

Supplementary Submission

Objectives of Horizontal Fiscal Equalisation

The Productivity Commission was required by its terms of reference to determine whether the 2018 reforms were operating “efficiently, effectively and as intended”. Yet, as the Interim Report observes:

“The intent of the 2018 reforms was not explicitly defined.”

The Commission was required to determine whether the reforms were operating “as intended”, but the intended policy outcomes themselves were not expressly stated in the legislation. They first had to be identified by interpretation and inference from material outside the Act.

The Commission therefore had to identify the objectives of the reforms by relying on extrinsic material, including the Explanatory Memorandum, the Australian Government’s response to the earlier Commission inquiry and ministerial second-reading speeches. In identifying what it regarded as the core intent, the Commission also had regard to the repeated formulation “The plan ...” in the Explanatory Memorandum.

There is nothing unusual in having regard to extrinsic material when interpreting legislation. The significance here, however, is the scale and continuing importance of the function. The CGC’s recommendations underpin the finances and capacity of every State and Territory to deliver services each year.

That difficulty is particularly significant given the importance of the distribution of GST revenue among the States and the need for confidence in the system by which that distribution is determined.

The statutory framework

The Commonwealth Grants Commission Act 1973 already recognises that an objective relevant to the distribution of GST revenue is properly capable of legislative prescription.

Section 16AB applies where a matter relating to GST revenue grants is referred to the CGC. Section 16AB(2) requires the Minister, in framing such a reference, to pursue the statutory objective concerning the fiscal capacity of the States and Territories to provide services, including associated infrastructure.

The significance of this provision is that Parliament has already prescribed an objective relevant to HFE. However, the statutory obligation is directed to the Minister in framing the terms of reference. The Act should also state comprehensive objectives governing the CGC directly when it performs its functions relating to GST distribution.

The CGC has itself acknowledged that pursuing HFE is “not an exact science” and requires it to apply “estimates, trade-offs and judgements”. The exercise of technical and expert judgment is both necessary and appropriate. Determining the underlying policy objectives to which that expertise and judgment are to be directed is, however, a different matter.

This gives rise to the governance issue raised in my original submission. The objectives of HFE are not sufficiently or explicitly prescribed. Administrative bodies commonly operate under statutory objectives that guide the exercise of their functions. The CGC should likewise apply the policy objectives prescribed by Parliament when exercising its technical judgment and expertise.

The Commission itself recognised the importance of clearly identifying those objectives in its 2018 HFE Inquiry, when it recommended that the Australian Government establish a revised objective for HFE and described establishing that objective as an “essential precursor” to improving the system.

Who should determine the objectives of HFE?

The Interim Report provides a further illustration of the issue. In developing its own framework for considering future GST arrangements, the Commission states:

“Developing such a framework requires clarity on what the HFE system should actually be seeking to achieve.”

The Commission then identifies the primary goal as equity or equality of fiscal opportunity, with efficiency, fiscal sustainability and certainty operating as constraints.

That raises the institutional question at the centre of my original submission:

Who should determine what the HFE system should actually be seeking to achieve?

My submission is that the answer should be Parliament through legislation.

The Commonwealth Grants Commission Act should expressly prescribe the objectives governing HFE and require the Commission to apply those objectives in performing its functions relating to GST distributions.

This would establish a clear distinction between the determination of policy and its application. Parliament should prescribe the objectives governing HFE. The Commonwealth Grants Commission should have responsibility for applying its expertise, technical methodology and independent judgment in giving effect to those legislated objectives.

The determination of the objectives of HFE is fundamentally a matter of public policy. Their application in determining State relativities is an expert and technical function. The former should be prescribed by the democratically accountable legislature; the latter should remain the responsibility of the CGC.

This would not diminish the independence or expertise of the CGC. Rather, it would provide the statutory policy framework within which that expertise is exercised and a clear basis against which the operation of the HFE system can subsequently be assessed.

Indeed, the existing s 16AB demonstrates that legislative prescription of an HFE objective is neither novel nor inconsistent with the institutional structure of the CGC. Parliament has already chosen to prescribe an objective relevant to GST distribution. The issue is whether that statutory framework should now be made more complete by prescribing sufficiently clear objectives applicable directly to the CGC when performing its GST functions.

Conclusion

The Interim Report itself illustrates the practical significance of the issue raised in my original submission.

In carrying out this inquiry, the Productivity Commission has encountered the difficulty of assessing whether reforms have operated “as intended” when the intended outcomes were not expressly stated in the legislation. It has consequently had to reconstruct those intentions from extrinsic materials.

At the same time, the Commission has recognised that developing an appropriate framework for HFE requires clarity about what the system should actually be seeking to achieve.

Those observations provide an opportunity for the Commission to address the institutional question which follows from them: who should prescribe those objectives, and by what means?

My submission is that the objectives governing HFE should be expressly prescribed by Parliament in the Commonwealth Grants Commission Act and made applicable to the Commonwealth Grants Commission in performing its functions relating to GST revenue grants.

I respectfully suggest that the Commission address that proposition in its Final Report.