, increased further from $11.9 billion in 1985-86 to $13.2 billion in 1986-87, but was then restricted to $13.6 billion during the recession of 1990-91.[11] Under the Keating, and subsequent Howard governments, these payments have again grown steadily to $16.8 billion in financial year 1998-1999.[12]

Specific Purpose Payments

Whereas the states were free to spend the financial assistance grants generally as they wished, another form, of federal assistance to the states, was introduced which did have restrictions placed on the way it could be spent. This was the special assistance grant (later known as the specific purpose payment or SPP): introduced by the Bruce-Page government in 1923 for the particular purpose of speeding the development of roads (to take the output of the newly developing car and truck industry in Australia). James Maxwell has written that "in 1923 the Commonwealth. . .offered a grant-in-aid of £500,000 on a fifty-fifty matching basis, for the development of main roads . . .The states had to specify in advance the roads on which expenditure was to be made and the construction plans."[13] After the Second World War, according to Mathews and Jay, "the Commonwealth gradually expanded the range of its specific purpose payments to the states by entering new fields such as education, health and welfare services, the development of rural resources, water resources".[14]

A great many of these specific purpose payments were introduced by federal governments in areas where they thought state expenditure was particularly deficient. Thus the Curtin government, in early 1945, as H.C. Coombs recalled, "proposed to lend money directly to the state housing authorities which would build dwellings and administer their renting with preference to low-income families".[15] Curtin's successor, Chifley, also felt that the state governments had been remiss in the area of spending of health. In his first year as prime minister he obtained passage of the *Hospital Benefits Act 1945* under which the states were to provide treatment free at the point of service: with the federal government (under a five year agreement with the states) compensating the states for the loss of revenue.[16]

[11] See ibid., pp.246,261; see also Brian Galligan, "Australian Federalism: The Challenge of Governing in the 1990s" in Ian March (ed.), *Governing in the 1990s: An Agenda for the Decade* (Longman Cheshire, Melbourne, 1993), p.300.

[12] Treasurer of the Commonwealth of Australia, *Budget Statements 1998-99*, budget paper no.3, pp.19-27.

[13] Maxwell, op.cit., p.121.

[14] Mathews and Jay, op.cit., p.221.

[15] H.C. Coombs, *Trial Balance* (MacMillan, Melbourne, 1981), p.69.

[16] Stephen Duckett, "Is Federalism Dead? The Case of Commonwealth-State Financial Relations *Economics and Health: Proceedings of the Eleventh Australian Conference of Health Economists* (Public Sector Management Institute, Faculty of Economics and Politics, Monash University, Melbourne, 1990), p.318.

In the early 1950s, Menzies discontinued Chifley's federal state health program. He did believe, however, that state spending was deficient in the area of university education, and he obtained passage of the *States Grants (Universities) Act 1951* to provide money to the states for the particular purpose of extending tertiary education. During the period of the Whitlam government (1972-1975) the use of special purpose grants was extended even further. Whitlam himself later wrote that "It was commonplace. . .for tied grants. . .to be made to the states. What had never before been attempted was the use of those grants to achieve far-reaching reforms in education. . .sewerage, transport and other urban and regional development programs."[17] Don Nicholls has pointed out that, during Whitlam's term in office, "specific purpose payments nearly doubled as a proportion of total Commonwealth payments to the states (from 26 per cent to 48 per cent)."[18]

The following Fraser government reduced the specific purpose payments to just over $2 billion in 1976-77 and then allowed them only to increase to just over $3 billion by 1981-82. The subsequent Hawke government reinstated the payments to their previous level: Nicholls has attributed this to "the increased provision of funds for social welfare, housing, roads and hospitals." In 1983-84, Hawke increased the level of specific purpose payments to $4.6 billion and by 1986-87 they had risen to $6 billion.[19] By 1990 they had increased to around $13 billion and have only risen gradually under the subsequent Keating and Howard governments: amounting to $14.9 billion in 1998-1999.[20]

3 THE ORIGINS AND DEVELOPMENT OF WHOLESALE SALES TAX, AND CONSUMPTION TAX

(a) Wholesale Sales Tax

Sales tax, according to Herbert Burton (writing in 1930), was "used in Egypt and Rome. . .[and then] Spain adopted the general sales tax as a permanent part of its fiscal system [in 1392]. . .Beginning as a tax of 1%. . .it was raised to 10%, and even 14%". It was in the 1920s, however, that the use of sales tax became more widespread amongst the nations of Europe and North America. Burton wrote that in France "as in Germany and Belgium, it ranks next to the income tax as a revenue producer. In Canada [where it was introduced in 1920] it is second only to the customs and excise".[21] The tax base of the sales tax, as Peter Groenewegen has described, "is the 'sale value' of the good in question and this 'sale value' is officially defined as the equivalent of a 'fair' wholesale price."[22]

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[17] E.G. Whitlam, *The Whitlam Government 1972-1975* (Viking, Melbourne, 1985), p.716.

