

# Submission to the Productivity Commission

## Review of the GST Distribution to States and Territories.

1. The main purpose of this submission is to urge the Productivity Commission to conduct a more balanced process than the 2018 Review and to make a special effort to prepare the report and analysis in a way the bulk of the community understands. This needs to include an analysis of the risks to Australian society of any proposals.
2. The bias in the 2018 Review process and report was disappointing, best summarised by one expert body, the SA Treasury, describing the 2018 Productivity Commission Review as “(deliberately) misleading”. The overall flavour of the 2018 Review, particularly in the multiple press releases prior to the final report that were probably more important in shaping the communities expectations than the Report itself, was that Australia’s horizontal fiscal equalisation processes were a mess, when the then Productivity Commission criticisms of horizontal fiscal equalisation were misrepresented and/or overstated (eg there was gaming behaviour when no evidence was found despite 2 years of study; constant reference to equalising to the richest State when the equalisation is to the average of all States/Territories) or manageable via standard Government processes (eg use of short term borrowing and loan repayment processes to handle contemporaneity/volatility issues, including because each jurisdiction was certain of the financial capacity over time to provide average standards of services). The 2018 Review also did not address the risks to Australian society of any changes.
3. Rather than there being real problems with the horizontal fiscal equalisation processes, the overarching and fundamental issue that pressured the Federal Government to make the 2018 changes in the GST arrangements was the embedded belief in WA that the current GST distribution arrangements were unfair. The WA community was constantly told by the WA Government and the WA media that the WA share of the GST was far too low. Without counterbalancing explanations, that belief was understandable as WA’s share of the GST was low given that most of WA’s needs to provide state-like services were funded by massive mining royalties. However, there was little counterbalancing of that embedded belief with the equity and other benefits to WA and Australia as a whole, discussed later in this submission.
4. Responsibility for the counterbalancing information rested with successive Federal Governments, particularly the Morrison Government, though by the time of the Morrison Government came into power, the lack of proper explanations to the WA community by all previous Federal Governments meant it was arguably too late to change the embedded beliefs in WA. However, at the time of the Morrison Government, three key and highly respected Federal Ministers were based in WA who could and should have made clarifying comments to the WA community to explain why the current horizontal fiscal equalisation arrangements were fair and to highlight the other benefits WA had as a result of WA’s mineral wealth. But these WA-based Federal Ministers chose not to. Instead, they did the opposite. The then Opposition made some early comments about the equity of the existing horizontal fiscal equalisation arrangements but quickly abandoned that position.

5. Given the embedded beliefs in WA, both major Federal political parties knew that opposing WA keeping most of its mining royalties for itself would have meant electoral defeat in WA. As a result, both parties agreed WA had to receive much more than its full horizontal fiscal equalisation entitlement of GST funds.
6. In my opinion, both major Federal political parties failed their duty to the nation. The same applies to the then Productivity Commission for not applying its usual professional standards in the 2018 Review that were independent of the wishes of the Government of the day.
7. The Morrison Federal Government (with the support of the then Opposition) used the Productivity Commission 2018 Review processes as the main rationale to give WA more GST money than was needed to provide average state-like services.
8. However, abandoning full horizontal fiscal equalisation in the manner proposed by the Productivity Commission would have created another layer of electoral/voter problems because the usual horizontal fiscal equalisation zero sum game rules would mean the additional “above standard” GST revenue WA was to receive by keeping most of its mining revenue for itself would have been funded by much lower GST payments to the other States/Territories. The Morrison Government recognised the problem by introducing the “no worse off guarantee” that allowed States/Territories other than WA to receive what they would have received had full horizontal fiscal equalisation been in operation. It was a brilliant political move as it effectively stopped all States/Territories' dissent to the changes. The current Albanese Government has continued that guarantee until 2030, though it appears the guarantee was conditional on the States/Territories taking on some of the Federal Government's expenditure priorities.
9. Some media analysts have argued along the lines that a perceived “mess” was replaced by a bigger “mess”.
10. The end result was the overall pool of internal and external revenue available to States/Territories has increased, first by WA's mining royalties (net of ups and downs, especially in other revenue areas and maybe expenditure areas if States/Territories took on additional functions from the Federal Government) and second by the Commonwealth topping up the GST pool to ensure no States/Territories is worse off by WA retaining most of its mining royalties. The most recent Commonwealth Grants Commission report shows all States/Territories, ie including WA, in total will receive over \$5 billion more in 2025/26 from the Federal Government than they would have under full horizontal fiscal equalisation. WA will receive around \$6 billion more from the GST pool in 2025/26 than it would have under full horizontal fiscal equalisation!!! Had the pre 2018 GST distribution arrangements applied, ie under full horizontal fiscal equalisation, WA's additional \$6 billion would have been shared by all States/Territories via the usual Commonwealth Grants Commission fiscal equalisation processes that would have meant all jurisdictions had the financial capacity to provide Australian average standards of services. The Federal Government would not have paid any top-ups to the GST pool.
11. But harmony has been achieved in Australia, albeit at a marginally higher cost to the Australian taxpayer than full horizontal fiscal equalisation as a result of the extra \$5 billion “no worse off guarantee”. This guarantee top-up is close to 5% of the total estimated \$95 billion GST payments in 2025/26. This extra 5% is not a waste of taxpayers' money as the community benefits from better standards of service given that the States/Territories provide key services like health, education and law and order,

