

RESPONSE TO INTERIM REPORT

INTRODUCTION

1. The Interim Report:
 - a) Recommends a return to the pre 2018 horizontal fiscal equalisation (HFE) arrangements as the preferred method for the distribution of the GST
 - b) confirms that the main issue with the GST distribution is not the Grants Commission HFE processes which are predominantly sound apart from some relatively minor tweaks.
 - c) restores Productivity Commission as an important national institution that can be trusted to make recommendations in the national interest that are independent of the politics of the day.
2. This contrasts with the Productivity Commission's 2018 GST Review processes which misled decision makers and the community at large with media reports and a final report which lay much of the need to move to partial HFE to the inadequacies of the Grants Commission HFE processes.
3. It is hoped the Final Report retains the Interim Report approach but expands on options that facilitate national harmony in Australia. This submission is using the word "harmony" to embrace the word "cohesion", so "national harmony" includes "national cohesion".

CONSIDERATION OF THE ISSUES

4. The move away from full HFE has occurred because of an embedded belief within the WA community that WA should receive more GST revenue than that determined by the full HFE processes which in turn led to political decisions to abandon full HFE.
5. WA's low share of the GST because of the mining royalties combined with inadequate explanation to the WA community of why that low relativity was appropriate, makes that embedded belief understandable. It reflects the unfortunate reality that the importance of full HFE to Australian society is little understood by the bulk of the community and even some decision makers. It was and still is easy for the WA media and Government to argue WA's low GST relativity is unfair.
6. While Governments should look at the "big picture" to ensure the settings for the totality of a society are optimal, as a democracy, changes in policy are required to be good politics. This disparity between optimal policy and politically acceptable policy has led to the situation we are in today. Bill Shorten, the Labor Opposition Leader at the time of the 2018 Review, described this issue in a recent 7:30 Report Interview with the TV host and Christopher Pine as a "wicked problem". That simple description exemplifies the dilemma faced by Australia.
7. Given the Prime Minister's comments, it is now certain that WA will continue to be over equalised in the GST distribution. The main issue now becomes how best minimise the material risks to harmony in the nation because of WAs over equalisation.

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8. This submission is narrowly focused on some of these risk issues and what can be done to mitigate the risks.

RISKS TO NATIONAL HARMONY AND MITIGATION OPTIONS

9. The risks to national harmony can be real or perceived. Both types of risk need to be mitigated because both can cause behaviours and policy actions that are not in the national interest.
10. By far the biggest risk to national harmony is the real risk of WA using its greater financial capacity to damage other States and Territories (States) in some way, again real or perceived damage.
11. While there are no doubt gradations in this risk, the key issue is competitive neutrality, a concept that has been at the forefront of public policy for many years.
12. The Federation benefits from a degree of competitive tension between the States as they strive to do better. That benefits Australia because it facilitates learnings from successful (and failed) policies. But if WA uses its greater financial capacity to compete in areas like Payroll Tax (and other people and industry attracting incentives), that will have dire consequences for all other jurisdictions. Other States will be to compete with WA but because they don't have the same financial capacity, will either have to raise revenue elsewhere or curtail services, which must inevitably affect the core services of Health, Education and Law and Order given they are such a large proportion of State expenditure. Such policies would be certain to raise ire in the community and be a material contributor to national disharmony.
13. Payroll Tax is a classic example of potential unfair competition. WA could reduce, even abandon, Payroll Tax and have the reduced Payroll Tax completely funded by the current \$6bn over equalisation. This is not a farfetched possibility as evidenced by the WA Opposition proposal in the most recent WA election to slash Payroll Tax.
14. This issue can also apply to community wide Government services like Health, Education and Law and Order. If WA's progressively improving financial advantage reaches the stage where standards of Government services and probably more importantly, subsidies, are far ahead of other jurisdictions, it will be perceived as inequitable in States other than WA and cause discontent in the community.
15. The appropriate mitigation to this competitive neutrality risk, and possibly other risks, appears to be twofold. First, provide information to the WA community of the nature of the risk and encourage a national interest belief/understanding in both the WA community and the WA Government that WA has a responsibility to use its financial advantage to act in a way that maintains national harmony. Second, develop a process whereby policy actions by WA that cause actual harm to other States will result in an adjustment to the WA share of the GST and/or a supplement outside the HFE processes to the other jurisdictions to offset the harm.
16. Part of the risk mitigation is encouraging WA to use its greater financial capacity to benefit the whole of Australia (and the world), such as increased research. Such

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activities will benefit WA as it develops a research base in WA and probably industries related to that research.

