

# International Studies Program

Working Paper 04-12  
November 2004

## The Impact of Equalization on Service Delivery

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# *The Impact of Equalization on Service Delivery*

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and

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*The Commonwealth Grants Commission*

## **1. The Australian Experience**

The founders of the Australian federal system<sup>2</sup> recognised the need for transfer payments from the national to state level governments and made provision in the Constitution to achieve that end. Transfers are required to overcome the vertical fiscal imbalance (VFI) between the levels of government and also to assist particular States. The arrangements for providing extra assistance to particular States were first formalised in 1933 with the creation of the Commonwealth Grants Commission (the Commission). In 1936, the Commission took the concept developed earlier by one of its members<sup>3</sup> and provided a definition of HFE. However, it was not until the early 1980s that a comprehensive system of HFE was introduced. As a result of this comprehensive system, the Commission has 26 years of data, from 1977-78 to 2002-03, on:

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<sup>1</sup> Catherine Hull is an Assistant Secretary at the Commonwealth Grants Commission. Bob Searle is a former Secretary of the Commission. The views expressed in this paper are those of the authors and not the Commission. We would like to thank Rosa Benedictos and Linda Pure for help with the data analysis.

<sup>2</sup> The Australian Federation comprises six States – New South Wales, Victoria, Queensland, Western Australia, South Australia, Tasmania – and two Territories – the Australian Capital Territory (ACT) and the Northern Territory. In this paper, the word State(s) should be read to include the ACT and the Northern Territory, unless the context indicates otherwise. All participate in the equalisation system.

<sup>3</sup> Professor L F Giblin, a member of the first Grants Commission, discussed the concept in a 1925 Tasmanian submission prepared for the proposed Royal Commission on Tasmanian Finances and in an appendix to the 1930 Tasmanian Submission to the Joint Committee of Public Accounts.

- (i) the revenues and expenses of the States on a largely comparable accounting and classification basis;
- (ii) Australian average per capita State revenues and expenses;
- (iii) standardised revenues and expenses of the States<sup>4</sup>;
- (iv) the relative revenue raising capacities of the States, and their relative costs of providing Australia average levels of services; and
- (v) the relative revenue raising efforts made by the States, and the relative levels of services they provide.

Using this database, it is possible to consider whether the HFE system has had an influence on the levels of services provided by the States. This paper provides information on the design of the Australian fiscal transfer system, explains how it interacts with other government policy instruments and political considerations, and uses the Commission's data to illustrate the drivers of service delivery outcomes.

### *The fiscal transfer system in Australia*

In Australia, the amount of revenue raised by the national government is much larger than its own purpose outlays require. By contrast, the States' own purpose outlays greatly exceed the revenues they raise from their own sources – there is a vertical fiscal imbalance. All nations with more than one level of government have some VFI, although it is not often as large as in Australia.

Fiscal transfers from the Australian Government to the States are used to redress VFI. Currently, about 60 per cent of the transfers are in the form of untied funds (funds the States can spend as they choose). The other 40 per cent are tied funds, or specific purpose payments (SPPs), which are grants that must be spent on the purposes for which they are given.

Untied funds comprise the revenue raised from a Goods and Services Tax (GST) imposed by the Australian Government and passed on to the States (less a small administration charge), and a number of other payments. The GST pool<sup>5</sup> is estimated to be \$42 billion<sup>6</sup> in 2004-05<sup>7</sup> and represents the largest single intergovernmental transfer in Australia. It represents about 35 per cent of the gross operating expenses of the States in total<sup>8</sup> and is growing. In the five years to 2002 -03, it varied from 30 per cent in Western Australia to 62 per cent in the Northern Territory. *A New Tax System*

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<sup>4</sup> The standardised revenue of a State is what it would raise if it applied the Australian average revenue imposts to its revenue bases. Its standardised expenses are what it would have to spend to provide the Australian average level of services, taking into account differences between the average experience and the use and unit costs of services it experiences.

<sup>5</sup> This comprises the GST revenue and most of the Health Care Grants paid to the States by the Australian Government as specific purpose payments.

<sup>6</sup> In US dollars, this equates to \$29.4 billion. One Australian dollar is worth about 70 cents US. The \$29.4b would be the equivalent of a grant scheme of \$US350 trillion in the US context.

<sup>7</sup> Australian Government (2004), *Federal Financial Relations 2004-05, Budget Paper No 3*, Canberra, CanPrint Communications Pty Limited, p10.

<sup>8</sup> Commonwealth Grants Commission (2004a), *Report on State Revenue Sharing Relativities, 2004 Review*, Canberra, CanPrint Communications Pty Limited pp4-5, available at [www.cgc.gov.au](http://www.cgc.gov.au).

*(Commonwealth-State Financial Arrangements) Act 1999* requires that the GST pool be distributed among the States according to HFE principles. The Commission is charged with the responsibility of recommending appropriate shares for the States.

The Act also makes it clear that the GST revenue allocated to each State may be spent according to each State's own priorities — that is, the Australian Government has no control over how States choose to spend the funds.

To achieve agreed national policy objectives in areas of State constitutional and traditional functional responsibilities (for example, in the health and education areas), the Australian Government provides SPPs. SPPs are used to influence State priorities and to support specific policy objectives of the Australian Government to which the States have agreed. The Australian Government does not seek to take over responsibility for State functions.

There are around 120 SPPs related to particular functional areas such as education, health, housing, social welfare, transport and local government. They cover capital as well as recurrent programs. Distribution arrangements differ for each SPP. Block grants for government schools are largely distributed on a per student basis, with additional per student payments for students with special characteristics, such as Indigeneity or remoteness. Home and Community Care grants are funded on a matching basis and other payments, such as that for the Natural Heritage Trust of Australia, are made on the basis of applications for funding.

### ***Horizontal fiscal equalisation in Australia***

The objective of HFE as applied in Australia has remained much the same since the very early days of the Commission, though its expression has varied over time. The objective is presently stated as:

**State governments should receive funding from the pool of goods and services tax revenue and health care grants such that, if each made the same effort to raise revenue from its own sources and operated at the same level of efficiency, each would have the capacity to provide services at the same standard.<sup>9</sup>**

The Commission uses this principle to make recommendations to the Australian Government on the share of the GST pool that each of the States should receive to allow it to provide services at the same standard, without having to make different tax efforts.

The definition makes it clear that States' fiscal capacities, not their performances, are being equalised. Fiscal equalisation is directed towards giving States the capacity to provide the same standard of service but does not require them to do so. As noted above, it is an essential feature of intergovernmental transfers in Australia that the GST revenue distributed among the States under equalisation arrangements is untied in the hands of the

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<sup>9</sup> Commonwealth Grants Commission (2004a), p4.

States. States have their own role in the federation and may follow their own policies on both sides of their budgets. The untied nature of these funds has important implications for service delivery outcomes.

### ***The Commonwealth Grants Commission's model***

To implement HFE, the Commission uses a closed model. Historical financial data are used to construct a picture of 'what States did' in terms of their revenue raising and service provision over the last five years. National per capita averages, or standards, are calculated for each function of government and head of revenue. This information is derived from State budgets, Government Finance Statistics (GFS) published by the Australian Bureau of Statistics and other sources. It is these standards, not the actual expenses or revenues of each individual State, that are the starting point. That is, the States are equalised to what, on average, they actually do.

Next, the Commission measures differences in States' per capita costs of providing services and per capita capacities to raise revenue. Only influences outside the control of State governments are recognised as 'disabilities' or 'needs'<sup>10</sup> and taken into account in the equalisation model. This requires data on State populations and their demographic and geographic characteristics, on resource endowments and on economic conditions. It also requires judgement to ensure that only those differences between the States that cannot be influenced by State policies are recognised.

For example, if State governments choose to pay higher wages to their public servants, the Commission would not recognise this as a valid reason for an adjustment to the standard. If, however, States need to pay higher wages to attract staff to very remote or highly urbanised areas, this would be considered a valid reason for an adjustment to the average per capita spend on a function. Such influences on the costs of providing services can be either positive or negative.

The standardised per capita expenses of a State on a function are calculated when these per capita needs are added to the standard, or subtracted from it (when the per capita costs are below standard). The standardised expense per capita represents the amount a State is considered by the Commission as needing to spend to provide the Australian average level of service.