[18] Nicholls, op.cit., p.123.

[19] ibid.; see also Groenewegen, op.cit., p.246.

[20] Galligan, "Australian Federalism", p.20; see also Commonwealth of Australia, *Budget Statement 1998*, budget paper no.3.

[21] Herbert Burton, "The Sales Tax" in the *Economic Record*, vol.6, November 1930, p.244.

[22] Peter Groenewegen, *Australian Wholesale Sales Tax in Perspective* (Australian Tax Research

In Australia, sales tax was introduced by the Scullin government (impressed by its application in Canada), “to meet a condition of unprecedented financial emergency”, as Scullin later put it: a looming revenue slump, caused by the Great Depression. As John Robertson wrote, in his account of Scullin’s budget for 1930-31, “Commonwealth. . . Revenue was to be aided by various means, including. . .a sales tax of 2½ per cent on a wide range of commodities. . .If it was an emergency measure, the legislation should have been temporary. . .However. . .this tax was one of his most lasting legislative bequests to the nation.”[23]

Despite its relative effectiveness in raising revenue, it was nevertheless assailed, at the time of its introduction, as unfair. Burton commented that “The tax sins against every principle of justice in taxation, and varies inversely as the ability to pay.”[24]

Although the rate of sales tax was soon increased - Peter Groenewegen later wrote that “Sales. . . tax varied from 2½ per cent to 8½ per cent in the first ten years of its existence”[25] - Nanak Kakwani later observed that, until the 1980s, “sales tax. . .[played] a minor role in the overall Australian tax system. During the 1970s the share of sales tax [in overall taxation revenue] declined”.[26] This is illustrated by the following figures for the amount of money collected in sales tax (and its percentage of overall federal revenue) between 1930 and 1980:

Sales Tax Revenue: Selected Years 1930-1980[27]

	Amount	Percentage of Total Federal Revenue
1930-31	$6 million	5.9%
1935-36	$19 million	15%
1940-41	$40 million	15.9%
1949-50	$85 million	8.2%
1954-55	$201 million	10.7%
1959-60	$328 million	13.1%
1965-66	$370 million	8.8%
1969-70	$569 million	8.9%
1975-66	$1.4 billion	8.3%

Foundation, Sydney, 1983), p.23.

[23] John Robertson, *J.H. Scullin: A Political Biography* (University of Western Australia Press, Perth, 1974), pp.252-253.

[24] Burton, op.cit., p.237.

[25] Peter Groenewegen, “Rationalising the Australian Taxation System” in the *Economic Record*, vol.47, 1971, p.536.

[26] Nanak Kakwani, “Progressivity Index of Sales Tax on Individual Expenditure Items in Australia” in the *Economic Record*, vol.59, 1983, pp.61-62.

[27] Peter Groenewegen, *Australian Wholesale Sales Tax in Perspective*, p.65.

1979-80	$1.8 billion	6.5%

During the period of the 1980-1982 recession, however, the Fraser government extended the deployment of sales tax as a proto-consumption tax, as Kakwani has also explained:

> in the 1981-82 Budget the government announced the introduction of a limited sales tax measure which amounted to the broadening of the sales tax base by including many consumption items previously exempt. . .[28]

As Burton had commented in 1930, Kakwani similarly remarked in 1983 that, in his opinion, the Fraser government had extended the application of the tax even though "indirect taxes are regressive and hit the poor harder than the rich."[29]

Despite the fact that commentators had been, once again, critical of applications of the sales tax, both the Fraser government, and the subsequent Hawke, extended its domain. While, on the one hand, the Hawke government endeavoured to focus the tax towards luxury goods – Hawke's Finance Minister (Peter Walsh) recalling that the 1986 Budget had included "Tax increases . . .from sales tax changes, including an increase to 20 per cent on the wholesale tax on wine. . .and an increase from 20 to 30 per cent in sales tax on higher priced motor vehicles"[30] – on the other hand the cumulative reach of sales tax extended to many items of purely household consumption. Robert Reid wrote in 1991 that,

> Most consumers have only a rudimentary understanding of sales tax. For example they are unaware that sales tax is included in the cost of numerous supermarket items. Detergents, soap and soap powders, tooth paste, soft drinks, toilet paper, stationery, pet foods, pens and pencils and razor blades are taxed at 20 per cent; biscuits, snack foods, ice cream, confectionary, flavoured milks and fruit juices at 10 per cent. Many other household items are taxed: furniture, crockery, glassware, cutlery, electrical equipment, cooking stoves, brooms, mops, brushes, buckets, garbage cans, floor coverings, bedding, drapery. . .to name but a few.[31]

With the extension of the sales tax to a wide range of goods - under the Fraser, Hawke, Keating and Howard governments - the amount of the tax raised (and its percentage of total federal revenue) steadily increased between the late 1980s and the late 1990s:

[28] Kakwani, op.cit., p.62.