though some will no doubt argue that may not be the best use of the nation's financial resources.

12. The key task now is to ensure continued harmony in Australian society.
13. That is more likely to occur if the issues, including risks of any options, are explained in terms decision makers and the bulk of the community can readily understand. We want the Australian community to be able to reconcile and find the right balance between the embedded belief in WA that WA residents deserve to have the financial capacity to provide higher standards of service versus the benefits full horizontal fiscal equalisation has brought to Australia.
14. In particular, the Review needs to highlight why horizontal fiscal equalisation is fair, has been a shaping feature of Australian society for nearly 100 years and is therefore one of the reasons contributing to Australia being the harmonious society it is. Fiddling with that principle is a risk to our harmonious society. Selfishness is infectious and irrationality prompts more irrationality, so Australia must get the balance right.
15. The Review needs to recognise the WA benefits of full horizontal fiscal equalisation in the past, albeit acknowledging that the previous benefits were massively less than the benefits being received today as a result of the mining royalties.
16. The nature of the advantage WA has because of the “luck” in having massive mineral resources in the extreme NW of Australia should be stressed and differentiated from policy actions a jurisdiction might take to increase its revenue capacity. It would be anomalous if the benefits of this “luck” in the NW of Australia was primarily for the benefit of people living in the extreme SW of Australia. Mind you, the resources “luck” in NW Australia also materially benefits Federal revenue collections, so that too is a part of the policy consideration mix, including a rationale for continuing the “no worse off guarantee” to the States/Territories other than WA.
17. That “luck” in having massive mineral reserves gives WA benefits far greater than royalties because those mining resources create huge industries and hence jobs. Governments around the world spend much of their time seeking ways and means of creating jobs and industry when WA has it handed on a platter, so that is a material benefit the WA community needs to appreciate.
18. At a more philosophical level, in 1977, Justice Rae Else-Mitchel, a Chair of the Commonwealth Grants Commission in the 1970’s and early 1980’s, described horizontal fiscal equalisation as “the glue that binds the Federation”, a phrase that is often reused in discussions about Australia’s fiscal equalisation arrangements.
19. Prime Minister John Howard when commenting in 1998 on NSW quest to have the then Commonwealth grants to the States/Territories distributed more on an equal per capita basis, provided a wonderful summary of horizontal fiscal equalisation when he said words to the effect that we’re all Australians and access to Government services should not depend on what State a person lives in. See the full text of his comment in the footnote below. <sup>(1)</sup>

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<sup>1</sup> “I’m an Australian and as far as I’m concerned all Australians should be treated equally no matter where they live. I’m not interested in arguments from a State Premier that he’s carrying somebody else’s load. I think Bob Carr is running advertisements which frankly are a waste of his taxpayers’ money. He’s basically saying that we’re not all meant to sort of look after each other....”