Similarly, if one State has a smaller (larger) revenue base than another for reasons beyond its control, and is not able to raise as much (more) revenue by applying the average rates of tax, then it has a greater (lesser) need for GST revenue. The standardised per capita revenue of a State is the amount the Commission calculates it would raise if it applied the Australian average effort to its tax base.

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<sup>10</sup> Disabilities or needs are defined as differences in the economic, demographic and physical circumstances of States that lead to differences in their relative costs of providing services and their relative revenue raising capacity. They are beyond the control of an individual State government.

The Commission's model can be presented mathematically in two ways.

A State's per capita share of GST revenue = its per capita share *plus* its assessed needs per capita (expense and revenue), *less* per capita needs due to SPPs;

or

A State's per capita share of GST revenue = its standardised per capita expenses *less* its standardised per capita revenues *less* its per capita SPP receipts, *less* a standard per capita budget result.

A State's share of the GST revenue reflects the amount it would spend to provide the standard level of services after taking account of the revenue it would raise from its own sources by making a standard revenue raising effort, its receipts from SPPs and allowing for a standard per capita budget deficit (or surplus). The second presentation recognises that the States can, and do, operate with a surplus or a deficit each year and provides for an average outcome to be reflected in the 'equalisation budget'. There are no 'needs' associated with the budget result as it is the same standard per capita amount for all States.

A full mathematical exposition of the model<sup>11</sup> and an explanation of how the Commission implements HFE can be found in its most recent report<sup>12</sup>.

## 2. What the Australian Data Show

As a by-product of the Commission's work, the data collected and generated can be used to calculate ratios to compare the level of services States provide and the effort they put into raising revenue.

A **level of service provision ratio** (or expense effort) is the ratio of actual expenses incurred by a State on a service to its standardised per capita expenses – what it actually spends compared to what the Commission considers it would spend if it were to provide the standard (average) level of services. An index above 100 indicates the extent to which the cost of providing the service is above the Australian average due to policy choices about service levels and/or relative inefficiencies.

A **revenue raising effort ratio** is the ratio of actual per capita revenue raised by a State to standardised per capita revenue – what it actually raises compared to what the Commission considers it would raise if it applied the average tax imposts to its revenue bases. An index above 100 indicates effort above the Australian average.

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<sup>11</sup> Commonwealth Grants Commission (2004b), *Report on State Revenue Sharing Relativities, 2004 Review, Supporting Information*, Attachment B: The Distributional Model A Mathematical Representation, Canberra, CanPrint Communications Pty Limited, pp341-350.

<sup>12</sup> Commonwealth Grants Commission (2004a), Chapter 2, p4.

Table 1 shows the level of service provision ratios for all State services and some selected services for 2002-03. These ratios suggest that five States provided services above the Australian average and three provided below average services. For the specific services included in the table:

(i) Victoria, Western Australia and the ACT provided above average levels of schools education, hospitals and housing, and below average levels of per capita roads expenses;

(ii) the Northern Territory provided services overall at above average levels but the specific services at below average levels<sup>13</sup>;

(iii) New South Wales and Queensland provided all but roads at below average levels; and

(iv) other States chose a mix of above and below average services.

**Table 1:** Service Provision levels and Revenue Raising Effort, Australian States, 2002-03

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
<b>Level of service provision ratio</b>									
All services	94.73	105.33	94.01	107.75	106.70	97.89	119.10	105.05	100.00
Schools education	94.76	106.53	96.15	104.90	111.35	103.59	100.02	80.56	100.00
Hospitals	90.49	134.41	69.01	125.37	90.99	80.09	111.15	78.64	100.00
Housing	93.45	114.72	69.74	101.67	167.55	94.06	196.48	54.90	100.00
Roads	118.87	88.34	117.85	66.25	80.05	112.00	55.74	22.59	100.00
<b>Revenue raising effort</b>									
Total State own source revenue	100.70	100.94	90.15	103.62	118.03	101.24	95.43	89.97	100.00

Source: Commonwealth Grants Commission (2004b).

The table also shows the revenue raising effort made by States across all revenues in that year. It shows that two States – New South Wales and Victoria - operated at close to the Australian average effort, three States – Queensland, the ACT and the Northern Territory - made below average effort and the rest made above average efforts. Queensland alone was a low taxing, low service provision State in 2002-03.

It is possible to compare the ratios across States as in Table 1, or over time for a particular States. Attachment A summarises the level of service provision ratios for the period 1977-78 to 2002-03 for all States for all services, Primary and Secondary Government Education, and Hospitals services. The ratios for Housing and Roads are

<sup>13</sup> According to Commission figures, the Northern Territory is spending well above average amounts on providing population and preventive health services, higher education, services to industry, general public services, depreciation and debt charges.

also included but cover only the later part of the period<sup>14</sup>. Primary and Secondary Government Education, Hospitals, Housing and Roads account for about 40 per cent of State expenses. Attachment B includes the total revenue raising effort ratios for the complete period.

In using these data, it is essential that their limitations be recognised. The ratios and what they tell us are only as good as the data used in their calculation. There can be errors in both the numerator – the actual financial data – and the denominator – the standardised figures arrived at by the Commission.

As noted above, the financial data are compiled using a range of sources. The States are largely responsible for reporting the information and it may not always be fully consistent across States or over time.

In estimating the standardised figures, the Commission uses a range of data of varying quality and reliability to quantify differences between the States in the non-policy influences on their costs. Generally, data measuring differences in the average use of services are more readily available and of better quality than data on differences in unit cost. The data can be as good as those available on student numbers to as poor as information available on what it costs to educate an Indigenous student compared to a non-Indigenous student. The Commission also uses its judgement to decide the range of influences it recognises. It could miss an important influence or simply not be able to obtain the data to measure the impact of an influence on State costs. For example, the Commission has found it impossible to quantify the impact of different climatic conditions on State depreciation expenses.

Over time, the nature of services and the scope of transactions used to define a service have changed. There has also been a change in GFS from a cash to an accrual basis, commencing in 1998-99. However, these changes should have affected State actual expenses and Australian standard expenses in the same way and should not cause major breaks in the series. However, if State expenses are affected differently from the average, then discontinuities in the time series ratios for particular States will occur.

The changes that the Commission makes to the way it calculates relativities in each review<sup>15</sup> can cause a noticeable break in the series. As well as changes to the methods used to calculate standardised revenues and expenses, the scope of the system has changed over time. The Northern Territory was included in the equalisation system in the 1985 Review and the ACT in the 1993 Review. The years when a break in the series might be expected because of a review have been noted in the attachments.

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<sup>14</sup> These services were included in the equalisation budget for the first time in the 1993 Review. Hence comparable data are available from 1987-88 for Roads but only from 1991-92 for Housing. Prior to 1991-92, Housing needs were calculated on a net basis and standardised gross expenses are not available.

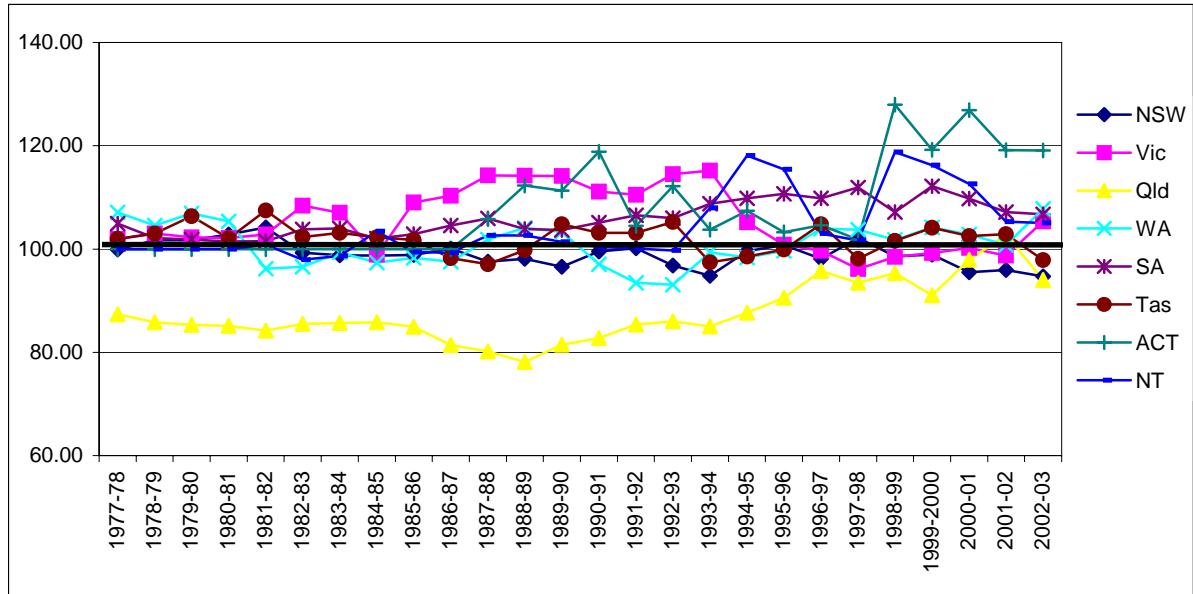
<sup>15</sup> The Commission first calculated State relativities in 1981 and undertook reviews of its methods in 1982, 1985, 1988, 1993, 1999 and 2004. A system of five yearly reviews was adopted in 1988 and the 1999 Review was a 'one off' delay to better align reviews with Census data availability.