[29] Kakwani, ibid.

[30] Peter Walsh, *Confessions of a Failed Finance Minister* (Random House, Sydney, 1995), p.160.

[31] Robert Reid, "Taxation Trends 1965-66 to 1988-89" in the *Australian Tax Forum*, vol.8, no.2, 1991, p.238.

Sales Tax: Selected Years, Late 1980s to Late 1990s[32]

	Amount	Percentage of Total Federal Revenue
1988-89	$9.4 billion	8.9%
1997-98	$16 billion	12%

(b) Taxes On Consumable Commodities

The use of consumption taxes – like the use of sales taxes – has a long history. They were employed (to exact a levy on luxury items) in the Roman Empire at the time of Cato.[33] In more recent times, the Netherlands, in the 1600s, led the way in widely applying the tax. Gustav Cohn wrote that “taxes on consumption. . .[became] highly developed in Holland . . .the English ambassador. . .was able to state [in 1672] that anyone who ate a dish of fish in Holland paid thirty different taxes on it.”[34]

Holland’s experience with consumption taxes later caused English economists, such as Adam Smith, to advise against the introduction of their use in England. He wrote in the 1770s, in the *Wealth of Nations*, that

> The impossibility of taxing the people, in proportion to their revenue. . .seems to have given occasion to the invention of taxes upon consumable commodities. . . Consumable commodities are either necessaries or luxuries. By necessaries, I understand. . . commodities which are indispensably necessary for the support of life. . .[and basic items such as a] shirt. . .[or] leather shoes. . .Any rise in the average price of necessaries, unless it is compensated by a proportionable increase in the wages of labour, must necessarily diminish. . .the ability of the poor to bring up. . .families, and consequently supply the demand for useful labour. . .The advanced price of. . .necessaries of life. . .must be compensated to the poor by a further advancement of their wages. The middling and superior ranks of people, if they understood their own interest, ought always to oppose all taxes upon the necessaries of life. . .[35]

Despite the cautions of Smith, and other early economists, about the wisdom of consumption taxes, successive governments, in Britain, in fact increased the extent of their application and by the early nineteenth century, according to William Green, if “The

[32] ibid., p.221; Australian Taxation Office, *Taxation Statistics 1997-98* (Australian Taxation Office, Canberra, 1999), p.101; Treasurer of the Commonwealth of Australia, *Budget Statement 1998-99*, budget paper no.1, p.2-36.

[33] Charles Bastable, *Public Finance*, second edition (London, MacMillan, 1903), p.498.

[34] Gustav Cohn, *The Science of Finance* (The University of Chicago Press, Chicago, 1895), pp.403-404.

[35] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, third edition (London, 1822), book 5, pp.331-332,335-336,340.

labourer. . .[used] salt he paid a tax thereon of three times its value. . .Leather. . .for shoes . . .[and] for clothing. . .was heavily taxed in proportion to its value. . .Candles [for house light] were also taxed. . .[as was] soap. . .and coal [the main source of heat]”.[36]

In Australia, as mentioned earlier, the first explicit manifestation of a consumption tax was Scullin’s sales tax, introduced at the onset of the Great Depression. For the next 40 years there was no further substantial consideration of consumption taxes until 1972 when then federal treasurer in the McMahon government (Billy Snedden) announced a full-scale inquiry into the taxation system. A five-person committee was appointed which included Justice Kenneth Asprey (as chair) and Professor Ross Parsons. Despite the Australian Labour Party having views, on many issues, at variance with the McMahon government, Whitlam, after taking office in late 1972, endorsed the work of the committee. Three years later, at the beginning of the last year of the Whitlam government, Asprey and his colleagues presented their report. A major recommendation of the committee was that “equity” should not be a consideration in the arrangements of taxation and, on this basis, it recommended the introduction of a levy on consumption in the form of a value added tax (VAT).[37]

Asprey’s report was, however, overlooked by Whitlam (preoccupied, by this time, with other matters) but, in late 1978, John Howard (treasurer in the Fraser government) decided to adopt Asprey’s suggestion, announcing, according to David Barnett, that “cabinet would consider. . .[a] report on. . .[a] VAT when it met early in the new year.” Resistance from large retail proprietors, amongst others, resulted in Howard temporarily abandoning the idea in early 1979.[38] Six years later, however, the following Hawke government decided to hold a major conference on taxation at which the treasurer (Paul Keating), as Hawke’s finance minister later recalled, argued “for. . .[a] consumption tax. . .with. . .passion and intensity”. Once again the proposal was defeated, in this instance, Keating’s advocacy of the tax was opposed by the trade union movement: concerned about the impact of such a tax on working people.[39] Another eight years later, however, the then leader of the federal opposition (John Hewson) adopted the introduction of a goods and services tax (GST) as a central part of Liberal Party policy for the 1993 election. Hewson, however, was narrowly defeated and, in 1995, John Howard, as the new leader of the opposition, declared that his party would “never, ever” re-advocate the adoption of a GST. Nevertheless, a month after John Howard won the federal election of March 1996, Graeme Samuel, president of the Australian Chamber of Commerce and Industry, declared that a GST had to “be on the [40] Howard decided to re-embark on the introduction of the tax. In the 1998 federal election the Liberal Party re-adopted a goods and services tax as a major part of its policy,

[36] William Green, *The Theory and Practice of Modern Taxation* (Commerce Clearing House, Chicago, 1933), pp.20-21.

