



29 November 2017

Productivity Commission  
Horizontal Fiscal Equalisation Submissions Department

sent via email: [hfe@pc.gov.au](mailto:hfe@pc.gov.au)

### **Business Council Horizontal Fiscal Equalisation Submission**

#### **To Whom It May Concern**

I write to offer the Business Council's support for the central finding of the Productivity Commission's draft report from the inquiry into Horizontal Fiscal Equalization (HFE), namely that there should be a revised objective for HFE such that it should aim to give states the fiscal capacity to provide a reasonable level of services.

In our submission to the inquiry the Business Council noted that the system of HFE as it is currently applied by the Commonwealth Grant's Commission (CGC) is too complex, and is not well suited to dealing with very large disparities between jurisdictions – as occurred during the recent resources boom – or when economic fortunes of states rapidly change.

The Business Council urged the Productivity Commission to consider ways to ensure the HFE system, while remaining policy neutral, does not disincentivise productive reform or impede national and inter-state cooperation.

Moving to a more partial form of HFE, such as implied by revising the objective to enable states to provide a reasonable level of services, can help deal with very large disparities and dull some of (but not all) the disincentives to productive reform within the system.

We encourage the Commission to continue to examine how to give rise to the proposed objective. Including by further developing the proposal to equalize to the second highest or average state and by giving consideration to proposals for quarantining a certain percentage of the GST pool for equal per capita distribution.

Once the Commission has finalized its preferred methodology to give rise to the revised objective, it should recommend the Treasurer task the CGC with implementation through the terms of reference for its annual assessment.

#### **Methodological changes**

The Business Council supports the Productivity Commission's draft finding that the Government should direct the CGC through the terms of reference to consider approaches to assessment that achieve a significant simplification and 'good enough outcomes'.

The Business Council has long advocated that there should be consistent guidelines for quarantining certain Commonwealth payments from HFE. The recommendation to achieve this outcome is therefore welcome. Any guidelines should be developed in partnership and agreed by all jurisdictions.

### Institutional reforms

The recommended institutional reforms to increase transparency and accountability of the CGC's assessment as well as public understanding of the process are welcome.

The draft recommendation that the Commonwealth and States commence a process to reform federal financial relations is strongly supported by the Business Council. While there have been numerous attempts to improve federal financial relations over many years, some of which led to temporary improvements, the fact remains that fiscal federalism in Australia is ill suited to dealing with the challenges of posed by Australia's changing demographics and globalized and increasingly complex economy. .

The system of Commonwealth-state relations is a matter of governance that impacts on almost all aspects of public policy – skills, health, and education to name a few - that are so important to people's everyday lives and the prospects of Australian businesses.

While improvements to HFE and individual areas of shared Commonwealth-state responsibility may be possible, without broader reform that address the imbalance between revenue raising and expenditure responsibilities, better outcomes will always be at risk due to poor accountability, blame shifting, and policy capriciousness – the benefits are likely to be less than they could be and likely time limited.

The Business Council urges the Productivity Commission to retain the recommendation on the need for broader reform to federal arrangements and extend it by including the key elements and issues that would need to be included in the terms of reference for any inquiry.

### Transitional arrangements

As noted in the Business Council's submission, the inquiry is the latest of many reviews in to the system of HFE in Australia, but previous reviews have not led to systemic or lasting change. As it finalizes its recommendations, the Commission should set out detailed and comprehensive transitional arrangements that deal with the legitimate need for states to plan for, and adjust to, new fiscal arrangements. This may require long lead times or Commonwealth support, or both.

Yours sincerely

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Chief Executive