***All services***

Figure 1 shows that service levels in the Australian States fall within a relatively tight bandwidth – generally no more than 20 per cent below average to no more than 20 per cent above average. The HFE system has provided State funding so as to enable this degree of consistency. However, the figure also shows a number of interesting trends.

- (i) Queensland has been a low service level State for the entire period, although its service levels have been increasing since the early 1990s. In 1989-90, Queensland elected its first Labor government for twenty years.
- (ii) Victorian service levels have generally been above average, particularly in the period 1984-85 to 1993-94. In 1993-94, they fell, following the election of the Liberal (conservative) government in 1992. Since the return to Labor governments, they have been increasing again.
- (iii) The ACT and the Northern Territory have tended to provide above standard services for the period. These two Territories were administered directly by the Australian Government before self-government and this may have conditioned service expectations. The ACT experienced a dip in service levels in the early to mid 90s, coinciding with the election of a Liberal government. The apparent fall in the Northern Territory level of service provision from 1997-98 may be due to data problems because of the change to accrual GFS in that year. At that stage, the Northern Territory Government had not adopted accrual budgeting and its accrual statistics were estimated.
- (iv) The service levels of the other States have moved around the average.

**Figure 1:** Level of Service Provision Ratios<sup>(a)</sup> – All Services



(a) A ratio of 100 indicates that the level of services is at the Australian average.  
 Source: Commonwealth Grants Commission, Reports, 1981 to 2004.

**Government primary and secondary education**

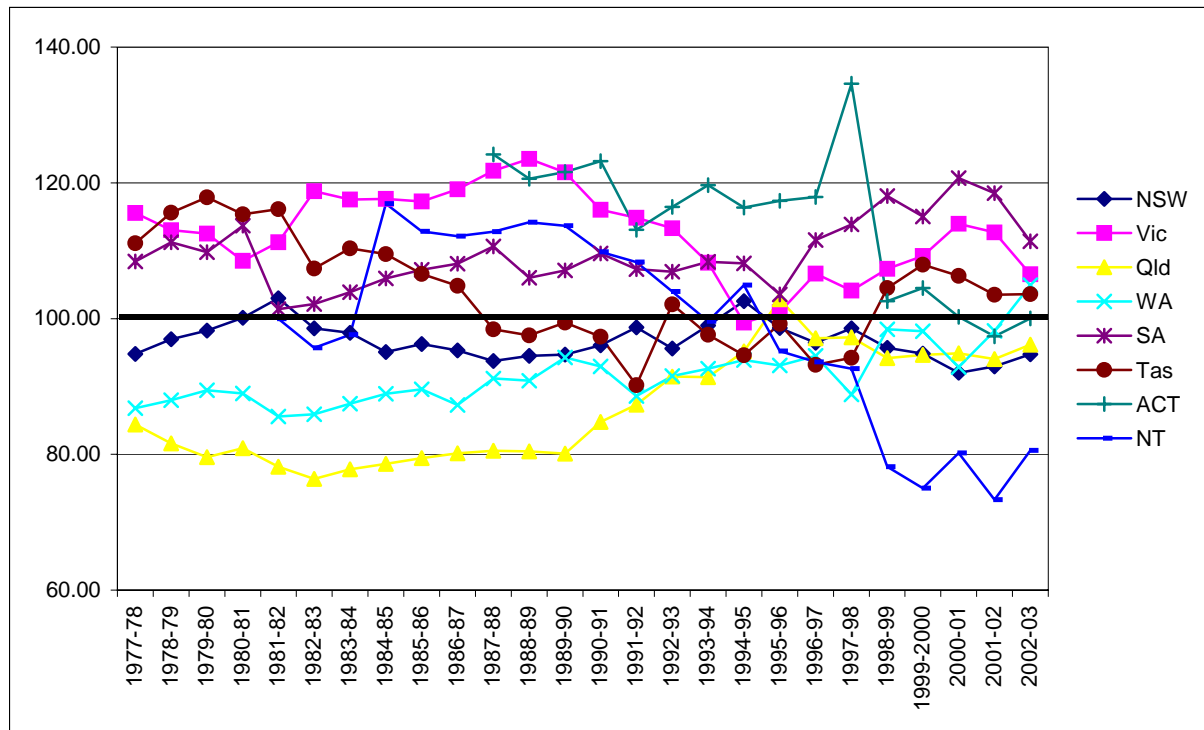
As for total service provision, the level of service provision ratios for government education suggest that States tend to provide services within 20 per cent of the Australian average. Some States traditionally provide services below the Australian average and others provide services well above that average. New South Wales, Queensland, and Western Australia have generally had ratios below the Australian average, although Queensland and Western Australia are closer to the average now than they were at the start of the period. South Australia has remained well above average for the period, as has Victoria, although its ratios have been trending closer to the average. This suggests that there are some States which value spending on education more than others. Again, the increase in education spending in Queensland came with a change in the party in government. Figure 2 illustrates the trends.

In 1994, the Commission published a paper<sup>16</sup> which found, as expected, that the apparent differences in State service levels could be attributed to different policies. It found that high service provision States (Victoria, South Australia and the ACT) paid their teachers more, provided more teachers per student and had more students in the non-compulsory years of schooling (over 15 years).

<sup>16</sup> Commonwealth Grants Commission (1994), *Information Paper No 1, Education Services, Analysis and Discussion of State Policies, 1994*, Canberra, Australia Government Publishing Service. The Commission also published similar papers which identified policy differences affecting Urban Transit and Police services.

An unexpected trend observed in the graph is the apparent fall in the level of government education services provided by the Northern Territory. It is possible that the observed fall to below 80 after 1998-99 is due to data anomalies (the change from cash to accrual GFS occurred in that year and the Northern Territory's actual expenses showed a decline in that year). However, the downward trend in Northern Territory level of service provision ratios commenced in 1984-85, although it was not until the mid-90s that service levels fell below the Australian average. This trend is of concern, given that twenty nine per cent of the population of the Northern Territory is Indigenous and Indigenous Australians have much lower educational outcomes than non-Indigenous Australians<sup>17</sup>.

**Figure 2:** Level of Service Provision Ratios<sup>(a)</sup> – Government Education



(a) A ratio of 100 indicates that the level of services is at the Australian average.

Source: Commonwealth Grants Commission, Reports, 1981 to 2004.