[37] R.H. Wallace, “Taxation Reform: But What is the Agenda?” in the *Economic Record*, vol.51, 1975, p.564.

[38] David Barnett, *John Howard: Prime Minister* (Viking, Melbourne, 1997), pp.89-90,97.

[39] Walsh, op.cit., pp.142,146.

[40] Ian Henderson, “GST – You Asked for It” in *The Australian*, 1 July 2000, p.38.

and as a major policy decision for electors. Once the Liberal Party was returned electorally, Howard embarked on introducing a bill for a GST in 1998.

4 THE NEW FEDERAL-STATE FINANCIAL ARRANGEMENTS ACCOMPANYING THE GST

(a) The Broad Basis of the GST Agreement

On 2 December 1998 the Howard government introduced legislation into the parliament under the title A New Tax System (ANTS) providing both for the replacement of the former wholesale sales tax by a goods and services tax (applying at a rate of 10%) from 1 July 2000), and for an alteration in federal financial assistance to the states. In April 1999 the state Premiers signed an agreement, with the federal government, on new arrangements for federal-state financial relations. This accord was entitled the Intergovernmental Agreement (IGA) on the Reform of Commonwealth-State Financial Relations. The agreement was to complement the Howard government's intended legislation.

In the meantime, John Howard had also been conducting discussions with the Australian Democrats. A month after the conclusion of the IGA, agreement was reached with the Democrats on the exclusion of food from the application of the GST. These developments led to a revised IGA being concluded in June 1999. The overall outcome of the accord between the federal government and the premiers, and the Howard government's negotiations with the Democrats, was as follows:

- removal of state reliance on financial assistance grants and revenue replacement payments from the federal government
- provision of all goods and services tax (GST) revenue to the states, to be spent according to their own budgetary priorities
- provision to the states of a role in determining the GST bases, and the GST rate, and related operational matters
- provision for transitional payments to the states, where necessary, so that no state will be worse off
- establishment of a timetable for the abolition of a range of state taxes
- states to fund and administer a First Home Owners' Scheme (FHOS) to mitigate the impact of the GST on the prices of homes for first home buyers (involving a lump sum payment, to those eligible, of $7,000 – effective from 1 July 2000)
- establishment of a Ministerial Council for Commonwealth-State Financial Relations[41]

[41]Treasurer of the Commonwealth of Australia, *Budget Statement 2000-01*, budget paper no.3, p.5;

(b) Essential Features of the Details of the New Arrangements

Removal of State Reliance on Financial Assistance Grants

States will no longer receive financial assistance grants (which, in the particular case of New South Wales, amounted to around $4.8 billion in financial year 1998-1999).[42]

Removal of State Reliance on Revenue Replacement Payments

In 1997 the Howard government introduced Revenue Replacement Payments (RRPs) to overcome the states' loss of income previously levied on various business franchises. David Collins has explained this as follows:

> [RRPs] were implemented as a result of 1997 High Court decisions in the *Ha and Lim v. NSW* and *Walter Hammond and Associates v. NSW* cases, which effectively declared unconstitutional all state business franchise fees. These taxes, on alcohol, tobacco and petroleum, raised revenue of $5.221 bn in 1996-97, their last year of operation. As a result of the potentially disruptive effects on state finances of such a revenue loss, the Commonwealth implemented 'safety net' arrangements. These consisted mainly of an increase in federal customs and excise duties on tobacco and alcohol, and an increase in the WST [wholesale sales tax] rate on alcoholic beverages. All revenue (less administrative costs) was returned to the states as RRPs. . .[43]

In financial year 1998-99, NSW received $1.975 billion in RRPs. Under the IGA, RRPs were abolished.[44]

Provision of All GST Revenue to the States

All of the revenue generated by the GST will be shared amongst the states in the form of GST revenue grants. The sum that the federal treasurer has estimated that NSW will receive, in the first year of the new arrangements, will amount to just over $7 billion.[45]

Establishment of a Timetable for the Abolition of a Range of State Taxes

The overall outcome of the negotiations over the GST – between the federal government

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Treasurer of New South Wales, *Budget Statement 1999-2000*, budget paper no.2, p.9-4.

[42] Treasurer of NSW, Budget Statement 1999-2000, budget paper no.2, p.3-20.

