

Submission to the Inquiry into the GST distribution reforms – Response to the interim report

Thank you for the opportunity to submit on this important issue to the Productivity Commission. I make this submission in my capacity as the independent federal member for Kooyong.

I agree with the position adopted in the Commission's interim report, that the 2018 changes to distribution of the goods and services tax (GST) in Australia have been almost entirely ineffective in achieving the stated objectives of those changes, while costing taxpayers more than four times what was envisaged. Most benefits from the changes have flowed to the richest state in the Commonwealth.

I therefore make the following recommendations to the Commission:

1. **That it reverses the ill-considered changes to GST distributions enacted by the Morrison government in 2018, and return to full horizontal fiscal equalisation, with the Commonwealth Grants Commission addressing any dominant-state effects.**
2. **If the 2018 changes must be retained, that the No Worse Off guarantee be made permanent, such that Victoria and other disadvantaged states are not left to pay for reforms they did not support.** This option is suboptimal. It represents an expensive second-best alternative, which will entrench the burden on and federal budget of the current system, and the inequitable effect upon taxpayers of the 2018 changes.

Any changes to the existing system need to be made such as to provide a clear and orderly means of transition, giving the states clarity about their obligations well in advance of the due date for expiration of the guarantee in 2029-2030.

The case for returning to horizontal fiscal equalisation

All States and territories have a responsibility to provide their residents with broadly equivalent standards of public services supported by a similar burden of state taxes.

After Western Australia's contemplation of secession referendum in 1933, the Commonwealth Grants Commission was established to support that principle.

For over 70 years Western Australia has received a greater share of untied Commonwealth grants than would be predicted by its population. That distribution was justified by the higher cost of delivering services to a small population across a vast area.

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Most taxpayers are unaware of the Commonwealth Grants Commission's activities. Essentially, it calculates each state's share of the GST by assessing how much revenue that state could raise from its own sources, and how much it would cost to deliver an average standard of services there. It turns that into a "relativity" for each state, such that each is able to provide comparable services at similar tax rates. Before 2018, that capacity was lifted to the level of the strongest state. Under the Morrison government's 2018 changes it was lifted to the stronger of NSW or Victoria, and no state's share can fall below a floor of 75 per cent of a population-based share.

The Morrison government's 2018 changes to GST distributions have subverted the system, making it more complex, less consistent and much more expensive.

As the Commission found in its interim report, the 2019 changes have benefited WA excessively.

The most significant of its findings were that:

- The 2018 reforms were forecast to cost the Commonwealth about \$5 billion to 2024-25. They have cost almost \$23 billion.
- Western Australia was expected to benefit by around \$3.9 billion over that period but has ultimately received most of the \$23 billion.
- In 2024-25, Western Australia received GST revenue equal to 113 per cent of its assessed fiscal needs, while all other states received 98 per cent.
- The Commission estimates that the cost of continuation of the 2018 reforms could reach \$12 billion/year.

The Commission also identified perverse outcomes from the 2018 reforms, such that – in the face of these changes - all states other than Western Australia now face disincentives to strengthen their revenue base.

Western Australia's right to levy mineral royalties is not in question, and its ability to take advantage of global commodity prices has benefited Western Australians enormously. But since 2018 WA has had the second-lowest level of government investment as a share of state product of any state, and its labour productivity growth has lagged Victoria and New South Wales.

- WA's per capita gross state product has risen from around 7 per cent above the national average in 2000 to more than 60 per cent above it in recent years.
- Its mineral royalties have grown from less than \$700 million in 2000-01 to more than \$11 billion a year.
- According to the ABS, the WA Government has recorded budget surpluses totalling \$26.1 billion since 2018-19. Its net debt has fallen while every other state's net debt has increased.
- Over the next four years WA is expected to record surpluses averaging \$2.6 billion a year – more than Victoria and South Australia combined.

The 2018 changes are now tasking the rest of the country with funding better services and lower taxes in one state that least needs that help.

The cost to Kooyong, Victorians and Australian taxpayers

Since 2018, Western Australia has received an additional \$22.4 billion in GST distributions.

Since the GST began, Victoria has received around \$31 billion less than its population share.

Absent the No Worse Off guarantee Victoria would have lost \$4.3 billion over the past four years - around \$1.8 billion in this year alone.

GST is the largest untied revenue source available to the Victorian Government. It helps pay for Victoria's hospitals, schools, public transport and community services. When the guarantee ends funding for those resources and infrastructure will have to be found from higher services or greater state debt unless the services are cut.

The national shortfall that the guarantee is currently covering – around \$5.1 billion in 2025-26 – is equivalent to the salaries of more than 35,000 nurses or teachers for a year.

The guarantee is paid from consolidated revenue and now expected to cost the federal budget close to \$60 billion by 2029-30 (as compared to the original estimate of around \$8 billion). At the same time our federal budget is forecast to remain in deficit for a decade.

Victorians are being told there is no money for Medicare, for housing, or for relief from bracket creep. Every dollar spent sustaining this arrangement is a dollar not available for those priorities.

Response to the Commission's interim options

I support the Commission's first option - a return to the pre-2018 system with the Commonwealth Grants Commission addressing any dominant-state effects. This option restores a single, consistent set of rules applying to all states, ends an uncapped cost to federal budget, and returns decisions on the distribution of the GST to an independent expert body.

The second option proposed by the Commission – returning to the pre-2018 system with direct, transparent payments for dominant-state effects – is a reasonable alternative only if those payments are publicly reported and subject to regular review.

If the Government insists on retaining the 2018 framework, the No Worse Off guarantee must be made permanent. The other states cannot be asked to absorb a loss they did not cause.

Whichever path is chosen, the transition must be announced as soon as possible, such as to provide certainty for the states in framing budgets beyond 2029-30.

I suggest that the Commission recommends further work, potentially with the Grants Commission, on whether equalisation could be achieved using a smaller set of readily available indicators. Revenue capacity might, for example, be proxied by gross state product per head. Expenditure needs might be proxied by the share of each population aged over 65, under 16, Indigenous, or living with disability. A simpler system would be more predictable for the states and more comprehensible to the public – and more resistant to politically-motivated subversion.

The integrity of the process

I note with concern that the Prime Minister has already ruled out any change to the Western Australian arrangements before the Commission has delivered its final report, and that the Commission and its staff have been subjected to unwarranted and unjustifiable personal abuse by the Premier of Western Australia.

The Parliament mandated this review in the 2018 legislation. It needs the Commission's frank and fearless advice. I welcome the Commission's statement that its process will not be influenced by political commentary, and I urge it to report without fear or favour.

Conclusion

The 2018 Morrison GST deal was made to win seats, not to improve our federation. It has cost almost five times what was promised, has made the richest state in the nation richer at the expense of every other state and every federal taxpayer, and has undermined a principle that has served Australia well for ninety years.

It should not be extended by a politically motivated Albanese government.

We need to restore GST distribution which treats every Australian fairly, wherever they live.

I thank the Commission for its work and for the opportunity to provide this submission.

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Independent Member for Kooyong