### *Hospital services*

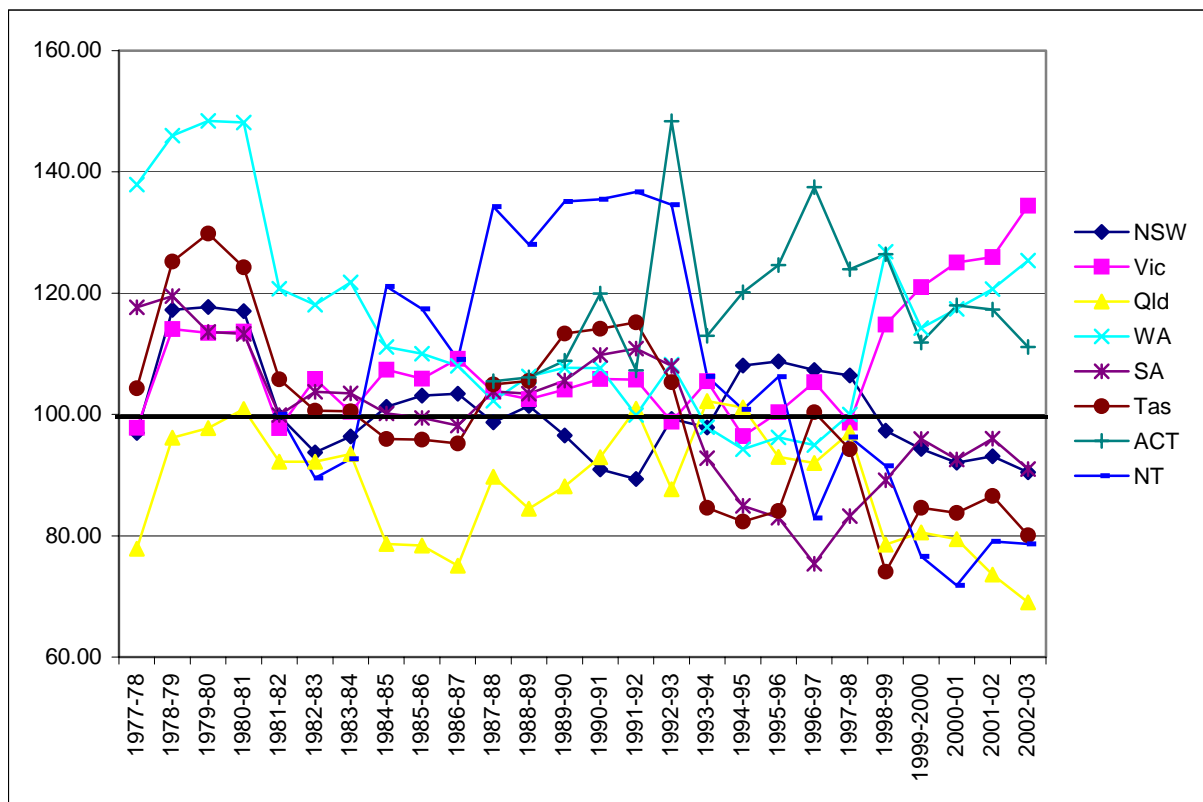
The picture painted by the Hospital services ratios (Figure 3) shows a greater range in the level of services provided in different States. For most States, it suggests the trend has been to reduce relative service levels. The graph again shows Queensland as a State providing below average levels of service for almost the entire period. For the earlier years, Western Australia and Tasmania provided well above average services but gradually reduced them towards the average. However, in recent times, Victoria,

<sup>17</sup> Commonwealth Grants Commission (2001), *Report on Indigenous Funding, 2001*, Canberra, CanPrint Communications Pty Limited, p195.

Western Australia again and the ACT are providing well above the average level of services. The five other States are below the average.

It is possible to speculate that the reductions that occurred in the early 1980s in most States came about because the Commission published its first report, providing information on the States' relative spending levels compared to those of the other States. However, as the service levels reduced and the populations of some States did not support this policy, governments were forced to invest more in hospital services. That is certainly the case for Victoria in recent times. After the cutbacks (and efficiencies) in the 1980s and 90s, the Victorian population is now demanding a higher level of services in its hospitals. Funding has been increased to support this.

**Figure 3:** Level of service Provision Ratios <sup>(a)</sup> – Hospitals



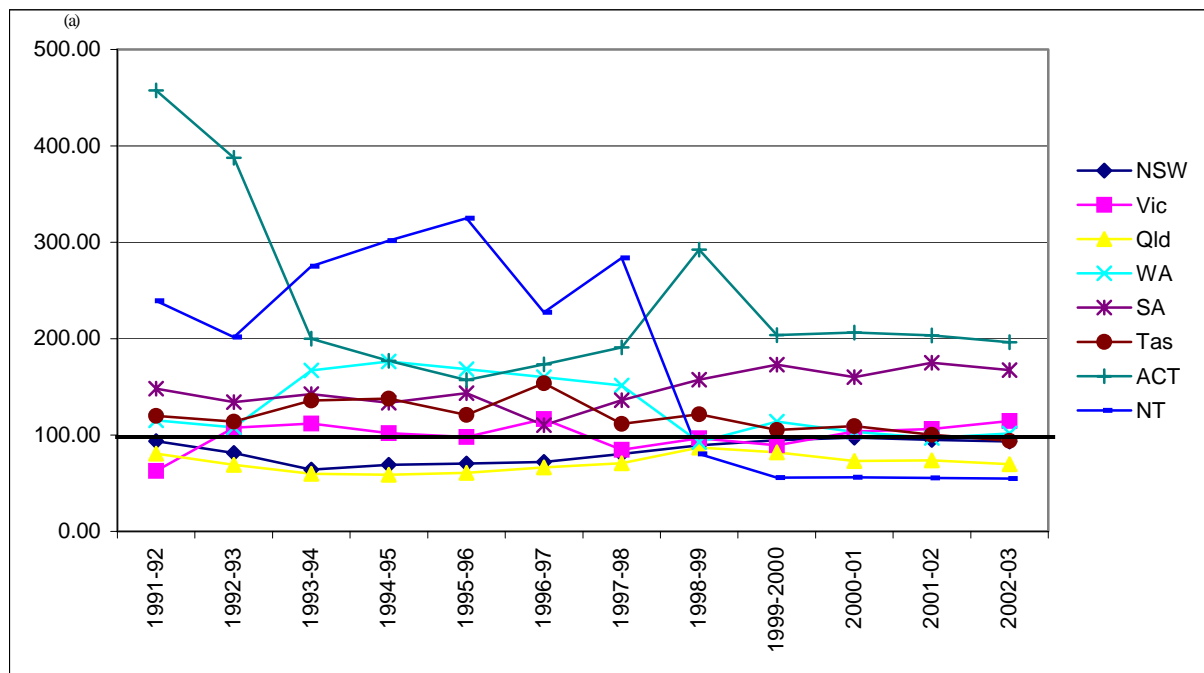
(a) A ratio of 100 indicates that the level of services is at the Australian average.  
 Source: Commonwealth Grants Commission, Reports, 1981 to 2004.

### Housing

Housing services were included in the equalisation budget for the first time in the 1993 Review, but on a net cost basis. In the following review, the Commission decided to undertake separate assessments of expenses and revenue raising capacity associated with public housing services. It did this because it believed that the needs relating to each were not offsetting. As a result, the data series for housing gross expenses commences in 1991-92.

Looking at Figure 4, the ratios suggest very large differences in levels of public housing services. Again, Queensland's services are well below standard and the ACT considerably above. Historically, the ACT and the Northern Territory had high levels of public housing dwellings per capita because the Australian Government provided them to attract public servants to live and work there. These levels have decreased over time, although for the ACT, they are still well above average – about twice the average. South Australia housing services are well above average because of the long-term effects of a public housing policy applied in the 1950s and 1960s to provide high levels of public housing to encourage a migrant workforce for the State's rapid industrialisation. Services in most of the other States appear to be converging. The fall in the Northern Territory's service level in the period since 1998-1999 could be due to the misallocation of depreciation expenses.

**Figure 4:** Level of Service Provision Ratios <sup>(a)</sup> – Housing



a) A ratio of 100 indicates that the level of services is at the Australian average.

Source: Commonwealth Grants Commission, Reports, 1981 to 2004.

## Roads

The ratios for roads suggest widely fluctuating levels of service – from 60 per cent below to 60 per cent above average Australian standards. Anecdotally, travellers in Australia say that they can tell when they are crossing State boundaries, not because of the signs, but because of the quality of the roads.