[43] David Collins, *The Impact of the GST Package on Commonwealth-State Financial Relations* (Australian Tax Research Foundation, Sydney, 2000), p.26.

[44] Treasurer of New South Wales, *Budget Statement 2000-01*, budget paper no.2, p.3-13.

[45] Treasurer of the Commonwealth of Australia, *Budget Statement 2000-01*, budget paper no.3, p.11.

and the state premiers, and between the Howard government and the Australian Democrats – in the area of state taxes, is as follows:

- the removal of bed taxes and share transfer duties will proceed
- the removal of financial institutions duty (FID) to be deferred to 1 July 2001
- gambling tax to be changed by either reducing existing tax rates or by reimbursing operators the amount of GST paid where tax rate adjustments are not possible
- the removal of debits tax to be delayed until 1 July 2005
- removal of stamp duties to be reviewed by the Ministerial Council, in light of the states' financial circumstances, after 2005[46]

Transitional Payments to the States

The form of assistance to be provided by the federal government, to ensure that no state is worse off, is designated as Budget Balancing Assistance (BBA). The nature of this assistance had been defined as follows:

> BBA will take the form of both one year interest free loans and grants to the states in 2000-01 and quarterly grants in subsequent years. BBA generally represents the difference between the guaranteed minimum amount (GMA) calculated for each jurisdiction and that jurisdiction's share of GST revenues.[47]

As far as New South Wales is concerned, Budget Balancing Assistance, in 2000-01, will amount to around $982 million: provided in the form of loans and grants.

Creation of a Ministerial Council

The Intergovernmental Agreement (IGA) provides for the establishment of a Ministerial Council which, in turn, will oversee the operation of the GST. The council is chaired by the federal treasurer and is formed of the state and territory treasurers. The Ministerial Council has established a GST Administration Subcommittee (GSTAS) which comprises federal, state and territory officials. GSTAS commenced operations on 1 July 1999 and has convened on at least five occasions.

Ultimate control over the rate of GST levied, however, rests basically with the federal government and the IGA's role is essentially one of discussing the implementation arrangements of the tax. As the Victorian Parliament's Federal-State Relations Committee has observed, "the Commonwealth Parliament. . .has legislative control over the rate of the

[46] Treasurer of NSW, *Budget Statement 200-01*, budget paper no.2, p.3-6.

[47] Treasurer of the Commonwealth of Australia, *Budget Statement 2000-01*, budget paper no.3, p.16.

Goods and Services Tax and the use to which the funds raised by that tax are put. Only a constitutional amendment would guarantee the states' rights to participate in revenue-[48]

5 ESTIMATING THE IMPACT OF THE NEW ARRANGEMENTS ON NSW

(a) Essential Features of NSW Revenue

The overall revenue attained by New South Wales, in each financial year, is approximately divided as follows: 60% own source revenue and 40% federal government grants. This is illustrated by the figures for 1998-99:

Overall NSW Revenue: 1998-99[49]

State Taxes	$14,137,000,000
Federal Government Grants (FAGs and SPPs)	$8,911,000,000
Financial Distributions	$1,444,000,000
Other	$807,000,000
TOTAL	$25,299,000,000

Amongst the individual taxes, stamp duties contribute the greatest amount to NSW own source revenue. This is illustrated by the following figures:

NSW Individual Revenue: 1998-99[50]

Stamp Duties	$3,942,000,000
Payroll Tax	$3,605,000,000
Safety Net Revenues (Alcohol/Petrol/Tobacco)	$1,975,000,000
Gambling and Betting	$1,419,000,000
Taxes on Motor Vehicle Ownership and Operation	$1,048,000,000
Land Tax	$948,000,000
Other Revenues (Fires Brigades Levy/Accommodation Levy etc)	$878,000,000
Debits Tax	$322,000,000
TOTAL	$14,137,000,000

[48] Victorian Parliament Federal-State Relations Committee, *Federalism and the Role of the States: Comparisons and Recommendations* (Parliament of Victoria, Melbourne, 1999), p.234.

[49] Treasurer of New South Wales, *Budget Statement 2000-01*, budget paper no.2, p.3-5.

[50] ibid., pp.3-13,3-14.

(b) Substantial Nature of the NSW Economy

New South Wales is the leading state in Australia, in a range of areas of production. Amongst the top 1000 public and private parent companies in Australia, 50% of those are located in New South Wales.[51] The consistency of production in the NSW economy is illustrated by the following figures for gross state product (GSP):

NSW Gross State Product: 1990-1999[52]

1990-91	$160.5 billion
1991-92	$160.7 billion
1992-93	$164.8 billion
1993-94	$171.3 billion
1994-95	$178.1 billion
1995-96	$185.7 billion
1996-97	$192.8 billion
1997-98	$201.6 billion
1998-99	$209.9 billion

New South Wales also has the highest number of wealthy citizens in Australia. One illustration of this is provided by the figures for those suburbs in Australia with taxpayers receiving the highest amount of dividend imputation credits:

Taxpayers Receiving Highest Amount of Dividend Imputation Credits: By Suburb 1995-96[53]

Suburb	Number of Tax Returns	Amount of Imputation Credit
Toorak (Vic)	8,938	$53,879,000
Spit Junction (NSW)	16,847	$49,642,000
Vaucluse (NSW)	9,340	$39,299,000
Brighton (Vic)	13,175	$35,452,000
Edgecliff (NSW)	5,536	$35,416,000
Bellevue Hill (NSW)	5,635	$28,573,000
Hawthorn (Vic)	12,470	$27,579,000
Kew (Vic)	13,577	$22,234,000
Lane Cove (NSW)	16,650	$22,106,000
Wahroonga (NSW)	14,066	$19,972,000

[51] First-BSB Group, *Links 1000* (1998) cited in *The Australian*.1 April 1998, p.32.

[52] Australian Bureau of Statistics, *Australian National Accounts: State Accounts 1998-99*, ABS Catalogue 5220.0, p.9.

[53] Laurie Aarons, *Casino Oz: Winners and Losers in Global Capitalism* (Goanna Publishing, Sydney, 1999), p.136 - figures compiled from Australian Taxation Office, *Australian Taxation Statistics 1995-96* (Australian Taxation Office, Canberra, 1998), table 3.6.

Woollahra (NSW)	4,962	$19,910,000
Killara (NSW)	7,553	$19,463,000
Nedlands (WA)	10,853	$18,592,000
St. Ives (NSW)	11,577	$17,996,000
Hunters Hill (NSW)	5,156	$16,435,000
Avalon Beach (NSW)	9,379	$15,827,000
Manly (NSW)	9,498	$15,808,000
Pymble (NSW)	9,394	$15,583,000
Cremorne (NSW)	7,985	$14,900,000
Rose Bay (NSW)	6,048	$14,502,000

This concentration of wealth, in New South Wales (particularly in Sydney), underpins the buoyancy of the property market which, correspondingly, accounts for the prominence of stamp duty as the major source of government receipts. In 1994, for example, the total value of residential property sales in NSW amounted to around $29 billion.[54]

(c) Constant Nature of GST Revenue

A good and services tax draws in more revenue because, as Chris Murphy has pointed out, “Compared with a GST, sales tax is inefficient because of its narrow uneven coverage of [55] The estimated amount of GST revenue to be distributed, in the first year of the new tax arrangements, is projected to amount to around $24 billion.[56]

Essentially a GST is focused on household consumption expenditure and, as this constantly expands, so does the amount raised.

(d) Potential Advantages for New South Wales

Hindrances to commercial development, in the state, have sometimes been alleged to derive from the various forms of state taxes. In 1996 the NSW Parliament’s State Development Committee held an inquiry into factors influencing the decisions of multinational companies to relocate their regional headquarters (RHQ) to Sydney. In its report, the committee summarised the feelings of the Sydney business community as follows:

> The Standing Committee received numerous submissions from industry groups and company representatives which claimed that state-based transaction taxes damaged the attractiveness of New South Wales as an RHQ investment location. There was a consensus of opinion that these taxes fell disproportionately on business

[54] NSW Office of State Revenue, *Index of Property Transactions*, 1995.

[55] Chris Murphy, *The Implications of A New Tax System* (Econtech, Canberra, 2000), p.4.

[56] Treasurer of the Commonwealth of Australia, *Budget Statement 2000-01*, budget paper no.3, p.14.

transactions and involved high costs of administration and compliance.[57]

According to the sentiments expressed by the business community, removal of state-based taxes such as Financial Institutions Duty and, possibly later on, Debits Tax, should increase Sydney's attractiveness as location for RHQs - and should therefore contribute to the economic growth of NSW.

(e) Budget Balancing Assistance and the Growth of the GST

As stated above, individual states will be provided with Budget Balancing Assistance (BBA), during the inaugural years of the GST's operations. BBA generally represents the difference between the guaranteed minimum amount (GMA) calculated for each jurisdiction and that jurisdiction's share of GST revenues. David Collins has defined the GMA as "the funding which would have been available to the states under current, pre-GST arrangements". As Collins further outlines, "Calculations are made of what the 'current funding' would have been and this figure constitutes the Guaranteed Minimum Amount [58] Estimation of the Guaranteed Minimum Amount, for New South Wales in the year 2000-01, is as follows:

Guaranteed Minimum Amount Calculations: New South Wales, 2000-01[59]

State Revenues Foregone: - FAGs - RRPs - Accommodation Taxes	 $5,214,300,000 $2,179,600,000 $72,400,000
also Reduced Revenues - Gambling Taxes	 $470,000,000
also Interest Costs	$3,300,000
also Additional Expenditures - First Home Owners' Scheme - GST Administration Costs	 $218,500,000 $273,700,000
also Other Items - Wholesale Sales Tax Payments	 $38,000,000
minus Reduced Expenditures - Off-Road Diesel Subsidies - Savings from Tax Reform	 $118,100,000 $147,300,000
minus Growth Dividend - Remaining State Taxes	 $42,200,000
TOTAL	$8,162,200,000

[57] NSW Legislative Council, Standing Committee on State Development, *Factors Influencing the Relocation of Regional Headquarters of Australian and Overseas Corporations to New South Wales* (Parliament of NSW, Sydney, 1996), p.79.