17. WA often uses the argument that it is already benefitting Australia by using the over equalisation to fund infrastructure to develop the resources sector. However, I understand the HFE system already equalises to allow all States to borrow and invest in infrastructure. In any case, all jurisdictions could mount the same type of argument, “give us more and we can do more”. But if WA’s argument is valid and not just a public relations type argument to convince the community and the Commonwealth politicians to continue supporting the over equalisation in WA, the Productivity Commission should report on this in detail to help allay some of the concerns in States other than WA. It should also report in detail if the argument is not valid. Two options if the current HFE processes don’t adequately address the relative capacity to invest in economy enhancing infrastructure are to either change the HFE processes or accommodate these needs outside the HFE processes.
18. Another part of the risk mitigation is continuing to demonstrate to WA that full HFE is fair and good for the nation. Even if that explanation is not fully accepted in WA, increasing the understanding within WA that WA’s over equalisation does affect other States in a manner that may require correcting actions will help achieve greater harmony in Australia. This includes
 - (a) Explaining why full HFE, which effectively means access to Government services do not depend on what State a person lives in, has been a largely unheralded feature shaping and building Australian society, including the economy, for nearly 100 years, and a fundamental part of making Australia the harmonious society it is. WA would not be as developed as it is had it not been for HFE. In other words, reinforcing and elaborating on the “big picture” aspects of full HFE. Abandoning that approach is therefore a risk to national harmony because the consequences of such abandonment can’t be predicted.
 - (b) WA had protection from the full HFE processes for nearly 80 years and supported these processes until it didn’t need that protection because of the mining royalties
 - (c) Justice Elise Mitchell’s description of HFE as “the glue that binds the Federation” epitomises the significance of HFE to Australia.
 - (d) Former Opposition Leader Bill Shorten’s description of the issue as a “wicked problem”, reinforcing there are difficult issues for the Federal Governments to address to maintain harmony within Australia.
 - (e) Correcting the often-quoted misinformation in WA that the Grants Commissions approach to poker machine revenue is a justification for WA keeping most of its mining royalties for itself, including highlighting how insignificant poker machine revenue is to each State compared to the benefits WA gets from its mining royalties, especially in per capita terms.
 - (f) Correcting the belief that WA has done something special and different by developing the iron ore industry. The iron ore resources are in the NW of WA. These resources are so far from major population centres and have much less policy concerns than developing coal and more particularly gas given the fracking type issues, that any jurisdiction would have facilitated the development of that iron ore industry had that opportunity arisen. The iron ore resource is a classic example of a revenue base that WA has because of the good fortune in having iron ore in Northern WA.
 - (g) Correcting the belief that WA needs the over equalisation to continue developing the resources sector, assuming that is not a valid argument. See paragraph 17 above.

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19. Another element of risk mitigation is to demonstrate to the community and Governments in States other than WA that the processes for dealing with WA's over equalisation are a reasonable compromise or not as bad as some are saying. This includes in particular
- (a) The No Worse Off Guarantee
 - (b) The Productivity Commission estimate that WA's over equalisation is only 13%, which doesn't sound such a large amount that it would seriously affect other States, though acknowledging that the over equalisation is large in \$ terms
 - (c) Bill Shorten's description of the issue as a "wicked problem", reinforcing there are difficult real and perceived issues to be addressed, which means the decisions on what to do have an element of "muddling through"
 - (d) If there is data to show WA is using its over equalisation to bolster the whole economy in a way other States cannot or do not, make this an important feature of the Final Report.
 - (e) Allay some level of concern by acknowledging that because this is a difficult issue it is likely to be under regular review with potential for policy adjustments to address any material problems that may arise, such as from competitive neutrality issues.

CONCLUSION

20. There is now little doubt WA will continue to be over equalised in the HFE processes. The Productivity Commission is encouraged to use the Final Report to confirm this outcome is a material risk to national harmony in Australia and to identify risk mitigation options, including those proposed in this submission.

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