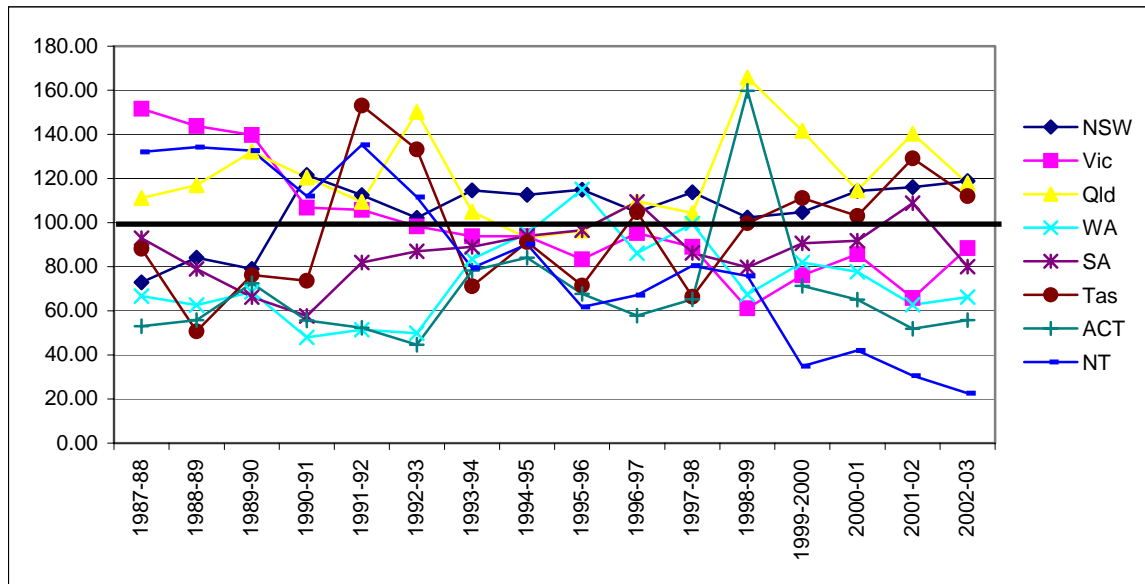
This can probably be understood in terms of how governments in Australia manage road maintenance and depreciation expenses. There are widely varying standards of roads constructed across the States and different maintenance regimes. In

part this is a response to traffic conditions, but States also make different decisions relating to the trade-off between construction standards and maintenance and also on what standards they consider appropriate for their States. Timing of road programs is also flexible. As a result, actual road expenses fluctuate in most States from year to year, although the Commission’s assessments of needs are relatively stable.

The graph is still surprising in that Queensland, a low service provision State and a State recognised for below standard roads, appears to be providing a high standard of service. Queensland argues that this is because the Commission fails to recognise all road lengths for which the Queensland government is responsible. The Commission is investigating this concern. The graph is also interesting in that the ACT and Victoria, with reputations for good quality road systems, have below Australian average ratios. These observations suggest that the Commission’s assessments may not adequately be identifying State disabilities, or that road construction and maintenance cannot be assessed as simply as the Commission has done in the past. High levels of expenses in the past can give an appearance of high standards of roads that maybe misleading, particularly if they are not adequately maintained from then on (note Victoria’s declining ratios).

As with Housing, there is a possible misclassification of depreciation expenses for the Northern Territory from 1998-99.

**Figure 5:** Level of Service Provision Ratios <sup>(a)</sup> – Roads



(a) A ratio of 100 indicates that the level of services is at the Australian average.  
 Source: Commonwealth Grants Commission, Reports, 1981 to 2004.

### 3. Influences on Service Delivery Levels

The above analysis suggests that HFE is ensuring that a reasonable standard of service is delivered to Australian citizens in all States. States do choose different levels of service provision in total and for particular services, but presumably for good reasons. The analysis suggests that some States choose to provide below standard services across the board and others tend to choose a mix of above and below standard services. The level of services in a State also varies over time. For some services, such as government education, there is a convergence towards the average. For others, no such convergence can be observed, although there are patterns of decreasing service levels in the 1980s, followed by increasing levels.

Thus, although States are given the capacity to provide the same standard of service through the HFE system, they exercise their right to choose the standard of service they offer their populations, presumably to better reflect voter and consumer preferences. The different patterns of service provision levels over time also suggests that there may be a range of other influences operating, not just HFE. Over time of course, State preferences change, with different parties forming the government and with changes in the preferences of their voting populations.

The effect of changes in government can be seen in the service level ratios. Service levels fell dramatically after the election of a Liberal Government in Victoria in 1992. They increased dramatically in Queensland after the fall of a conservative Government in 1989. The changes in government in the ACT – from the Australian Government before self-government, and from Labor to Liberal since then - can be observed.

Although the HFE system of itself does not result in similar service levels across Australia, the by-product information generated may cause convergence. In particular, there is evidence that State governments, government inquiries, and lobby groups use the data the Commission publishes. There is also evidence that the level of service States provide is influenced by other government policy choices, including:

- (i) a government's view on the revenue raising effort its population is prepared to support; and
- (ii) SPP agreements.

Examples are provided below.

### *Use of Commission data in influencing service standards*

State governments have in the past used Commission data to review their financial positions and to assist in formulating their budgets. For example, the New South Wales Commission of Audit<sup>18</sup> and the South Australian Commission of Audit<sup>19</sup> used Grants Commission data on service levels to make judgements about where relative 'over servicing' was occurring. The report of the New South Wales Commission of Audit noted:

**The Commonwealth Grants Commission, the only body with reliable comparable information about all States, identifies over servicing of public transport in New South Wales in comparison with other States, to cost \$56 m per annum. (p41)**

The Grants Commission never uses its data to talk of over servicing, but the levels of service provision ratios did show that New South Wales was delivering a public transport service at well above the Australian average per capita cost. The Commission of Audit did not consider this to be justified. In all, the Inquiry recommended that the New South Wales Government reduce both its taxation and its expenditure.

As a result, a Commission on the Cost of Government was established to identify services on which the New South Wales Government was spending more than other States and to decide whether this was due to inefficiencies that could be removed or, if it represented a higher standard of service, whether it was justified by community requirements. In New South Wales, service levels fell in the early 1990s (after these inquiries), as can be observed most clearly in the Hospitals data.

Similarly, the South Australian Commission of Audit of 1994 concluded that South Australia's expenditures were significantly higher than most other States. It said that the above average expenditures on debt charges, health, education, law and order, and culture and recreation, as assessed by the Commonwealth Grants Commission, were 'mainly due to policy choice and/or relative operating inefficiency' (Vol 2, p59). As a result, it recommended that 'general government spending must be reviewed and constrained' (Vol 2, p91). These above-standard service levels and their decline in 1995-96 are illustrated in the graphs, particularly for education, hospitals, and roads. Interestingly, service levels overall (all services) did not fall, so funds must have been redirected to areas considered to be of greater importance. It is also interesting to note that service standards have climbed again in recent times, particularly in education and health.

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<sup>18</sup> New South Wales Commission of Audit (1988), *Focus on Reform, Report on The State's Finances*, Sydney, Government Printer New South Wales.

<sup>19</sup> South Australian Commission of Audit (1994), *Charting the Way Forward, Improving Public Sector Performance*, Adelaide, Gillingham Printers Pty Ltd.

A number of State governments<sup>20</sup> have told Commission staff that the Commission's data are used in formulation of their budgets. Where a service appears to be above the Australian average level, departments and agencies are asked during budget preparation to justify the level in terms of community preferences.

Government inquiries also use Commission data to check whether appropriate service levels are being delivered. The Queensland Treasury<sup>21</sup> asked the Commission to confirm that Queensland was making an increased effort in providing foster care services. It had been asked to update Commonwealth Grants Commission information on the funding of child protection services in Queensland because in 1999 it had suggested that these services had been under funded<sup>22</sup>.

Non-government school groups in some States have also used the Commission's data to argue that the sector<sup>23</sup> was receiving a poor deal compared to the sectors in other States. Also lobby groups have used Commission data to argue for increased funding in State budgets. New areas of funding, or increased funding, can be observed in State budgets in response to community demands (more police, spending to reduce waiting lists in hospitals, etc), particularly where those groups can show that services are below Australian standards.

Use of Commission data in this way tends to move service delivery standards towards the average.