[58] Collins, op.cit., p.14.

[59] ibid.,p.16.

For 2000-01 the federal government has estimated Budget Balancing Assistance for the individual states as follows:

Budget Balancing Assistance: 2000-01 (in millions of dollars)

	NSW	VIC	QLD	WA	SA	NT	TAS	ACT
GMA	8162.4	5690.8	4973.1	2584.7	2484.3	1275.3	1062.7	511.9
GST Revenue Share	7180.3	5027.3	4604.1	2337.8	2247.7	1212.7	971.9	470.6
BBA	982.1	663.5	369.0	246.9	236.5	62.6	90.8	41.3
(BBA Loan)	674.3	412.6	114.1	159.6	161.8	45.7	65.1	22.4
(BBA Grant)	307.8	250.9	254.9	87.3	74.7	16.8	25.6	18.9

The need for BBA will eventually diminish, as overall GST revenue increases, but this will occur gradually. It is for this reason that the NSW Treasurer has commented, in his *Budget Statement 2000-01*, that

> Current projections suggest that net revenue benefits to New South Wales will not occur until 2007-08. . .[these] estimates are premised on real economic growth of 3.5 per cent, per annum, after 2003-04, yielding an expected increase in GST revenue from $24 billion in 2000-01 to $39 billion in 2007-08. . .[60]

(e) Impact of the Commonwealth Grants Commission's Approach on the Distribution of GST Revenue

Although the Howard government has stated that all revenue raised through the GST will be returned to the states, the revenue will be distributed according to Commonwealth Grants Commission (CGC) guidelines. The essential approach of the commission – established to redress the difference between the tax-raising capacities of the states – is that of distributing federal grants on a basis of attempting to equalise the revenue-raising capacities of the states. The CGC's approach, to establishing a basis for distribution for the grants, involves establishing what the commission calls "per capita relativities". Per capita relativities for each assessment year are formulated on the basis of a number of considerations, including the following:

> calculation of the amount which a state would need to spend, in order to provide the average level of public services - given its demand and cost structure disabilities [the state's per capita standardised expenditure]
>
> calculating the amount a state could raise, if it made an average effort to raise revenues from its own sources [the state's per capita standardised revenue]

[60] Treasurer of New South Wales, *Budget Statement 2000-01*, budget paper no.2, p.8-7.

> calculating the total assistance the state would require, to enable it to provide the average standard of state-type services – assuming that it provided these services at an average level of efficiency and made the average effort to raise revenue from its own sources [the state's total financial assistance requirement on the basis of standardised per capita expenditure and revenue adjusted by state population data][61]

The result of the CGC's formulations is as follows:

Commonwealth Grants Commission Per Capita Relativities: 2000[62]

New South Wales	0.90913
Victoria	0.87049
Queensland	1.01830
Western Australia	0.98365
South Australia	1.18258
Tasmania	1.51091
ACT	1.11289
Northern Territory	4.16385

The application of the CGC's relativities, to the apportionment of GST revenue (of just over $24 billion), has resulted in the following distribution for 2000-01:

GST Revenue Distribution Among the States and Territories: 2000-01 (estimated)[63]

New South Wales	$7,180,300,000
Victoria	$5,027,300,000
Queensland	$4,604,100,000
Western Australia	$2,337,800,000
South Australia	$2,247,700,000
Northern Territory	$1,212,700,000
Tasmania	$971,900,000
Australian Capital Territory	$470,600,000
TOTAL	$24,052,600,000

[61] Collins, op.cit., p.45.

[62] Treasurer of the Commonwealth of Australia, *Budget Statement 2000-01*, budget paper no.3 p.14.

[63] ibid.

(g) Possible Adverse Impact of the Commonwealth Grants Commission's Approach

While the CGC's approach, to apportioning federal funding, has the intention of providing an element of fiscal "equalisation" amongst the states, some of the states themselves have argued that, in fact, the CGC methodology does more than that. On a state-by-state basis, the per capita distribution of GST revenue varies widely, as the figures below illustrate:

GST Revenue Per Capita – Individual States and Territories: 2000-01 (estimated)[64]

	GST Revenue Per State	State Population	GST Revenue Per Capita/Per State
NT	$1,212,700	194,500	$6,247
TAS	$971,900,000	470,300	$2,068
ACT	$470,600,000	311,100	$1,511
SA	$2,247,700,000	1,496,100	$1,502
QLD	$4,604,100,000	3,549,300	$1,297
WA	$2,337,800,000	1,877,500	$1,245
NSW	$7,180,300,000	6,448,800	$1,113
VIC	$5,027,300,000	4,753,900	$1,058

