

## Australia – An Overview of Fiscal Arrangements

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Australia is a federal constitutional monarchy with two primary levels of government, the Commonwealth Government and six state and two territory governments. A third level of local government is constituted by State laws. The Australian Constitution defines the powers of the Commonwealth with residual powers vested in the States, although in practice there are significant areas of overlap between the powers and activities of the Commonwealth and the States. There are some areas of mutual responsibility where, to the extent of any disagreement between Commonwealth and State laws, the Commonwealth laws prevail. The Territories operate under Commonwealth laws and are not constitutionally entrenched but generally operate in the same way as the States. Each State and Territory has its own constitution and parliamentary government. Local government only has the powers delegated to it by the States.

The Commonwealth is responsible for matters reaching across State and Territory borders and for international and external matters, including defence, communications, immigration and citizenship, foreign affairs, trade regulation, banking and monetary policy, customs and income support transfer payments (including in respect to health care and tertiary education). State governments are responsible for remaining matters, such as policing and law enforcement, primary and secondary education, roads and public transport, local government, sewerage and utilities and the delivery of health care. There are many areas in which both levels of government are involved such as health care, roads and transport and education. The geographic/population size and activities of local government vary across the States and Territories, though they fairly consistently handle local roads, garbage collection and development control.

### Spending

The States have constitutional responsibility for the major service delivery functions in education, health, community services and law and order and the Territories are similarly involved in these areas. As a result, the States and Territories account for approximately 40 percent of all government expenditure in Australia. The health and education portfolios combined account for about 50 percent of expenditure by State and Territory governments. The Commonwealth accounts for approximately 56 percent of government expenditure in Australia with its main areas of spending being social security and welfare, defence and health and education.

### Taxation

The Commonwealth government controls the greatest sources of revenue in company and income taxes, the Goods and Services Tax (GST) and customs and excise duties. The States rely mainly on property and payroll taxes for their revenue, having handed over their income taxation and customs and excise powers to the Commonwealth. Local government relies exclusively on property taxes for own-source revenues. In 2002-2003,

Commonwealth revenues were 81.8 percent of revenue for all levels of government, State and Territory revenues were 15.2 percent and local government revenues were 3 percent.

The Commonwealth relies exclusively on its own revenue to finance its responsibilities. The States and Territories rely on the Commonwealth for approximately 40 percent of their revenues. This proportion varies, however, with some smaller States and Territories receiving a much higher proportion. This reliance on Commonwealth funds gives the Commonwealth significant policy influence in areas beyond its responsibilities, mainly through transferring funds for specific purposes. Local governments are also heavily reliant on transfers from both the Commonwealth and State and Territory governments.

### **Equalization/Federal transfers**

There is a steep imbalance in Australia between the revenue raising powers of the levels of government and their responsibilities such that the Commonwealth collects revenue significantly beyond its expenditure needs and the States and Territories collect revenue that falls short of their expenditure needs. As such there are significant transfers between the Commonwealth and State and Territory governments in the form of untied grants and Specific Purpose Payments.

Under an intergovernmental agreement between the Commonwealth and the States and Territories, all revenue from the GST (\$31.2 billion in 2002-2003) is transferred to the States and Territories as untied grants making up approximately 25 percent of their revenues. There are also significant transfers from the Commonwealth to the States and Territories for specific purposes such as funding for hospital services, which make up about 15 percent of State and Territory revenues. The Commonwealth gains significant policy influence through these specific purpose payments into areas that are not traditionally within its responsibilities. This creates tensions between the levels of government as well as causing structural problems within some service delivery areas, particularly health, where complex funding structures cannot adequately respond to changes in service delivery and shifts in demand.

Australia also engages in horizontal fiscal equalisation aimed at delivering a similar level of services to citizens in each State and Territory. This is done by distributing the main untied grants (i.e. the GST) among the States and Territories based on 'relativities' developed by the Commonwealth Grants Commission (CGC). The CGC is an independent body that reports to the Commonwealth Minister for Finance on the relative revenue raising and service delivery capacities of the States and Territories and developing relativities for distributing GST revenue on this basis. This process is controversial among 'donor' States, i.e. those States that generate more GST revenue within their borders than they receive after distribution under the CGC's relativities.

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