### ***Revenue raising effort***

States' revenue raising efforts tend to be above average if they are providing above standard services and below average if the State is supporting below standard services. Queensland is the classic example. Its revenue raising efforts were well below average in the earlier years – less than 60 per cent of the Australian average, rising to 90 per cent of the Australian average as its service provision levels have crept up. Similarly South Australia's revenue raising efforts have increased from below average to above average to support its increased service standards. New South Wales and Victoria have maintained revenue raising efforts generally slightly above the Australian average to support their above standard services. Figure 6 illustrates State policy decisions on revenue raising efforts. Figure 7 compares the revenue raising efforts and service provision levels of Queensland, South Australia, and Victoria.

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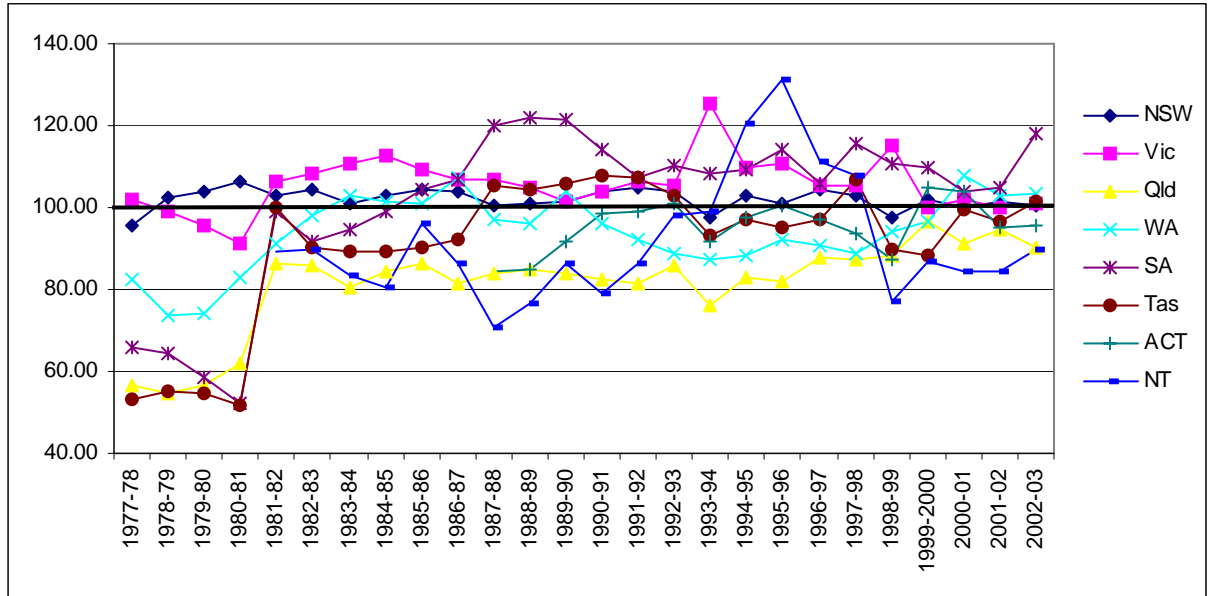
<sup>20</sup> Personal communications between State Treasuries and Commission staff.

<sup>21</sup> Letter from Queensland Treasury to the Commission, 16 October 2003.

<sup>22</sup> Forde Inquiry into the Abuse of Children in Queensland Institutions (1999).

<sup>23</sup> Catholic Education Office.

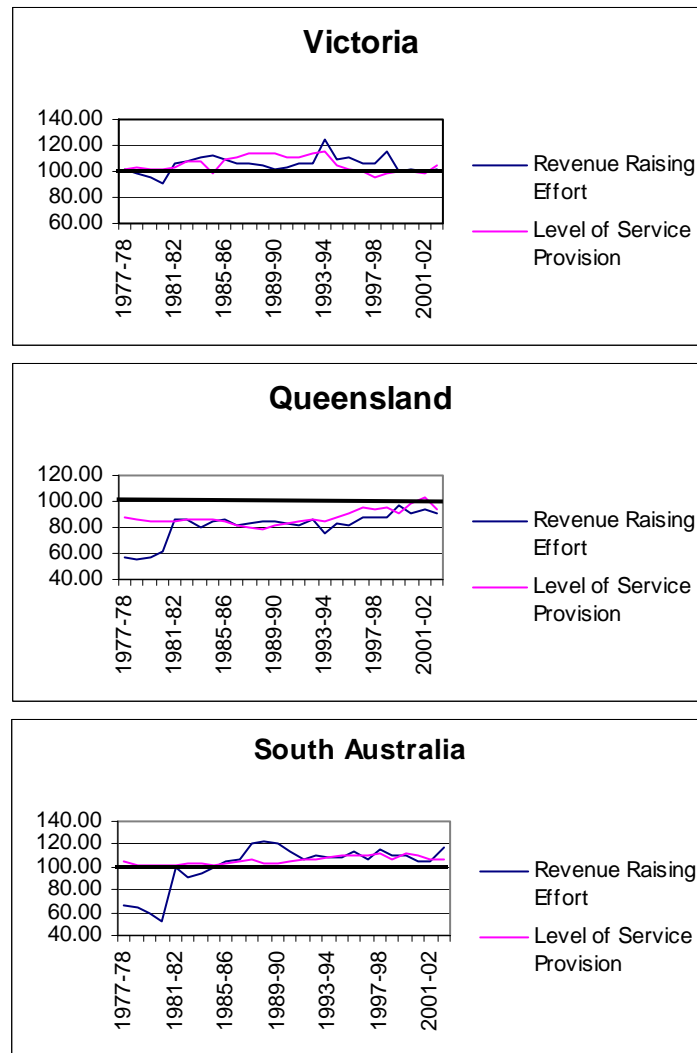
**Figure 6:** Revenue Raising Effort <sup>(a)</sup> – Total Revenue



(a) A ratio of 100 indicates that the revenue raising effort is at the Australian average.  
 Source: Commonwealth Grants Commission, Reports, 1981 to 2004.

The choice of overall service standards must be supported by a State’s willingness or otherwise to make a revenue raising effort. Figure 7 shows that States’ revenue raising efforts and their levels of service provision track well. That was not the case in the years prior to the first Commission review (1981), particularly for Queensland and South Australia. It has largely been the case since, although there have been some divergences. Where a State chooses a lower revenue raising effort than its service levels, it needs to borrow above average amounts to support the difference. Similarly, where a State imposes a greater revenue effort than its service level requires, it can repay an above average amount of borrowing or operate at a larger than average surplus.

**Figure 7:** Comparison of Revenue Raising Efforts and Service Levels, Three States, 1978-79 to 2002-03



### *Impact of SPP programs*

The Australian Government uses its greater financial resources to influence service provision in areas which are constitutionally the responsibility of the States. It does this through SPP programs which, as discussed earlier, are provided according to agreed conditions. Thus the Australian Government can act to increase resources provided for particular services, or to influence particular outcomes.

The convergence observed earlier in government school services could be due to the influence of the Australian Government which, together with the States, is seeking to produce outcomes of a higher standard (increases in literacy and numeracy levels is a clear objective) and to ensure the education services made available to our students are more uniform. As a result, SPPs for school purposes are conditional on States adopting

the same starting age, reporting standards and testing procedures to evaluate literacy and numeracy.

The Health Care Grants for hospitals do not appear to be causing any such move towards uniformity in service standards. The difference may be the amount of expense involved in providing hospital services, with the States and the Australian Government both contributing large sums of money and the potential for substitution great. In addition, there do not appear to be any clear agreed national outcomes. Conditional arrangements within the HCG program are at the margin, such as reporting requirements, or requirements to reduce waiting lists. Funding does not appear to be tied to improving health outcomes. Not surprisingly, the States and the Australian Government blame each other for poor performance of the hospital sector which they often attribute to cost shifting – as one level of government increases funding, the other moves it out.

#### **4. Conclusion**

There are many influences on service delivery levels in Australia. Australia is a federation and it has an HFE system that provides certainty that all States have the capacity to provide the same standard of service. The federal system also means that State governments can choose not to do so. They can choose instead to satisfy the preferences of the people who live in their jurisdiction. These preferences are expressed at elections through changes in government and through lobby groups that tell governments about their needs. The HFE system is not designed to achieve uniformity, but to give flexibility – to deliver equality in diversity<sup>24</sup>.