By contrast, the division of GST amongst the states – on a collective per capita level – is as follows:

GST Total Revenue Per Capita Australia Wide: 2000-01 (estimated)[65]

Total GST Revenue Disbursement	$24,052,600,000
Australian Population	19,104,600
GST Revenue Per Capita Australia-Wide	$1,295

These figures would appear to verify the NSW Treasurer's claim, in his budget statement for 2000-01, that, amongst the GST revenue as it is apportioned between the states and territories, "the cross subsidy from New South Wales to other states remains substantial."[66] This would certainly seem to be so, if we project GST revenues for the states and territories: based on population multiplied by the Australia-wide GST revenue per capita figure of $1,295:

[64] these figures approximate to the estimates in Treasurer of NSW, *Budget Statement 2000-01*, budget paper no.2, p.8-15. The state and territory population figures are from ABS Catalogue 3101.0.

[65] for current population figures see Australian Bureau of Statistics, *Australian Demographic Statistics*, ABS Catalogue 3101.0.

[66] Treasurer of NSW, *Budget Statement 2000-01*, budget paper no.2, p.8-16.

States and Territories: Projected GST Revenue Based on Australia-Wide Per Capita Average (estimated)

State/Territory	Australia Per Capita Average	Population	Projected GST Revenue
NT	$1,295	194,500	$251,877,500
ACT	$1,295	311,100	$402,874,500
TAS	$1,295	470,300	$609,038,500
SA	$1,295	1,496,100	$1,937,449,500
WA	$1,295	1,877,500	$2,431,362,500
QLD	$1,295	3,549,300	$4,596,343,500
VIC	$1,295	4,753,900	$6,156,300,500
NSW	$1,295	6,448,800	$8,351,196,000

On this basis, there is a substantial difference between what each state and territory would get if the $24 billion GST revenue was divided simply according to population, and what each state and territory obtains under the CGC's approach of trying to equalise the tax raising capacity, and expenditure needs, of the different jurisdictions:

States and Territories: Revenue Distribution on Simple Population Basis versus Distribution on CGC Basis (estimated)

State/Territory	Population-Based GST Revenue	CGC-Based GST Revenue
NT	$251,877,500	$1,212,700,000
ACT	$402,874,500	$470,600,000
TAS	$609,038,500	$971,900,000
SA	$1,937,449,500	$2,247,700,000
WA	$2,431,362,500	$2,337,800,000
QLD	$4,596,343,500	$4,604,100,000
VIC	$6,156,300,500	$5,027,300,000
NSW	$8,351,196,000	$7,180,300,000

CONCLUSION

In some respects it could be asserted that the real perspective, within which to understand the new federal tax, is not that of changes in Commonwealth-State financial relations but that of a constant intention, on the part of some policy makers, to gradually shift the focus of revenue raising from direct tax (usually income tax) to indirect tax. In this scenario, the states were more the facilitators of what was, primarily, a federal policy. This is, to some degree, the view of Professor Brian Galligan. In a 1998 paper, delivered to the Samuel Griffith society, Galligan observed, firstly, that the trend towards the states managing with their "own source income" had already been initiated by the Fraser and Hawke government. As he remarked, "During the 1980s the states were forced to become somewhat less dependent on Commonwealth grants and rely more heavily on their existing tax sources.

. .such as gambling." Secondly, according to Galligan, handing "the proceeds. . .[of the GST] over to the states. . .was no doubt a clever strategy to win the support of outspoken state premiers".[67]

On the other hand, it could be equally said that, viewed over the long run, NSW seems likely to gain from the way in which the GST has been introduced. At the beginning, the state appears to lose – in respect to the shares of GST revenue gained by the other jurisdictions – over the years however, as the level of overall GST income steadily rises, NSW should eventually gain. Furthermore the business community, at least according to their own declarations, have seen individual state taxes as an impediment to commerce and, therefore, the consequent phasing out of those taxes should lead to a further increase in business activity. As the state with the greatest amount of business activity, New South Wales should, again, benefit.

As the state with the greatest amount of wealthy citizens (who will pay more GST), New South Wales is not only in a better position to make up the difference - between what it initially loses in GST revenue share and what it would have received under the old arrangements – but is possibly in a better position to assist the smaller states.

Robert Garran, the Sydney barrister (and secretary to the NSW Premier George Reid) who played a prominent role in the deliberations over the constitution, commented in 1897 that "It is only by finding a basis of apportionment which will be fair to each state in the proposed federation that an acceptable scheme of union will be reached."[68] This, as far as the division of the GST is concerned, remains the heart of the issue.

[67] Galligan, "Federal Renewal", pp.243,249.

[68] ibid., p.239.