Source: 4 BC Radio interview with Alan Jones, 6/11/1998

20. Most people would agree that WA is receiving too great a share of the nation's revenues. But given the current embedded beliefs in WA and Australia's democratic processes, changing the current arrangement won't be easy. Maybe the Review could address processes by which the WA community can be convinced its current share of the GST is too large.
21. Unfortunately, the media in WA can't be relied on to give a balanced view to the people of WA. I visited family and friends in WA during the Review process, and after reading a 29 August 2018 misleading Editorial in the West Australian newspaper commenting on the inequity of current horizontal fiscal equalisation arrangements, I wrote a short letter to better explain the equity of the GST arrangements and the risks to the nation of abandoning those arrangements. The next day, there were several irrational/unbalanced letters in that paper, but mine was not published. This was clear evidence that the newspaper did not want the WA community to be given a more balanced/informed view (which has implications beyond this matter).
22. Overlaying all of the analysis requires an understanding of the share of the nation's resources that should go to the States/Territories (and local govt). In the early years after the GST was introduced, Heads of Treasury undertook that type of analysis, following detailed work by NT Treasury in the late 1990's that showed the States/Territories share of Federal revenues fell from 35% to 25% in the Hawke/Keating era. It is unknown if that Heads of Treasury type of work still occurs, but it should, and be published with analysis. This type of transparency would enable the community to better understand the issues surrounding the shares of the nation's revenues going to the different levels of Government as part of the quest to ensure harmony in Australian society. Data and observation lead to understanding and understanding is essential for good decisions, whether those decisions are in the ballot box or in making policy choices.
23. That analysis in the paragraph above will, of course, need to take account of whatever revenue WA continues to receive over and above its full horizontal fiscal equalisation share.
24. I have come to the conclusion that it is better to err on the side of the States/Territories, including WA, receiving "too much" than "too little", given the nature of the services States/Territories provide and the need to ensure harmony in Australia. In addition, in the short and probably long-term geopolitical environment and WA's relative isolation in the West of the country, it is also in the nation's broader interests if WA is more highly populated than it is today, which a higher GST share would facilitate.
25. The broad options appear to be
  - As is
  - Less benefit to WA. eg initially a 50% floor.
  - WA use the above standard revenue for expenditures that benefit the whole of Australia.

The Productivity Commission and others will no doubt analyse these types of options, hopefully with a risk analysis.

26. Regarding risks, in addition to assessing the risks with whatever options the Productivity Commission analyses, particularly the "too much" versus "too little" type risks and the implications of any differences in standards of services between jurisdictions in Australia, an important risk to national harmony is tax competition. Under the current arrangements, WA has significantly more financial capacity than other jurisdictions, and

WA could use that capacity to lower taxes. The current Opposition in WA has said they wanted to do just that. This would have disastrous effects on other States/Territories as these jurisdictions would effectively be forced to follow material tax reductions in WA, like lower payroll taxes, to ensure industry did not move from their jurisdiction to WA. It would cause significant disharmony in Australia. It is therefore urged that this risk and appropriate mitigation measures be addressed. For example, if there is predatory tax competition, one clear option is to reduce WA's GST share. Another mitigation measure is to indicate that such a policy would trigger a reappraisal of the GST distribution arrangements. A third mitigating option might be for the Federal Government to compensate the States/Territories for the revenue losses caused by WA.

27. As a final comment, it is essential that Australia remains a harmonious society. That overrides all issues. Harmony in Australian society is a function of expectations, and the Review needs to help the respective Governments, particularly the Federal Government, keep community expectations within reasonable bounds. This applies to the expectations of the WA community, particularly if the current benefits are to be reduced, but also to the communities elsewhere in Australia as they grapple with understanding why WA, with most of the population living in the bottom SW corner of Australia, is receiving such a large share of the benefits of mineral resources in the NW of Australia. Managing expectations starts with an unbiased analysis of the issues in a way the community understands.

Ken Clarke

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