However, the information generated as a by-product of the HFE system allows governments and other groups to ask questions about why standardised per capita expenses on services differ between States. If they are higher for reasons that relate to the preferences of the population, then this is good government decision making. If they are the result of inefficiency, or inertia, they need to be changed.

Other State government policies, such as those relating to revenue raising effort, and Australian government policy as expressed through SPPs, can also have an influence on service levels. Higher service levels must be supported through higher revenue efforts. SPPs can have the effect of raising overall service standards to an ideal level and, where there is strong State support for these standards, to a convergence in service levels across States.

All the policy instruments used by the Australian Government and the States play their role in helping to achieve appropriate service standards for Australian residents, regardless of where they live. Both equality and diversity (choice) are important goals in Australian culture and our systems work to achieve them.

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<sup>24</sup> Commonwealth Grants Commission (1995), *Equality in Diversity: History of the Commonwealth Grants Commission, Second Edition*, Canberra, Australian Government Printer.

## **Postscript**

The Heads of the Australian Government Treasury and State Treasuries are presently conducting a review of the implementation of HFE in Australia. They are seeking to simplify the system to give greater confidence in the results and to make them more understandable. There is concern that the present complexity of the system and the intensive way in which it uses available data are not sustainable.

While some States are very supportive of the review, others are not. Those States not supporting the review are concerned that simplification will result in a reduction in equalisation because their needs will not be properly measured. They are also concerned that it may result in the re-introduction of special deals for States that can no longer have their needs dealt with appropriately under a single, comprehensive system. Many are asking the question of whether this will be going forward, or going backward, to a system of political gamesmanship.

Simplification may also lead to a reduction in the need for data on government service provision. If less data are produced, the effect on accountability and the ability to make comparisons of State operations may be of some concern.

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## Attachment A

**Table A-1:** Service Provision Level Ratios <sup>(a)</sup>, Australian States, 1978-88 to 2002-03 - All Services

Year	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	CGC Report
1977-78	99.93	101.95	87.33	107.07	104.93	101.93	na	na	1981 Review
1978-79	101.70	102.98	85.78	104.53	102.15	103.02	na	na	1982 Review
1979-80	101.70	102.23	85.33	106.90	101.80	106.33	na	na	
1980-81	102.80	102.12	85.10	105.35	101.46	102.06	na	na	
1981-82	104.15	102.80	84.17	96.19	101.50	107.47	na	100.84	1985 Review
1982-83	99.30	108.38	85.51	96.54	103.82	102.32	na	97.93	
1983-84	98.82	107.02	85.70	99.36	104.01	103.12	na	98.64	
1984-85	98.75	98.94	85.82	97.37	102.03	102.27	na	103.43	1988 Review
1985-86	98.83	108.98	84.92	98.31	102.90	101.77	na	99.42	
1986-87	100.11	110.28	81.42	97.54	104.57	98.26	na	99.31	
1987-88	97.58	114.26	80.17	101.82	105.88	97.08	105.76	102.66	1993 Review
1988-89	98.10	114.20	78.11	104.09	103.89	99.77	112.28	102.64	
1989-90	96.56	114.16	81.48	103.32	103.66	104.81	111.27	101.39	
1990-91	99.54	111.13	82.79	97.04	105.09	103.12	118.81	100.38	
1991-92	100.17	110.50	85.36	93.47	106.54	103.13	104.51	100.12	
1992-93	96.82	114.50	85.98	93.07	105.99	105.20	112.17	99.70	1998 Update
1993-94	94.84	115.18	85.02	99.33	108.76	97.42	103.77	107.95	1999 Review
1994-95	99.62	105.16	87.69	98.34	109.82	98.52	107.38	118.12	
1995-96	100.78	100.82	90.55	99.67	110.69	99.88	103.23	115.41	
1996-97	98.12	99.65	95.76	103.93	109.79	104.79	104.61	102.99	
1997-98	102.14	96.13	93.49	103.71	111.93	98.09	101.83	101.66	
1998-99	98.62	98.49	95.35	101.77	107.13	101.60	127.91	118.77	2004 Review
1999-2000	98.93	99.26	91.03	104.19	112.17	104.10	119.24	116.23	
2000-01	95.51	100.23	97.92	102.82	109.75	102.49	126.89	112.57	
2001-02	95.96	98.72	102.73	100.75	107.16	102.90	119.13	105.30	
2002-03	94.73	105.33	94.01	107.75	106.70	97.89	119.10	105.05	

(a) A ratio of 100 indicates that the cost of providing services is at the Australian average. Na indicates data not available.

Source: Commonwealth Grants Commission, Reports, 1981 to 2004.

**Table A-2: Service Provision Level Ratios <sup>(a)</sup>, Australian States, 1978-88 to 2002-03 – Government Primary and Secondary Schools**

Year	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	CGC Report
1977-78	94.78	115.58	84.41	86.78	108.41	111.08	na	na	1981 Review
1978-79	96.96	113.02	81.62	87.99	111.21	115.59	na	na	1982 Review
1979-80	98.22	112.51	79.59	89.42	109.79	117.86	na	na	
1980-81	100.13	108.51	80.89	88.93	113.66	115.36	na	na	
1981-82	103.00	111.24	78.16	85.58	101.41	116.12	na	100.00	1985 Review
1982-83	98.56	118.76	76.37	85.89	102.15	107.39	na	95.69	
1983-84	97.93	117.53	77.78	87.43	103.87	110.35	na	97.63	
1984-85	95.09	117.62	78.61	88.93	105.91	109.47	na	116.92	1988 Review
1985-86	96.26	117.27	79.44	89.58	107.17	106.58	na	112.85	
1986-87	95.33	119.02	80.17	87.26	108.08	104.84	na	112.12	
1987-88	93.75	121.80	80.55	91.19	110.64	98.41	124.17	112.78	1993 Review
1988-89	94.49	123.53	80.43	90.83	106.00	97.52	120.60	114.22	
1989-90	94.69	121.54	80.12	94.30	107.08	99.40	121.60	113.70	
1990-91	96.06	116.01	84.76	92.97	109.58	97.32	123.19	109.81	
1991-92	98.72	114.84	87.33	88.56	107.27	90.19	113.06	108.29	
1992-93	95.58	113.30	91.46	91.57	106.90	102.09	116.48	103.97	1998 Update
1993-94	98.97	108.20	91.38	92.64	108.37	97.61	119.65	99.58	1999 Review
1994-95	102.55	99.42	95.17	93.92	108.14	94.59	116.38	104.94	
1995-96	98.59	100.98	102.85	93.10	103.53	99.21	117.37	95.20	
1996-97	96.46	106.62	97.11	94.54	111.54	93.18	117.90	93.60	
1997-98	98.54	104.11	97.26	88.84	113.89	94.22	134.58	92.61	
1998-99	95.71	107.33	94.20	98.44	118.04	104.49	102.58	78.20	2004 Review
1999-2000	94.82	109.19	94.66	98.16	115.03	107.93	104.51	75.03	
2000-01	92.02	113.95	94.91	92.85	120.68	106.31	100.26	80.22	
2001-02	92.95	112.71	94.06	98.21	118.48	103.50	97.37	73.34	
2002-03	94.76	106.53	96.15	104.90	111.35	103.59	100.02	80.56	

(a) A ratio of 100 indicates that the cost of providing services is at the Australian average. Na indicates data not available.

Source: Commonwealth Grants Commission, Reports, 1981 to 2004.

**Table A-3: Service Provision Level Ratios <sup>(a)</sup>, Australian States, 1978-88 to 2002-03 - Hospitals**

Year	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	CGC Report
1977-78	96.96	97.79	77.90	137.89	117.65	104.33	na	na	1981 Review
1978-79	117.24	114.11	96.18	145.97	119.50	125.21	na	na	1982 Review
1979-80	117.73	113.46	97.73	148.43	113.63	129.87	na	na	
1980-81	117.05	113.65	100.92	148.16	113.30	124.24	na	na	
1981-82	99.72	97.74	92.23	120.75	99.93	105.84	na	100.00	1985 Review
1982-83	93.76	105.85	92.23	118.11	103.74	100.63	na	89.54	
1983-84	96.36	100.45	93.48	121.78	103.47	100.54	na	92.68	
1984-85	101.26	107.42	78.66	111.12	100.16	95.95	na	121.11	1988 Review
1985-86	103.12	105.93	78.38	110.04	99.43	95.84	na	117.42	
1986-87	103.43	109.16	75.10	108.02	98.15	95.22	na	109.05	
1987-88	98.69	103.77	89.75	102.29	103.79	104.97	105.48	134.30	1993 Review
1988-89	101.43	102.56	84.48	106.30	103.42	105.56	106.10	128.06	
1989-90	96.53	104.10	88.13	107.68	105.58	113.33	108.87	135.12	
1990-91	90.95	105.89	92.94	107.68	109.80	114.14	119.96	135.51	
1991-92	89.39	105.76	100.98	99.91	110.88	115.20	107.29	136.68	
1992-93	99.25	98.80	87.69	108.22	108.00	105.36	148.37	134.57	1998 Update
1993-94	97.84	105.49	102.21	97.90	92.80	84.63	112.96	106.26	1999 Review
1994-95	108.09	96.40	101.17	94.25	84.93	82.36	120.15	100.83	
1995-96	108.78	100.40	93.00	96.22	82.99	84.08	124.65	106.25	
1996-97	107.36	105.31	91.98	94.94	75.37	100.40	137.48	82.93	
1997-98	106.43	98.64	97.02	99.99	83.23	94.28	123.92	96.28	
1998-99	97.34	114.85	78.57	126.83	89.17	74.07	126.39	91.52	2004 Review
1999-2000	94.32	120.99	80.56	114.24	95.94	84.62	111.87	76.60	
2000-01	92.04	125.05	79.44	117.41	92.60	83.75	117.97	71.83	
2001-02	93.08	125.92	73.62	120.65	96.02	86.54	117.29	79.07	
2002-03	90.49	134.41	69.01	125.37	90.99	80.09	111.15	78.64	

(a) A ratio of 100 indicates that the cost of providing services is at the Australian average. Na indicates data not available.

Source: Commonwealth Grants Commission, Reports, 1981 to 2004.

**Table A-4:** Service Provision Level Ratios <sup>(a)</sup>, Australian States, 1978-88 to 2002-03 – Housing

Year	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	CGC Report
1991-92	93.79	62.71	80.74	115.26	148.26	119.86	457.57	239.25	
1992-93	81.44	107.51	69.21	107.82	134.11	114.04	387.67	201.53	1998 Update
1993-94	64.05	112.03	59.83	167.12	142.69	135.89	200.06	275.11	1999 Review
1994-95	69.02	101.93	58.87	176.28	133.67	137.80	177.12	301.50	
1995-96	70.36	97.85	60.67	168.53	143.68	120.94	157.27	324.90	
1996-97	72.06	116.46	66.48	160.19	110.43	153.78	173.52	227.10	
1997-98	80.51	84.72	70.87	151.37	136.30	111.60	190.91	283.86	
1998-99	89.38	96.55	87.07	92.77	157.48	121.58	292.49	80.42	2004 Review
1999-2000	94.83	89.23	82.05	113.84	173.10	105.27	203.75	55.70	
2000-01	97.32	103.82	73.09	103.48	160.13	109.23	206.22	56.24	
2001-02	95.18	106.38	73.60	96.89	174.97	100.21	203.20	55.48	
2002-03	93.45	114.72	69.74	101.67	167.55	94.06	196.48	54.90	

(a) A ratio of 100 indicates that the cost of providing services is at the Australian average. Na indicates data not available.

Source: Commonwealth Grants Commission, Reports, 1981 to 2004.

**Table A-5:** Service Provision Level Ratios <sup>(a)</sup>, Australian States, 1978-88 to 2002-03 - Roads

Year	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	CGC Report
1987-88	72.88	151.58	111.20	66.70	92.84	88.19	52.98	132.04	1993 Review
1988-89	84.00	143.77	116.95	62.67	78.98	50.77	55.73	134.22	
1989-90	78.98	139.66	132.16	68.54	66.17	76.28	72.44	132.62	
1990-91	121.57	106.76	120.51	48.02	57.72	73.59	55.72	112.03	
1991-92	112.45	105.86	109.38	51.48	81.93	153.10	52.27	135.27	
1992-93	102.12	98.30	150.22	49.90	86.99	133.20	44.64	111.65	1998 Update
1993-94	114.65	93.71	104.94	83.52	88.99	71.12	78.27	79.43	1999 Review
1994-95	112.66	93.71	93.10	95.07	93.93	91.10	84.02	90.08	
1995-96	114.96	83.38	96.43	115.03	96.52	71.41	67.61	61.79	
1996-97	104.84	95.24	109.70	86.08	109.43	104.75	57.86	67.08	
1997-98	113.80	88.94	104.39	99.64	86.17	66.38	65.24	80.40	
1998-99	102.26	61.11	165.78	67.34	79.64	99.68	159.66	75.78	2004 Review
1999-2000	104.76	76.14	141.59	81.92	90.61	111.14	71.28	34.89	
2000-01	114.32	85.59	114.60	77.67	91.71	103.05	65.04	42.07	
2001-02	116.12	65.83	140.23	62.69	108.89	129.11	51.92	30.60	
2002-03	118.87	88.34	117.85	66.25	80.05	112.00	55.74	22.59	

(a) A ratio of 100 indicates that the cost of providing services is at the Australian average. Na indicates data not available.

Source: Commonwealth Grants Commission, Reports, 1981 to 2004.

## Attachment B

**Table B-1:** Revenue Raising Effort Ratios<sup>(a)</sup>, Australians, 1978-88 to 2002-03 – Total State Own Source Revenue

Year	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	CGC Report
1977-78	95.55	102.08	56.83	82.61	66.09	53.14	na	na	1981 Review
1978-79	102.25	99.12	54.88	73.67	64.31	54.89	na	na	1982 Review
1979-80	103.92	95.76	56.44	74.06	58.67	54.84	na	na	
1980-81	106.51	91.10	61.94	82.89	52.09	51.82	na	na	
1981-82	102.78	106.49	86.17	91.41	98.84	99.91	na	89.20	1985 Review
1982-83	104.49	108.42	86.03	97.81	91.49	90.04	na	89.53	
1983-84	101.04	110.84	80.39	102.93	94.78	89.41	na	83.26	
1984-85	102.77	112.65	84.38	101.39	99.03	89.35	na	80.55	1988 Review
1985-86	104.42	109.17	86.29	101.16	104.48	90.17	na	96.26	
1986-87	103.83	106.74	81.70	107.24	106.93	92.03	na	86.13	
1987-88	100.56	106.78	83.67	97.17	120.14	105.13	84.50	70.84	1993 Review
1988-89	101.17	104.66	85.00	96.13	122.08	104.25	85.04	76.54	
1989-90	101.57	101.41	83.87	103.72	121.41	105.90	91.67	86.19	
1990-91	103.69	103.76	82.65	96.32	113.91	107.72	98.35	78.94	
1991-92	104.98	106.51	81.40	92.16	107.22	107.15	99.25	86.50	
1992-93	104.11	105.41	85.99	88.97	110.34	102.94	100.76	98.24	1998 Update
1993-94	97.37	125.24	75.91	87.51	108.49	93.38	91.65	99.03	1999 Review
1994-95	103.04	109.84	83.00	88.44	109.14	96.99	97.45	120.69	
1995-96	100.96	110.62	81.88	92.33	114.26	95.22	100.47	131.23	
1996-97	104.17	105.39	87.66	90.57	105.89	97.04	96.98	111.22	
1997-98	102.78	105.45	87.34	88.86	115.45	106.91	93.60	107.87	
1998-99	97.55	114.92	88.31	94.19	110.77	89.93	87.43	77.10	2004 Review
1999-2000	101.80	100.02	96.39	96.58	109.57	88.37	104.78	86.88	
2000-01	100.13	101.95	91.07	107.94	104.06	99.43	103.94	84.42	
2001-02	101.70	99.98	94.48	103.06	104.70	96.61	94.99	84.36	
2002-03	100.70	100.94	90.15	103.62	118.03	101.24	95.43	89.97	

(a) A ratio of 100 indicates that the revenue raising effort is at the Australian average. Na indicates data not available.

Source: Commonwealth Grants Commission, Reports, 1981 to 2004.